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Hurricane Energy: For the First Time, the English Court Declines to Approve a Restructuring Plan

28 June 2021

At a Glance

The English court declined to sanction the restructuring plan of Hurricane Energy plc today, 28 June 2021. This is the first time the court has done so since the restructuring plan procedure was introduced (in June 2020); it follows the court's approval of the first seven restructuring plan cases.

The court declined sanction because:

- it rejected the company's evidence as to the "relevant alternative" to the restructuring plan;
- accordingly, on the facts, it was not satisfied that one of the threshold conditions for cross-class cram-down (the "no worse off test") had been satisfied; and
- in any case, the court would not have been willing to exercise its discretion to sanction this plan.

The case represents an important test of the parameters of the restructuring plan procedure. It demonstrates that:

- the court will critically assess plan companies' evidence as to the most likely alternative to the plan, especially absent a "burning platform" and where future profitability is inherently uncertain;
- the court will consider other options open to plan companies to meet any liquidity shortfall;

- where the “relevant alternative” is not an immediate liquidation but rather continued trading, it is not necessary for opposing stakeholders to pinpoint what strategy/ies the company is most likely to adopt; rather, the company’s possible courses of action are factors to be considered in determining whether there is a realistic possibility that the financial outcome for stakeholders would be better than under the plan;
- in considering whether a plan fairly allocates value between the different stakeholders, the court will consider potential upside from future trading combined with possible steps to address the repayment of debt upon maturity; and
- absent a “burning platform”, and where a restructuring could reasonably be undertaken at a later stage, the court may conclude that junior stakeholders should not immediately be deprived of their interests but instead wait and see if actual performance over the coming months improves the outlook for such stakeholders.

Background

Company	Hurricane Energy plc (the “**Company**”), an AIM-listed oil exploration company
Financial Difficulties	The Company anticipated it would be unable to repay its $230 million unsecured bonds (the “**Bonds**”) on maturity in July 2022.
Restructuring Plan Proposal	$50 million of the Bonds would be released and the maturity date of the Bonds extended to 31 December 2024, in exchange for the allotment of shares in the Company (representing 95% of the fully diluted shares following such allotment) and an increase in the rate of interest payable on the Bonds. This would enable an extended wind-down, potentially until February 2024, after which (in the absence of further investment) the Company’s only active oil well would be decommissioned, the remaining business wound down and all third-party creditor claims settled. The ad hoc committee of bondholders (the “**AHC**”) supported the restructuring plan.
Relevant Alternative	The Company’s case was that the most likely alternative to the restructuring plan was for the Company to continue trading until end May 2022, cease operations in June 2022 and commence an

	orderly wind down, followed by liquidation c. April 2023. However, the court rejected this; see further below under “No worse off”.
Convening Hearing	The Company sought a single class meeting of bondholders to vote on the plan. However, the court directed the convening of two meetings: one for the bondholders and one for the Company’s shareholders, essentially on the basis that the rights of shareholders whose shares are being diluted via a plan *are* “affected by” a plan, such that they must be permitted to vote on it (unless the company applies to exclude them from voting based on a lack of genuine economic interest; the Company had not done so in this case).
Voting	Bondholder class: approved by 100% of those voting, representing c. 85% of total bond debt — i.e., class approved. Shareholder class: rejected by c.92% of those voting, representing c. 33% of total shares — i.e., class rejected. The Company sought sanction of the plan under the court’s power to sanction a plan which not every class has approved (sometimes termed “cross-class cram-down”).
Opposition and Proposal to Replace Board	Shareholder Crystal Amber, which holds c. 15% of the Company’s shares, instructed counsel to oppose sanction of the plan. Sanction was also opposed by a large number of individual shareholders. Crystal Amber requisitioned an emergency general meeting for the purpose of replacing certain directors; that meeting was scheduled for 5 July 2021 (i.e., shortly following conclusion of the sanction hearing). See further below under “Urgency”.

Criteria for “cross-class cram-down”

Unlike a scheme of arrangement, a restructuring plan may still be confirmed by the court even where one or more classes do not vote in favour, provided two threshold conditions are satisfied:

1. the court is satisfied that no member of the dissenting class(es) would be any worse off under the plan than they would be in the event of the "relevant alternative" (which is whatever the court considers would be most likely to occur if the plan were not sanctioned); and
2. at least one class (whether creditors or shareholders) who would receive a payment, or have a genuine economic interest in the company, in the event of the relevant alternative, has voted in favour.

The second condition was clearly satisfied given the bondholder class had approved the plan. However, the court was not persuaded that the first condition had been satisfied on the basis of the Company's evidence.

No worse off

Determining whether the "no worse off" condition is satisfied involves the following three steps.

1. Identifying what would be most likely to occur in relation to the Company if the plan is not sanctioned	It was common ground that, if the plan was not sanctioned, the Company would most likely, in the short to medium term, continue trading profitably — i.e., the relevant alternative did not involve any immediate insolvency process. The court did not accept that the most likely (or even a likely) outcome was that the board would adopt a strategy that would lead to the Company's insolvent liquidation.
2. Determining what would be the outcome or consequences of that for the dissenting class — here, the Company's shareholders	This was the critical question: absent the plan, would shareholders be better off than having a 5% stake in equity that promised no meaningful return (see below)? It was common ground that the burden lay on those proposing the plan to demonstrate that the shareholders would not be any better off than receiving a less-than-meaningful return, if they retained their shares and the Company continued trading for at least the next year.
3. Comparing that outcome with the	It was common ground that the plan was not anticipated to provide any meaningful return to shareholders and that, even in respect of

outcome and consequences for the shareholders if the plan is sanctioned	*any* return to shareholders, the current shareholders' interest in it would be limited to 5% following their dilution under the plan.

The court held that:

- a broad approach was required in determining whether shareholders were "any worse off" as a result of the plan: it was necessary to take into account all incidents of their rights as shareholders;
- while there would likely be a shortfall between the cash available at the Bonds' maturity date and the $230 million required to repay the Bonds in full, that shortfall would likely be less than that indicated in the Company's evidence;
- if the Company were able to trade beyond May 2022 and fund the shortfall (e.g., by raising money from a third party or existing shareholders, or other possible options — which the court considered were not unrealistic), there was a realistic prospect that the Company would be able to discharge its obligations to the Bondholders *and* retain an income-producing asset with at least the potential for exploitation, and which would therefore be of at least some value to its shareholders;
- that fact was enough to refute the contention that the shareholders would be no better off under the relevant alternative than under the plan; as Zacaroli J. stated, "in other words, to retain 100% of the equity in Company [*sic.*] that is continuing to trade, with a realistic prospect of being able to repay the Bonds in due course, is to my mind a better position than immediately giving up 95% of the equity with a prospect of a less than meaningful return as to the remaining 5%"; and
- accordingly, the "no worse off" threshold condition was not satisfied.

Discretion

Given the court's conclusion that the "no worse off" threshold condition was not satisfied, the court had no jurisdiction to sanction the plan and the question of whether to exercise its discretion did not arise. However, the court observed that, if it *had* been necessary to exercise its discretion whether to sanction the plan, it would nonetheless have refused sanction. Its principal reasons were as follows.

1. The Company was profitable, and anticipated to remain profitable for at least the next year.
2. The Company's evidence was that its operational oil well was likely to remain economically viable until early 2024.
3. Notwithstanding the projected shortfall between available cash and the sum required to redeem the Bonds at maturity, there was a reasonable possibility that the size of the shortfall might be such that measures could be taken, such as refinancing, so that it could be bridged.
4. The question posed by the Company and the AHC, of whether the Company could generate sufficient cash from trading alone to repay the Bonds in full at maturity, was too narrow and ignored the possibility of such measures being taken.
5. The restructuring plan would remove, immediately and irrevocably, all but a fraction of the current shareholders' equity in the Company.
6. In considering whether the plan fairly allocated value between the different stakeholders, it was not sufficient to conclude that the current valuation of the future revenue stream from the well indicated that this would be insufficient to repay the Bonds in full. This would deprive the shareholders of any potential upside which could be generated from future trading combined with steps the new board might legitimately take to address the repayment of the Bonds on maturity.
7. The option of continued trading beyond July 2022 would most likely be preserved such that, if actual performance and the steps taken by the new board did not improve the financial outlook over the coming months, it was reasonable to believe that a restructuring could be undertaken at a later stage. This reinforced the conclusion that shareholders should not immediately be deprived of anything other than a *de minimis* interest in the equity.
8. Given the relevant alternative in this case (continued trading), it was relevant, in considering what consequences might flow, to take account of the fact that the interests of the Company, the shareholders and the Bondholders were likely to be aligned in ensuring the Company continued to exploit the relevant area of oil until it ceased to be economically viable.
9. There was no other sufficient ground of urgency which made it imperative that the Bonds be restructured now. In particular, the AHC's desire to obtain control of the Company was not a good reason to deprive the shareholders, now, of all but a fraction of their equity in the Company rather than waiting to see if actual performance over the coming months improved the outlook for the shareholders.

Urgency

As noted, a minority shareholder, Crystal Amber, requisitioned an emergency general meeting of the Company in order to replace certain directors. The court had accommodated the Company's desire for urgency in respect of the sanction hearing and the court's judgment.

However, the court held that "the fact that the board is likely imminently to be replaced is not in my judgment a good ground of urgency (particularly as I have rejected the submission that the new directors would be likely to take precipitate action leading to an early insolvent liquidation). Unless and until a company goes into a formal insolvency process, the identity of those managing it is under the ultimate control of the general body of shareholders. It is their collective right to replace the board if they see fit".

Ultimately, the desire to avoid the replacement of the board was not a legitimate ground for urgency.

The convening judgment is here; the sanction judgment is here.

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Suggested Reading

- 26 April 2023 Speaking Engagement PLI's Bankruptcy & Reorganizations 2023: Current Developments
- 24 February 2023 Sponsored Event The 19th Annual Wharton Restructuring and Distressed Investing Conference
- 17 February 2023 Award Chambers Global: The World's Leading Business Lawyers 2023