UPDATE

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Aubit International: Guidance on the new restructuring officer regime in the Cayman Islands

Update prepared by Nicholas Fox and Lisa Yun (Cayman Islands)

The Grand Court of the Cayman Islands has provided further guidance on the new restructuring officer (**RO**) regime under section 91B of the Companies Act (2023 Revision) (the **Act**), which came into force on 31 August 2022.

In *Re Aubit International* (Unreported, 4 October 2023), the Grand Court dismissed a petition to appoint restructuring officers and found that it did not have jurisdiction to grant the relief requested on the basis that there was no credible evidence of a rational restructuring proposal with reasonable prospects of success.

The judgment provides helpful guidance on section 91B of the Act and is only the second judgment to consider the new RO regime (the first being Kawaley J's decision in *Oriente Limited* (Unreported, 8 December 2022)). The case provides further clarification on the considerations that should be taken by the Court when considering the appointment of ROs and warns that the court will guard against potential abuse of the new regime.

Background

On 23 August 2023, Aubit International (the **Company**), a company incorporated in the Cayman Islands as an exempted company, presented a petition under section 91B of the Act seeking the appointment of ROs on the grounds that the Company was insolvent and unable to pay its debts and intended to present a compromise or arrangement to its creditors (the **Petition**).

Law

Under section 91B(1) of the Act, a company may present a petition to the Court for the appointment of a RO on the grounds that the company (i) is, or is likely to become, unable to pay its debts within the meaning of section 93 of the Act and (ii) intends to present a compromise or arrangement to its creditors either pursuant to Cayman law or the law of a foreign court or by way of a consensual restructuring.

Weakness of this Petition

The Petition appears to have been a weak petition, for two reasons.

First, the supporting evidence was in a poor state. Whilst the evidence provided included numerous letters of support from stakeholders (a good number of whom appear to have been management-affiliated), it provided only very limited financial information regarding the Company and its creditors and also contained material omissions (eg it initially failed to mention ongoing US litigation against the Company).

Second, the restructuring proposal was unorthodox and manifestly unsatisfactory, in that it contained two stages:

(i) An asset and information gathering phase – in order to be able to formulate the terms of recovery and a restructuring plan. In support of this, the Petition sought relief seeking, *inter alia*, that powers be conferred on the proposed ROs, including powers to recover all assets of the Company and to take all necessary steps to take possession of and collect documentation and information, and to investigate

into the affairs of the Company (powers that the Court commented were '*extraordinary*' and appeared less than fully comfortable contemplating – at least on the facts of this case); and

(ii) the more typical restructuring stage, only once the financial position and potential asset recoveries had been ascertained. As the Court noted, the evidence *'puts no meat on the bones of the proposed restructuring plan*'.

It was conceded by the Company that this approach was '*unusual, if not unique*'.

Stakeholder position

One set of creditors appeared at the petition hearing, through their counsel.

Unsurprisingly, these creditors appeared less focused on the strict application of the threshold tests and much more motivated by the safety that would be afforded by the appointment of independent professionals as soon as possible.

To that end, the creditors' position was that: (a) they agreed with the Company that there was a need for an investigation in this case; (b) they could not assess the feasibility of any restructuring plan being proposed, as very little detail or substance had been included with the Company's application; (c) provided that independent officeholders were appointed as a matter of urgency and stakeholders' interests protected by an order granting those officeholders extensive powers, the creditors did not wish to *'focus on technical defects of the Company's motivations at this stage*'; and (d) they thought it probable that the matter may transition into provisional or official liquidation in due course, so their position was entirely without prejudice to their right to later seek a winding-up order if necessary.

Earlier case law on corporate restructuring

In considering the Company's petition for the appointment of ROs, Doyle J provided a comprehensive review of the Cayman case law on corporate restructurings that pre-dated the new RO regime. He cited, with approval, Kawaley J's judgment in *Oriente Group Limited* (Unreported, 8 December 2022), which stated that the previous authorities on *'light touch*' provisional liquidations remained both relevant and persuasive.

Doyle J went on to refer to a number of other leading decisions, including of Doyle J in *Silver Base Group Holdings Limited* (Unreported, 22 November 2021), Segal J in *Midway Resources International* (Unreported, 30 March 2021) and Smellie CJ in *Sun Cheong Creative Development Holdings Limited* [2020 (2) CILR 942], amongst others.

Considerations for the Court when considering the appointment of restructuring officers

From review of the prior case law, and noting the express provisions of section 91B of the Act, Doyle J provided a list of principles that the Court may take into account when considering applications for the appointment of ROs including, *inter alia,* the following:

- Before the Court has jurisdiction to exercise its broad discretion to appoint ROs, the burden is on the petitioner to satisfy the Court that the statutory limbs in section 91B(1)(a) and (b) are *both* satisfied, namely that it:
  - (b) is or is likely to become unable to pay its debts; and
  - (c) it intends to present a restructuring plan to its creditors.
- In relation to the second limb, the intention to present a restructuring plan must be a realistic, genuine, bona fide held intention on adequate grounds and the Court will need to be persuaded that there is a rational and credible restructuring plan, even if only provided in outline. While there is no need for a detailed pre-formulated or finalised plan, entirely abstract or hypothetical restructurings are not sufficient and there must normally be tangible proposals with support from, or meaningful engagement with, at least some unconnected creditors.
- Only if both limbs are satisfied, does the Court then have a wide discretionary power to appoint ROs. That power will normally be exercised if the Court is satisfied that the appointment would benefit those having the financial interest in the company to be rescued (ie its creditors).
- In exercising this discretion, the Court must consider whether:
  - (a) the restructuring is likely to be more beneficial to creditors than a winding-up petition;
  - (b) there is a real prospect of a restructuring being effected for the benefit of the general body of creditors;

(c) that in all circumstances, it is in the best interests of the creditors to try and achieve a restructuring.

- In terms of evidence, the Court will normally expect to see:
  (a) evidence of some form of engagement with creditors prior to the petition being presented;
  (b) independent evidence on the benefits of a restructuring as against a winding-up order (and may be sceptical about the views of management in that respect, if management's conduct would likely fall under close scrutiny if a winding-up order is made);
  (c) accurate, ideally independently verified evidence of the company's financial position, including financial statements (preferably audited or otherwise independently verified), a list of creditors specifying whether they are secured or not and if secured the extent of any security, and whether the creditors have any connection with the management of the company, their locations, the amounts outstanding to each of them and an indication of the extent of the consultation with them and whether they support or oppose the appointment of ROs.
- The Court also warned that the petitioner should *'have all their ducks in a row'* before filing the petition and that it should not assume that if it's evidence is inadequate, it will simply be able to obtain an adjournment at the petition hearing.

The need to guard against potential abuse

The Court then went on to discuss the need to guard against potential abuse of the new RO regime.

The Court placed particular emphasis on this issue, focusing on it heavily in the operative part of its judgment. In doing so, the Court signalled that it would vigilant in policing the RO regime and be alert to potential attempts to abuse it.

The Court referred to the importance that foreign courts could be assured that the Cayman Court would police this regime properly, and be alert to decline relief in unmeritorious cases, saying:

> '*it is important that foreign courts readily provide recognition and assistance. The protection of the new regime by the judiciary from potential abuse should enhance international judicial cooperation from other countries*.'

and

> '*Jurisdictions around the world can have confidence in the judiciary of the Cayman Islands to appropriately consider and balance the interests of all concerned in respect of applications for the appointment of ROs. Foreign jurisdictions should not hesitate to recognise and provide assistance to ROs appointed by the Financial Services Division of the Grand Court of the Cayman Islands. They may rest assured that Cayman judges at first instance in the Financial Services Division, reinforced by a strong and internationally well-regarded Court of Appeal and the JCPC, will be vigilant to guard against any potential abuse of the restructuring officer regime*'.

Findings

The Court went on to dismiss the petition. It did so primarily for two reasons.

First, the Court was not satisfied that the two-phase process advocated by the Company was appropriate in the circumstances of this case, observing that '*The major part of the relief sought in the Petition, described as the phase one relief, was plainly inappropriate*'. Indeed, given the tenor of the judgment and the nature of the applicable test, it is doubtful that a two-stage process like the one proposed by the Company will ever satisfy the threshold test for appointing ROs.

Second, the Court plainly found the Company's evidence deficient in a number of significant ways. The core findings were that the Court was not persuaded that there was a real prospect of a restructuring being effected, and it was not satisfied that the appointment of ROs would benefit creditors.

Conclusion

The decision is welcome guidance on the recently introduced RO regime and highlights the importance of preparing for a petition properly in advance, including gathering together all necessary financial information and engaging constructively with creditors well in advance of a filing, particularly unsecured creditors that are not connected to the company.

The decision is also a timely reminder that, notwithstanding the flexibility of the RO regime and the wide discretion afforded to the Court in relation to it, the Court will be vigilant in guarding against any risk of abuse of that regime. It follows that it will be important to ensure that any petitions pursuant to section 91B are brought only for proper purposes to appoint ROs to facilitate and finalise a financial restructuring.

Contacts

Nicolas Fox
Partner
Mourant Ozannes (Cayman) LLP
+1 345 814 9268
nicholas.fox@mourant.com

Lisa Yun
Senior Associate
Mourant Ozannes (Cayman) LLP
+1 345 814 9218
lisa.yun@mourant.com