KIRKLAND & ELLIS

Petrofac: Court of Appeal **Overturns** Restructuring Plans

Critical Guidance for Future Cases Involving New Money

1 JULY 2025

At a Glance

The English Court of Appeal today handed down its judgment allowing the appeal against the restructuring plans of Petrofac, which the High Court approved in May.

In allowing the appeal brought by two of Petrofac's joint venture partners, Samsung and Saipem (who are also direct competitors of Petrofac), the Court of Appeal overturned the High Court's sanction of Petrofac's plans.

The judgment is only the third Court of Appeal case on restructuring plans (following *Adler* and *Thames Water*) and the first to consider the "fair share" of post-restructuring benefits between senior creditors and those who would be (largely) out of the money in the relevant alternative to the plan.

The appeal was brought on two grounds:

1. **"No worse off" test:** the judge was wrong to hold that even though Saipem and Samsung would be "worse off" under the plans, they would not be "worse off" in a way that was relevant for the purposes of the statutory "no worse off" test; and
2. **Fairness and discretion:** the judge was wrong to sanction the plans because the benefits preserved or generated by the plans were not being fairly shared between the plan creditors.

The Court of Appeal allowed the appeal on the basis that the benefits preserved or generated by the plan were not fairly shared between the plan creditors (ground 2). It rejected the challenge based on the "no worse off" test (ground 1), although its reasoning differed from that of the High Court.

The judgment has major implications for restructuring plans going forward - in particular, regarding permissible terms of new money and fees. Going forward, where a plan involves new money that is conditional upon sanction of a restructuring plan:

- Plan companies will need to provide cogent evidence – either by way of expert evidence or by evidence of market testing – to explain why the allocation of value preserved or realised by the restructuring is a fair reflection of the cost at which funding could be obtained in the market.
- This must be by reference to the financial position of the plan company following the restructuring. It is not appropriate to rely on difficulties in obtaining funding in the very different context of obtaining funding for the pre-restructuring, insolvent company.
- It will not necessarily be a sufficient answer to say that all creditors were offered the opportunity to participate in the new money.
- Nor will it be sufficient to rely on the fact that certain senior creditors who were offered the opportunity to participate in the new money elected not to do so, absent evidence as to their reason for not doing so.
- **Appeal:** Petrofac may seek permission to appeal to the Supreme Court.
- **Costs** remain to be determined.

See Key Takeaways on next page.

- For further background, see our [Alert] on the first-instance approval of the plan and the headline terms of the plans in the [Annex].

"The cross-class cram down power was not designed as a tool to enable assenting classes to appropriate to themselves an inequitable share of the benefits of the restructuring."

"What matters … is what price could be obtained in the market for new debt and/or equity funding in the restructured Group, once it was freed of virtually all of its debt."

"The most obvious way of demonstrating this would be evidence from a market expert as to the range of prices that debt or equity might have been obtained by the restructured Group. The plan companies, however, adduced no such evidence. Another way would be evidence of market testing."

Extracts from the Court of Appeal's judgment, 1 July 2025

Key Takeaways

No Worse Off Test

"No worse off" test: Court should compare financial value of creditor's existing rights in relevant alternative against financial value of new/modified rights under plan. Clearly satisfied in Petrofac's case

Competitive advantage: beyond scope of "no worse off" test. Focus on "rights", rather than "interests", is fundamental

No "remoteness" test for "no worse off" test

Broader prejudice which a creditor may suffer as a consequence of a plan can be taken into account as a matter of discretion

Appeal: Remains possible. The relevant alternative to the plans (not contested on appeal) was disorderly liquidation

Fairness and Discretion

Provision of new money: If returns on new money are materially above-market, excess cost must be analysed as a benefit of the restructuring. If new money is conditional on restructuring, returns should reflect fact lending is to the *restructured* group (not the insolvent, pre-restructuring group) - or else be justified as a benefit of the restructuring

Burden lies on plan company to show that returns on new money are either on-market or else justified as part of "fair allocation" of benefits preserved or generated by the restructuring

"Fair allocation": continuing emphasis on assessment of what constitutes a fair allocation of benefits preserved or generated by the restructuring; first CoA judgment to fully consider fairness of allocation between in- and (largely) out-of-the-money classes

Work fees in focus: CoA noted that work fees, to be paid in equity, would be worth c.$24-30m (rather than $7m originally agreed), following a post-restructuring equity valuation – and not calculated by reference to actual value to plan companies of work done or amount of time expended by AHG members

Ground 1: “No Worse Off” Test

Appellants’ Arguments

The appellants argued that the Court was wrong to hold that even though Saipem and Samsung would be “worse off” under the plan, they would not be “worse off” in a way that was relevant for the purposes of the statutory test.

1. **Limitations of “no worse off” test:** the Court was wrong to hold that the “no worse off” test is limited in requiring the consequences sustained by the opposing creditor (a) to be sustained “in their capacity as such” and (b) not to be “too remote”.
   - Instead, the proper approach would be for the Court to have regard not only to the direct monetary returns that the appellants would make on their claims against the plan companies, but also to any indirect economic benefits which would accrue to them if the group entered liquidation.
   - In that event, the appellants would be freed of a competitor and would stand to make substantial profits from future business which would otherwise have been taken by the Petrofac group.
2. **Remoteness:** alternatively, if the Court applied the right test, the Court was wrong on the question of remoteness. Specifically:
   - the Court was wrong to introduce an undefined test of “remoteness”; and
   - the Court was wrong on the facts to conclude that the competitive advantage that would accrue to the appellants on the group’s liquidation was too remote to be taken into account.

Court of Appeal’s Judgment

Dismissing Ground 1 of the appeal, the Court of Appeal held as follows.

1. **“No worse off” test satisfied:** The Court was correct to find that the “no worse off” test was satisfied on the facts.
2. **Correct framing of “no worse off” test:**
   - The Court is required to determine the financial value which a creditor’s existing rights would likely have in the relevant alternative, and to compare it with the financial value of the new or modified rights which the plan offers in return for the compromise of those existing rights.
   - That enquiry is primarily concerned with the *financial* value of rights of the creditor against the plan company.
   - However, where a plan compromises or releases other rights of the creditor, it extends to those other rights.
     - Where a plan interferes with rights of creditors against third parties, such as guarantors, the scope of the “no worse off” test must extend to such rights.
   - In Petrofac’s case, the loss of a competitive advantage upon sanction of the plans was clearly beyond the scope of the “no worse off” test.
   - This approach – which focusses on the valuation of rights affected by the plan – is preferable to some form of remoteness test as adopted by the High Court. There is no basis in the wording of the statute for such an approach.
   - However, any broader prejudice that a creditor may suffer as a consequence of a plan being sanctioned goes to the issue of discretion.

Ground 2: Fairness and Discretion

Appellants' Arguments

The headline complaint of the challengers under Ground 2 was that the benefits of the plans were not being fairly shared with them. They contended that the judge did not approach the question of fairness in the right way and that he based his exercise of discretion to sanction the plans on a number of errors of principle and fact.

Specifically, the Court (a) was wrong in the way it analysed the below five features, (b) took account of irrelevant factors and (c) failed to take account of relevant factors.

1. **The enrichment of the secured creditors:** Senior creditors participating in the new money would receive a return of 141%-166%. One member of the ad hoc group would receive a return of 234%-280%. Absent exceptionally good reasons, profit-making such as this is not permissible in a restructuring plan.
2. **The preserved value is not fairly shared with Saipem and Samsung:** The appellants recognised that they were unsecured creditors and therefore their share of the upside would be less than the share enjoyed by the secured creditors. However, they contended that the benefits must be shared in a proportionate way and in a way that properly recognised the very significant contribution being made by them.
3. **The vertical comparison:** The Court was wrong to attach no weight to the point that the challengers would be worse off under the plans (in the broad, "real world" sense).
4. **The horizontal comparison:** The challengers were being treated adversely as compared to (nearly) all other stakeholders.
5. **The open offers:** The challengers and the plan companies had made open offers prior to the sanction hearing. The existence of the open offers, and the limited delta between them, was relevant to the question of discretion.

Court of Appeal's Judgment

Allowing Ground 2 of the appeal and setting aside sanction of the plans, the Court of Appeal held as follows.

1. **Benefits for out of the money classes:** Existing authority (in *Thames Water*) does not mean that out of the money classes can fairly be excluded from the benefits of a restructuring and need only be given a *de minimis* amount (to satisfy the jurisdictional requirement that the plan should amount to a "compromise or arrangement").
2. **Provision of new money:**
   - **Ranking:** Those providing new money to facilitate a plan are properly entitled to rank ahead of pre-existing indebtedness in respect of that new money; this is well-established.
   - **Returns:** If returns to creditors lending new money are "materially in excess of that which could be obtained in the market", then the cost of the new money should be analysed as a benefit conferred by the restructuring.
   - **Risk:** Critically, the new money was conditional upon completion of the restructuring. Accordingly, evidence as to difficulties in obtaining funding for the *pre-restructuring* insolvent group was not relevant. What mattered was what price could be obtained in the market for new debt and/or equity funding in the *restructured* group.
     - A reasonable starting point for this is the value ascribed to the post-restructuring group by an independent expert.
     - Teneo had concluded Petrofac would have a post-restructuring equity value of c.$1.5-1.85 billion. This required an explanation, rooted in credible evidence (such as expert evidence or market testing), as to why the plans should give what appeared to be an immediate three-fold or even higher return on the new money.
   - **Burden of proof:** The burden rests on the plan company to show that returns on new money are either (a) equivalent to that which could be obtained in the market or (b) justified as a fair allocation of post-restructuring benefits.

Annex: Background, Terms of and Voting on the Plans

- ***Plan Companies:*** Petrofac Ltd (LSE-listed parent) and its indirect subsidiary, Petrofac International (UAE) LLC
- ***Purpose of Plans:*** To rescue the plan companies and produce a better result for creditors than in the relevant alternative, via:
  - debt-for-equity swap, in which most of the equity would be allocated to secured creditors, with a larger allocation for those who elected to provide new money;
  - write-off of various unsecured liabilities of the UAE plan company, including those relating to a project in Thailand; and
  - provision of $355 million new money, in the form of debt and equity.
- ***Relevant Alternative:*** The plan companies asserted — and the High Court agreed – that the relevant alternative to the plans was disorderly liquidation. This was disputed by Saipem and Samsung, who argued (in the High Court) that the correct relevant alternative was instead a different restructuring under which the challengers would receive more than under the plans. The challengers did not pursue this argument on appeal.
- ***Class Constitution:*** Saipem and Samsung contended — unsuccessfully — that there should not be a single meeting of the senior secured funded creditors, but that the members of the ad hoc group should be convened in a separate meeting (principally based on fees payable to the AHG). The challengers received permission from the Court of Appeal to appeal the convening order. However, this challenge was not ultimately pursued on appeal.

	CREDITOR CLASSES	TREATMENT UNDER PLANS	APPROVALS (BY VALUE, OF THOSE VOTING)
	For both plans		
1	Two secured noteholders providing $80 million cash collateral for new cash-backed guarantee facility	▸ Full debt for equity swap (though partial reinstatement for those providing new money notes) ▸ Greater proportion of post-plan equity for new money providers ▸ Plan consideration in respect of contingent claims (of ABN and Argonaut) issued only if and when relevant contingency occurs	100%
2	Other senior secured funded creditors		88%
3	ABN (claims re clean fuels project)		100%
4	Argonaut (claims re clean fuels project)		100%
	Parent's plan only[1]		
5	Thai Oil (claims re clean fuels project) plus director claimants and insurance restitutionary claimants[2]	Released for share of £1 million non-shareholder claims settlement fund plus warrants	0% — i.e., rejected
6	Shareholder claimants[2]	Released for share of £1 million shareholder claims settlement fund plus warrants	99.99%
7	Samsung and Saipem (JV partners) and PSS (JV contractor)	Assumption of c.$1 billion of plan companies' JV liabilities (to Thai Oil). Claims released for share of £1 million plus warrants (two tranches, together representing 3.5% of the listed parent's share capital)	0% — i.e., rejected
	UAE subsidiary's plan only		
8	Samsung, Saipem and PSS, plus Thai Oil	110% of return in insolvency alternative (in cash or equity)	0% — i.e., rejected

1. A claims adjudication process would be used to determine entitlements of these classes to receive distributions.
2. These were potential claims of directors and employees and shareholders and potential restitutionary liabilities to Petrofac's former D&O insurers, relating to conduct which resulted in an SFO investigation.