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Kirkland Alert

English Court Refuses to Approve Waldorf Production's Restructuring Plan, Citing Concerns as to "Fair Allocation" of Post-Restructuring Value

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At a Glance

The English Court today refused to sanction the restructuring plan of Waldorf Production as a matter of its discretion.

The plan had been opposed by the UK tax authority, HMRC, and an unsecured creditor, Capricorn (the **Unsecured Plan Creditors**). In this midmarket case (involving <$225 million of debt), which closely follows the court's approval of Madagascar Oil's restructuring plan (see our *Alert*) and the Court of Appeal's seminal judgment in *Petrofac* (see our *Alert*), the court held that:

- the correct relevant alternative to the plan was indeed a formal insolvency process, as the plan company contended, and not another restructuring, as the Unsecured Plan Creditors argued;
- accordingly, the statutory "no worse off" test was satisfied;
- however, there had been no (or no sufficient) attempt to consider the fair allocation to all stakeholders of the benefits expected to be generated by the restructuring — in particular, where the contribution to be made by the dissenting Unsecured Plan Creditors would enable a solvent sale of the plan company which could not otherwise be achieved (as the bondholders would, in practice, be unable to enforce their security);

- whilst the court's exercise of its power to bind a dissenting class does *not* require pre-plan negotiations with dissenting creditors as a formal "jurisdictional precondition", the failure in this case to engage or negotiate with the Unsecured Plan Creditors (whose counterproposals were rejected) denied the court an important basis for assessing the fairness (or otherwise) of the distribution to Unsecured Plan Creditors envisaged under the plan. This elevated the burden on the plan company to establish that the plan proposed was fair;
- there was no evidence (e.g., liquidity or cash-flow forecasts) to substantiate the plan company's argument that the Unsecured Plan Creditors' counterproposal was unaffordable; and
- accordingly, the plan company had not discharged the burden of showing that the plan was "fair" and that it was "appropriate, just and equitable" to exercise the court's discretion to sanction it.

The court carefully analysed what it termed the "trilogy" of Court of Appeal judgments as to the treatment of dissenting classes (i.e., *Adler*, *Thames Water* and *Petrofac*). It ultimately agreed that Waldorf's plan had been "designed in a pre-*Thames* world" and that the (lack of) negotiations with the Unsecured Plan Creditors had "clear echoes of the mistaken approach to out of the money creditors that was rejected in *Thames Water*".

The plan company intends to appeal the decision and to apply for its appeal to be directly to the UK Supreme Court. A consequentials hearing — including as to whether an appeal can be made direct to the Supreme Court — will be heard within 14 days. Relatedly, Petrofac's application for permission to appeal to the Supreme Court (against the Court of Appeal's decision to overturn sanction of its restructuring plan) remains to be determined.

Background

Plan Company:	Waldorf Production UK plc
Near-term history:	The plan company's ultimate parent companies had entered administration in June 2024. The bonds were refinanced in July 2024 (the **July Refinancing**); in December, the administrators reported that they had received no offers for the plan company

	that were considered implementable or acceptable to the bondholder steering committee, due at least in part to the concerns of prospective bidders as to the overall debt profile of the plan company.
Aim:	To enable the plan company to continue to trade whilst it pursues a solvent sale and, in the event that a solvent sale is not consummated, to enable plan company to continue to realise value from its assets for the benefit of its creditors
Relevant alternative:	Formal insolvency proceedings (although this was contested — see below)

Outline terms:

Class	*Proposed treatment*	*Voting*
1. Secured bondholders[1]	Two-year maturity extension; various covenant amendments	100% approved
2. Unsecured creditors — namely HMRC[2] and Capricorn Energy[3]	Compromised for cash payment of 5% plus contingent upside-sharing payments	100% rejected

Grounds of opposition:

Capricorn asserted that:

1. the "no worse off" test was not satisfied because the relevant alternative was not an insolvency but a different restructuring (in which they would be better off); and
2. the court should not exercise its discretion to sanction the plan, principally on the basis that the plan did not represent a fair allocation of the benefits of the restructuring and as certain historic transactions ought to be investigated by an insolvency officeholder.

Similarly, HMRC asserted that:

1. the "no worse off" test was not satisfied because the relevant alternative was (a) the plan as amended by the terms of one of two joint counterproposals made by HMRC and Capricorn or (b) a scenario in which the plan company agreed a "Time To Pay" arrangement with HMRC and reached a deal with

	Capricorn — in which case, HMRC would be in a better position than under the plan; 2. the court should decline to sanction the plan because it was: (a) unfair generally; and/or (b) unfair to HMRC, in view of its critical public function as the collector of taxes; and 3. the proposed plan was an abuse of the process, for various reasons.
Alternative offers from Unsecured Plan Creditors:	*Option A*: 20% cash payment (rather than the 5% proposed under the plan) *Option B*: 5% cash payment plus upside sharing instrument representing 25% of bondholders' recoveries post-sanction[4]

Judgment

The court held as follows.

Lack of engagement/negotiation:

- The plan company had launched the plan without even attempting to properly negotiate a settlement — despite Capricorn having made it clear that it was open to discussing a compromise. Similarly, the plan company's management engaged in transactions that made it impossible to meet its energy profit levy liabilities to HMRC and never intended to disclose the plan to HMRC until after its announcement, whilst continuing to owe accrued liabilities to HMRC that it intended to "cram down" rather than pay. The court characterised the history of the plan company's dealings with HMRC in respect of its tax affairs as "disturbing".
- There had been no engagement or negotiation with the Unsecured Plan Creditors prior to launch of the practice statement letter for the plan — nor any meaningful engagement, still less any real negotiations, post-launch.

Relevant alternative: With some reluctance, the court concluded that the correct relevant alternative to the plan was indeed a formal insolvency process, as the plan company contended, and not another restructuring, as the Unsecured Plan Creditors argued. What is put forward as a relevant alternative must be sufficiently clear, certain and defined for the purpose of satisfying its function in the statutory architecture

(including the identification of proper classes, the assessment of whether a creditor is "no worse off", as well as the assessment whether a plan is sufficiently consistent with existing entitlements). "An inchoate alternative, even though it may be likely to be achieved, has not the characteristics required."

The court's assessment of the feasibility of the Unsecured Plan Creditors' counterproposals was partly driven by the fact the bondholder steering committee had rejected such proposals. A member of the steering committee gave evidence that the rejection of the counterproposals was partly based on a point of principle against setting a dangerous precedent in allowing junior creditors to "jump senior creditors" to improve their recoveries.

No worse off test: Accordingly, the "no worse off" test was satisfied: it was clear (and not disputed) that, in formal insolvency proceedings, the Unsecured Plan Creditors would be worse off than under the plan.

Fairness: The plan did not fairly allocate the benefits preserved or generated by the restructuring. In particular:

- *Source of benefits*: "all the benefits of the restructuring are generated by the extinguishment of the debts owed to HMRC and Capricorn. The Bondholders are not contributing anything, save for the extension of the maturity date". Notably, the claims of the Unsecured Plan Creditors in this case could not be left behind or extinguished except through a restructuring plan;
- *Allocation of post-restructuring benefits*: the plan had been devised between the plan company and the bondholders without any input or involvement from the Unsecured Plan Creditors and without any consideration or even identification of the relevance of what might be a fair allocation of the envisaged benefits of the plan (as distinct from what the Bondholders determined arbitrarily to be a suitable amount to pay over the *de minimis* amount that unsecured creditors would be entitled to receive in an insolvency process);
- *Comparison of outcome in relevant alternative*: in this case, a comparison with the relevant alternative should not be the predominant comparator in assessing fairness of the plan; instead, the court appeared to suggest that the appropriate point of comparison should be what the Unsecured Plan Creditors might "fairly and reasonably have negotiated for their support in circumstances where it has already been demonstrated that any sale process is likely to fail whilst their debts remain in place";
- *Touchstone for "fairness"*: "what falls to be assessed in determining the fairness of the plan at the discretion stage is whether what the plan would achieve is a fair and

reasonable allocation of the benefits of the restructuring having regard to the amounts contributed by each creditor class, including the class proposed to be crammed down";

- *Relevance of negotiation*: the pattern and results of previous negotiations is likely to offer a very useful perspective on what constitutes a fair allocation, "both in setting upper limits to the expectations of the dissenting class proposed to be crammed down, and in providing a useful insight into whether the dissenting class has negotiated fairly and reasonably, or whether it has in truth been seeking to extract too much in term of value from its right of veto". The failure to enter into any negotiations raised a difficulty for the plan company, as it meant there was no evidence as to whether or not the Unsecured Plan Creditors were acting reasonably in demanding more. However, the Court of Appeal's judgment in *Petrofac* should not be regarded as establishing a jurisdictional precondition of pre-plan negotiations with the dissenting creditor(s).

The court distinguished the exercise of the discretion in restructuring plans from that in schemes of arrangement. Echoing previous judgments, the court reiterated that, in a scheme, the fact that each class must vote in favour is "a large part of the answer" to the court's exercise of discretion, "unless there is evidence that the results are polluted by the majority vote having been improperly motivated"; "it is one thing that (as in a Part 26 scheme) the views of the regiment within a class should prevail unless polluted by improper purpose and/or majority pursuing objectives of which the minority may substantially be deprived, and quite another (as in a Part 26A plan) to overrule a majority class dissent".

The court was also careful to distinguish Waldorf's case from the ordinary case in which senior creditors seek to rely on their position in the waterfall to impose a deal on a junior class:

- In the ordinary case, the secured creditors can realise very significant value by enforcing their security over the assets of the debtor company and causing a sale of those assets. The relevant alternative is therefore sale of the assets through a security enforcement — and the restructuring plan is a means by which it is hoped additional value will be preserved over and above such a forced sale.
- However, that was not the case here; it was not suggested that the bondholders had the ability to realise any significant value through a security enforcement, presumably owing to the complex regulatory environment in respect of the secured assets (North Sea oilfield licences).
- As a valuable asset sale through a security enforcement was not possible, it was necessary to sell the plan company itself — but the plan company was only capable

of being sold if the liabilities owed to HMRC and Capricorn were extinguished. Far from making a minimal contribution to the benefits of the restructuring, therefore, HMRC and Capricorn were making the vital contribution.

Accordingly, the evaluation of the contribution made by "out of the money" classes to the benefits preserved or generated by a restructuring may well differ in future, more typical cases.

***Other considerations against sanction*:** The court briefly raised certain other factors against sanction, including regarding management's historic conduct[5] and the fact that the plan sought to cram down HMRC.

***Sanction refused*:** Accordingly, the court refused to exercise its discretion to sanction the plan. The judgment expressed hope that negotiations might yet yield an agreed amount for the Unsecured Plan Creditors, suggesting that an agreed revised plan could be presented on an accelerated timetable. As noted, the plan company intends to apply for an appeal to be directly to the UK Supreme Court.

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1. Comprising c.$55 million original bonds and c.$62 million super-senior bonds, in outstanding principal ↩

2. In respect of c.$75 million energy profit levies ↩

3. In respect of c.$30 million liabilities under a noncompleted M&A agreement ↩

4. *Plus*: payment of the Unsecured Plan Creditors' costs; engagement of independent committee of inquiry regarding any viable claims against third parties or directors arising out of the July Refinancing and/or an interim dividend in 2022. After the plan company and bondholder steering committee rejected both these options and refused to negotiate either of them, the Unsecured Plan Creditors amended the options, abandoning the requirement that an independent committee be established and adjusting Option A to provide for a cash payment of 15%. ↩

5. Including (a) involvement in an "enormous" interim dividend paid in 2022 on the basis of "obviously deficient" management accounts, which the court found were a substantial cause of the company's financial difficulties) and (b) a deliberate decision to "trade on regardless", without approaching HMRC for a Time To Pay arrangement, whilst instead formulating a restructuring plan premised on cramming down HMRC. ↩

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