Brent crude’s 18-month slide from above $110/bbl to a January 2016 low of under $30/bbl led to a number of high-profile North Sea upstream restructurings. This article considers what we can learn from recent cases and how they can inform the approach of companies, lenders, bondholders and restructuring professionals in future cases in the sector.

The first lesson is that fluctuating market conditions can have a material impact on restructuring discussions. Where the value of an exploration and production company is its principally UK continental shelf licences, the value of these licences is likely to fall alongside a drop in the oil price. As a result, self-help remedies, such as selling assets or raising new debt or equity, become harder to deliver. For the first wave of cases, the oil price decline undermined potential rescue options resulting in formal insolvency processes. In particular, administrators were appointed to Iona in January 2016 (subsequently applying the 2009 Oilexco technique of using a company voluntary arrangement to compromise creditor liabilities and facilitate a sale of the company) and First Oil in February 2016 (where the administrators concluded a “pre-packaged” sale of certain of First Oil’s field interests to Zennor Petroleum). The low oil price ultimately worked against solvent restructuring options and resulted in the appointment of administrators.

The second lesson is that a formal insolvency proceeding (such as administration) can protect value for creditors, but the risk of value destruction means it is unlikely to be a preferred option at the outset of negotiations. The principal challenge with insolvency proceedings is formulating a strategy that has the support of necessary stakeholders, including:

- obtaining the support of the Oil and Gas Authority (OGA) so that officeholders or their firms are not exposed to decommissioning liability, the OGA will consent to asset sales, will refrain from ordering a change of control following a share sale and/or will not revoke licences;
- securing the necessary funding to implement the strategy; and
- ensuring the proposed officeholders are comfortable with the potential risks of personal liability. These risks can be managed – as Oilexco, and more recently Iona and First Oil, have demonstrated – with the effect that an administration sale is a viable mechanism to maximise value for a company’s creditors.
The third lesson is that potential decommissioning liability associated with taking equity in licence-holding entities and the potential reputational consequences of holding equity-like instruments complicate exit routes for financial creditors, including debt for equity swaps and selling down to opportunist investors. While it may be possible in most cases to structure around the risk of shareholders’ legal exposure to decommissioning liability under the Petroleum Act 1998, financial creditors are generally reluctant to hold equity or equity-like instruments. This may, however, have softened in the Premier Oil restructuring completed in July 2017 where financial creditors were offered warrants (or synthetic warrants) representing approximately 15% of the shares in the company — although this falls well short of the 50% control test in the Petroleum Act 1998 which triggers decommissioning liability.

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Larger consensual restructurings, such as EnQuest (announced October 2016) and Premier Oil, followed the initial wave of smaller independent distress. These companies entered the downturn with larger and more complex capital structures, including a mix of lender and bondholder debt. While they faced similar challenges, eg capex demands of key developments, higher leverage and a depressed oil price, consensual restructurings were delivered using English law schemes of arrangement benchmarked against the alternative of administration. Schemes are a flexible tool to deliver changes to capital structures with support of a majority in number representing at least 75% by value of scheme creditors (or each class of them) present and voting — notwithstanding unanimous consent requirements in finance documents. The commercial changes include, among other things, amending maturity dates, financial covenants and pricing, linking bond coupons to Brent crude and amending governance restrictions in finance documents. The lesson from these larger cases is that complex consensual restructurings can be implemented and it is critical that stakeholders understand their alternative outcome on administration to understand their commercial leverage in negotiations with other stakeholders.

As a result of these issues, stakeholders (and frequently senior secured lenders) can expect to be presented with hard choices in this sector as they weigh up the deliverability and terms of consensual solutions (including with new super-senior money) against an insolvency outcome. This is particularly acute where the sensitive multi-party negotiations around the terms of a consensual deal can be affected by a fluctuating oil price and key project milestones, not to mention that providers of new capital may be working to different timetables as they weigh up competing investment opportunities. The real difficulty this sector presents is steering a course to a solution against such a fluid backdrop.

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