# Oil on Troubled Waters: successful restructuring of Ocean Rig Group

In *Ocean Rig* [1], the Grand Court sanctioned four inter-related schemes of arrangement (the "**Schemes**"), as part of a group restructuring of over US$3.69 billion of New York law governed debt – in value terms, the largest judicially approved restructuring in the Cayman Islands. In each case, the scheme companies moved their COMI from the Marshall Islands to the Cayman Islands not long before the Schemes were promoted; but that did not prevent the Schemes subsequently receiving recognition in parallel Chapter 15 proceedings.

Creditor participation and support at the scheme meetings was high, but there was opposition from a significant creditor, Highland Capital Management LP and affiliates ("**Highland**"), which voted against the proposed scheme of the parent company Ocean Rig UDW Inc ("**UDW**"), on which the other schemes were conditional. Highland also objected to the UDW scheme at both the convening hearing and the sanction hearing.

Highland's position changed over the course of the two hearings, but Highland's main arguments were that:

- two class meetings, and not one, should be convened for the UDW scheme, which would have given Highland a sufficient interest to block the whole restructuring;
- and/or the UDW scheme was unfair and Highland should be entirely carved out of the group restructuring.

## The Proposed Schemes

In order to continue as a going concern, UDW, an international contractor of offshore deepwater drilling services, needed to restructure around US$3.69 billion of debt held directly by UDW or through three of its wholly owned subsidiaries ("**DOV**", "**DFH**", "**DRH**"; collectively the "**Silo Companies**" and collectively with UDW the "**Group**"). Four interlinked schemes were proposed within a 'light touch' provisional liquidation of UDW and the Silo Companies. There was a successful COMI shift of all four companies from the Marshall Islands to the Cayman Islands, which withstood an objection in the related US Chapter 15 proceedings [2].

**DOV** and **DFH** sought to compromise their secured term loan facilities of over US$3 billion plus accrued interest outstanding ("**Term Loans**"). **DRH** sought to compromise its secured notes with over US$450 million plus accrued interest outstanding ("**DRH Notes**").

**UDW** sought to compromise (i) unsecured notes issued by UDW with over US$130 million plus accrued interest outstanding ("**UDW Notes**") as well as (ii) UDW's guarantees of the Term Loans and the DRH Notes ("**UDW**

**Guarantees**"). The distinctions between UDW noteholders and UDW guarantee creditors were at the core of this case.

The Schemes proposed a reduction of debt through an exchange for (mostly) equity, a smaller debt burden, and cash. If the Schemes were to fail, it was common ground that the result would be a liquidation of the Group, with value destruction for all creditors (i.e. all creditors would receive less in a liquidation than under the Schemes).

One of the features of the Group restructuring was that a funded Preserved Claims Trust ("**PCT**") was to be established to preserve, in particular, the claims to set aside alleged fraudulent conveyances that had been asserted by Highland in a draft complaint aimed at, among others, UDW's chief executive officer (George Economou) and chief financial officer (Anthony Kandylidis). Under the PCT, if the trustees considered that there was merit to the claims they could be pursued for the benefit of all UDW scheme creditors.

## Highland's Objection

Objections to the restructuring had initially been raised not only by Highland but also by an ad hoc group of DRH noteholders ("**DRH Group**"). Negotiations between the Group and the DRH Group, represented by Campbells, led to a modified proposal being put before the Court, which allowed for a substantially increased recovery for DRH noteholders. As a result, the DRH Group was able to support the DRH and UDW schemes.

By the time the Schemes were presented to the Court at the convening hearing, therefore, the only objection being voiced was from Highland and related to the UDW scheme. Given that the schemes proposed in respect of the Silo Companies were conditional on sanction of the UDW scheme, however, Highland's objection threatened to block all of the Schemes.

Highland held 56.5% of the UDW Notes, and in that capacity was a creditor in the sum of around US$74m, representing around 2% of the total amount of the claims of UDW's scheme creditors. Highland objected to the UDW scheme on the bases of class composition and fairness.

## Class Composition

Highland's key objection at the convening hearing related to the number of class meetings that should be convened in relation to the UDW scheme, it being common ground that there should be only one class in respect of the DRH, DFH, and DOV schemes.

Should the UDW scheme comprise one class (as proposed by UDW) or more than one class (as proposed by Highland)? If the UDW Notes were in a class of their own, as Highland proposed, Highland's majority ownership of those notes would allow it to block the UDW scheme and therefore prevent all the schemes from going ahead without modification.

The Court confirmed the two-stage test for class composition [3]:

1. Is there **any** difference between the strict legal rights of creditors **either** prior to **or** under the scheme?
2. If there is any difference, are the **rights so dissimilar so as to make it impossible for those creditors to consult together with a view to their common interest**? Or, on the assumption that the relevant scheme were to fail, is there objectively **more to unite than divide the creditors of the proposed class**, ignoring for that purpose any personal or extraneous interest or subjective motivation?

The main focus of Highland's attack was on the first stage of the test.

*Stage 1 (existing rights):* Highland argued that the UDW guarantee creditors had different *existing rights* from the UDW noteholders because, unlike the UDW noteholders, the UDW guarantee creditors had (i) security elsewhere in the group structure and (ii) dual recourse rights (i.e. they could sue and/or prove for the same debt in a liquidation of the relevant Silo Company as primary obligor as well as against UDW as guarantor).

The Court accepted UDW's argument that, when the Court compares *existing rights* of different creditors at stage 1, the Court must look only at the rights that each creditor is to release against the scheme company in question [4]. In other words, the Court could not consider security rights against other group companies or recourse against another group company for the same debt. To the extent that some English cases might be said to suggest otherwise, that is not good law in the Cayman Islands [5].

*Stage 1 (rights under the scheme [6]):* Highland also argued that the UDW guarantee creditors benefited from inducements which were never even offered to Highland or the UDW noteholders. Early signatories to a restructuring support agreement ("**RSA**") would receive consent fees and be reimbursed for their professional fees; but Highland was never invited to sign up to the RSA. The Court found that the consent fees were payable in respect of and out of the assets of the Silo Companies. That meant that they were not part of the *quid pro quo* for the release of rights at the UDW level – even if support for the Silo Companies necessarily required support for the UDW scheme on which the success of the Silo Companies' schemes depended.

*Stage 2:* The Court also found that there was, in any event, more to unite than to divide the creditors of the proposed single class at UDW, given the fact that the outcome, if the Schemes were to fail, was a Group liquidation that would leave all those creditors (including the UDW noteholders) in an economically worse position than under the Schemes. The difference in rights was not sufficiently dissimilar to prevent consultation together with a view to their common interest; the UDW guarantee creditors' security was found to be worthless (they were effectively unsecured) and the financial inducements were immaterial.

## Fairness

Highland argued that the UDW scheme was unfair and that Highland should be entirely carved out of the restructuring, so as to be able to pursue claims under the New York Debtor and Creditor Law arising out of alleged fraudulent conveyances from UDW; alternatively the Court should refuse to sanction the UDW scheme. In return for not being schemed, Highland would agree not to collect from UDW any sums due pursuant to the UDW Notes or any scheme consideration. It was common ground that the result of scheming Highland was that Highland would no longer be a creditor (Highland would be a shareholder in new UDW), and so could not file its claim in the USA.

On fairness, the question to be determined by the Court was whether the UDW class was fairly represented by those who attended the meeting (in person or by proxy) and whether the majority acted in good faith and did not coerce the minority in order to promote interests that were adverse to those of the class whom they purported to represent.

Although other challenges were made, Highland's key fairness objections were that:

1. the UDW majority had additional interests which motivated their vote in favour of the UDW scheme, and so their votes should be disregarded; and
2. scheming Highland would unfairly prevent Highland from pursuing a complaint under the New York Debtor and Creditor Law.

*Additional Interests:* Highland sought to argue that the voting had been unrepresentative and/or was affected by special interests. In particular, Highland contended that where a party's support for the scheme is based in part on different or additional interests to the class as a whole, that party's vote should be disregarded. As the UDW guarantee creditors had additional motivations to support the UDW scheme (their interests in the Silo Companies' schemes being sanctioned and their right to consent fees), Highland said that their votes in the UDW scheme meeting should be disregarded, leaving only Highland's 'no' vote to be taken into account.

The Court held that if a creditor is motivated by an *additional* interest to support a scheme, the Court is not thereby obliged to disregard that creditor's vote. The vote may be disregarded only if the additional interest clashes with and is adverse to the interests of the class. The Court approved the 'but for' approach taken by the English court in *Apcoa* whereby the objecting creditor must show that the majority *could not* have voted for the scheme, absent the additional interest [7]. On the facts the Court was satisfied that the UDW guarantee creditors could have voted for the UDW scheme, absent additional interests – relying in part on the fact that some UDW noteholders who had no other group debt voluntarily chose to support the UDW scheme [8].

*Highland's Draft Complaint:* The PCT preserved claims alleged in Highland's draft complaint for the purpose of the trustees being able to pursue them (if meritorious) for the benefit of all UDW scheme creditors. The Court held that there could be no unfairness *to Highland* if the UDW scheme resulted in *all UDW creditors* losing their standing to pursue claims which all those creditors would otherwise have had the right to pursue under the New York Debtor and Creditor Law: all UDW creditors were being treated equally [9]. Moreover, the PCT was a fairer way to deal with the alleged claims, since it would treat all UDW's scheme creditors ratably and would not give any priority to anyone.

In any event, the Court held that the UDW scheme could not be modified by the Court if the scheme company was opposed to the modification. As a matter of principle, the Judge's task was to consider whether the Schemes before the Court were fair and reasonable (without necessarily being the fairest, best or most reasonable), and not to undertake any comparative exercise between the proposed Schemes and hypothetical alternatives.

## Commentary

The successful *Ocean Rig* restructuring underscores the flexibility of Cayman schemes of arrangement. Moving the COMI of proposed scheme debtors to the Cayman Islands for the purposes of restructuring group debt, including where the debt is governed by New York law, provides debtors with an effective restructuring solution.

There was overwhelming creditor participation and support for the Schemes. The legal analysis supported the commercial imperative that Highland should not succeed in bringing down the Schemes, as a hold-out minority creditor, to the detriment of all other creditors.

The decision was grounded in commercial good sense in at least one other respect. Groups are commonly restructured by way of interlinked schemes of arrangement, and group creditors often have 'cross-holdings' (i.e. they hold debt owed by different scheme companies). The decisions on class composition and fairness in *Ocean Rig* are consistent with that commercial reality. The existence of cross-holdings should not lead to a proliferation of classes (the consequence of Highland's approach on class); and a creditor's vote should not be disregarded merely because it also has an additional interest in the successful promotion of an inter-related scheme. Otherwise, group restructuring by inter-related schemes of arrangement might be impracticable if not impossible.

Another interesting facet of the case was that the US and Cayman Courts approved a court-to-court protocol – not for co-operation between two sets of officeholders (since the same officeholders acted in both jurisdictions) but between the two Courts. This appears to be a first for the Cayman Islands and it reflects the spirit of discussions currently taking place in the Judicial Insolvency Network.

[1] Mr Justice Parker, unrep., 18 September 2017 (Cause Nos. FSD 100, 101, 102 and 103 of 2017)

[2] Although the group companies were previously all Marshall Islands entities, UDW was incorporated in the Cayman Islands in 2016 as a result of a transfer by continuation under Part XII of the Companies Law (2016 Rev.); and the Silo Companies were registered foreign companies under Part XIII of the Companies Law. Accordingly, the Cayman Islands Court had jurisdiction over each of UDW, DOV, DFH and DRH.

[3] Following the "*modern approach*" applied by the English Court in *Re Apcoa Parking Holdings GmbH & Ors* [2014] EWHC 3899 (Ch), per Hildyard J at [52].

[4] Judgment at [57], [66]-[68]

[5] *Stemcor* [2016] BCC 194 at [18] in reliance on *Re Uniq* [2012] 1 BCLC 783 at [24]. The Court considered these authorities on this issue during the course of argument, although they are not referred to in the judgment.

[6] Unlike with existing rights, the Court should compare benefits received by creditors from the restructuring as a whole, without confining itself to benefits conferred by the scheme company itself.

[7] Judgment at [93]-[95], [121]

[8] Judgment at [121]-[122]

[9] Judgment at [125]

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