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ARTICLE

The Cayman Restructuring Toolkit: Exploring the Flexible Restructuring Options on Offer in the Cayman Islands

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Synopsis

The Cayman Islands provisional liquidation regime has proven to be an extremely useful and flexible tool to assist with complex financial restructurings. In circumstances where a Cayman Islands company is insolvent or potentially insolvent, its board of directors must have regard to creditors' interests as a whole when discharging their fiduciary duties and ideally be engaging with the company's creditors in order to try and agree upon a consensual restructuring solution. However, such a consensual out-of-court process would typically require unanimous support (or acquiescence) from all of the company's creditors and therefore the company's board of directors may wish to consider alternative options to mitigate the risk that a disgruntled creditor may seek to disrupt any restructuring process by commencing proceedings against the company. This article focuses on the provisional liquidation regime in the Cayman Islands and how it can be a useful tool for companies who are facing an imminent debt crisis.

Provisional liquidation in the Cayman Islands – traditional v 'soft touch'

The traditional purpose of the appointment of provisional liquidators is to preserve and protect a company's assets pending the hearing of a winding up petition in respect of the company where there is evidence of potential dissipation or misuse of assets. In such circumstances, a creditor can make an application to the Grand Court of the Cayman Islands (the 'Grand Court') seeking the appointment of provisional liquidators to a company pursuant to section 104(2) of the Companies Law (2018 Revision) (the 'Companies Law').

However, the Cayman Islands provisional liquidation regime offers an alternative route to appointing provisional liquidators in circumstances where a Cayman Islands company intends to implement a financial restructuring. Pursuant to section 104(3) of the Companies Law, provisional liquidators can be appointed on a 'soft-touch' basis in order to protect the company from creditor enforcement action or proceedings being commenced or continued without the leave of the Court. The moratorium that is triggered on the appointment of provisional liquidators provides breathing space for a company to negotiate with its stakeholders and propose and implement a restructuring without the risk of the process being derailed by the actions of one or more dissenting creditors. Notably, however, such moratorium does not extend to restrict the rights of secured creditors who may enforce their security notwithstanding the appointment of provisional liquidators. Accordingly, standstill agreements with secured creditors or seeking supporting relief in other relevant jurisdictions (such as Chapter 15 in the United States) may still be necessary.

Pursuant to section 104(3) of the Companies Law, following the presentation of a winding up petition, a company may at the same time make an application seeking the appointment of provisional liquidators where (a) the company is or is likely to become unable to pay its debts; and (b) the company intends to present a compromise or arrangement to its creditors. There is no statutory definition of the terms 'compromise' or 'arrangement' in the Companies Law. The Grand Court typically construes these terms broadly but they must involve some element of 'give and take' on both sides.[1] In practice, this can include a Cayman Islands scheme of arrangement, a Chapter 11 plan or restructuring, or a foreign scheme of arrangement

Provisional liquidation is available to any company liable to be wound up under the Companies Law following the presentation of a winding up petition against the company. Any creditor, shareholder, the company itself or (in respect of regulated businesses) the Cayman Islands Monetary Authority can apply for the appointment of provisional liquidators between the presentation and the hearing of the winding up petition. However, an application seeking the appointment of 'soft touch' provisional liquidators on restructuring grounds pursuant to section 104(3) of the Companies Law (that is, where a company is or is likely to become

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1 *Re XL Capital Ltd* (unreported, Smellie CJ, Cause No. FSD 66 of 2010) (5 March 2010).

unable to pay its debts and the company intends to present a compromise or arrangement to its creditors) may only be made by the company itself (if properly authorised). Accordingly, as it stands a creditor can only make an application seeking the appointment of provisional liquidators where there is a genuine need to safeguard the assets of the company pending the hearing of a winding up petition and there are no provisions in the Companies Law which allow creditors to apply for the appointment of 'soft touch' provisional liquidators.

Whilst the presentation of a winding up petition is a necessary prerequisite to access the Cayman Islands provisional liquidation regime, 'soft touch' provisional liquidation does not necessarily result in the formal winding up of the debtor company. Rather, where a 'soft touch' provisional liquidation is used to support a successful financial restructuring where the debtor company survives, the end result is usually that the winding up petition is dismissed and the newly restructured company continues as a going concern. Provisional liquidation when used in a restructuring context in the Cayman Islands is therefore somewhat of a misnomer since the object of the proceedings is to typically rescue the company as a going concern rather than to liquidate and dissolve the company.

Provisional liquidators are officers of the Grand Court and agents of the company to which they owe fiduciary duties to act in good faith and in the interests of the company as a whole. However, the powers of the provisional liquidators are not circumscribed by statute and instead are expressly set out in the court order appointing them. Accordingly, there is scope for the provisional liquidation regime to be used with real flexibility in the context of a restructuring depending upon how much control over the process the provisional liquidators are intended to have.

In a 'soft touch' provisional liquidation, the provisional liquidators would typically work alongside the existing directors to develop and propose a restructuring without completely displacing the directors' powers. Ultimately, the order appointing the provisional liquidators will clearly set out which powers the provisional liquidators are able to exercise (often limited to oversight of the progress of the restructuring and reporting to the Grand Court and the company's creditors) and which powers will be retained by the directors.

Typically the Grand Court has been flexible in allowing sufficient time for the provisional liquidators to consider whether a restructuring is capable of being agreed and implemented in the circumstances. However, if it is evident to the Grand Court that there is no realistic prospect for a successful restructuring to be implemented and for the company to continue as a going concern, it is likely that the winding up petition will be listed and an order made for the appointment of official liquidators to the company.

Recent restructurings in the Cayman Islands

The Cayman Islands has recently seen a number of large cross-border restructurings in the Grand Court where companies have benefited from the flexibility of the 'soft touch' provisional liquidation regime. In June 2018, the Grand Court appointed 'soft touch' provisional liquidators to Abraaj Holding ('Abraaj'), the largest private equity fund in the Middle East, and its wholly owned subsidiary, Abraaj Investment Management Limited ('AIML'), both of which are Cayman Islands companies.[2]

One of Abraaj's creditors, The Public Institution for Social Security in Kuwait ('PIFSS'), presented a winding up petition in the Grand Court on 25 May 2018 on the grounds that Abraaj had failed to pay an undisputed debt and was therefore unable to pay its debts as they fell due. A week later, another creditor of Abraaj, Auctus Fund Ltd ('Auctus'), filed an application pursuant to section 104(2) of the Companies Law for the appointment of provisional liquidators to Abraaj and AIML on the grounds that the companies were being mismanaged by the incumbent management team and the appointment of provisional liquidators was necessary to avoid further mismanagement and the potential dissipation of assets. Auctus also presented a winding up petition in relation to AIML. In response to the applications filed by PIFFS and Auctus, Abraaj and AIML respectively filed applications with the Grand Court for the appointment of 'soft touch' provisional liquidators which were supported by a number of Abraaj and AIML's secured creditors.

In reaching its decision to appoint 'soft touch' provisional liquidators to Abraaj and AIML, the Grand Court noted that an application for the appointment of 'soft touch' provisional liquidators is only available to the company and cannot be made by a creditor under Cayman Islands law. In the circumstances, the Grand Court noted that Auctus' applications for the appointment of provisional liquidators to Abraaj and AIML, although alleging mismanagement of both companies, had accepted that provisional liquidators needed to be appointed with a mandate to promote a restructuring of Abraaj and AIML.

Whilst the Companies Law is clear on who may present a winding up petition and/or make an application for provisional liquidators to be appointed, the Grand Court has grappled on numerous occasions with the issue of whether or not the directors of a company are authorised to present a winding up petition in circumstances where they are not duly authorised by the

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2 *Abraaj Holdings*, (unreported, McMillan J, Cause No. FSD 95 of 2018) (June 2018).

company's shareholders. Such issue stems from what is known as the *Emmadart* principle, which originates from the English case of *Re Emmadart Ltd.*[3] The effect of *Emmadart* was that the directors may only present a winding up petition in the name of the company if such action is authorised or ratified by the company's shareholders at a general meeting. The *Emmadart* principle has been upheld as applicable in the Cayman Islands, most recently in *Re China Shanshui Cement Group Limited*[4] where Mangatal J held that a winding up petition presented by the company's directors was not valid on account of the directors not having been authorised by the shareholders to present the winding up petition. Accordingly, the Grand Court was bound to conclude that the directors' application to also appoint provisional liquidators must also fail given that the prerequisite winding up petition had not been validly presented.

That requirement for shareholder authorisation is also reflected in the Companies Law which provides that where the company's articles of association (if the company was incorporated post 1 March 2009) authorise the directors to do so, the directors may present a winding up petition without the sanction of a resolution of the shareholders passed at a general meeting. However, an issue arises in circumstances where the company was either incorporated prior to 1 March 2009 or the articles of association do not, in any event, authorise the directors to present a petition without shareholder authorisation. In a restructuring context, this could be fatal since extracting the necessary authorisation from shareholders who are economically disenfranchised may not be possible. Additionally, where the debtor is listed, extracting the necessary consent from a dispersed group of shareholders may be practically impossible or at least logistically challenging. As such, concern existed that if a company's directors were unable to present the necessary winding up petition in the name of the company due to a lack of shareholder authorisation, the company could not seek the appointment of 'soft touch' provisional liquidators in order to implement a restructuring. That concern has however been abated following the successful Cayman Islands restructuring of *CHC Group Ltd*[5] ('CHC'), the world's largest commercial helicopter services provider, where the Grand Court determined that in certain circumstances, directors of a company can make an application for the appointment of 'soft touch' provisional liquidators without the need for a shareholders' resolution or authorisation in the company's articles of association. The CHC restructuring was primarily achieved by way of a Chapter 11 proceeding in the United States Bankruptcy Court for the Northern District of Texas filed by CHC and certain of its subsidiaries.

The CHC restructuring however envisaged a transfer of CHC's assets to a new Cayman Islands limited liability company which would become the parent company of the restructured group. The method of implementing that transfer involved an asset sale to be completed within the framework of a Cayman Islands provisional liquidation proceeding which required validation by the Grand Court. However, CHC's articles of association did not authorise the directors of CHC to present a winding up petition without shareholder authorisation.

The solution was for an intra-group creditor to petition for the winding up of CHC, thereby opening the gateway for the company itself to apply for the appointment of 'soft touch' provisional liquidators. This caused the Grand Court to consider whether an application to appoint provisional liquidators required shareholder authorisation. The Grand Court found that shareholder authorisation was not required and that the decision in *China Shanshui* had '…no bearing on the situation where there is a separate creditor winding up petition in existence and where in those limited circumstances there [is] an application by the company, through its directors, for the appointment of [joint provisional liquidators]'. The CHC decision is the first time that the Grand Court has provided a judgment confirming the validity of this work around.

Cayman Islands schemes of arrangement

There have been a number of recent high-profile cross-border restructurings in the Cayman Islands, such as *Ocean Rig UDW Inc.*[6] and *Mongolian Mining Corporation*,[7] where the scheme of arrangement process and 'soft touch' provisional liquidation regime were successfully used together to implement their respective debt restructurings. The sophisticated restructuring toolkit on offer has ensured that the Cayman Islands remains at the forefront as one of the premier jurisdictions of choice to implement complex cross-border restructurings.

A Cayman Islands scheme of arrangement is a court approved compromise or arrangement between a company and its creditors or shareholders. A scheme of arrangement is frequently used to implement a restructuring of a company's financial liabilities by varying or

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3 *Re Emmadart Ltd* [1979] Ch 540.
4 *Re China Shanshui Cement Group Limited* [2015] (2) CILR 255.
5 *In the matter of CHC Group Ltd* (unreported, McMillan J, Cause No. FSD 5 of 2017) (24 January 2017).
6 *Ocean Rig UDW Inc., (in provisional liquidation) and others* (unreported, Parker J, Cause Nos. FSD 100, 101, 102 and 103 of 2017) (18 September 2017).
7 *Mongolian Mining Corporation* (unreported, McMillan J, Cause Nos. FSD 99 of 2016) (7 July 2016).

cramming in the rights of the relevant creditors and/or shareholders of a company but may also be used to complete corporate transactions such as a group restructuring or reorganisation, acquisitions, mergers and take-private transactions. Accordingly, a scheme is not a formal insolvency process as such and the directors would remain in control of the company whilst formulating the terms of and promoting a scheme outside of a liquidation. It is however usual for a restructuring that is implemented by way of a Cayman Islands scheme of arrangement to be conducted within the framework of a 'soft touch' provisional liquidation so as to take advantage of the automatic stay on creditors' claims whilst the restructuring is ongoing.

A scheme requires the approval of each class of affected stakeholder that is, at least a majority in number representing 75 per cent in value of those actually voting need to vote in favour of the terms of the proposed scheme at the court convened scheme meeting(s). Once the proposed scheme of arrangement has been approved by the relevant stakeholders and sanctioned by the Grand Court, all affected stakeholders will be bound by the terms of the scheme (including any dissenting stakeholders and/or any stakeholders that have not voted).

Proposed reform

It is proposed that a new court supervised restructuring moratorium regime will be in force in the Cayman Islands in the near future. The process would allow a company to petition for the appointment of restructuring officers to obtain a stand-alone restructuring moratorium (separate from the winding up regime) thereby offering companies with more avenues by which to benefit from an automatic stay on claims. In the meantime, 'soft touch' provisional liquidation is an extremely helpful tool for any Cayman Islands company that is considering its options in the face of a possible default, and provides a formal Court led process, and statutory protection, in order to effectively restructure its debt and continue as a going concern.

International Corporate Rescue

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

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