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Financial Restructuring Group

Client Alert

Storm Clouds Gather: High Court Refuses Sanction of Restructuring Plan for Hurricane Energy plc

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On 28 June 2021, Zacaroli J declined to sanction a restructuring plan (the "**Plan**") in respect of Hurricane Energy PLC (the "**Company**") under section 901F of the Companies Act 2006 ("**CA 2006**"). The Company is part of a group whose business is extracting oil stored within fractures in solid rock beneath the sea. Although the Company anticipated being able to trade profitably in the near-term, it predicted that it would be unable to repay its bonds in full at maturity and proposed the Plan to, amongst other things, extend maturity, reduce principal and issue equity to the bondholders, who would take ownership of 95% of the shares.

The unusual sanction decision followed an equally unusual convening hearing, during which Zacaroli J ordered that a meeting of shareholders of the Company be convened to vote on the Plan, in addition to the bondholder class. The judge disagreed with the Company's justification for excluding shareholders, that they were not "affected" by the Plan. In the judge's view, the shareholders were "affected" by the Plan as a result of their envisaged dilution from 100% down to 5% of the Company's equity and the disapplication of their statutory pre-emption rights, were the Plan to be sanctioned.

At the Plan meetings, the bondholder class voted unanimously to approve (with 84.89% of the bondholders voting) whilst the shareholder class voted 92.34% to reject the Plan (with 32.8% of shareholders voting). The Company then sought to activate the cross-class cram-down feature, asking the court to sanction the Plan over the objection of the shareholder class. A note of urgency was introduced as the Company aimed to implement the restructuring before a general meeting could take place at which the existing board was likely to be replaced by the disgruntled shareholders.

The cross-class cram-down feature requires that two threshold conditions are met. First, the court must be satisfied that, if the Plan were sanctioned, none of the members of the dissenting class would be worse off than they would be in the event of the relevant alternative ("**Condition A**"). Secondly, that the Plan has been agreed by a class who would receive a payment, or have a genuine economic interest in the company, in the event of the relevant alternative ("**Condition B**"). The "relevant alternative" is whatever the court considers would be most likely to occur in relation to the company if the compromise or arrangement were not sanctioned. The focus of the sanction judgment was on whether Condition A had been satisfied.

The court identified Condition A as involving three steps: (i) identifying what would be most likely to occur in relation to the Company if the Plan is not sanctioned, (ii) determining what would be the outcome or consequence for the shareholders and (iii) comparing that outcome with the outcome and consequences for the shareholders if the Plan is sanctioned.

The judge considered the first limb to be less controversial. Crucially, this was not a case where an imminent liquidity crisis or impending maturity rendered a formal insolvency process the most likely alternative. Instead, it was common ground that the Company would continue trading for at least a year. The core point of contention between the Company and the dissenting shareholders was then the question of what followed that period of trading, and what the outcome for shareholders might be.

In the Company's view there would be a controlled wind-down of activities, continuing extraction from a particular well (the P6 well) until the charter for a floating production storage and offloading vessel (the "**FPSO**") necessary for extraction came to an end, followed by decommissioning and liquidation. In the Company's estimation, there would not be sufficient cash to repay the bonds in full following that process.

The shareholders posed a more optimistic range of alternatives, arguing that the narrow focus on the amount that could be generated from the P6 well by maturity ignored other possibilities which had merit and deserved to be considered, including that performance could improve, that trading could continue past maturity, that refinancing options could open up or that the Company could reduce its debt burden by market buy-backs.

The core question facing the court was whether the shareholders would be better off in the absence of the Plan (taking into account all the incidents of their rights as shareholders) than having a 5% equity interest which promised no meaningful return. In essence, was the reasonable "chance of something" worth more than the certainty of 5% of not very much.

The shareholders' "chance of something" amounted to an analysis of (i) whether more revenue could be generated from the P6 well than the Company's proposal foresaw, (ii) whether there might be alternatives available to the Company to bridge any repayment shortfall, (iii) whether the FPSO charter (vital to the exploitation of the P6 well) could be extended for a sufficient period and (iv) whether the board would be able to keep going to allow the group to achieve this outcome. On each of the above, the court was able to see at least a credible counter-argument to the Company's stated position. Accordingly, in its view, "[retaining] 100% of the equity in a Company that is continuing to trade, with a realistic prospect of being able to repay the bonds in due course is […] 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%".

As with all cases, the judgment will be specific to the facts of the matter. The judgment seems clear that the same conclusions may not have been reached, for example, if the Company had argued and been able to evidence that the most likely alternative to the sanctioning of the Plan would be a formal insolvency process. Some may query whether the outcome of this case could have the unintended consequence of deterring companies from seeking compromises and arrangements in good time, ahead of liquidity crises and looming maturities. However, it does seem to echo a theme that has featured in scheme cases: that the more "solvent" the company, the more careful one should be when looking at the rights and outcomes of stakeholders.

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