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Restructuring remodelled: proposed new regime in the Cayman Islands

By Mark Goodman and Hamid Khanbhai, Campbells

Legislation is anticipated that may establish a stand-alone restructuring proceeding in the Cayman Islands. In the meantime, the mechanics of initiating the restructuring of a company, subject to the supervision of the Cayman Court, remain fluid.

Restructuring in the Cayman Islands occurs in an international context. There has not yet been the hot rush of reorganisations that many predicted would result from the cooling of a Chinese economy awash with easy credit. Since the oil price crash, though, oil services companies have been in vogue.

The Cayman Islands has many attractions for international groups in need of restructuring. An obvious one is that a scheme of arrangement, the principal mechanism for restructuring in the Cayman Islands, is likely to be swifter and cheaper than filing for Chapter 11 protection.

However, recent developments might have reduced the appeal of the Cayman Islands for restructuring, were it not for new judicial and (anticipated) legislative solutions.

SCHEMES OF ARRANGEMENT IN THE CAYMAN ISLANDS

There is currently no stand-alone restructuring proceeding in the Cayman Islands, although that may soon change, as explored further below. In the absence of consensus between creditors and the company, the key tool for restructuring in the Cayman Islands is the scheme of arrangement. A scheme can involve creditors as well as members of the company, and will enable the company to cram down dissentients, if the requisite majorities are achieved at scheme meetings and the Court is persuaded to sanction the scheme. Secured creditors cannot be crammed down; they are entitled to enforce contractual security, with the result that a deal inevitably has to be done with them outside the scheme process.

In order to restructure a company with the breathing-space afforded by a moratorium on claims against the company, the scheme of arrangement needs at present to be promoted within a provisional liquidation wrapper. This is somewhat counter-intuitive; but a petition needs to be presented for the winding up of the company, along with a simultaneous application for the appointment of provisional liquidators to promote or to assist the company in promoting a scheme of arrangement.

If provisional liquidators are successfully appointed for that purpose, the winding up petition is deferred, to be revived only if the scheme fails. The company and the provisional liquidators can then go about the business of preparing for and presenting the scheme of arrangement.

This is not a liquidation of the company, except in name, since the objective of such a scheme is to avoid a liquidation of the company and to save it as a going concern. One of the factors that the Court commonly considers, in deciding whether or not to sanction the scheme, is whether the scheme provides a better return to stakeholders than they would otherwise have received in a liquidation.

RECENT PROBLEMS – COMMERCIAL AND LEGAL

The procedure in the Cayman Islands, by which provisional liquidators are appointed to help rescue a company, reflects a practice that had developed in England specifically in respect of insurance companies, absent English statutory provisions enabling administration orders over their affairs.

The procedural quirk of needing to present a winding up

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petition in order to save the company as a going concern has recently caused both commercial and legal problems in the Cayman Islands. Both may soon be resolved by the legislature.

The commercial problem is in part presentational. Clients who are less familiar with the Cayman Islands as a jurisdiction ask why a liquidation process and a liquidator are needed at all, when the aim is not to wind up the company but to save it. The liquidation label can also cause commercial problems of substance. Recognising this, judges have shown flexibility in tailoring the approach in a particular case to make it clear that the process is one of restructuring rather than liquidation. This may not solve all problems, however, since a company listed on a public exchange may not be able to prevent being delisted.

In addition to the commercial problem, there are two legal problems.

1. Winding Up Problem

The first legal problem is that a company in need of restructuring cannot simply rely on quick-thinking and pragmatic directors. In *China Shanshui Cement*[1], the Grand Court held that the directors of an insolvent company cannot present a petition to wind up the company on the strength of a board resolution, unless expressly permitted by (i) the articles of association or (ii) an ordinary resolution.

This is inconvenient but entirely orthodox. It is inconvenient because directors cannot act with the speed that the situation requires. It also makes it more difficult for directors to comply with their duties, which at that stage are likely to involve consideration of creditors' interests. Cayman Islands companies rarely have an express provision entitling the directors to petition to wind up the company. Seeking an ordinary resolution takes time, especially when the company is listed on a public exchange, at precisely the moment when there is no time to lose. The requirement of an ordinary resolution also gives the decision to shareholders who are most likely out-of-the-money if the company is or is likely to become insolvent.

As unhelpful as it is, however, the decision in *China Shanshui Cement* is orthodox: it reflects the common law position in England (see *Re Emmadart Ltd* [1979] Ch 540) before the introduction of a statutory 'fix' in that jurisdiction. *China Shanshui Cement* has quickened the blood of lawyers and insolvency practitioners in the Cayman Islands, and following a proposal put to the legislature, it is hoped that the Legislative Assembly may soon introduce its own statutory fix to this problem, as explored further below.

2. Appointment Problem

Prior to the introduction of any new legislation in the Cayman Islands, however, practitioners have tried to engage the right side of their brains to arrive at creative temporary solutions. In reaction to *China Shanshui Cement*, a practice has developed whereby the directors approach a 'friendly' creditor to present a winding up petition, with the intention that the company (acting by its directors) may then piggyback on the creditor's winding up petition to apply for the appointment of provisional liquidators to promote the scheme.

The counter to this is the second legal problem, which is consequential on the first. The winding up rules[2] in the Cayman Islands can be read as limiting the company's ability to seek the appointment of provisional liquidators to promote a scheme to circumstances in which the winding up petition was one that had been presented by the company (and not, for example, by the 'friendly' creditor). If that reading is correct, then the door would close on assistance from a friendly creditor for a restructuring by scheme of arrangement with the benefit of the statutory moratorium on claims against the company.

NEW SOLUTIONS

It was with some anticipation, therefore, that judgment was recently handed down in *CHC Group Limited*[3]. In that case, the company sought to piggyback on a creditor's winding up petition in order to apply to seek the appointment of provisional liquidators to promote a scheme of arrangement.

After considering the relevant case law, Mr Justice McMillan granted the company's application for the appointment of the provisional liquidators. *CHC Group Limited*, therefore, represents judicial approval of the 'friendly' creditor fix for restructuring in the Cayman Islands, although it is important to note that some uncertainty remains, since the argument based on the winding up rules, referred to above, does not appear to have been brought to the attention of the Court.

On the horizon, though, is anticipated legislative change that may consign both these legal problems to the pages of unread journals and the dustbin of jurisprudential history. In particular, it has been proposed that:

- No provisional liquidation wrapper will be necessary for a scheme of arrangement with the benefit of a moratorium on claims.
- Instead, there will be a standalone Restructuring Moratorium Proceeding ("RMP"), in which a company may apply for the appointment of restructuring officers. Amongst other things, this resolves the optical difficulty of needing to petition to wind up the company and seeking the appointment of liquidators.
- Any company's directors will be able to resolve to cause the company to present a petition for the restructuring of the company in the RMP. This RMP petition is to be distinguished from a winding up petition, which is no longer necessary. So the RMP regime side-steps the Winding Up Problem; and the Appointment Problem no longer arises.

In addition to changes to the restructuring regime, it is also proposed that the Companies Law will be amended in order to provide a statutory fix for the Winding Up Problem. This would have the effect that directors of insolvent companies have more flexibility to decide to wind up a company, without the need for express permission in the articles of association or by way of a prior ordinary resolution.

CONCLUSION

The mechanics of initiating the restructuring of a company subject to the supervision of the Cayman Court are still in a state of flux. *CHC Group Limited* may provide succour for a practice that had already developed to temper the consequences of *China Shanshui Cement*, but there is still need for a legislative solution. It is hoped that one will be signed into law in the not too distant future.

Footnote:

1 Unreported, Grand Court, 25 November 2015, Mangatal J, FSD 178 of 2015

2 Order 4 rule 6(1) of the Companies Winding Up Rules

3 Unreported, Grand Court, 24 January 2017, McMillan J, FSD 5 of 2017

MARK GOODMAN

Title: Partner
Company: Campbells
Tel: +1 345 914 5898
Email: mgoodman@campbellslegal.com
Web: www.campbellslegal.com

HAMID KHANBHAI

Title: Senior Associate
Company: Campbells
Tel: +1 345 914 5834
Email: hkhanbhai@campbellslegal.com
Web: www.campbellslegal.com

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CAYMAN ISLANDS
Guy Manning, Partner and Head of Litigation, Insolvency & Restructuring
E gmanning@campbellslegal.com

BRITISH VIRGIN ISLANDS
Callum McNeil, Partner
E cmcneil@campbellslegal.com

HONG KONG
Ross McDonough QC, Senior Partner and Managing Partner Hong Kong
E rmcdonough@campbellslegal.com

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