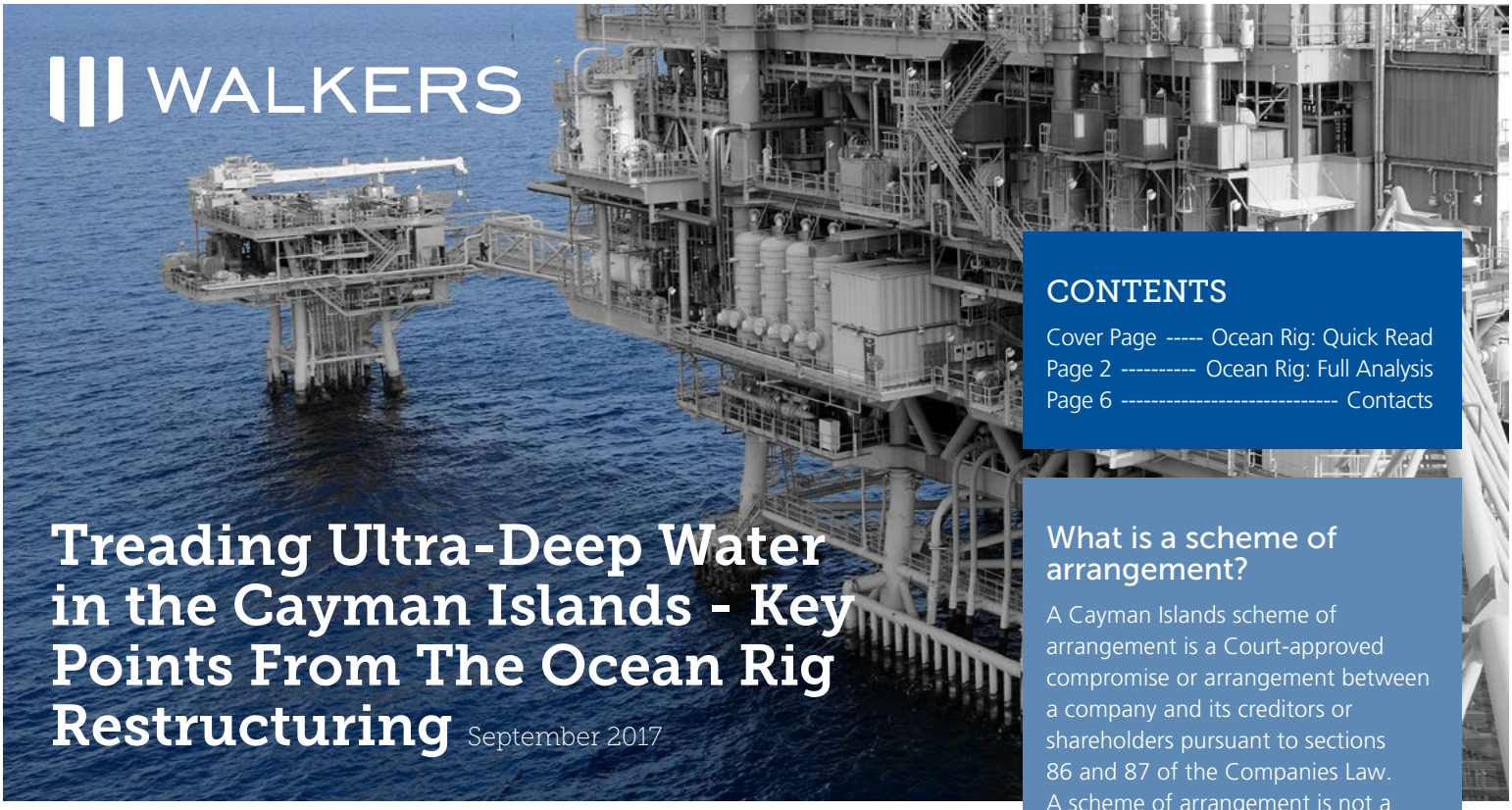

WALKERS

Treading Ultra-Deep Water in the Cayman Islands - Key Points From The Ocean Rig Restructuring

September 2017

CONTENTS

Ocean Rig: Quick Read

- The Cayman Court recently sanctioned schemes of arrangement for four companies within the Ocean Rig group. All involved a COMI-shift from the Marshall Islands to the Cayman Islands and also utilised the Cayman Islands provisional liquidation toolkit.
- The restructuring reduces the Group's debt from approximately US$3.69 billion to approximately US$450 million and provides equity and cash to existing creditors.
- The process was complex and contested with a number of significant objections to one of the schemes (the UDW Scheme) being raised by a creditor of the parent company, including objections relating to the proposed class composition for voting purposes, the alleged unfairness of the UDW Scheme, the valuation methodology used to value assets and distribute restructuring consideration, and the indirect removal of the objecting creditor's standing as a creditor of UDW for the purposes of pursing certain New York law claims.
- Many of those objections raised novel and interesting points of law which will be of relevance to participants in the global restructuring market. From a US perspective, it is notable that Chapter 15 recognition was also sought, and granted, with the Cayman Islands being recognised as each company's 'centre of main interests' (COMI), in the face of creditor opposition alleging a Cyprus COMI before the US Bankruptcy Court.
- The case demonstrates that the Cayman Court is well equipped to adjudicate such restructurings, including by grappling with novel issues in scheme of arrangement jurisprudence. More generally, the case involved a significant cross border element and demonstrates that the Cayman Islands remain at the forefront of cross-border restructuring following on from the early days of the Drax and Countrywide parallel English and Cayman Islands schemes of arrangement.
- Accordingly, offshore debtors may wish to consider utilising the Cayman Islands scheme of arrangement process when seeking an effective platform to deliver a targeted and robust financial restructuring solution.
- Please see over the page for further detailed analysis.

What is a scheme of arrangement?

A Cayman Islands scheme of arrangement is a Court-approved compromise or arrangement between a company and its creditors or shareholders pursuant to sections 86 and 87 of the Companies Law. A scheme of arrangement is not a formal insolvency process. The scheme of arrangement process is frequently used to implement a financial restructuring, but is also often used to complete corporate transactions, such as group restructurings or reorganisations, acquisitions, mergers and take-private transactions.

What is provisional liquidation?

A provisional liquidator may be appointed where, amongst other circumstances, a company is or is likely to become unable to pay its debts and the company intends to present a compromise or arrangement to its creditors. Provisional liquidation proceedings provide a moratorium against creditor claims. The provisional liquidators' powers are set out in their appointing order and can be tailored to result in what practitioners refer to as "soft touch" provisional liquidation whereby the provisional liquidators work alongside the existing directors to develop and propose a restructuring but without usurping the directors' powers entirely.

Ocean Rig: Full Analysis

The Ocean Rig Restructuring

The Grand Court of the Cayman Islands (the "Cayman Court") has sanctioned Cayman Islands schemes of arrangement (the "Schemes") in relation to four companies within the Ocean Rig group of companies (the "Group"), notwithstanding complex and well developed arguments against one of the Schemes advanced by an objecting creditor.

The Group

The Schemes concerned four companies in the Group - Ocean Rig UDW Inc (in provisional liquidation) ("UDW", being the Group's parent company) and three of its subsidiaries, Drill Rigs Holdings Inc (in provisional liquidation) ("DRH"), Drillships Financing Holding Inc (in provisional liquidation) ("DFH") and Drillships Ocean Ventures Inc (in provisional liquidation) ("DOV", and together with UDW, DRH and DFH, the "Scheme Companies"). The Group's business is the ownership and operation of a fleet of semi-submersible and ultra-deep water drilling rigs which are contracted out to provide oilfield services for offshore exploration, development and drilling.

Financial Circumstances and Appointment of Joint Provisional Liquidators

The Group's organisational and capital structure is essentially divided between three debt and asset silos. DRH, DFH and DOV are each a holding company of a silo. Each silo owns significant assets and had issued debt secured against such assets, but there was no cross-collateralisation between the silos.

DRH had issued senior secured notes originally due October 2017 and governed by New York law (the "2017 Notes") secured against the assets of the DRH silo. DFH was indebted under a New York law governed credit agreement (the "DFH Credit Facility") secured against the assets of the DFH silo. DOV was indebted under a New York law governed credit agreement (the "DOV Credit Facility") secured against the assets of the DOV silo. The principal outstanding under such notes and facilities pre-restructuring is understood to have been US$459.7 million under the 2017 Notes, US$1.83 billion under the DFH Credit Facility, and US$1.27 billion under the DOV Credit Facility.

UDW, the parent company of the Group, had issued senior unsecured notes due April 2019 and governed by New York law (the "2019 Notes"). The principal outstanding under the 2019 Notes pre-restructuring is understood to have been US$131 million. The creditor objecting to the scheme in respect of UDW (the "UDW Scheme") had a sizeable holding in the 2019 Notes. In addition, UDW had guaranteed the obligations of each of DRH, DFH and DOV under the 2017 Notes, the DFH Credit Facility and the DOV Credit Facility, respectively (such guarantees, the "UDW Guarantees"), and, relevantly, had granted security over the shares it held in each of DRH, DFH and DOV.

The Group experienced financial pressure following the recent global decline in oil prices. Following the entry into of a restructuring support agreement between DFH, DOV and DRH and certain of their creditors, on 27 March 2017 and following an application by each of the Scheme Companies, the Cayman Court appointed Eleanor Fisher of Kalo (Cayman) Limited and Simon Appell of AlixPartners Services UK LLP as joint provisional liquidators (the "JPLs") of each of the Scheme Companies. The Scheme Companies made the applications on the grounds that each company is or is likely to become unable to pay its debts and each company intends to present a compromise or arrangement to its creditors. The appointment of provisional liquidators on such grounds is a relatively common feature of Cayman Islands' restructurings and carries a number of advantages, including a moratorium commencing from the date of appointment which provides that no suit, action or other proceeding shall be proceeded with or commenced against the company except with the leave of the Cayman Court.

When must a company be registered as a foreign company?

The Companies Law provides that all companies, bodies corporate or corporate entities existing under the laws of a jurisdiction outside the Cayman Islands that carry on business within or establish a place of business in the Cayman Islands, must register with the Cayman Islands Registrar of Companies as a foreign company. The Companies Law sets out a non-exhaustive list of what constitutes carrying on business and this includes: (i) the sale by or on behalf of a foreign company of its shares or debentures, and (ii) the offering, by electronic means, and subsequently supplying, real or personal property, services or information from a place of business in the Cayman Islands or through an internet service provider or other electronic service provider located in the Cayman Islands. From the date of registration, ongoing compliance requirements apply.

When may a company be continued into the Cayman Islands?

Part XII of the Companies Law permits a body corporate incorporated, registered or existing with limited liability and a share capital under the laws of any jurisdiction outside the Cayman Islands to register by way of continuation as an exempted company limited by shares under the Companies Law. A number of detailed pre-conditions to registration exist, including, among other things: (i) that the applicant must be incorporated, registered or existing in a jurisdiction whose laws permit or do not prohibit the transfer of the applicant in the manner provided by the Companies Law, and (ii) that the company is able to pay its debts as they fall due.

In addition, following the appointment of the JPLs, each of the Scheme Companies applied for relief in the United States Bankruptcy Court for the Southern District of New York (the "US Bankruptcy Court") under Chapter 15 of the United States Bankruptcy Code ("Chapter 15"). An order under Chapter 15 recognising the appointment of the JPLs and the Cayman Court proceedings in respect of the Schemes as "foreign main proceedings" was entered on 24 August 2017 recognising the Cayman Islands as each Scheme Company's 'centre of main interests' ("COMI"), notwithstanding one objecting party arguing that COMI was in Cyprus. Subsequently on 20 September 2017, following the sanctioning of the Schemes by the Cayman Court, the US Bankruptcy Court issued an order giving full force and effect to each of the Schemes.

COMI Shift

One notable feature of the Schemes is that all four Scheme Companies were incorporated and registered in the Marshall Islands and remain so, save for UDW which was registered by way of continuation into the Cayman Islands on 14 April 2016 under Part XII of the Cayman Islands Companies Law (2016 Revision) (the "Companies Law"). The effect of such registration by continuation is that UDW is treated under Cayman Islands law for all purposes as if it had been incorporated and registered as a Cayman Islands exempted limited company from the date of its registration by continuation.

Each of DRH, DFH and DOV remain Marshall Islands companies. However, each had assets in the Cayman Islands, was carrying on business in the Cayman Islands and had, prior to the commencement of the scheme of arrangement process, registered as a foreign company in the Cayman Islands under Part IX of the Companies Law.

The jurisdiction of the Cayman Court with respect to schemes of arrangement is wide and extends to any company liable to be wound up by the Cayman Court under the Companies Law. In that regard, the Cayman Court may make a winding up order in respect of, amongst others: (i) a company incorporated and registered in the Cayman Islands (and that includes by way of continuation in from another jurisdiction), and (ii) a foreign company which has property located in the Cayman Islands, or is carrying on business in the Cayman Islands, or is the general partner of a Cayman Islands limited partnership or which is registered as a "foreign company" under Part IX of the Companies Law. As such, notwithstanding their Marshall Islands origin, all four companies were brought within the jurisdiction of the Cayman Court to enable them to access the Cayman Islands scheme of arrangement process, which, due to the actions taken to move relevant interests, was capable of being recognised as foreign main proceedings under Chapter 15.

The Schemes

Each of the Scheme Companies had proposed a standalone scheme of arrangement, but they are inter-conditional upon each other, save that in the event that the DRH Scheme failed, the Schemes in respect of UDW, DFH and DOV could still proceed. The Schemes provide for a reduction in the Scheme Companies' financial indebtedness from approximately US$3.69 billion to approximately US$450 million under a new credit agreement borrowed by various members of the Group. As consideration for the reduction of debt, scheme creditors are entitled to a mixture of equity in UDW, cash consideration and entitlements under the new credit facility.

Creditors voted on each Scheme separately at the respective scheme meetings. It is a core feature of a scheme of arrangement that creditors affected by the scheme vote in classes with each class being comprised of those creditors whose rights are not so dissimilar as to make it impossible for the creditors to consult together with a view to their common interest. For the scheme to be approved by the creditors, each separate class must approve the scheme and if any one class does not approve the scheme, the scheme will fail; it is not possible for a senior class to cram-down a junior class by way of a cross-class cram down, but it is possible to cram-down a minority within a class. It is also possible for there to be only a single class of creditors voting on a scheme in circumstances where the class analysis indicates that all creditors have sufficiently similar rights. One of the functions of the Cayman Court at the first court hearing in the scheme process (often referred to as the convening, or directions, hearing) is to consider the class composition proposed by the company promoting the scheme. For a class to approve a scheme, it must be approved by a majority in number representing not less than 75% in value (of those present and voting) of the relevant claims.

In respect of the Schemes, the DRH, DFH and DOV Schemes were voted on by a single class of creditors of each company, namely the ultimate beneficial owners of the 2017 Notes (for the DRH Scheme), the lenders of record under the DFH Credit Facility (for the DFH Scheme) and the lenders of record under the DOV Credit Facility (for the DOV Scheme).

In respect of the UDW Scheme, a single class of creditors was proposed, but comprising both the ultimate beneficial owners of the 2019 Notes *and* the relevant secured creditors in respect of the UDW Guarantees (being the ultimate beneficial owners of the 2017 Notes, the lenders of record under the DFH Credit Facility and the lenders of record under the DOV Credit Facility). UDW proposed a single class comprising creditors in respect of different liabilities on the basis that the security granted by UDW in favour of the UDW Guarantee creditors over the shares of DRH, DFH and DOV was of no value due to the fact that DRH, DFH and DOV are insolvent. As such, UDW argued that the holders of the 2019 Notes and the UDW Guarantee creditors were in substantially the same position, and therefore able to consult together, because they were both effectively unsecured creditors as against UDW, notwithstanding the share pledges granted by UDW in favour of the UDW Guarantee creditors.

Objections to the Schemes

One creditor with a substantial holding of 2019 Notes and pre-restructuring equity in UDW objected to the UDW Scheme at both the convening hearing and the sanction hearing.

The principal objections raised at the convening hearing included, among other things, that:

(a) the holders of the 2019 Notes and the UDW Guarantee creditors should not vote together as a single class in respect of the UDW Scheme because of their differing rights, including that the UDW Guarantees were secured, whereas the 2019 Notes were unsecured. The objecting creditor also raised an argument that different rights existed because the UDW Guarantee creditors had, via their primary claims against DRH, DFH and DOV under the 2017 Notes, DFH Credit Facility and DOV Credit Facility, rights against different entities within the Group, which rights were not shared by holders of the 2019 Notes;

(b) the UDW Scheme is unfair because the claims of creditors under the UDW Guarantees should be admitted, for scheme purposes, net of any realisations from the principal debtors under the primary liabilities to which the UDW Guarantees relate;

(c) a discounted fair market value approach was not appropriate for the valuation of the Group's assets;

(d) certain equity being offered to management via a management equity plan to be implemented by the Schemes was "above market"; and

(e) the effect of the UDW Scheme was to remove the objecting creditor's standing as a creditor of UDW thereby preventing that objecting creditor from asserting certain rights under New York law which that creditor alleged were available to it as a result of a series of accusations made in respect of the conduct of UDW's management and that of certain other group companies. In that regard, it is notable that part of the UDW Scheme proposal includes a "litigation trust" into which any claims which UDW may have in respect of those facts and circumstances are assigned, with any realisations from such claims being applied for the benefit of creditors under the UDW Scheme.

Following the convening hearing, and notwithstanding the objections raised, the Cayman Court (Justice Parker) made an order convening scheme meetings for each Scheme in the terms sought by the Scheme Companies, including that the holders of the 2019 Notes and the UDW Guarantee creditors vote together in a single class for the purposes of the UDW Scheme, even though the UDW Guarantee creditors were technically secured but the 2019 Notes were not. At the actual scheme meetings, each Scheme was approved by an overwhelming majority of creditors.

Following the subsequent sanction hearing held on 4 to 6 September 2017 the Cayman Court (Justice Parker again) exercised its discretion to sanction each Scheme, thereby finding in favour of the Scheme Companies and rejecting the arguments raised by the objecting creditor in respect of the UDW Scheme. Such further objections raised at the sanction hearing included that:

(a) the UDW Guarantee creditors' votes were not fairly representative of the class;

(b) the UDW Scheme was unfair to the objecting creditor and/or subject to a "blot" on the scheme such that the Cayman Court should refuse to exercise its discretion to sanction it (noting that the Cayman Court retains ultimate discretion and is not bound to sanction a scheme, even if it is approved by the requisite majority of creditors); and

(c) the UDW Scheme should be amended to remove the objecting creditor from its scope because that objecting creditor had submitted an alternative restructuring proposal whereby it would be carved out of the UDW Scheme such as to preserve its rights as a creditor of UDW under New York law, but in return voluntarily agreeing to stay any attempts to collect payment from UDW under the 2019 Notes.

In addition, the sanction hearing involved submissions as to the proper role of the Cayman Court at the sanction hearing.

Whilst the written judgment addresses a vast number of complex legal points in response to the objecting creditor's arguments which are beyond the scope of this advisory, several key points are worthy of brief mention:

(a) the judgment confirms, as a matter of Cayman Islands law and following English law, that it is possible for secured and unsecured creditors to consult together in the same class in circumstances where the security held by the secured creditors is worthless;

(b) the Cayman Court rejected an argument that the rights and interests of the various creditors under each of the four Schemes should be viewed holistically when looking at class composition for one of the Schemes. Rather, the Cayman Court reaffirmed the established position that the relevant test for class composition concerns the *rights* held by a creditor as against the *particular scheme company* in question, and not rights against third parties (including rights against other entities in the group); and

(c) in response to an argument that the votes of the UDW Guarantee creditors were not fairly representative of the class for the purposes of the UDW Scheme (as a result of what was argued to be the UDW Guarantee creditors' special interests as both guarantee creditors of UDW and primary creditors of DRH, DFH and DOV), the Cayman Court found that there is no reason to discount the votes of creditors with additional interests where there are "independent and good reasons" for voting in favour of the scheme and that for such an argument to succeed, it is necessary to establish that an intelligent and honest member of the scheme class concerned but without those special interests could not have voted in favour of the scheme.

Commentary

The Ocean Rig restructuring process demonstrates that the Cayman Islands scheme of arrangement process is flexible

and is well equipped to work through complex restructurings. The UDW Scheme was also vigorously contested and raised some complex points of law.

Foreign Debtors and "COMI Shifting"

With regard to access to the Cayman Islands restructuring regime by foreign companies, the wide jurisdiction of the Cayman Court is reflective of the modern approach to "forum shopping" being considered appropriate in certain circumstances where it provides a better return for creditors compared with what might be possible under the laws of the home jurisdiction. The test for jurisdiction in the Cayman Islands and the reference back to companies liable to being wound up under the Companies Law also provides a measure of certainty as to the circumstances in which the Cayman Court will entertain and consider a scheme of arrangement promoted by a foreign debtor.

The practice of migrating jurisdictions to access restructuring processes (including those not available in the home jurisdiction) is often referred to as the practice of "COMI-shifting", the concept of COMI being a central feature of the UNCITRAL Model Law on Cross Border Insolvency. Whilst the Cayman Islands are not party to the UNCITRAL Model Law on Cross Border Insolvency or any similar international framework relating to cross-border insolvency, the Ocean Rig Schemes are a notable example of how the Cayman Islands' flexible statutory regime may, in any event, be accessed and utilised by foreign debtors to bring about a successful debt restructuring, including where there is no suitable process in the home jurisdiction.

Examples of specific activities which can assist with enabling a non-Cayman Islands company to register as a foreign company in the Cayman Islands include: the opening of bank accounts in the Cayman Islands, carrying on head office administrative functions in the Cayman Islands, having a Cayman Islands resident director appointed, holding board meetings in the Cayman Islands, keeping statutory books and records in the Cayman Islands and informing creditors of a Cayman Islands correspondence address.

The Cayman Islands also has a rich history with cross-border restructuring matters. For example, some of the first parallel scheme of arrangement processes combining an English scheme of arrangement and a foreign scheme of arrangement involved a Cayman Islands scheme of arrangement; notably the Drax and Countrywide restructurings[1]. The Ocean Rig restructuring is another example of how the Cayman Islands remain amongst the forefront of the international restructuring jurisdictions.

Complexity

With regard to the ability of the Cayman Court to adjudicate issues in complex financial restructurings, it is notable that many of the arguments raised by the objecting creditor were legally complex and tested points of law that had either not previously been addressed in the Cayman Court or which seemingly ran contrary to what was understood to be the relatively settled position in other scheme of arrangement jurisdictions (such as England and Australia, which, amongst other jurisdictions, share a common scheme of arrangement heritage and the Court decisions of which are considered persuasive, but not binding, in the Cayman Islands), or which had also not been fully addressed at great length in such other jurisdictions. It is helpful therefore that the Cayman Court saw fit to dismiss such arguments, paving the way for the consummation of the restructuring.

In particular, the decisions of the Cayman Court in relation to class composition, and the effect of special interests held by certain creditors on whether the Court should exercise its discretion to sanction a scheme of arrangement, will be useful for parties seeking to plan a restructuring in similar circumstances. In that regard, it now seems clear that, as a matter of Cayman Islands law and where liquidation is the correct comparator to the scheme, any rights which a guarantor creditor of a parent company may have in its separate capacity as a primary creditor of a subsidiary obligor in respect of the same issued debt are not relevant for determining class composition for a scheme of arrangement at the parent level and are not, without more, sufficient to demonstrate that the guarantee creditors' votes at the parent level are not fairly representative of the class.

In addition, another notable feature of the UDW Scheme is a trust (comparable to the "litigation trust" employed in a number of cases under Chapter 11 of the United States Bankruptcy Code), whereby UDW has assigned certain claims it may have arising out of certain facts and circumstances complained of by the objecting creditor into a funded trust. To the extent any realisations flow from the prosecution of the claims assigned into that trust, the proceeds will be distributed to the creditors of UDW in accordance with their entitlements under the UDW Scheme. Whilst it is understood that such litigation trusts are becoming more common in the United States, they are less common in scheme of arrangement led restructurings and do not benefit from statutory recognition in the Cayman Islands. Nevertheless, the flexibility of the Cayman Islands scheme of arrangement process demonstrates that it can readily adapt to the commercial requirements of a contested restructuring by incorporating such a feature and the Cayman Court was complementary of such a trust, holding it to be a "fair" way of dealing with such claims for the benefit of all creditors.

Interface with Foreign Laws

In terms of the interface between a Cayman Islands restructuring and foreign laws, the Cayman Court will seek to be persuaded that, if it sanctions a scheme of arrangement, it is likely to have effect in other relevant foreign jurisdictions so that the Court is not acting in vain. Where the restructuring involves, as is often the case, New York law governed bonds or credit agreements, there is an established pathway for seeking the enforcement of Cayman Islands scheme of arrangement

1 Walkers acted on both the Drax Holdings Limited (2003) and Castle Holdco 4, Ltd (Countrywide) (2009) schemes of arrangement.

orders in the United States under Chapter 15[2]. In addition, where provisional liquidation proceedings are utilised alongside a Cayman Islands scheme of arrangement process, there are various examples of the US Bankruptcy Courts recognising the appointment of joint provisional liquidators as a foreign main proceeding, thereby opening up avenues of automatic and discretionary relief under Chapter 15, although COMI considerations from a Chapter 15 perspective will clearly need to be considered on a case by case basis.

A targeted financial restructuring

More generally, the Cayman Islands scheme of arrangement process can facilitate an efficient financial restructuring that may, for example, restructure the liabilities of only certain companies within the group without the need to place the entire group into an insolvency or restructuring process.

Such an approach can have significant cost and timing advantages. Notably, an indicative scheme of arrangement timetable for the Court process may take between six to eight weeks and involve at least two Court hearings (although contested schemes of arrangement can take substantially longer). The Cayman Court has also proven to be accommodating in assigning the same judge to proceedings throughout the process and scheduling hearings at appropriate times and has also produced a comprehensive written judgment in short order following the sanction hearing.

Whilst there will be occasions where a larger insolvency or restructuring process is called for, in many circumstances where a targeted financial restructuring is all that is necessary, the Cayman Islands scheme of arrangement process can deliver an effective solution, including where the debt is governed by New York law and where the relevant debtors are Cayman Islands companies or other offshore companies that can be "COMI-shifted" to be brought within the Cayman Court's jurisdiction.

2 Recent examples include the schemes of arrangement of Mongolian Mining Corporation (recognition and enforcement in the Southern District of New York), LDK Solar (recognition and enforcement in Delaware) and Suntech Power Holdings (recognition and enforcement in the Southern District of New York).

Contacts

Walkers can assist with all aspects of the Cayman Islands scheme of arrangement process and with Cayman Islands restructuring mandates more generally. Notable examples of Walkers' recent restructuring mandates include the Mongolian Mining Corporation, LDK Solar and Ocean Rig schemes of arrangement and the CHC Helicopter group restructuring.

For further information please contact:

Neil Lupton
Partner, Cayman Islands
T: +1 345 914 4286
E: neil.lupton@walkersglobal.com

Barnaby Gowrie
Partner, Cayman Islands
T: +1 345 914 6365
E: barnaby.gowrie@walkersglobal.com

Fiona MacAdam
Senior Counsel, Cayman Islands
T: +1 345 914 4273
E: fiona.macadam@walkersglobal.com

Gordon Davidson
Associate, Cayman Islands
T: +1 345 814 4685
E: gordon.davidson@walkersglobal.com

Jason Taylor
Associate, Cayman Islands
T: +1 345 914 4290
E: jason.taylor@walkersglobal.com

John O'Driscoll
Partner, London
T: +44 (0)20 7220 4987
E: john.o'driscoll@walkersglobal.com

Fraser Hern
Partner, Singapore
T: +65 6603 1692
E: fraser.hern@walkersglobal.com

Click here for our global Insolvency and Dispute Resolution contacts.