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Cayman Islands

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IN SUMMARY

The first part of this chapter looks at the key aspects of the successful Cayman Islands restructuring regime, including the use of provisional liquidators to protect the debtor from its creditors while it formulates and presents a compromise or arrangement to its creditors. The second part considers the requirements for seeking the appointment of provisional liquidators in an asset protection role in cases of fraud, as reaffirmed by the Grand Court in two recent decisions.

DISCUSSION POINTS

- Restructuring
- Schemes of arrangement
- Provisional liquidation
- Statutory moratorium
- Creditors' meetings
- COMI shift
- The rule in *Gibbs*

REFERENCED IN THIS ARTICLE

- Section 104(3)(b) of the Cayman Islands Companies Act 2021
- *In the Matters of Ocean Rig UDW Inc, Drill Rigs Holdings Inc, Drillships Financing Holdings Inc and Drillships Ocean Ventures Inc, (Each in Provisional Liquidation)*
- *In the Matter of LDK Solar Co, Ltd (in Provisional Liquidation)*
- *Anthony Gibbs & Sons v La Societe Industrielle et Commerciale des Metaux* (1890) 25 QBD 399
- *CW Group Holdings* (unreported, 3 August 2018, Parker J)
- *Re Emmadart Ltd* [1979] 1 Ch 540

Introduction

With global vaccination rates lifting consumer sentiment there are reasons to be optimistic about economic recovery from the global pandemic. However, new virus mutations, uneven vaccination rates, and reducing levels of government economic support measures all mean that the economic outlook remains uncertain and many market sectors will continue to face challenges in the medium term. As the world continues to grapple with the human cost and economic effects of covid-19, the Grand Court of the Cayman Islands has seen an increase in cases involving the use of the Cayman Islands' effective and efficient restructuring regime, as well as an increase in cases where volatility has exposed fraud or mismanagement, resulting in action by shareholders (contributories).

Cayman Islands provisional liquidators can take on multiple roles, including protecting a company from its creditors while it formulates a compromise or arrangement, and, in cases involving fraud, protecting the assets of the company from dissipation by rogue management.

In this chapter we consider, in the first part, the Cayman Islands restructuring regime and the use of provisional liquidators with a restructuring mandate. In the second part, we provide insights and reflections on recent cases involving allegations of fraud and the appointment of provisional liquidators with an asset protection mandate.

Part 1: 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 of the United States Bankruptcy Code, as well as recognition in other key jurisdictions.

Debt can be restructured in the Cayman Islands in relation to Cayman companies, as well as foreign companies that are re-domiciled to, or registered as foreign companies in, the Islands for the specific purpose of restructuring debt. For example, in the matter of *Ocean Rig*,[1] the oil services group transferred and shifted the centre

1 *In the Matters of Ocean Rig UDW Inc, Drill Rigs Holdings Inc, Drillships Financing Holdings Inc and Drillships Ocean Ventures Inc, (Each in Provisional Liquidation)* [2017 (2) CILR 495].

of main interest (COMI) of 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.

Breathing room

Usually, the first order of business in a restructuring case is to protect the debtor entity from its creditors to allow the debtor to work with its advisers to formulate a proposal to creditors. In the Cayman Islands, the process, perhaps counter-intuitively, involves either the company (where it is empowered to do so) or a 'friendly' creditor presenting a winding-up petition against the company, which then opens the jurisdiction in section 104(3) of the Companies Act (2021 Revision) which allows a company that is, or is about to become, insolvent to apply for the appointment of provisional liquidators where the company intends to propose a compromise or arrangement to its creditors. The effect of the appointment of provisional liquidators is to bring about a moratorium on claims against the company in the jurisdiction. The winding-up petition is then generally adjourned while there is a viable restructuring plan under consideration. 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 provisional liquidators are generally empowered to seek recognition in relevant jurisdictions and there are numerous examples of cases where Cayman-appointed provisional liquidators have been recognised in other relevant jurisdictions.

A bill has been proposed 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).

Schemes of arrangement

The principal debt (and equity) restructuring tool in the Cayman Islands is the scheme of arrangement under section 86 of the Companies Law (2021 Revision).

The principles that apply to Cayman schemes are based on the well-established principles of 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.

The moratorium described above allows the company an opportunity 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.

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 that 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 achieved within 12 weeks. The more complex the scheme or the more vocal any dissent, the more likely it would be that the process would run its course over a longer period of time.

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, 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 basis 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 shift

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

Re-domiciling the company or registering it as a foreign company is relevant to the 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* 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 case of *LDK Solar*, 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 that is to be offered to creditors. However, it is clear from the language in section 104(3)(b) of the Companies Act that the court may appoint

provisional liquidators even where there are no fully formulated restructuring plans, as was the case, for example, in *CW Group Holdings*. 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 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.[2]

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.

Part 2: the use of provisional liquidators in fraud cases

In the context of a restructuring, a provisional liquidator can be appointed on the application of the company to protect it from its creditors while it formulates a compromise or arrangement. By contrast, in cases involving dissipation or misuse of assets, mismanagement or conduct oppressive to minority shareholders, a creditor or contributory can seek the appointment of provisional liquidators to protect the assets of the company from rogue management.

2 See *Re Emmadart Ltd* [1979] 1 Ch 540 and *Re China Shanshui Cement Group Limited* [2015 (2) CILR 255].

Section 104(2) of the Companies Act (2021 Revision) provides that provisional liquidators may be appointed, on the application of a creditor, contributory or (in certain cases) the Cayman Islands Monetary Authority, at any time between the presentation of a winding-up petition and the making of a winding-up order on the grounds that:

- there is a prima facie case for making a winding-up order; and
- the appointment of a provisional liquidator is necessary in order to prevent:
  - the dissipation or misuse of the company's assets;
  - the oppression of minority shareholders; or
  - mismanagement or misconduct on the part of the company's directors.

In two unrelated judgments handed down in the same week,[3] the Grand Court dismissed applications to appoint provisional liquidators pursuant to section 104(2) of the Companies Act (2021 Revision) due to a failure by the applicants to satisfy the requirements of 'prima facie case' and 'necessity'.

In both cases, the applications were made following the presentation of a contributory's winding-up petition on just and equitable grounds alleging a justifiable loss of trust and confidence in the company's management due to alleged fraudulent conduct. In summarily dismissing the applications, the Court has confirmed that it is a serious step to appoint provisional liquidators and that there is a heavy and onerous burden on those that seek such orders.

The four 'hurdles'

In *ICG I*, Justice Doyle confirmed that on a plain reading of section 104(2) an applicant seeking the appointment of a provisional liquidator has four main hurdles to overcome:

- the presentation of the winding-up petition hurdle: the applicant must satisfy the court that a winding-up petition has been duly presented and a winding-up order has not yet been made;
- the standing hurdle: the applicant must satisfy the court that the applicant has standing to make the application to appoint a provisional liquidator (ie, the applicant is a creditor or contributory of the company);

3 See the judgments of Doyle J in *In the matter of ICG I* (unreported, 4 August 2021, FSD 0192 of 2021) and Parker J in *In the matter of Al Najah Education Limited* (unreported, 9 August 2021, FSD 0119 of 2021).

- the prima facie case hurdle: the applicant must satisfy the court that there is a prima facie case for making a winding-up order on the petition; and
- the necessity hurdle: the applicant must satisfy the court that the appointment of the provisional liquidator is necessary to prevent the dissipation or misuse of the company's assets, the oppression of minority shareholders, or mismanagement or misconduct on the part of the company's directors.

Standing

The standing hurdle might be dismissed as a mere formality, but the wording of the statute and the developments at common law mean that even this hurdle can be a trap for the unwary.

A contributory may only present a just and equitable winding-up petition, pursuant to section 94(3) of the Companies Act (2021 Revision) where:

- the shares, or at least some of them, are partly paid;
- the shares were originally allotted to the contributory or have been held by the contributory (registered in its name) for a period of at least six months immediately preceding the presentation of the winding-up petition; or
- the shares devolved on that contributory through the death of a former holder.

Where shares are often held by nominees or custodians, the requirement that shares have been held for a period of at least six months immediately preceding the presentation of the petition has caused many a contributory's petition to flounder.

A contributory must also demonstrate a 'tangible interest' in the liquidation, which usually requires evidence that there will be more than a negligible surplus for distribution to contributories after payment of all creditor claims,[4] or, at least, that the contributory would achieve some advantage or minimise some disadvantage by the proceedings.[5]

Prima facie case

On the prima facie case hurdle, Doyle J in *ICG I* commented that there has been much debate over the years as to the test to be applied in the Cayman Islands and whether the applicant was required to show a good prima facie case or merely a prima facie case, and the meaning of those phrases.

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4 *Re Rica Gold Washing Co Ltd* (1879) 11 Ch D 36 at 42–43.

5 *Re Chesterfield Catering Co Ltd* [1997] Ch 373; *Hamilton v Brown* [2017] 1 BCLC 269.

Doyle J referred to the decisions of Parker J in *Grand State Investments Limited*[6] and Segal J in *Re Asia Strategic Capital Fund LP*[7] as authority for the proposition that it was not necessary for the applicant to demonstrate that a winding-up order will be granted; a prima facie case is established where it is likely – on the basis of a case established by allegations supported by evidence that has not been disproved at the interim stage – that the petitioner would obtain a winding-up order on the hearing of the petition.

Doyle J ultimately concluded in *ICG I* that it was not necessary for him to determine the standing and prima facie case hurdles as it was clear to him that the applicant had failed to overcome the necessity hurdle.

The issue was, however, determined in *Al Najah Education Limited*, with Parker J adopting a consistent position to the authorities cited by Doyle J in *ICG I*.

The necessity hurdle

In *Al Najah Education*, Parker J confirmed that there must be clear or strong evidence to show that there is a serious risk that one or more of the wrongs identified in section 104(2)(b) of the Companies Act may well occur if provisional liquidators are not appointed.

In *ICG I*, Doyle J considered the tests to be applied where it is alleged that the appointment of provisional liquidators is necessary in order to prevent the dissipation or misuse of the company's assets or mismanagement or misconduct on the part of the company's directors. Doyle J held that:[8]

> *The risk of dissipation test: there is a heavy burden on the applicant, requiring clear or strong evidence as to necessity, to show that the assets of the company are being, or are likely to be, dissipated to the detriment of the petitioner and that there is a serious risk that the assets may not continue to be available to the company unless provisional liquidators are appointed; and*
>
> *The test for mismanagement or misconduct on the part of the company's directors: mismanagement or misconduct on the part of the directors connotes culpable behavior involving a breach of duty or improper behavior that involves a breach of the governing documents and governance regime.*

6 Unreported, 28 April 2021, FSD 0011 of 2021 (RPJ).

7 *Re Asia Strategic Capital Fund LP* 2015 (1) CILR N-4.

8 Citing the tests described by Segal J in *Re Asia Strategic Capital Fund LP*.

Application of section 104 in cases of fraud

While the appointment of provisional liquidators under section 104 will always turn on the particular facts of a given case and the strength of the written evidence (particularly as the evidence will only be tested summarily, and witnesses will not be subject to cross-examination), evidence of fraud will often provide a clear path over both the prima facie case hurdle and the necessity hurdle. This is particularly so where the alleged wrongdoers remain in control of the entity in question, thus presenting a risk that one or more limbs of section 104(2)(b) will apply.

A good example of section 104 being relied upon in the case of fraud was *In The Matter of HQP Corporation Limited* (unreported, 16 July 2021, FSD 190 of 2021 – DDJ),[9] where certain disadvantaged shareholders relied upon section 104 to prevent, on an urgent basis, the redemption of shares which, if effected, would have resulted in a small number of shareholders stripping all value out of the company and the company becoming insolvent. The case concerned an admitted fraud by the company's principal and former CEO, whereby various performance metrics had been significantly inflated to induce new investment and to persuade existing shareholders to consent to that new investment and to subordinate their rights to those of the new shareholders. Following the discovery of the fraud, those new shareholders – who had the least restrictive share rights – submitted redemption requests, which (under the company's highly unusual articles) would have had the effect of stripping all value out of the company and leaving the majority of shareholders with nothing.

The petitioners (who petitioned qua contributories on various just and equitable grounds and, alternatively, as contingent or prospective creditors on the grounds of insolvency) were able to introduce evidence of the admission of fraud and also of the company's inevitable insolvency if the redemptions were to be effected. In addition, the petitioners asserted under section 104 that the appointment of provisional liquidators (and the consequential stay on redemptions) was necessary to prevent the dissipation or misuse of company assets (in the sense of such assets not being rateably distributed among creditors) and to prevent oppression to minority shareholders. Because the articles provided that redemption would not take effect until a payment to shareholders was in fact made, the court directed the provisional liquidators not to make any payments and thereby ensure that no redemptions were effected.

9 Campbells acts for the petitioners in *Re HQP*.

It is long settled that the appointment of provisional liquidators is a most serious order, which demands the most anxious consideration by the court, and that the circumstances of the case have to justify taking such a drastic step. Nevertheless, while the relief in *HQP* was granted under urgency and without opposition, the case highlights the court's willingness to appoint provisional liquidators where it can be shown that a serious fraud has occurred and where there is an immediate need to protect stakeholders as a result of the same, thereby overcoming both the prima facie case hurdle and the necessity hurdle described above.

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Mark is a partner in Campbells' litigation, insolvency and restructuring group where he specialises in insolvency, restructuring and investment fund litigation. Mark advises and appears in the Cayman Islands courts on behalf of provisional and official liquidators, creditors, shareholders, directors, managers and other professional service providers in relation to a broad range of pre- and post-liquidation disputes. He has acted in litigation involving widely varying commercial contexts and structures, but his practice principally involves distressed and failed investment funds.

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Campbells specialises in insolvency and restructuring, investment fund litigation and liquidation disputes. The group acts for insolvency professionals, creditors, investors, directors and other professional service providers in connection with all aspects of the restructuring and winding up of companies, investment funds, limited partnerships and structured finance entities. They have specific experience of coordinating cross-border appointments, obtaining injunctions, assisting with gathering evidence and obtaining recognition and assistance from overseas courts.

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