DISTRESS IN THE OFFSHORE SECTOR: ALTERNATIVE APPROACHES TO RESTRUCTURING

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The chief executive of Oil & Gas UK, Diedre Michie, has warned that the combination of COVID-19 and the latest oil price collapse, "coming so soon after one of the worst downturns in our history", has left the UK oil industry "in a paper-thin position".

The fall in the oil price has required oil and gas companies operating in the North Sea to announce significant reductions in their exploration and production expenditure. These actions are necessary to maintain cash flows in the short term and ensure the viability of the business in the long term. However, they will also have a negative effect on oil companies' supply chains, which have barely recovered from the previous downturn.

We are already seeing a decreasing rate of utilisation in the offshore supply vessel (OSV) market, with many owners approaching their creditors for yet another round of restructurings. While the OSV market is often "first in line" to take the brunt of any downturn in the offshore sector, there is no question that drilling contractors are also looking anxiously at their backlog with many already anticipating a requirement to review their financing arrangements. New technological advances and industry practices are also accelerating the obsolescence of various types of floating units – from drilling rigs and ships to floating accommodation units.

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But the main concern that many market commentators are voicing in this current downturn is that prior to the previous collapse of 2015/16 many service providers had been enjoying largely positive income flows – with oil prices being sufficiently high to allow them to make significant profits in an industry that was (arguably) already structurally oversupplied at the time. And yet even with this backdrop and the reasonable levels of liquidity achieved during this period, when the collapse came many contractors had to seek Chapter 11 protection or strike deals with their creditors.

For the contractors that did survive the last downturn (and many did not) – whether their survival was achieved by way of refinancing or restructuring, or simply by sound financial management over previous years – the prevailing feeling has been that large swathes of the offshore sector have remained over-supplied, with contractors holding on to the hope (perhaps rather than the expectation) that the market would at some point recover releasing them from their own financial lockdown. Unfortunately, COVID-19 and the latest oil price collapse has seen many offshore contractors having to retire back to their drawing boards.

One lesson learnt from the last downturn is that, for all its advantages, Chapter 11 is by no means the only, or always the most suitable, option for restructuring especially in the offshore sector. Other alternatives exist that are less expensive and that may also be better at preserving value for creditors and the company. One such alternative that has been used successfully in a number of cases is the scheme of arrangement, which is a restructuring process available under the UK Companies Act through which a company can propose a compromise or arrangement with its creditors. Schemes of arrangement are also part of the law in jurisdictions whose legal systems derive from English law, such as Singapore, Hong Kong, Bermuda and the Cayman Islands. Schemes are more streamlined and flexible than Chapter 11, while also offering a mechanism with extraterritorial reach.

Whilst a scheme of arrangement does not normally involve an insolvency moratorium (although the Singapore variant can include this feature), it does offer a process through which a company's debts can be restructured and dissenting creditors crammed down. Bibby Offshore (through a UK scheme) and Ocean Rig (through a Cayman scheme) showed how this process can be utilised in conjunction with other restructuring tools (such as centre of main interest (COMI) shifts and Chapter 15 recognition) to effectively restructure debt governed by New York law and of companies incorporated in jurisdictions other than the jurisdiction of the scheme itself.

Inevitably the long-term goal must be that whatever pain the industry has to endure now must give rise to a sustainable and competitive, but still profitable, market place. Unfortunately, as it has proven in the past, the offshore market suffers the same vagaries as any other maritime sector – with a boom bust and back again cycle and the inevitably painful penchant for oversupply that this can bring.

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