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ARTICLE

LDK Solar: A New Dawn in International Restructuring

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The importance of cross border judicial co-operation in the restructuring of multinational corporations cannot be overstated; it is one of the essential components for the successful restructuring of a company with an international presence. The recent success story of LDK Solar Co., Ltd ('LDK'), which entered provisional liquidation in the Cayman Islands in February 2014 and involved the restructuring of the LDK group's non Peoples' Republic of China ('PRC') debt (also referred to as 'offshore debts'), is a paradigm example of what happens when courts from three countries co-operate, culminating in what is said to be the first judicially approved, multi-jurisdictional debt restructuring of its kind for a PRC based group.

The global market conditions which affected LDK

LDK is a Cayman Islands' holding company for a group of companies located throughout the world involved in the manufacture and sale of a variety of photovoltaic ('PV') products used in the generation of solar power. With the benefits of lower-cost labour and ready access to raw materials, virtually all of the group's manufacturing is undertaken via PRC incorporated companies based at various sites in mainland PRC.

The LDK group expanded its operations into Europe and the US in order to access the global PV markets, extending its operations outside of its main manufacturing base in the PRC and facilitating access to international capital markets.

Between 2011 and 2013, following the introduction of anti-dumping laws in the EU and a general reduction in the availability of government subsidies following the global financial crisis, the solar power industry suffered significant financial challenges with the key issues being the reduction of the price of solar panels and the declining price of polysilicon, a key raw material used to manufacture solar panels.

By the first quarter of 2011 the spot price of polysilicon had fallen from a 2008-high of around USD 500 per kilogram to just over USD 90 per kilogram, before slumping further to just under USD 24 per kilogram by the second quarter of 2012.

At these prices, the cost to the LDK group of producing polysilicon was greater than its selling price. Already overburdened with debt taken on to fund the expansion programs of earlier years, LDK was not able to sustain these operating losses which led to the group scaling back its production of polysilicon, ultimately culminating in the suspension of the manufacture of polysilicon products.

LDK's debt burden

In addition to borrowings from PRC institutions of approximately USD 2.9 billion, secured against LDK group companies based in the PRC, LDK had offshore debts (non-PRC based lending and security) of USD 1.1 billion. These offshore debts included holders of senior notes issued by LDK ('Senior Notes'), holders of preferred shares issued by LDK Silicon & Chemical Technology Co., Ltd ('LDK Silicon'), a subsidiary of LDK ('Preferred Shareholders') which were guaranteed by LDK, intercompany creditors and unsecured creditors of LDK, made up predominantly of professional advisers.

In mid-2013, it became clear that LDK would have insufficient funds to repay the Senior Notes due in February 2014 and if a consensual restructuring could not be achieved then the results would be disastrous for the group and its stakeholders.

As a result of these financial pressures, and in the lead up to the maturity of the Senior Notes, an informal committee of holders of the Senior Notes was formed to consider the restructuring options available. However, without support from all Senior Note holders, management recognised that it needed to protect against adverse creditor actions being taken against the LDK group in various jurisdictions. On 27 February 2014, the day prior to the final maturity of the Senior Notes, LDK filed for provisional liquidation before the Grand Court of the Cayman Islands ('Grand Court') and Eleanor Fisher and Tammy Fu of Zolfo Cooper were appointed as joint provisional liquidators ('JPLs').

Protection from creditors

The purpose of appointing the JPLs was to protect LDK from adverse creditor action by taking advantage of the

moratorium on actions against the company brought into effect by virtue of section 97 of the Cayman Islands' Companies Law (2013 Revision), which provides that once provisional liquidators are appointed no suit, action or other proceedings can be commenced without the leave of the Grand Court. This is a well-established process for the restructuring of Cayman Islands' companies which originally developed as a means of restructuring UK-based insurance companies in the absence of statutory provisions enabling administration orders over their affairs,[1] and is now enshrined in section 104(3) of the Companies Law, which allows the appointment of provisional liquidators in circumstances where a company is or is likely to become unable to pay its debts and intends to propose a compromise or arrangement to its creditors. In the case of LDK, the company would have become unable to pay its debts upon the final maturity of the Senior Notes on 28 February 2014.

The appointment of provisional liquidators in this context is the analogue of the US chapter 11 process or a UK administration and the process is usually invoked by the company petitioning for its own winding up and seeking the appointment of provisional liquidators. Upon appointing provisional liquidators to propose a compromise or arrangement, the Grand Court will adjourn the petition either to some fixed date or generally. The precise scope of the JPLs' role is not defined in statute but rather in the order by which the provisional liquidators are appointed.[2] This ensures that the Grand Court has the flexibility to appoint provisional liquidators on such terms as may be appropriate on a case by case basis. There is similar flexibility as to the role of the directors of the company in the restructuring process;[3] the order appointing provisional liquidators will generally dictate the extent to which the directors' powers are displaced by the provisional liquidators, allowing the Grand Court to determine if it should be for the directors to take the lead in formulating the proposal to creditors (a so called 'light touch' provisional liquidation) or to confine their role to assisting the provisional liquidators in formulating and proposing a compromise.

In the case of LDK, professional advisers were engaged well in advance of the final maturity of the Senior Notes and significant progress had been made in negotiations with major creditors before the appointment of the JPLs was sought. Once appointed, the JPLs played a central role in negotiating the terms of the schemes of arrangement with creditors (with certain management functions delegated to the directors pursuant to the terms of a protocol).

The challenge of negotiating with the Senior Note holders, who held notes through a trustee and as a consequence the precise number and value of claims was uncertain, was managed by establishing an ad hoc group representing approximately half of the Senior Note holders to represent the interests of that class in negotiations with the JPLs.

Binding creditors in multiple jurisdictions

A significant complicating feature of the restructuring of LDK's offshore debts was the fact that the liabilities arose in three different jurisdictions. In the case of *Gibbs & Sons v Société Industrielle des Métaux*[4] (which would be highly persuasive precedent in the Cayman Islands), the English Court of Appeal considered the extent to which an English law governed debt could be discharged by a French liquidation of the defendant. In that case, Lord Esher MR held that French law could not discharge an English law governed debt on the basis that French law was not the 'law of the country to which the contract belongs, or one by which the contracting parties can be taken to have agreed to be bound; it is the law of another country by which they have not agreed to be bound'. A compromise or arrangement approved by the Grand Court in isolation would not therefore be effective as a means of compromising US or Hong Kong governed liabilities.

LDK considered with its advisers the options available to bind US or Hong Kong creditors, including a similar approach to that taken in the restructuring of Fu Ji Food and Catering Services[5] ('Fu Ji Food'). In that case, Fu Ji Food was a Cayman Islands incorporated holding company which was also registered as a foreign company in Hong Kong and had substantial business interests, subsidiaries and assets within the PRC as well as having its shares listed on the Hong Kong Stock Exchange. Fu Ji Food was placed into provisional liquidation by the High Court of Hong Kong ('High Court'), but that approach provided incomplete protection where creditors were at liberty to seek the winding up of the company in the Cayman Islands. The High Court therefore sought the Grand Court's assistance by requesting that the High Court appointed liquidators be recognised by the Grand Court. In an act of judicial co-operation, the Grand Court granted the High Court's request and gave recognition to the Hong Kong appointed liquidators as if they had been appointed by the Grand Court, recognising the company's substantial connections

Notes

1 See *Re English and American Insurance Co. Ltd* [1994] 1 BCLC 649 (per Harman J at page 650c) and *Re Fruit of the Loom Ltd* (unreported, Grand Court, 30 October 2000) (per Smellie CJ at page 8).
2 Companies Law (2013 Revision), section 104(4).
3 Companies Winding up Rules 2008 (as amended), Order 4, rule 6(3)(f).
4 (1890) 2 QBD 399.
5 Re Fu Ji Food and Catering Services Holdings Ltd (FSD Cause No. 222 of 2010).

with Hong Kong. However, given the complex nature of LDK's structure and the location of its assets and liabilities in jurisdictions other than the Cayman Islands and Hong Kong, it was considered that the Fu Ji Food approach was not likely to be effective as a means of protecting LDK through the restructuring process; the failure to achieve a successful restructuring of LDK's offshore debts in one jurisdiction would leave LDK exposed to potential adverse creditor action which could ultimately lead to the failure of the offshore restructuring as a whole.

In the case of LDK the JPLs engaged in extensive negotiations with the key creditors, which culminated in the JPLs signing Grand Court-sanctioned restructuring support agreements ('RSAs') with a majority of Senior Note holders and Preferred Shareholders. The terms of the RSAs required the JPLs to promulgate two separate but inter-conditional schemes of arrangement in the Cayman Islands (one scheme for each of LDK and LDK Silicon) and three separate but inter-conditional schemes of arrangement in Hong Kong (one scheme for each of LDK, LDK Silicon and LDK Silicon Holding Co., Limited – a Hong Kong-incorporated key asset holding subsidiary (the 'Scheme Companies')).

A scheme of arrangement is a form of statutory contract which is sanctioned by the Grand Court pursuant to section 86 of the Cayman Islands' Companies Law (2013 Revision) (and equivalent statutory provisions in Hong Kong) and enables a company to bind creditors or shareholders to some form of compromise or arrangement providing more than 50% by number and 75% by value of those attending and voting in each class approve the scheme.

The term 'compromise' is an important feature of any scheme as some element of 'give and take'[6] will be required before the Grand Court will approve any such scheme. Similarly, the Grand Court will need to be satisfied that the scheme document and supporting explanatory statement contain all the information reasonably necessary to enable creditors (or shareholders as applicable) to make an informed decision about the merits of the proposed scheme. Another vital consideration is the composition of the classes of creditors or members who will eventually consult together at the creditors' class meetings and vote to approve or reject the scheme. The key test as to whether the classes of creditors or members have been properly constituted is whether the members in each class have rights which are not so dissimilar as to make it impossible for them to consult together with a view to their common interest.[7]

In the case of LDK, there were three classes of creditors constituted by reference to their respective rights in the event of a liquidation, namely the holders of the Senior Notes, the Preferred Shareholders and unsecured creditors. The JPLs also entered into a separate but inter-conditional Grand Court-sanctioned settlement agreement with another major creditor whose claims against LDK and certain subsidiaries would have placed it in a class of one for the purposes of a scheme.

In addition to the Cayman Islands and Hong Kong schemes, three chapter 11 cases were filed in respect of US-based subsidiary guarantors and it was also necessary for the JPLs to obtain protection for the Scheme Companies from adverse creditor action in the US, which the JPLs achieved by filing for recognition as foreign representatives as a 'foreign main' proceeding under chapter 15 of the US Bankruptcy Code. In order to obtain that recognition, it was necessary to satisfy the US Court that LDK's centre of main interest was the Cayman Islands. This was achieved by demonstrating that the control of LDK had effectively been exercised from the Cayman Islands from at least the date of the appointment of JPLs.

Implementation of the schemes

In LDK's case, the scheme process was streamlined by both the High Court and the Grand Court taking a pragmatic approach to compliance with the formalities; the same explanatory statement was used for all schemes and the class meetings in both jurisdictions ran consecutively via video link from locations in Hong Kong and the Cayman Islands.

Perhaps the most significant feature of LDK's restructuring from a legal perspective was the extent to which the High Court was prepared to accept that it had jurisdiction to sanction schemes promulgated in Hong Kong by a Cayman Islands-domiciled company.

In sanctioning the schemes, the Honourable Mr Justice G. Lam accepted that the High Court had jurisdiction to do so on the bases, amongst other things, that a significant portion of LDK's debt was governed by Hong Kong law, the creditors holding that debt had voted in favour of the schemes, LDK's bank accounts were located within Hong Kong, one of the directors and the then CEO were resident in Hong Kong and certain management decisions had, prior to the appointment of the JPLs, been made within Hong Kong.

In the event, the Cayman Islands schemes were sanctioned by the Honourable Mr Justice Jones QC on 7 November 2014 and the Hong Kong schemes were sanctioned by the Honourable Mr Justice G. Lam on 18 November 2014, with the US Bankruptcy Court for the District of Delaware granting recognition to the JPLs and granting comity to and giving full force and

Notes

6 *Re Sphinx* (unreported, Grand Court, 5 May 2010).

7 Practice Direction 2 of 2010. See also Re Hawk Insurance Company Ltd [2001] EWCA Civ 241.

effect to the schemes within the US, via chapter 15 recognition on 21 November 2014, thereby securing the success of the restructuring of the offshore debts across all three jurisdictions.

Timescale for a Cayman Islands provisional liquidation

If, as in the case with LDK, a provisional liquidation with inter-conditional schemes is considered to be the most appropriate course of action then it can be completed in a relatively short time frame. In the case of LDK, it was approximately 10 months between the date of it first entering provisional liquidation, 27 February 2014, and the schemes becoming effective, 10 December 2014.

As with any legal process, navigating through a provisional liquidation quickly and efficiently generally translates into cost savings. If support from the various classes of creditors is prevalent, sufficient funding is in place for the costs of the restructuring from the outset (including sufficient cash for any cash consideration payable under the terms of a scheme) and there is an experienced team of advisers working with the company it could be possible to have a company enter provisional liquidation in the Cayman Islands and exit again via a scheme within a considerably shorter period.

Another advantage of moving through the process as quickly as possible is to mitigate the stigma and reputational risk attached to a company being in a formal insolvency proceeding. The sooner the company can exit the provisional liquidation and be returned to the control of the directors, the sooner the restructured entity can return to stability and focus on its business going forward, which is ultimately in the interests of all stakeholders.

One of the keys to achieving a successful restructuring in as short a timescale as possible is the degree of communication between the JPLs, the stakeholders and the courts. Honest, upfront communication is critical to maintaining momentum during the provisional liquidation, even if the information provided may initially be negatively perceived. Often, the difficult circumstances the company finds itself in will require frank discussions between the provisional liquidators, creditors and senior management. Ensuring stakeholders understand that the company's management and provisional liquidators are driven by seeking to achieve the best outcome for all stakeholders is extremely important to reaching agreement. Fortunately, in the case of LDK the overwhelming majority of creditors were in agreement that creditor compromises via the schemes was the best approach in the circumstances.

If the provisional liquidators cannot implement a scheme or other type of settlement with a company's creditors or does not believe that there would be a viable business post restructuring then there may be no other alternative other than to apply to court to have the company wound up. Generally this will result in a worse outcome for all stakeholders and one that a provisional liquidator would seek to avoid, however, in the absence of sufficient funding or creditor support the eventual winding up of the company would be inevitable in the majority of those situations.

The next LDK

In circumstances where most Cayman Islands' exempt companies will have an operating presence in at least one (and usually several) foreign jurisdictions, it seems likely that the approach taken in the restructuring of LDK's offshore debts is an approach which is likely to be used more frequently by Cayman Islands' incorporated companies in the future. With a number of PRC entities defaulting on bonds over the past 12 to 18 months, it is interesting to examine the annual maturities of offshore debt[8] from PRC based bond issuers. By the end of 2021 there is approximately USD 206.6 billion of debt due to mature, with approximately USD 51.4 billion relating to high yield notes.[8]

Whilst historically government support for struggling PRC entities has been strong, recent defaults seem to indicate a potential wavering in the PRC's policy of bailing out defaulting companies. If the PRC government allows defaults then some of the bonds due to mature before the end of 2021, especially the riskier high yield bonds, will almost certainly default.

A bond default is normally synonymous with financial difficulty for a company, however it does not necessarily mean that the company in question does not have a viable future as a going concern. A temporary cash-flow shortage as a result of market pressures (in LDK's case, a sharp decline in polysilicon prices) does not necessarily mean that the company should be wound up. Often, the restructuring of the company's business provides a better return to creditors than a liquidation, but that does not always mean that a company will require protection from its creditors as soon as it defaults on its bonds.

Identifying whether or not the bond default is a question of timing or whether there are more serious financial difficulties being experienced by the company is key to understanding how to achieve the optimal solution for creditors. If it is the former, then a restructuring of the company's debts may not be necessary if

Notes

8 In this context 'offshore debt' means any debt owed to non-PRC entities or individuals.

9 Includes PRC based corporate issuances of (i) RMB offshore bonds and (ii) US$ or HK$ denominated bonds. Based on Bloomberg.

a consensual solution can be agreed with all bondholders, for example by extending bond maturity dates by agreement, however if it is the latter then attempting to restructure the company's debts will be crucial to the company's survival.

Assuming a restructuring of the debt is required, consideration should first be given to whether this can be achieved by way of an agreement with creditors outside of a formal insolvency process or whether an agreement which formally binds all creditors, such as a court sanctioned scheme of arrangement, is required. The key advantage of a scheme is the ability to bind dissenting creditors or shareholders and it therefore provides the company with an alternative where a consensual agreement with all creditors cannot be achieved.

If the company has aggressive creditors, or creditors with whom it has no open line of communication, as was the case with several of the holders of Senior Notes of LDK, then it may have no option other than to seek the protection of the court by seeking the appointment of provisional liquidators with a mandate to propose a compromise or arrangement to creditors. If the company allows a creditor to file a winding up petition then it may lose control of the process and find the court less sympathetic to the company's views as to the feasibility of a restructuring when compared to a situation where the company has taken a proactive approach in dealing with its creditors. Other advantages of the appointment of provisional liquidators in such circumstances are that the provisional liquidators (as court-supervised fiduciaries) bring a degree of objectivity and credibility to negotiating with creditors which maximises the prospect of successfully negotiating a solution, but at the same time protects assets for the benefit of creditors in the event that no such solution can be agreed.

For the reasons described above, the defaulting company should give careful consideration as to which jurisdiction to seek protection and the extent to which recognition of the provisional liquidators will have the effect of extending protection to other jurisdictions. Unless appropriate steps are taken to protect against adverse creditor action in all relevant jurisdictions the restructuring process will, at best, be slower and more expensive and, in the worst case, may ultimately prove unsuccessful.

Benefits of a restructuring via a Cayman Islands' provisional liquidation

In circumstances where there are bases to choose a primary jurisdiction in which to commence the protective insolvency process, some questions to consider are:

- Do significant cost advantages / disadvantages exist when choosing one jurisdiction over another?;
- Does the legal jurisprudence of that jurisdiction support company restructurings and provide a stable legal platform for the restructuring to be effective?;
- Is the jurisdiction where the initial protection is being sought capable of being recognised in other relevant jurisdictions?; and
- Where is the centre of main interest likely to be located?

The Cayman Islands has a sophisticated legal system based on the UK common law system supplemented by locally enacted statutes and a small body of reported cases. The Cayman Islands also benefits from a high number of experienced and qualified professionals, the majority of which have vast experience of cross border issues due to the nature of the types of companies incorporated within the Cayman Islands.

Liquidators appointed by the Grand Court are routinely recognised by the US Bankruptcy Court and the courts of numerous other well-established financial centres. Given the close ties between the Cayman Islands and the UK it is typically a straightforward process for a Cayman Islands' insolvency proceeding to be recognised in the UK via section 426 of the Insolvency Act 1986.

In the US, Cayman Islands' based liquidators regularly seek chapter 15 recognition of their liquidations in order to protect any assets which may be located in the US or to bring legal claims in that jurisdiction. Whilst the history of US courts granting chapter 15 recognition is certainly varied for foreign liquidators, there is clear jurisprudence that dictates whether a foreign proceeding will be recognised. The topic of chapter 15 recognition regularly prompts much commentary that is beyond the scope of this article, therefore it is sufficient to say that establishing the centre of main interest in the country where the initial insolvency protection has been sought and granted will be a key factor in obtaining recognition in the US, as was the case with LDK. Cayman Islands' liquidators are acutely aware of these requirements and are experienced in making such applications.

Conclusion

LDK is a paradigm example of when a Cayman Islands' provisional liquidation can be used as an extremely effective tool in restructuring a company's international debt burden. Obtaining approval of the schemes in Hong Kong and recognition of the provisional liquidation in the US was absolutely crucial to being able to effectively and cost efficiently ensure that LDK's offshore debts had been restructured in a manner which provided a better return to creditors than a liquidation.

If, as predicted, there is an increase in the number of PRC based groups with an international presence defaulting on their liabilities then there will likely be continued demand for international restructurings of the kind implemented by LDK. If that proves to be the case then international judicial co-operation, such as that demonstrated in the case of LDK, will be key to ensuring that such restructurings are implemented successfully.

International Corporate Rescue

International Corporate Rescue addresses the most relevant issues in the topical area of insolvency and corporate rescue law and practice. The journal encompasses within its scope banking and financial services, company and insolvency law from an international perspective. It is broad enough to cover industry perspectives, yet specialized enough to provide in-depth analysis to practitioners facing these issues on a day-to-day basis. The coverage and analysis published in the journal is truly international and reaches the key jurisdictions where there is corporate rescue activity within core regions of North and South America, UK, Europe Austral Asia and Asia.

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