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Sino-Ocean: English Court Approves Restructuring Plan, Notwithstanding First Challenge on “Gerrymandering” and Discounting Votes

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At a Glance

The English Court today approved the UK restructuring plan (**UKRP**) of Sino-Ocean despite opposition from a creditor, Long Corridor, which held c.1.5% of the liabilities under the plan. The case is the first UKRP to be opposed on “gerrymandering” grounds; the first “cram-across” by claims governed by non-English law and subject to an overseas scheme; and the first opposed case on the “discounting” of votes in a UKRP.

Long Corridor’s opposition was principally on the basis that:

- the plan was too generous to shareholders, who retain a majority of the equity in the plan company without contributing new value — whereas a “fairer plan” would provide greater benefit for plan creditors and dilute existing shareholders to a small percentage;
- the inclusion of a particular class, Class A, in the UKRP was unprecedented and unjustified, given the relevant claims were governed by Hong Kong law and were to be compromised via a parallel, inter-conditional Hong Kong scheme of arrangement — i.e., their inclusion within the UKRP raised “gerrymandering” concerns as to the artificial proliferation of classes in order to engineer a consenting class;
- consent from another class, Class C, should be disregarded as approval was only obtained based on affirmative votes from a creditor which was also an affiliate of one of Sino-Ocean’s largest shareholders — i.e., whose vote was allegedly motivated by

its interest in promoting the interests of shareholders, which was adverse to the interests of the creditor class; and
- a meeting of shareholders ought to have been convened given the plan involved a dilution of members' shareholdings and, absent such a meeting, the court did not have jurisdiction to sanction the plan.

The court held that:

- unless a putative alternative plan is specified in detail, it is impossible for the court to judge the effect on creditors of that plan;
- the UKRP fairly allocated value as between the creditor classes;
- although the plan might appear "unduly generous" to existing shareholders, the retention of most of the equity was justified on the basis of the benefits in the plan company remaining a Chinese-state-owned enterprise;
- the "gerrymandering" objection was misconceived;
- the evidence cast substantial doubt as to whether the creditor who was also a shareholder affiliate was in fact influenced by a consideration that was adverse to the interests of the creditor class; any motivation to assist the shareholder affiliate was to be regarded as an additional reason rather than the predominant reason for the creditor's consenting vote; and
- shareholders' rights were not actually "affected" by the UKRP, given they had approved the issuance of the relevant instruments at an extraordinary general meeting; accordingly, no shareholder meeting was necessary for the UKRP.

The convening judgment is here. The sanction judgment is here. The Hong Kong scheme sanction hearing is scheduled for 24 January 2025.

Background

Plan Company	Sino-Ocean Group Holding Limited, incorporated in Hong Kong and listed on the Hong Kong Stock Exchange. Property development group with underlying assets primarily in China
Financial Difficulties	Defaulted on debt; facing enforcement action by various creditors. Hong Kong winding-up petition presented but adjourned to allow the group to promulgate the UKRP and Hong Kong scheme

<table>
<tr><td>Purpose of Plan</td><td>Debt reduction via c.$6.3 billion debt for debt swap; restore group to sustainable financial health</td></tr>
<tr><td>Relevant Alternative</td><td>Formal insolvency proceedings triggering a liquidation of the group’s property portfolio and a combination of enforcements, insolvency filings and distressed sales</td></tr>
<tr><td>Class Constitution and Voting</td><td>
<table>
<tr><th>Creditors</th><th>Governing Law</th><th>Voting</th></tr>
<tr><td>1. Class A</td><td>Hong Kong</td><td>Approved</td></tr>
<tr><td>2. Class B</td><td>English</td><td>Rejected</td></tr>
<tr><td>3. Class C</td><td>English</td><td>Approved, but only by reason of positive votes cast by one of the group's largest shareholders; rejected by unconnected creditors</td></tr>
<tr><td>4. Class D (subordinated)</td><td>English</td><td>Rejected</td></tr>
</table>
</td></tr>
<tr><td>Treatment of Shareholders</td><td>Shareholders were excluded from the UKRP and Hong Kong scheme (and were supportive); their shareholdings were diluted through issue of new shares but the value of their existing shares would be enhanced by successful implementation of the restructuring</td></tr>
</table>

Judgment

- *Relevant alternative*: The court held that the correct “relevant alternative” to the plan was insolvent liquidation, as the plan company had argued. It was not an alternative plan, as Long Corridor had argued; “unless a putative alternative plan is specified in detail it is impossible for the court to judge the effect on creditors of that plan”. There was also evidence that the Class A creditors and shareholders would not support an alternative plan of the type advocated by Long Corridor.
- *Gerrymandering*: Long Corridor argued that the plan company was deliberately fracturing the vote of the different classes, with a view to obtaining the ability for the

court to “cram down” any dissenting classes. In particular, it argued against the inclusion of Class A in the UKRP, given the Hong Kong law debt would be compromised under the Hong Kong scheme (and Class A creditors had no nexus with the UK). However, the court held that the “gerrymandering” objection was misconceived; the Class A creditors who voted in the UKRP were bound as a matter of English law (and in a way that would be recognised by Hong Kong law). There was nothing artificial in the inclusion of the Class A creditors in the UKRP.

- *Vote discounting*: The court held the evidence cast substantial doubt as to whether the creditor who was also a shareholder affiliate was in fact influenced by a consideration that was adverse to the interests of the creditor class. Any motivation to assist the shareholder affiliate should be regarded as an additional reason rather than the predominant reason (given conflict-of-interest policies, the fact that a majority of other members of the relevant class also voted in favour, and as there were rational bases for the relevant creditor class to approve the plan). Accordingly, on the facts, the benefit to a shareholder affiliate would have been at most an additional reason rather than a predominant reason for the creditor’s vote.
- *Inclusion of shareholders in UKRP*: Long Corridor argued that a meeting of shareholders ought to have been convened (given the plan involved a dilution of members’ shareholdings) and that, absent such a meeting, the court did not have jurisdiction to sanction the plan, following the case of *Hurricane Energy* (see our *Alert*). However, the court held that it was artificial to say that shareholders’ rights were being affected by the UKRP; shareholders’ rights had been fully respected and they had accepted the dilution of shareholding implicit in the plan. Accordingly, there would be no point joining shareholders as a class.
- *Division of post-restructuring value between creditors*: The court held that, as between the different creditor groups, the plan company had done its best to allocate fairly the value preserved or generated by the UKRP over and above the relevant alternative. Although this led to different groups of *pari passu* creditors (Classes A to C) receiving different amounts of consideration under the plan, this was explained by the fact that, in the relevant alternative, the different classes would have different rights against other companies in the group and so would be anticipated to receive different recoveries. Accordingly, the departure from the general principle of equal treatment for equal-ranking creditors was justified.
- *Retention of equity by existing shareholders*: The court held it was clear that shareholders were obtaining disproportionate value out of the restructuring, given they would obtain nothing in the relevant alternative but would retain a majority of equity under the plan. In considering the potential justification for this apparently “unduly generous” treatment, the court held that the “gifting” and “new money” justifications for the retention of value by existing shareholders are not the only possible justifications. Citing the Court of Appeal’s judgment in *Adler* (see our *Alert*),

the court held that “in considering whether there is a good reason or proper basis for departing from a division of the benefits of a restructuring plan that is strictly proportionate to how the different classes of creditor and shareholder would fare in the relevant alternative, the court takes a pragmatic view, focused on the overall interests of creditors”. Here, the justification for treating shareholders substantially better than they would do in the relevant alternative was that the plan company considered it important that its two largest shareholders, which were Chinese-state-owned enterprises, should retain minimum holdings of 15% each so that the plan company would continue to be regarded as a state-owned entity. This status was said to result in various benefits including a more helpful reception by state organisations and access to lower interest rates in the market than for privately-owned entities. The court concluded that, on the evidence, there was no plan which could have been put forward which would provide a better return to creditors by giving them substantially more equity.

> After the court expressed sympathy for Long Corridor’s argument that the state-owned shareholders were not required to retain their shareholding (i.e., the alleged benefits of the retention of equity might dissipate if the holdings were sold), the state-owned shareholders provided undertakings to the plan company to retain their existing shares for a minimum of two years. This obviated the need for the court to make it a condition to the plan that such undertakings be given by the shareholders. The court required the plan company to undertake to use all reasonable endeavours to enforce the undertakings given by the state-owned shareholders.

- *Explanatory statement*: in its convening judgment, the court held that the original explanatory statement did not give sufficient prominence to the effect of the plan on shareholders. However, the explanatory statement had already been sent out by the time the convening judgment was delivered. At sanction, the court held the position was nonetheless sufficiently clear in the explanatory statement for creditors to understand the point, given their sophistication. Going forward, plan companies and their advisors should ensure the effect of a plan on shareholders is clearly disclosed, even if they are not included in the plan.

Other Notable Aspects

The case is also notable as:

- as noted, the UKRP is being promulgated in parallel to an inter-conditional Hong Kong scheme (as in *Hong Kong Airlines* in 2022);
- it is a fairly unusual example of a restructuring plan of a listed company (others include e.g., *Premier Oil* and *Superdry*);
- equal-ranking classes voted separately based on their different "rights out" of the restructuring, with the different consideration designed to reflect the creditors' differing prospects of recovery in a liquidation scenario (given they held guarantees against different group companies);
- creditors were offered the opportunity to elect different types of security;
- existing (listed) shareholders retained the majority of the equity without contributing new value;
- the court requested the explanatory statement be amended to give greater prominence to the expected commercial effect of the UKRP for shareholders; and
- the court slowed down the proposed timetable by c.6 weeks (including the Christmas/New Year holidays) on the basis that late receipt by creditors of the final relevant alternative report and related materials meant that creditors would require more time to obtain advice and assess fairness.

This judgment may yet be appealed.

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Related Services

Practices

- Restructuring

Suggested Reading

- 23 January 2024 Kirkland Alert Adler: English Court of Appeal Overturns Restructuring Plan
- 28 June 2021 Kirkland Alert Hurricane Energy: For the First Time, the English Court Declines to Approve a Restructuring Plan

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