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GUIDE

Take privates by way of a scheme of arrangement in the Cayman Islands

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Introduction

There has been an increasing number of take-private transactions involving exempted companies incorporated in the Cayman Islands in recent years and this trend is set to continue, particularly in Hong Kong where the majority of companies listed on the main board of The Hong Kong Stock Exchange (**HKEX**) are Cayman-incorporated.

Whilst the privatisation of an exempted company incorporated in the Cayman Islands and listed on a foreign stock exchange (the **target**) can be structured as a statutory merger, a scheme of arrangement or a tender offer coupled with compulsory acquisition, the privatisation of a Cayman Islands company listed on the HKEX would typically be a scheme of arrangement. The bidder (which is the party that plans to take the target private, sometimes known as the 'offeror') (the **bidder**) is usually an existing controlling shareholder of the target and sometimes forms a consortium with other major shareholders or management.

This guide examines the key features and requirements for taking a Cayman Islands company private by way of a scheme of arrangement.

Scheme of Arrangement

What is it?

A scheme of arrangement is a compromise or arrangement made between the target and its shareholders which allows for the rights of the shareholders (or any class of them) to be varied, and it is subject to a court-supervised process and approval by the Grand Court of the Cayman Islands (the **court**) pursuant to section 86 of the Companies Act (as amended) of the Cayman Islands (the **Act**) for it to take effect. A take-private scheme of arrangement is typically structured as either a 'cancellation scheme' (where the target proposes to its shareholders to cancel their shares and subsequently issue new target shares to the bidder) or a 'transfer scheme' (where the target proposes to its shareholders to transfer their shares to the bidder), in each case in return for cash or securities from the bidder. The choice of the proposed scheme is usually driven by stamp duty or tax considerations (for example, in certain jurisdictions, a 'transfer scheme' may attract stamp duty whereas a 'cancellation scheme' may not).

What are the key requirements to implement a scheme?

The target in a scheme of arrangement is principally responsible for preparing all the necessary documentation and for driving the process, hence a scheme of arrangement is only used where the target is in favour of the offer from the bidder. It is typical for the target to prepare a composite scheme document (which usually includes, amongst others, the expected timetable, letters from the board, independent board committee and independent financial advisers, the scheme of arrangement document, notice of the relevant meetings, etc.) which will be sent to its shareholders and to put in place some form of merger agreement between the target and the bidder setting out how the target will conduct the proposed scheme (for example, a timetable for the various stages of the process).

Court hearings and approval

Once the scheme has been formulated, the target will need to obtain permission from the court to put the scheme to its shareholders by convening a shareholders meeting. This is obtained at the first hearing (the **first hearing**), the purpose of which is to satisfy the court that the target has properly identified the appropriate classes of shareholders and that the material which is to be provided to the shareholders contains sufficient information to enable them to make an informed decision about the merits of the proposed scheme. If the court is satisfied on these points, the target may put the scheme to the shareholders and seek the required approval (see 'Voting requirements' below).

If the required statutory majorities are attained, the court will be asked at a second hearing (the **second hearing**) to sanction the scheme. All shareholders 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 court is satisfied that the prescribed procedures have been followed and the interests of all relevant parties have been properly considered, it will usually consider that the stakeholders are the best judges of their own commercial interests and approve the scheme. Once the scheme has been approved, it will be effective against all the creditors and shareholders of the target, even those dissented.

Voting requirements

A Cayman scheme of arrangement must be approved by at least 75% in value of the shareholders or class of shareholders who are present and voting either in person or by proxy at the shareholders meeting under section 86 of the Act, often known as the 'value test'[1]. It is important to note that a scheme of arrangement must also comply with any applicable listing rule or takeovers code. For example, a scheme of arrangement for taking a Hong Kong-listed company private must, amongst others, be approved by at least 75% of the votes cast by shareholders other than the bidder and its concert parties[2] (ie disinterested shareholders) present and voting at the shareholders meeting.[3]

In each case, the court will consider whether separate class meetings are needed and, if so, the composition of the classes. The statutory thresholds of approval apply to each class of shares. In general, a shareholder class for this purpose is where the shareholders' rights against the target are not so dissimilar as to make it impossible for them to consult together with a view to their common interest, taking into consideration how their rights may be affected by the proposed scheme. As such, a shareholder 'class' for the purpose of a scheme of arrangement could be different from the different classes of shares issued by the target. The appropriate composition of classes will be determined at the first hearing (see 'Court hearings and approval' above).

What are the key steps?

The key steps for implementing a scheme of arrangement are as follows:

- File petition and interlocutory summons for court directions.
- First hearing (see 'Court hearings and approval' above).
- Notice of meeting and proxies will be sent to the shareholders of the target. The meeting of the shareholders will take place and the resolutions approving the proposed scheme will need to be passed by the statutory majorities (and comply with any other requirements as may be imposed by the relevant listing rules or takeover codes).
- Second hearing (see 'Court hearings and approval' above). If the court sanctions the proposed scheme, it will issue an order approving the scheme.

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[1] The Companies (Amendment) Act 2021 of the Cayman Islands, which came into force on 31 August 2022, abolished the 'headcount test' which required members' scheme of arrangement to be approved by a majority in number, representing at least 75 per cent in value, of shareholders or class of shareholders who are present and voting either in person or by proxy at the relevant shareholders meeting. This change aimed to eliminate the uncertainty that the 'headcount test' had historically brought to schemes of arrangement (particularly where shares of public companies are held by a nominee entity) which are typically used for the privatisations of Cayman Islands companies listed on the HKEX.

[2] Persons 'acting in concert' is defined in The Codes on Takeovers and Mergers and Share Buy-backs (the **Takeovers Code**) published by the Securities and Futures Commission of Hong Kong.

[3] Rule 2.10 of the Takeovers Code.

- File court order with the Registrar for registration, upon which the scheme will become effective and will bind all shareholders of the target.

As a scheme of arrangement necessarily involves the court, it is inevitably more costly and time consuming than a take-private by way of statutory merger or by tender offer. However, it gives more certainty to the bidder as an approved scheme will bind all shareholders, whether or not they voted in favour of the scheme or not.

Financing a scheme of arrangement

A take-private transaction by a scheme of arrangement may often be financed by a loan which is advanced to the bidder or, alternatively, its parent. There will usually be a robust security package, including share security over the bidder and post-merger target, debentures and guarantees at various levels up the bidder group structure and, post-merger, from the target and, potentially, various target group companies which are required to accede to the financing as guarantors and/or security providers. The loan proceeds, together with equity injected from the investors, are usually used to meet the costs of buying-out the existing shareholders of the target and to funding the working capital requirements of the business post its de-listing.

Contacts

A full list of contacts specialising in Cayman Islands law can be found here.

This guide is only intended to give a summary and general overview of the subject matter. It is not intended to be comprehensive and does not constitute, and should not be taken to be, legal advice. If you would like legal advice or further information on any issue raised by this guide, please get in touch with one of your usual contacts. You can find out more about us, and access our legal and regulatory notices at mourant.com. © 2022 MOURANT OZANNES ALL RIGHTS RESERVED