GRR INSIGHT

Americas Restructuring Review 2021

Edited by

Richard J Cooper and Lisa M Schweitzer

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Preface

Welcome to *The Americas Restructuring Review 2021*, one of *Global Restructuring Review*'s annual, yearbook-style reports.

Global Restructuring Review, for those new to us, is the online home for international restructuring specialists everywhere, telling them all they need to know about everything that matters.

Throughout the year, the *GRR* editorial team delivers daily news about cross border developments, plus surveys and longer reads; organises the liveliest events ('GRR Live') – covid allowing; and provides our readers with innovative tools and know-how products, such as our new *GRR* recognitions dataset. In addition, assisted by external contributors, we curate a range of comprehensive regional reviews – online and in print – that delve deeper into developments than the exigencies of journalism allow.

The Americas Restructuring Review, which you are reading, is part of that series. It delivers insight and thought-leadership from 36 pre-eminent practitioners from both American continents.

Across 14 chapters, and 180 pages, it is part invaluable retrospective, part primer on restructuring practice in different markets, with plenty of crystal ball gazing thrown in. All contributors are vetted for their standing and knowledge before being invited to take part.

Together, these contributors discuss recent changes and what they mean, with footnotes and relevant statistics.

This edition covers Argentina, Bermuda, Brazil, Canada, Cayman Islands, Chile, the Dominican Republic, Mexico, the United States (from several perspectives) and Venezuela. It also has a great overview on the emergence of Chapter 11-like processes in several European countries (the United Kingdom, Germany and the Netherlands in particular) and on the latest strategies being used by hedge funds and other distressed investors to get exceptional returns.

Among the gems it contains

- a report from 'the front line' of restructuring in the Dominican Republic, by a firm at the heart of its biggest cases;

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- an honest appraisal of Mexico's economic future – it looks set for a particularly tough time owing to the three 'P's' – pandemic, politics and pre-existing poor economic performance; and
- an inside view of the *LATAM Airlines* Chapter 11, particularly its debtor-in-possession package, in a chapter all about how US debtor-in-possession practice seems to evolving.

Plus so much more. We hope you enjoy the *Review*. If you have any suggestions for future editions, or want to take part in this annual project, my colleague and I would love to hear from you. Please write to insight@globalrestructuringreview.com.

David Samuels
Publisher
November 2020

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Cayman Islands

Guy Manning and Paul Kennedy
Campbells

In summary

The first part of this chapter looks at the key aspects of the successful Cayman Islands restructuring regime. The second part reflects on the validation of transactions after a winding-up petition has been presented and the Cayman Islands Court of Appeal's recent guidance in that area.

Discussion points

- Schemes of arrangement
- Provisional liquidations
- Statutory moratoriums
- Creditors' meetings
- Centre of main interests shifting
- The rule in *Gibbs*
- 'Friendly' creditors' petitions
- Validation of post-petition transactions

Referenced in this article

- *Ocean Rig* [ref]
- *Anthony Gibbs & Sons v La Societe Industrielle et Commerciale des Metaux* (1890) 25 QBD 399
- *LDK Solar* [ref]
- 104(3)(b) of the Companies Law
- CW Group Holdings (unreported, 3 August 2018, Parker J)
- *Re Emmadart Ltd* [1979] 1 Ch. 540
- *Re China Shanshui Cement Group Limited* [2015 (2) CILR 255]
- *Re CHC Group Ltd* (unreported, 24 January 2017, McMillan J),
- *Tianrui (International) Holding Company Limited v China Shanshui Cement Group Limited* [ref]
- *Burton v Deakin Ltd* [1977] 1 WLR 309

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Introduction

The Cayman Islands continues to be at the forefront of developments in restructuring and insolvency law offshore and among common law jurisdictions. As the world continues to grapple with the human cost and economic effects of covid-19, many companies have chosen the Cayman Islands as an effective and efficient jurisdiction to restructure their debt and many investors have sought remedies from the Cayman courts in relation to insolvent or even fraudulent businesses. Campbells have been instructed in the most significant recent restructuring and liquidation matters to come before the Cayman Islands courts including Luckin Coffee, Abraaj, Green Dragon and the Biscayne Group.

This chapter is in two parts. In the first part we consider the Cayman restructuring regime and why it has been so successful in recent years. In the second part we review a recent Cayman Islands Court of Appeal decision that examines one of the key parts of the Cayman insolvency regime: the effective prohibition on post-petition transfers of assets or shares.

Restructuring in the Cayman Islands

Why the Cayman Islands?

The Cayman Islands has proved to be an attractive restructuring jurisdiction, not least because the Cayman courts have considerable experience with efficient management of large debt restructurings. Common law principles apply, which will be familiar to practitioners in jurisdictions such as England, Hong Kong and Singapore. Debt restructurings in the Cayman Islands often involve cross-border issues and there is a wealth of precedent for successful applications for recognition under Chapter 15.

Debt can be restructured in the Cayman Islands in relation to Cayman companies, as well as foreign companies that are redomiciled to, or registered as foreign companies in, the Islands for the specific purpose of restructuring debt.

For example, Ocean Rig, the oil services group, recently transferred and shifted the centre of main interests (COMI) for four group companies from the Marshall Islands to the Cayman Islands and successfully restructured over US$3.6 billion of debt through four interrelated Cayman schemes of arrangement. The COMI shift was necessary for the successful application for Chapter 15 recognition.

Overview

The principal debt (and equity) restructuring tool in the Cayman Islands is the scheme of arrangement under section 86 of the Companies Law (2020 Revision) (the Law). Cayman schemes are based on English schemes and so the law, and at least some of the procedure, will be familiar to practitioners experienced in English restructurings. The scheme process is a court process that is initiated by the filing of a scheme petition. There is then a directions hearing for the purpose of ordering the convening of scheme meetings, followed by one or more meetings where creditors consider and vote on the restructuring plan, and (if approved at all meetings) a second hearing where the court considers whether or not to sanction the scheme. If sanction is granted by the court, the scheme takes effect on the filing of the order and the scheme terms are then implemented, usually without further reference to the court.

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For group debt, each individual company with debt that needs to be restructured must be the subject of separate scheme proceedings and meetings. In order to streamline the process, however, the Cayman court manages the related proceedings together. Scheme terms are often inter-conditional, so one does not take effect unless all are sanctioned by the court. The restructuring can be completed quickly. It is possible for the process, from filing of the scheme petition to sanction being granted, to be completed in 12 weeks. The more complex the scheme or the more vocal any dissent, the more likely that the process will run its course over a longer period of time.

Breathing room

Schemes in the Cayman Islands often take place within a provisional liquidation in order to take advantage of the statutory moratorium on claims that arises once provisional liquidators are appointed. The moratorium prevents creditors seeking to wind up or bring any claim against the company in the jurisdiction. A winding-up petition must be presented alongside directions adjourning the hearing of the petition and an application by the company for an order appointing provisional liquidators, on the grounds that the company is or is likely to become unable to pay its debts (on a cash flow basis) and intends to present a compromise or arrangement to its creditors. The provisional liquidators' powers are derived from the order appointing them and their function is to act as restructuring officers in substance but not in name (but see further below). In some cases, they are given full powers by the court and effectively displace the directors for the duration of the restructuring. In others, they are given 'light-touch' powers and work alongside or oversee the directors in promoting the restructuring.

The moratorium provides breathing space for the company to negotiate or continue negotiations with key creditors for the purposes of developing and drawing up a restructuring plan. It is only once that plan is fully formed that a scheme petition can be presented to the court. Once the court approves the scheme, the provisional liquidators are discharged and (subject to the scheme terms) the winding-up petition is dismissed and the company continues as a going concern.

A bill is currently being considered by the legislature that would amend the law so that a winding-up petition will no longer be needed to take advantage of a moratorium. A company looking to restructure its debt would instead be able to present a petition seeking the appointment of restructuring officers (as opposed to provisional liquidators) and a moratorium on claims against the company would arise on presentation of that petition (rather than on the appointment of the officeholders).

Creditors' meetings

The creditors' meetings are central to the scheme process. Dissenting creditors in a given class can be crammed down by the majority, but approval must be obtained at all meetings convened in respect of a given scheme company. There is no cross-class cramdown. The threshold for approval at any given meeting is a majority by number and 75 per cent by value,

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although this takes into account only the votes actually cast in person or by proxy (and not the whole body of creditors if some did not vote). As turnouts at meetings can be low, it is possible to obtain approval with votes representing a minority of the issued debt.

Dissenting creditors who are outvoted at a class meeting may seek to challenge the restructuring at one or both of the two court hearings, principally on the bases that the classes were not properly constituted or that the scheme was unfair because the majority did not act in good faith or did not fairly represent the views of the class.

COMI shifting

As noted above, the attractiveness of the Cayman Islands for restructuring has led to instances where companies and groups of companies have shifted their COMI to the Cayman Islands for the purpose of restructuring debt.

In order for the Cayman court to have jurisdiction over a foreign company whose debt is to be restructured, it may need to be re-domiciled or registered as a foreign company:

If a company is solvent, it may be possible to re-domicile the company to the Cayman Islands using a process known as a 'transfer by continuation'. This is a swift and administrative process, but it must be possible under the laws of the company's existing jurisdiction. In the recent Ocean Rig restructuring, one of four Marshall Islands companies was continued in the Cayman Islands as a Cayman company. If a company is insolvent or of doubtful solvency, it cannot be transferred by continuation but it may still be registered in the Cayman Islands as a foreign company. That is sufficient for the Cayman court to have jurisdiction for the steps set out above. In *Ocean Rig*, the other three Marshall Islands companies were registered as foreign companies in Cayman.

Re-domiciling the company or registering it as a foreign company is relevant to a Cayman court's jurisdiction, but additional steps are required to shift COMI for the purposes of any future Chapter 15 application, including (for example) holding company meetings in the Cayman Islands.

Most companies trading internationally will have assets or some form of corporate presence in a number of jurisdictions. The long-standing rule in *Gibbs* (see *Anthony Gibbs & Sons v La Societe Industrielle et Commerciale des Metaux* (1890) 25 QBD 399) requires that debts are compromised in the jurisdiction of the obligation. A single-jurisdiction solution will not protect a corporate group with an international presence from adverse creditor action in every jurisdiction. In those cases, a coordinated approach between restructuring advisers in multiple jurisdictions may be necessary to achieve effective protection.

In the *LDK Solar* case, a major producer of photovoltaic products, a successful restructuring of substantial debt was achieved through two Cayman schemes of arrangement, three Hong Kong schemes of arrangement, Chapter 15 recognition of the schemes and Chapter 11 plans of reorganisation with respect to US subsidiaries.

In these uncertain times, it may not necessarily be the case that the need to restructure debt was foreseen and there may not be firm proposals in place for the compromise or arrangement to be offered to creditors. However, it is clear from the language in section 104(3)(b) of the Companies Law that the court may appoint provisional liquidators even where there are

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no fully formulated restructuring plans, as was the case, for example, in *CW Group Holdings* (unreported, 3 August 2018, Parker J). In that case, consistent with the approach of the court in various previous cases, provisional liquidators were appointed on a light-touch basis to work with existing management in formulating the details of a proposal to creditors.

For those without a firm proposal to put to creditors already in place, the provisional liquidation process provides a flexible mechanism for securing the breathing space necessary to work with advisers in formulating a restructuring plan. The interests of creditors are protected by the appointment of court-supervised, independent fiduciaries, the extent of whose precise powers are determined on a case-by-case basis depending on the circumstances.

In ordinary circumstances, the question as to whether a company should take steps to place itself into a liquidation process is a matter for the shareholders in a general meeting. Directors of a company cannot present a petition in the name of the company without the assent of the shareholders, unless the company is incorporated after 1 March 2009 and its articles expressly authorise the directors to petition without the shareholders' approval (see *Re Emmadart Ltd* [1979] 1 Ch. 540 and *Re China Shanshui Cement Group* Limited [2015] (2) CILR 255.

However, in circumstances where shareholder assent cannot (or cannot easily) be obtained, a practice has developed by which a creditor is encouraged to present a creditor's petition for liquidation so that the company may then make a cross-application for the appointment of provisional liquidators for the purpose of a restructuring. This approach received judicial approval in the case of *Re CHC Group Ltd* (unreported, 24 January 2017, McMillan J), which provides further confirmation of the flexibility of the restructuring regime in Cayman and the pragmatic approach of the Cayman judiciary.

Validation of post-petition transactions

One of the characteristic features of common law insolvency and restructuring regimes in many jurisdictions is the bar on post-petition transactions in company assets or shares. The main purpose is generally to prevent outsiders from 'stealing a march' on existing creditors and to prevent directors or others in control of companies' assets from disposing of assets while the petition has been filed but not heard, without the blessing of the court. Likewise many shareholders' petitions relate to the voting and control of companies and allegations of abusive or oppressive conduct by directors or the majority. For obvious reasons, the courts tend to seek to maintain the status quo as far as possible until the liquidator is able to perform his or her statutory role. There is a clear potential for damage to the collective interests of creditors or shareholders if trading in assets or shares were permitted outside of court supervision and the liquidators' control.

Section 99 of the Law provides:

> *When a winding up order is made, any disposition of the company's property and any transfer of shares or alteration in the status of the company's members made after the commencement of the winding up is, unless the Court otherwise orders, void.*

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The Cayman Islands Court of Appeal provided helpful clarification as to the purpose and effect of section 99 of the Law and the principles to be applied in granting validation orders in an important decision handed down earlier this year: *Tianrui (International) Holding Company Limited v China Shanshui Cement Group Limited*. Shanshui Cement Group (the Company) is a holding company whose subsidiary is among the largest of the cement producers in the People's Republic of China. Its shares were listed on the Hong Kong Stock Exchange (HKSCC). In 2014, China prohibited expansion of the domestic cement industry to tackle serious production overcapacity, which meant that expansion could only be achieved by merging with existing producers. This resulted in major shareholders of the Company (who are also its direct competitors) seeking to expand their holding and becoming involved in what has been described as a bitter take-over battle for control of the Company.

Tianrui Holding Company (Tianrui), one such major shareholder, presented a just and equitable winding-up petition against the Company alleging that Asia Cement Corporation (ACC) had acted improperly in concert with China National Building Materials Co Ltd (CNBM) (both rival shareholders who were at the time in control of the board of the Company) to dilute Tianrui's shareholding and try to squeeze it out. Tianrui alleged that this was achieved by the directors improperly exercising their powers to issue bonds (which were subsequently converted into shares) to parties related to ACC and CNBM.

In March 2019, the Company sought validation of 18 proposed transfers of shares (representing 43.96 per cent of the Company's issued share capital and including those that were the subject matter of the petition) to the HKSCC to facilitate the trading of those shares through a central clearing and settlement system (CCASS) for the public stock market in Hong Kong. In order to trade using the CCASS, shareholders must transfer their legal title to the HKSCC (which acts as a common nominee), prior to depositing their shares into the system. The CCASS indicated that, before it would accept the deposit of shares, it required the Cayman court to validate the transfer of legal title to the HKSCC.

Tianrui submitted that, by virtue of sections 45 and 54 of the Hong Kong Securities and Futures Ordinance, the proposed transactions should not be validated because it would make it impossible to unwind those transactions. It would, therefore, cause serious and irreversible consequences and would prejudice the outcome of the petition because it would be impossible to unwind the improper and dilutive share issue that Tianrui sought to impugn as part of the conspiracy to dilute its own shareholding if the petition is upheld.

Grand Court decision

In the first instance, the Honourable Justice Mangatal ordered that the transfers should not be avoided by the provisions of section 99. Mangatal J accepted the Company's case for validation: that it was a response to the CCASS's request and that it wished to reduce the illiquidity of its shares, which the judge thought (applying the well-known test for validation set out in *Burton v Deakin Ltd* [1977] 1 WLR 309) were reasons that an intelligent and honest director could reasonably hold in good faith and had a clear commercial basis. Further, she found that Tianrui had not provided any compelling evidence that the transfers were detrimental to the Company.

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The judge also held that, since the shares were fully paid up, the transfers did not run afoul of the rationale of section 99, which she considered was to prevent shareholders from evading liability by transferring partly paid shares to a man of straw after winding up has commenced.

Court of Appeal decision

The Court of Appeal overturned the decision of Mangatal J. It accepted Tianrui's contention that the judge misunderstood the purpose of section 99 and failed to identify the correct approach to validation under that section.

Moses JA, delivering a unanimous decision of the Court of Appeal, confirmed that the fundamental purpose of section 99 is to maintain the status quo between presentation and resolution of the winding up petition so as to render effective the section's retrospective function. He said (at paragraph 41):

> *as a matter of principle, a court, in every case, must satisfy itself that any order it makes does not undermine or frustrate the maintenance of the status quo pending resolution of the petition, and that, on the contrary, the order should be made in furtherance of that objective. This principle should not alter according to the particular circumstance of the case. Of course, its application will vary from case to case.*

Second, the Court of Appeal found that the section:

> *applied to all companies, the subject of a compulsory winding up, whether the company is solvent or not, whether it is a trading company or undertakes some other business, and whether the winding up is on the grounds of insolvency or on just and equitable grounds.*

In applying these principles, the Court of Appeal made the following important observations.

It is dangerous to assume that a court may be relieved of the responsibility of careful scrutiny and caution merely because the company is solvent. The court can make no assumptions as to the propriety of the proposals of the directors and will need to be satisfied that they are consistent with the purposes of the section and for the benefit of the company and those interested in the value of its assets.

The Court of Appeal adopted the submission of Tianrui that:

> *just as in the case of a creditor's petition validation will not be allowed to undermine the purpose of a winding up (i.e. pari passu distribution), in a just and equitable petition a validation order should not undermine the objective of stopping or reversing oppressive conduct.*

Careful scrutiny is needed not just to protect creditors in an insolvency petition but also contributories at a stage when no one can say whether the petition in respect of a solvent company will succeed or not.

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As the transfer of legal title from a shareholder to the HKSCC fell squarely within section 99, the court only ought to have made a validation order in circumstances that assisted in preserving the status quo and which did not frustrate the purpose of section 99. This required a careful analysis as to the reason why the shares were to be deposited into the CCASS and, above all, consideration as to whether validating such a transaction would impede or frustrate the purpose of section 99, as Tianrui contended. The Court of Appeal found that Mangatal J mistakenly neither questioned nor scrutinised the Company's case for validation.

The Court of Appeal undertook the task of scrutinising the Company's proposal itself and found:

- no explanation was given as to why the shareholders wanted to deposit their shares into the CCASS at a time when it seemed unlikely they would want to sell their shares;
- there was no evidence as to why the Company, which is a holding company, the parent of operating subsidiaries, wanted to raise finance;
- there was no reasonable explanation for the transaction other than that proffered by Tianrui, namely that the deposit was intended to baulk the unwinding of those transactions and any future restoration of the status quo, should the petition be successful; and
- the transactions proposed were not made in the ordinary course of business: the Company's business is in holding interests in subsidiaries, it is not in the business of trading in its own shares.

The Court of Appeal concluded that the judge made material errors of law leading her to fail to consider relevant evidence and to make necessary assessments of that evidence. Accordingly, her exercise of evaluative judgment could not stand, the order was reversed and the Court of Appeal refused to make a validation order.

Conclusion

This is a welcome clarification from the Court of Appeal confirming that the fundamental purpose of section 99 of the Law (whether the company is solvent or insolvent) is to maintain the status quo. All applications made for validation under this section will be carefully scrutinised by the court to ensure consistency with that purpose.

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Guy Manning is head of Campbells' Litigation, Insolvency & Restructuring Group. He advises and appears in the Cayman Islands Courts on behalf of creditors, shareholders, provisional and official liquidators, directors, managers and other professional service providers in relation to the restructuring and liquidation of Cayman companies and other entities. Guy also has an active general litigation practice involving widely varying commercial contexts and structures, but with a particular emphasis on shareholder and investment fund disputes. He has been involved in many of the jurisdiction's highest profile disputes, liquidations and restructurings.

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