BACK TO THE DRAWING BOARD FOR RESTRUCTURING PLANS—PART 26A OF THE UK COMPANIES ACT 2006

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UK Finance Alert

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SAIPEM & ORS V PETROFAC LIMITED AND PETROFAC INTERNATIONAL (UAE) LLC [2025] EWCA CIV 821

Executive Summary: Negotiating Leverage Handed to Out of the Money Creditors

In a sweeping decision, the UK Court of Appeal has handed meaningful negotiating leverage to out of the money creditors. All those involved in major UK restructurings must take careful note of the detail and ramifications of the decision.

The case has shone a spotlight on two features of the court's broad discretion to refuse to sanction a plan under its cross-class cram-down jurisdiction, namely that:

- The court must be satisfied that a plan provides a 'fair distribution' of any 'benefits' of the restructuring to all classes, *including* out of the money classes; and
- The burden of proving fair distribution rests with the plan company.

The practical effect of this decision is dramatic. The process by which restructuring plans have come to be promulgated—as a bilateral negotiation between the plan company and an ad hoc group of one of the most senior class of creditors (AHG), with scant regard to the out of the money classes—will no longer suffice.

Background: the UK Court's Jurisdiction to Cram Down Dissenting Classes Under s.901G Companies Act 2006

By way of reminder, there are two hurdles to the court's jurisdiction to sanction a plan in the face of any dissenting class:

- Firstly, that no dissenting class member is worse off under the plan than in the 'relevant alternative'; and
- Secondly, that at least one class with a genuine economic interest in the relevant alternative has approved the plan by the requisite 75% majority.

However, even if these two hurdles are satisfied, the court retains a broad discretion as to whether to sanction the plan, and there is no presumption in favour of sanction simply because the technical criteria are satisfied.

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It is the content of this 'broad discretion' that was at the heart of the case.

What is a 'Fair Distribution'?

Unsurprisingly, the court emphasised that what constitutes a fair distribution depends on the facts. The court will conduct extensive review, particularly when materially differential treatment of distribution is offered for no discernible reason. As regards to an out of the money class, depending on the facts, what constitutes a fair distribution to them might constitute a material percentage. In any event, it is clear that any prior suggestion to the effect that an out of the money class can fairly be excluded from the benefits of a restructuring on the basis that they have no genuine economic interest in the company, or that they need only be given a *de minimis* amount necessary to satisfy the jurisdictional requirement that the plan is a 'compromise or arrangement', is of historical interest only.

While little detailed guidance can be elicited from the judgment, three factors are clear:

- The court will be alive to what efforts have been made to conduct a real negotiation;
- The terms of new money will be scrutinised against market terms; and
- If the principal benefits of the restructuring have been contributed by the compromise of existing creditor claims, it will not be a fair distribution if a principal share of the benefits are allocated to others (e.g., to the providers of new money).

Each of these points is explored further below.

A Real Negotiation

The judgment describes the court's approach to negotiation: “(T)he proper use of the cross-class cram down power is to enable a plan to be sanctioned against the opposition of those unreasonably holding out for a better deal, *where there has been a genuine attempt to formulate and negotiate a reasonable compromise between all stakeholders*.” (at paragraph 191) (emphasis added)

The court elaborated, by way of example, that absent the Part 26A legislation, if a class of creditor who would receive a distribution from the realisation of assets in the company's liquidation wished instead to obtain the *additional benefits* of the preservation of the company itself, and thus the value of its business as a going concern, free of the claims of other classes of creditors, then such a class would need to negotiate with the plan company and those other classes to give up their claims. This would inevitably require a genuine commercial compromise by all parties.

Under Part 26A, the cross-class cram-down power provides a mechanism to prevent “one or more classes of creditors from exercising an unjustified right of veto” but not “to enable assenting classes to appropriate to themselves an inequitable share of the benefits of the restructuring.” (at paragraph 131)

New Money

Market Testing: If new money is conditional on the plan being sanctioned, the plan company must prove that the new money terms are justified by reference to market testing, particularly in circumstances where it is being provided by the AHG and is to be properly characterised as a 'benefit' of the restructuring (as further explained

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below). The AHG cannot grant themselves 'too much unfair value' (as put by Professor Sarah Paterson and referred to by the court).

Is the New Money a Cost or Benefit of the Restructuring?

The answer to this requires a multistep approach. The first is to characterise whether new money forms part of the plan and if so, whether it is a cost or benefit of the restructuring. The answer to that question is as follows.

- If the restructuring removes sufficient of the company's debt burden so that it is better placed to access new funding and at more advantageous rates in the market, then the new money *does not in itself form part of the plan.*
- If, however, the restructuring itself includes new money being committed so that it is available to the restructured company immediately following and conditional on sanction of the plan, then the returns on the new money are:
  - A *cost* of the restructuring if:
    - The new money is provided from independent third parties following a competitive process in the market; or
    - Existing creditors of the plan company are invited to participate in providing the new money and the returns to such creditors are equivalent to what it would cost the plan company to obtain the funding in the market; or
  - A *benefit* conferred by the restructuring if the returns offered to those providing new money are such that it costs materially more than could be obtained in the market, and existing creditors are invited to participate in the new money.

Burden of Proof

The plan company bears the burden of showing that the returns on new money are not a benefit of the restructuring requiring a fair allocation of those benefits.

Offering New Money to Dissenting Classes Is No Answer

Offering dissenting (or all) classes the same opportunity does not neutralise any inherent unfairness in its terms. The court noted that there may be many varied reasons why creditors are not prepared to make the further investment required in order to participate in that opportunity (regardless of whether they are unable to do so). The fact they do not wish to do so is not necessarily a reason for depriving them of a share in the benefits of the restructuring to which they would otherwise be entitled.

Work Fees

The court will scrutinise whether work fees to be paid to the AHG are a true reflection of the value and time provided by them in promulgating the plan.

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THE FACTS OF THE CASE PROVIDE COLOUR TO THESE PRINCIPLES AND WHAT CONSTITUTES FAIR DISTRIBUTION OF THE BENEFITS OF THE RESTRUCTURING

Contributions by Stakeholders to the Restructuring

The evidence showed that the low case value to be generated by the plans was approximately US$1.25bn (being the difference between the day one equity value in an amount of US$1.5bn in the restructured company as a going concern, and the amount that the plan companies' assets would have realised in the relevant alternative of a liquidation (being US$250m)). The valuation evidence showed that this was contributed to by a:

- Write-off of US$900m of Senior Secured Funded Debt;
- Write-off of approximately US$3bn of unsecured debt; and
- Provision of the new money (including a cash back guarantee facility) in an amount of US$430m to the restructured group.

The aggregate equity return to the plan creditors was to be shared as follows:

- The secured and unsecured creditors were to receive US$329m in cash and equity, in aggregate comprising not even 33.3% in the newly restructured group,
- The AHG providers of the new money were to be allocated equity comprising 67.7% of the newly restructured group, as well as the following additional benefits:
  - An equity allocation in the restructured group by way of 'Work Fees'; and
  - Further equity by way of 'Backstop Fees' (for underwriting a portion of the new money).

The first instance judgment (at paragraphs 43 and 44) provides helpful tables of pre and post restructuring relevant percentages.

New Money

The court found that the plan companies had failed to justify the returns on the new money as a cost of the restructuring, such that the plans had been formulated (and any negotiations as there may have been between the creditors were done so) on a 'false premise'(at paragraph 191).

The lack of evidence as to the cost at which funding could be obtained in the market prevented the Court from identifying whether the new money was a cost or benefit to the restructuring and thus, whether the returns were fairly allocated. The burden of proof was not met and the plans could not be sanctioned.

Work Fees

The quantum of the work fees was agreed between the AHG and the plan companies before the post restructuring valuation report was available but, rather than calculating the amount by reference to the actual value to the plan companies of the work done (or amount of time expended) by members of the AHG, it was simply fixed as an agreed percentage (2.5%) of the AHG's aggregate holding of the Senior Secured Funded Debt (which, at that time, was equivalent to US$7.1m).

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Critically, it was further agreed that if the plan was sanctioned, the work fees would be paid in equity and the number of new ordinary shares that would be issued (i.e., approximately 428m) was fixed on the basis of a notional post-restructuring equity value of US$351m. The valuation evidence put the actual post restructuring equity value of the group at between US$1.5–1.85bn and therefore, the number of new ordinary shares to be issued to the AHG in respect of the work fees alone would be worth between US$24.1m and US$29.9m (rather than the US$7.1m originally agreed).

Meaning of 'No Worse Off'

Finally, the court rejected the appeal on the grounds that the dissenting class were 'worse off' than in the relevant alternative. The court held that the test was confined to rights attaching to the creditors in their capacity as creditors, rather than any indirect interest (such as loss of a competitor) that the dissenting classes would gain if the plans were not sanctioned.

It remains to be seen whether there will be an appeal to the Supreme Court.

Concluding Thoughts

Whilst restructuring plans are transactional at heart, this decision is testament to the fact that they require a litigious mindset from the outset. A plan company and their counsel will need to anticipate robust and creative arguments from stakeholders. Equally, stakeholders should engage early with counsel to fully deploy the arguments available to them, successfully influence the plan, or negotiate better terms.

The UK's restructuring plan legislation is only five years old and case law is evolving. This decision is proof that the court is alive to the breadth of its discretion in sanctioning a plan. Future cases will undoubtedly further test the content of the court's discretion, along with a range of other issues.

Whichever side of the restructuring plan you might find yourself on, be sure to call on your trusted K&L Gates lawyer. We have a diverse international restructuring and insolvency practice serving a broad range of clients and providing creative solutions to transactional and adversarial difficulties resulting from financially distressed circumstances across the Americas, Europe, the Middle East and Africa, and Asia Pacific.

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