

Schemes of Arrangement: A Restructuring Tool in the Cayman Islands

UPDATE

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Alternative investment vehicles and/or businesses experiencing financial distress may wish to consider all available options, including the use of restructuring tools to protect their interests. For companies seeking to effect a restructuring in the Cayman Islands, a scheme of arrangement is a useful tool

As the world's leading domicile for the establishment of offshore investment vehicles, special purpose vehicles and other corporate structures, the Cayman Islands has developed a sophisticated financial services regime, with a legal system based on the English common law, and a court system which routinely deals with complex commercial matters, including corporate restructurings¹.

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.

Schemes of Arrangement

A scheme of arrangement is a court supervised restructuring process which allows for the rights of creditors or shareholders to be varied, by cramming down on non-consenting parties in appropriate circumstances². A scheme can also be used to implement a pre-pack, where all the stakeholders are agreed on its terms.

It is possible to apply to the Cayman court for orders staying unsecured creditor claims to allow time for a potential restructuring to be explored and negotiated. This is at present achieved through the appointment of a court officer, who assists in supervising the process³.

The role of the court officer can vary according to the circumstances, and it is possible to have debtor in possession proceedings subject to the supervision of the court officer.

What is a scheme?

A scheme is a court-approved compromise or arrangement made between a company and its creditors or members (or any class of them). The company proposing the scheme must be able to demonstrate that its creditors or members receive some benefit in exchange for the surrender of their existing rights in and/or against the company.

¹ 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 Grand Cayman is the Judicial Committee of the Privy Council in England. Members of the English Bar can be permitted to appear before Cayman Courts.

² Although frequently used in the context of a financial restructuring, schemes can also be used to facilitate group restructurings, reorganisations, mergers or take privates.

³ The current legislation provides for a provisional liquidator, even in circumstances where there is no intention to liquidate the company. However, reforms have been approved which will introduce the concept of a dedicated restructuring officer as well as an automatic global moratorium on unsecured creditor claims upon the filing of an application for his or her appointment. The appointment of provisional liquidators will no longer be necessary.

In assessing a scheme, the court will consider the interests of the relevant class⁴ of creditor or shareholder and seek to ascertain whether the class as a whole will benefit. Whether such benefit is sufficient is a commercial matter for the creditors or members, and is not a matter for the court to determine. Accordingly, so long as each class of creditors or members are in support of the scheme, all creditors/members will be bound by it irrespective of whether they voted for it or not.

The court has jurisdiction to consider a scheme in relation to any company which is liable to be wound up in the Cayman Islands, such as where the company is registered in, has property in, or carries on business in the Cayman Islands. The court's jurisdiction in this respect is broad and a number of recent cases confirm that the act of shifting a company's centre of main interests (COMI) to the Cayman Islands may be sufficient to ground that jurisdiction⁵.

Approval of the scheme

Once the scheme has been formulated by the company, it is necessary to obtain permission from the court to put the scheme to its stakeholders. This is obtained at a hearing, the purpose of which is to satisfy the court that the company has properly identified the appropriate classes of stakeholder and that the material which is to be provided to the stakeholders contains sufficient information to enable them to make an informed decision as to the merits of the proposed scheme. If the court is satisfied on these points, the company may put the scheme to the stakeholders and seek their approval.

In order to proceed, the scheme must be approved by a majority in number, representing 75 per cent in value, of each stakeholder class. Voting can be in person or by proxy.

To protect the rights of those persons with the real economic interest in the company, the court has held that it may be necessary to "look through the register" for voting purposes. This allows a single custodian/nominee to vote separately on behalf of each underlying investor⁶.

If the requisite majorities are attained, the court will be asked at a second hearing to sanction the scheme. All members or creditors who voted at the scheme meetings are entitled to attend and be heard at the sanction hearing, including those who object to the scheme.

Whilst the law does not set out a substantive test which the court must apply when determining whether to sanction the proposed scheme, so long as the Grand Court is satisfied that prescribed procedures have been followed and the interests of all relevant parties, such as creditors and shareholders, have been properly considered, it will usually consider that the stakeholders are the best judges of their own commercial interests and approve the scheme.

Effect of a Cayman scheme

Once the scheme has been approved, it will be effective against the company's stakeholders, even those who dissented.

However, to ensure its efficacy, it may be necessary to have the scheme recognised in other jurisdictions. Cayman schemes are internationally recognised, including under Chapter 15 of the United States Bankruptcy Code.

⁴ The Court requires that creditors be grouped based upon their rights against the company which must be 'not so dissimilar as to make it impossible for them to consult together with a view to their common interest'. These rights are not their private interests but those which they have against the company which may be affected by the scheme.

⁵ See *Ocean Rig, LDK Solar and Suntech* schemes by way of example.

⁶ See *Re Uni-Asia Holdings Limited* which affirmed the practice set out in *Re Little Sheep Group Limited* [2012] (1) CILR 34.

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