# The Restructuring Review of the Americas 2018

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# The Restructuring Review of the Americas 2018

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# Cayman Islands

## Christopher Harlowe and Tisha Hobden

*Mourant Ozannes*

The Cayman Islands is a highly sophisticated offshore jurisdiction and the world's leading domicile for offshore hedge funds. It is a premier jurisdiction of choice for the establishment of offshore investment vehicles, special purpose vehicles and other corporate structures. If such companies experience financial distress, their stakeholders may wish to consider the options open to them to protect their interests.

The Grand Court of the Cayman Islands has a dedicated Financial Services Division, which deals with complex civil cases arising in the financial sector and is very experienced in dealing with corporate restructurings. A number of the Grand Court and Cayman Islands Court of Appeal judges are former English High Court and Court of Appeal judges or highly experienced former Cayman Islands commercial litigation practitioners. The ultimate court of appeal for cases commenced in the Cayman Islands is the Judicial Committee of the Privy Council in England. Members of the English Bar can be permitted to appear before Cayman courts. Cayman jurisprudence broadly follows its English parent, save where a specific statutory provision has been introduced or case law has developed to address Cayman-specific issues. It is notable for its modern and outward-looking character, and in many areas, such as cross-border insolvency and restructuring, it is at the forefront of worldwide developments.

In the Cayman Islands, a binding restructuring can be effected without any court involvement if all affected parties agree to it. If unanimous consent cannot be achieved, the two main methods for restructuring a company are schemes of arrangement and restructuring provisional liquidations, both of which require court applications and oversight. A scheme of arrangement is the only formal restructuring process in which the rights of creditors or shareholders can be varied, and requires an order of the court to take effect. A company may also apply to court for a provisional liquidation to protect itself from its creditors while it restructures its business: in that case, the provisional liquidation simply acts as a 'protective wrapper' to allow the restructuring to be implemented.

## Schemes of arrangement

Although Cayman Islands law has no formal rehabilitation process for companies in financial distress equivalent to the US chapter 11 or the English administration order, a company may still enter into a scheme of arrangement with a view to restructuring its debts.

### *What is a scheme?*

A scheme is a court-sanctioned arrangement made between a company and its creditors or members (or any class of them) in accordance with sections 86 and 87 of the Cayman Islands Companies Law (2016 Revision) (as amended) (the Law). Schemes can also be implemented within a liquidation. Although frequently used in the context of a financial restructuring, schemes can also be used to facilitate group restructurings, reorganisations, mergers or take privates.

The Grand Court has jurisdiction to consider a scheme in relation to any company that is liable to be wound up in the Cayman Islands. The Grand Court is sympathetic to 'COMI shifting' to the Cayman Islands to give the Grand Court such jurisdiction. In *Ocean Rig UDW Inc*,[1] the Grand Court had no difficulty in considering and approving a scheme in relation to a company that had been incorporated and registered in the Marshall Islands, but that had relocated to the Cayman Islands shortly before the scheme process was started.

The company that is the subject of the scheme must be a party to the proposed arrangement. A scheme must involve an element of accommodation on each side for it to be effective; there must be some compensating advantage for creditors or members in return for giving up some or all of their rights. A scheme can provide for the release of a third party, such as a guarantor, which is not itself a party to the proposed arrangement.

A scheme can be entered into with all or some of the members or creditors of a company, so the scope for using a scheme is wide. While schemes can be used to alter the rights of members, creditor schemes are frequently implemented in Cayman and provide a formal process for rescuing a distressed entity. A scheme can be used:

- as part of a scheme of reconstruction or amalgamation;
- to reorganise the share capital of a company;
- to merge one company with another; or
- to merge two or more companies under a new holding company.

### *Relevant legislation*

The procedure for entering into a scheme of arrangement is set out in section 86 of the Law and Grand Court Rules (GCR) Order 102, rule 20. There is also a practice direction dealing with schemes of arrangement,[2] the contents of which were recently confirmed by the Cayman Islands Grand Court.[3]

Section 86 of the Law provides for court sanction of schemes of arrangement or reconstruction agreed between a company and its members, or a company and its creditors. The application for sanction can be made by the company, a creditor or, if the company is in liquidation, by the company's liquidator. The GCR also provide a clear procedural pathway and directions for the sanction of such schemes.

There is no statutory obligation on a company or its directors to propose a scheme of arrangement.

### *Why use a scheme?*

One of the benefits of using a scheme is that once the court has sanctioned a scheme, all creditors or members of each class concerned are bound by its terms whether they voted for it or not. As a result, the issue of the proper constitution of classes is a critically important one. Creditors must be grouped together with other creditors who share rights against the company that are 'not so dissimilar as to make it impossible for them to consult together with a view to their common interest' – those rights being assessed by reference to their rights that may be affected by the scheme, and not by their individual private commercial or financial interests. The Grand Court will wish to be satisfied that the proposed class composition is justifiable as



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a precondition of giving directions to place the scheme proposal before creditors.

While the scheme is being promoted, the directors remain in control of the company and can formulate the terms of the proposed scheme, although if the scheme is being promoted while the company is in liquidation, it will typically be led by the company's liquidators. There are no statutory restrictions on a company subject to a scheme of arrangement carrying on business. If the company is not in liquidation, the business continues to be carried on by the directors. If it is in liquidation, the liquidators can carry on the business, subject to certain restrictions.

### *Procedure*

To initiate a scheme, the company, or if the company is in liquidation, the liquidator, will issue contemporaneously:

- a petition with the Grand Court seeking the sanction or approval of the proposed scheme; and
- a summons for an order to convene a meeting of the appropriate class of creditors or members. The summons is supported by an affidavit describing the purpose and effect of the proposed scheme, providing the information necessary to enable the Court to determine whether it should allow meetings of the different classes of members' or creditors' meetings and, if so, the composition of the classes. The supporting affidavit will exhibit the proposed scheme together with any supplementary documents to which it refers, voting instructions and an explanatory memorandum describing the merits of the proposed scheme.

The primary purpose of the first court hearing is to satisfy the court that the classes are properly constituted and that the explanatory memorandum contains sufficient information to enable the stakeholders to make an informed decision as to the merits of the proposed scheme. Provided that the court is satisfied on these points, it will be asked to approve the convening of the first meeting and to direct the timeline for the approval of the scheme.

Once the court's approval to proceed has been given, the scheme has to be approved by the creditors or members of the company or the relevant class concerned at the court-approved meeting. The scheme must be approved by a majority representing 75 per cent in value of the members or class of members voting, whether in person or by proxy. As it is always necessary to take account not only of the numbers of members who approve the scheme but also the value of their holdings, the resolution to approve the scheme must be by way of a poll.

These voting procedures appear to be relatively straightforward, but voting does not always involve a simple head-count of those present at the meeting. For example, proxies, nominees and custodians may often wear many different hats on behalf of multiple investors at a single meeting. The recent decision of the Grand Court of the Cayman Islands in *Re Uni-Asia Holdings Limited* affirms the voting practice of 'looking through the register' when clearing houses or custodians are used, for the purpose of determining whether statutory majorities have been achieved, as set out in *Re Little Sheep Group Limited*.[4] Based on this line of authority, it is clear that depositories are entitled to have votes counted separately in circumstances where they act for several underlying investors. As in *Uni-Asia*, the court may intervene and insist on amendments to scheme documents and orders to protect an individual's right to be counted.

The chairman of the meeting will report the outcome of the meeting to the court. If the requisite majorities are attained, the court will be asked at a second hearing to sanction the scheme. Members or creditors who voted at the meeting convened by the court are entitled to attend and be heard at the sanction hearing.

The Law does not set out a substantive test which the court must apply when determining whether to sanction the proposed scheme. However, before granting an order, the court must be satisfied that prescribed procedures have been followed and the interests of all relevant parties, such as creditors and shareholders, have been properly considered and are not prejudiced. The court will usually consider that the members are the best judges of their own commercial interests.

If the scheme is sanctioned by the court at the sanction hearing, a copy of the order made by the judge must be filed with the Registrar of Companies. The scheme only becomes effective and binding on creditors or members and against the company itself (or if the company is in liquidation, on the liquidator and contributories of the company) once the order has been filed.

The Grand Court has extensive experience in handling scheme petitions from a variety of industries and strives to ensure its directions are consistent and practical. Recent practice suggests that subject to unforeseen complexities, the overall time from the commencement of proceedings to final approval will be approximately eight to 10 weeks.

## Restructuring provisional liquidations

A scheme of arrangement does not confer the protection of a statutory moratorium on the company while the scheme is being presented and negotiated. Accordingly, some companies seek protection from the claims of unsecured creditors by appointing one or more provisional liquidators, whose appointment will automatically trigger a moratorium against creditor claims or enforcement, giving freedom to restructure free from creditor pressure. Provisional liquidators are normally appointed to protect company assets pending the hearing of a winding up petition. However, in Cayman, the provisional liquidation process is also used as a tool to assist with restructurings.

This type of protection is essential where a Cayman Islands company sits within a network of companies undergoing restructuring in a foreign jurisdiction. Placing the Cayman Islands company into provisional liquidation protects it from creditors who are not subject to any moratorium put in place by the onshore court, while the wider restructuring of the group, including the Cayman Islands company, takes place. In this context, the aim of a provisional liquidation is similar to the UK administration process or proceedings pursuant to Chapter 11 of the US Bankruptcy Code.

### *Provisional liquidation procedure*

The provisional liquidation jurisdiction is governed by section 104 of the Law. Section 104(2) deals with the traditional grounds for such an appointment, namely that a provisional liquidator is required to prevent the dissipation or misuse of company assets in the period between the issue of a winding up petition and its eventual hearing. The important subsection for restructuring purposes is section 104(3), which provides that the company can make an *ex parte* application to appoint a provisional liquidator on the grounds that:

- it is or is likely to become unable to pay its debts within the meaning of section 93;[5] and
- the company intends to present a compromise or arrangement to its creditors.

A compromise or arrangement has been held to include a Chapter 11 restructuring or a foreign scheme of arrangement. In order to take advantage of this provision, the company must present a winding up petition against itself. Once the restructuring process is successfully concluded, the petition is simply withdrawn and the company continues in existence.



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At present, section 104(3) only provides for an application for the appointment of a provisional liquidator to be made by the company itself and does not confer the same benefit on creditors, contributories or the Cayman Islands Monetary Authority.

### *Power to present a winding up petition*

The Grand Court decision in *Re China Shanshui Cement Group Limited* [6] considered what happens when company directors wish to unilaterally effect a restructuring without shareholder support.

In *China Shansui*, a winding up petition was filed with the intent to follow up with an application for the appointment of a provisional liquidator for restructuring pursuant to section 104(3). The Court held that a company could not present a winding up petition without either shareholder sanction or an express provision in the articles of association authorising the directors to present a petition on the company's behalf. In doing so, the Court confirmed the position in *Re Emmadart Ltd* [7] and found that an earlier case on the same topic, *Re China Milk Products Ltd,* [8] was wrongly decided.

In *Re Emmadart*, it was held that the directors of a company act as its agent and require the authority of either the articles of association or the shareholders to present a petition. The rationale behind this decision was that the directors of a company only have the authority to take those steps that are necessary to manage the business in its ordinary course. Termination of the company's business is not in its ordinary course and to commence a termination process such as issuing a winding up petition, even if for the purposes of a restructuring, the directors must act with specific authority.

In *China Milk*, it was held that directors of an insolvent company could present a winding up petition on behalf of and in the name of the company, without reference to the shareholders and irrespective of the terms of the articles. The intention behind the decision was presumably to enable insolvent companies to seek court assistance to restructure their businesses, and thus to survive, without the need for shareholder approval. However, in *China Shanshui*, the Court took a different view, being swayed by the fact that the legislature had the opportunity to amend the Companies Law in 2007 to allow for such action but did not to do so.

The more recent decision in *CHC Group Ltd* [9] considered both *China Milk* and *China Shanshui*, despite the fact that the specific circumstances in *China Milk* and *China Shanshui* were slightly different than those being considered in *CHC*. In the *CHC Group* case, the company had no express power to present a winding up petition against itself either in its articles or by a specific shareholder resolution, and so had no authority to issue a winding up petition to start the provisional liquidation process. However, a separate intra-group creditor issued a winding up petition against the company, which was then followed by an application by the company, acting by its directors, for the appointment of joint provisional liquidators for the purpose of restructuring. It was held that where a creditor has already filed a winding up petition in respect of a company, not only may the directors of the company apply by themselves for the appointment of joint provisional liquidators, but they may also do so without a shareholders' resolution or express provision in the company's articles of association.

This interpretation appears to contradict the English common law position in *Re Emmadart* as well as the common law position in the Cayman Islands as established in *China Shanshui*. However, the Court in *CHC* held that *Re Emmadart* did not apply, because it had nothing to do with company restructurings. In any event, *CHC* confirms the effectiveness of the work-around of having a 'friendly' creditor, not the company, issuing the petition for provisional liquidation for the purposes of restructuring. While the legal profession has been cognisant of this approach for some time, *CHC* was the first judgment confirming its availability. These points may be addressed in the future either by the Court of Appeal or by the Cayman Islands Legislative Assembly.

### *What happens once provisional liquidators are appointed?*

The appointment of provisional liquidators triggers a moratorium on claims, and the court will grant the provisional liquidator such other powers as it thinks fit, appropriate and required in the circumstances of the case. There are few powers prescribed for provisional liquidators by statute; provisional liquidators are subject to the court's supervision and only carry out the functions given to them by the court. The scope of their powers will depend upon the reason for their appointment. If a company restructuring is proposed, existing management can be allowed to remain in control of the company and the company may carry on business – including the formulation and implementation of the restructuring – subject to the supervision of the court and provisional liquidators. The court will be mindful not to disturb the debtor in possession requirement pursuant to Chapter 11, and accordingly, the provisional liquidators' powers are usually referred to as 'light touch', often limited to a power to monitor the progress of the foreign restructuring and to report to the court and the creditors. A provisional liquidator will be keen to ensure that creditors in a foreign restructuring are afforded the same rights as they would enjoy in proceedings under Cayman law. It is, of course, open to the provisional liquidators to make an application to the court for additional powers should it become necessary to do so.

The moratorium does not prohibit secured creditors from enforcing their security.

### *Recognition in foreign jurisdictions*

The Cayman Islands' provisional liquidation regime is capable of recognition in other jurisdictions. Provisional liquidators appointed under section 104(3) have been recognised pursuant to Chapter 15 of the US Bankruptcy Code – examples include LDK Solar Co Ltd and Suntech Power Holdings Co Ltd.

The Grand Court commonly draws on common law cross-border insolvency principles to recognise overseas attempts to effect a restructuring. Accordingly, the Grand Court has on numerous occasions appointed provisional liquidators to companies in the Cayman Islands (at the behest of either the company itself or creditors), which are subject to extant Chapter 11 proceedings in the US.

Cayman has not yet adopted the UNCITRAL Model Law on Cross-Border Insolvency, or the Judicial Insolvency Network Guidelines for Cooperation in Cross-Border Insolvency Matters. However, the Court applies common law principles of cross-border insolvency in international restructuring matters.

### *Potential changes – new restructuring moratorium procedure*

While the current process for restructuring provisional liquidations is useful, it is paradoxical that the company must present a petition to wind itself up and demonstrate its own insolvency as a precondition of implementing measures to rescue it. With this in mind, proposals have been put forward to revise the provisional liquidation regime by amending the Law and Companies Winding Up Rules. Such proposals call for the creation of a standalone, court-supervised restructuring moratorium, separate from the winding up regime.

In summary, the proposals would mean:

- there would be no need to present a winding up petition;
- applying to appoint a restructuring officer would give rise to an immediate moratorium; and



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- the moratorium would have extra-territorial effect, although enforcement would only be possible in the Cayman Islands in respect of parties subject to *in personam* jurisdiction.

The threshold for obtaining a restructuring moratorium would be the same as that for appointing provisional liquidators pursuant to section 104(3).

The relevant proposal paper is awaiting submission to the Insolvency Rules Committee for review, but it is hoped these changes will make it easier for companies to benefit from the moratorium on claims; in the meantime, companies can take advantage of the procedure as provided for in section 104(3).

## Conclusion

While the global economy remains uncertain, it is expected that complex restructurings will continue to come before the Cayman courts. Over the past few years Cayman has featured in several complex cross-border restructurings, such as the restructurings of the Vantage Drilling Group and Kaisa Group Holdings Ltd. Vantage was restructured through a Chapter 11 process in the US and an official liquidation in Cayman. Kaisa was restructured through Hong Kong and Cayman Islands schemes of arrangement together with Chapter 15 relief. Ocean Rig UDW Inc, a NASDAQ listed offshore deepwater drilling contractor, recently completed one of the largest ever cross-border restructurings in the Cayman Islands, reducing its liabilities by over US$3 billion.

## Notes

1 Unreported, 18 September 2017.
2 Practice Direction 2 of 2010 – Schemes of Arrangement and Compromise Under Section 86 of the Companies Law.
3 In *Re Uni-Asia Holdings Ltd* (Unreported, 16 May 2017).
4 [2012] (1) CILR 34.
5 Ie, that the company is experiencing cash flow insolvency.
6 [2015] (2) CILR 255.
7 [1979] 2 WLR 868, first applied in the Cayman Islands in *Re Global Opportunity Fund Ltd* [1997] CILR Note 7a.
8 [2011] (2) CILR 61.
9 Unreported, 24 January 2017

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