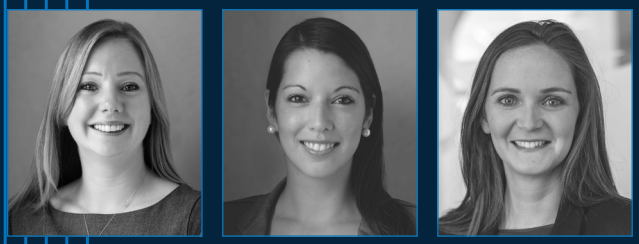
NEW RESTRUCTURING OFFICER REGIME TO BE INTRODUCED INTO THE CAYMAN ISLANDS



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Introduction

The Cayman Islands continues to be at the forefront of developments in restructuring and insolvency law in the offshore world and one of the premier jurisdictions of choice to facilitate complex and high-value cross-border restructurings.

The much-anticipated reforms to the insolvency legislation in the Cayman Islands are now expected to come into force during the course of 2022 and will provide practitioners and their clients with an alternative restructuring tool. The amendments to Part V of the Cayman Islands Companies Act (the "Companies Act") will introduce a new restructuring officer regime available to companies in financial distress, which can be accessed without the need to present a winding up petition to the Grand Court of the Cayman Islands ("Cayman Court").

Upon filing the application seeking the appointment of restructuring officers, an automatic and standalone restructuring moratorium will immediately arise which will have extraterritorial effect, similar to a Chapter 11 stay or English administration moratorium, within which a restructuring may be proposed and implemented (by way of a Cayman Islands scheme of arrangement, a restructuring process in a foreign jurisdiction or consensually, as between affected stakeholders).

Reforms to the restructuring regime

The key amendments include:

- Companies may present a petition to the Cayman Court for the appointment of a restructuring officer on the grounds that the company:
  a. is or is likely to become unable to pay its debts; and
  b. intends to present a compromise or arrangement to its creditors (or classes thereof) either, pursuant to the Companies Act, foreign law or by way of a consensual restructuring.
- The petition seeking the appointment of a restructuring officer may be presented by the directors of a company: (i) without a shareholder resolution and/or an express power to present a petition in its articles of association; and (ii) without the need to file a winding up petition as a prerequisite (addressing the issues raised by the *Emmadart* principle – see further below).
- The standalone restructuring moratorium will automatically arise on filing the application seeking the appointment of restructuring officers such that no suit, action or other proceedings, whether domestic or foreign, shall be proceeded with or commenced against the company and no resolution can be passed for the company to be wound up, except with leave of the Cayman Court (previously a moratorium would only be triggered upon the appointment of provisional or official liquidators).
- The restructuring moratorium will have exterritorial effect, as a matter of Cayman Islands law.
- Cayman Islands schemes of arrangement will be able – as a matter of Cayman Islands law – to compromise English law-governed debt (potentially, therefore, enabling the 'Rule in *Gibbs*' applicable under English common law to be overcome (see further below)), thereby expanding the scope of the applicability of the Cayman Islands restructuring regime to more debt restructuring situations.
- For shareholder schemes of arrangement, the "headcount test"' will be removed such that only the "majority in value" test is required to be satisfied to approve a proposed shareholder scheme of arrangement at the relevant meeting(s).
- Secured creditors with security over the whole or part of the assets of the company will remain entitled to enforce their security without the leave of the Court and without reference to any restructuring officer.

Background to the reforms

The current position in the Cayman Islands is that debtors seeking the protection of a moratorium from unsecured creditor action in order to have the benefit of "breathing space" whilst a restructuring is negotiated and/or

implemented must present a winding up petition and then subsequently seek the appointment of provisional liquidators in order to secure a stay for that purpose. Whilst this restructuring mechanism is well-established, the appointment of provisional liquidators can create negative public perception issues owing to the stigma of insolvency and liquidation attached to the necessary statutory filing of a winding up petition to obtain such moratorium. As matters stand, this may result in the potential diminution in value of the company or its assets, trigger insolvency clauses in contracts and/or cause reputational damage.

Additionally, access to the provisional liquidation regime has proven difficult for certain companies as a result of the decision in *China Shanshui*.[1] Under the Companies Act, a winding up petition may be presented by the company, any creditor, any contributory, or the Cayman Islands Monetary Authority in certain circumstances.[2] However, an application seeking the appointment of provisional liquidators on restructuring grounds (i.e. where 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) may only be made by the company itself. Whilst the Companies Act is clear on who may present a winding up petition and/or make an application for provisional liquidators to be appointed, the Cayman Court has wrestled on a number of 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 company's shareholders.

This issue stems from the English case of *Re Emmadart Ltd* [1979] Ch 540. It was held that, on the basis of Section 224(1) of the English Companies Act 1948 (which is similar to Section 94(1) of the Companies Act, being the equivalent provision under Cayman Islands law) it was not permissible for directors to present a winding up petition in the name of the company without either a shareholders' resolution or the power to present such a petition being conferred in the company's articles of association. The decision in *Emmadart* was applied by the Cayman Court in *Banco Economico SA v Allied Leasing and Finance Corporation*,[3] which concerned a directors' application to discharge provisional liquidators and which was dismissed by the Cayman Court on the basis that the directors lacked the requisite standing (applying *Emmadart* by analogy).

The position under Cayman Islands law was later "muddied" by the decision of Jones J in *China Milk*,[4] in which it was held that directors of an insolvent company were entitled to present a winding up petition in the name of the company without reference to its shareholders and irrespective of the terms of the articles of association. Jones J concluded that the reform of the Companies Act in 2007 must have been intended to allow the directors to present a winding up petition on behalf of an insolvent company (and drew a distinction with the position in respect of solvent companies), notwithstanding that the Companies Act contains no such express limitation.

However, in *China Shanshui*, Mangatal J declined to follow the earlier decision in *China Milk* and held that a Cayman Islands company was unable to access the Cayman Islands provisional liquidation regime on the basis that a winding up petition presented by the directors of the company was not valid as the directors were not authorised by the shareholders to present the petition and no power was contained in the company's articles of association (regardless of whether the company was solvent or insolvent). Accordingly, the Cayman Court was also bound to conclude that the director's application to appoint provisional liquidators on restructuring grounds must also fail given that the prerequisite winding up petition had not been validly presented.

China Shanshui endorsed the English Court's approach in *Emmadart*,[5] restoring (and clarifying) what was generally understood to have been the position under Cayman Islands law. In *China Shanshui,* Mangatal J held that Cayman Islands legislature, having had the opportunity to address the position as set out in *Emmadart* and *Banco Economico*, refused to do so and, further, that the inclusion of Section 94(2) in the Companies Act provided "statutory confirmation" of the position as set out in *Emmadart*.

In a restructuring scenario, the lack of relevant authorisation in the articles of association may be fatal for the company since obtaining the necessary resolution from shareholders who are economically enfranchised may simply not be possible. The result of this is that there is often a need to find a "friendly" creditor to file a winding up petition[6] in order to open up the gateway for the company to apply for the appointment of provisional liquidator but this may be difficult to achieve in a timely manner (or at all).

The proposed reforms to the Companies Act seek to address these issues.

Key amendments to the restructuring Officer Regime

Appointment of a restructuring officer

Mirroring the circumstances in which a provisional liquidator could previously be appointed, Section 91B of the Companies Act provides that a company may present a petition to the Cayman Court for the appointment of a restructuring officer on the grounds that the company:

a. is or is likely to become unable to pay its debts; and

b. intends to present a compromise or arrangement to its creditors (or classes thereof) either, pursuant to the Cayman Islands Companies Act or a foreign law or by way of a consensual restructuring.

However, unlike provisional liquidation (as to which, see

1 *In the matter of China Shanshui Cement Group Limited (unreported, Grand Court, 25 November 2015, Mangatal J, FSD 178 of 2015).*
2 Section 94(2) of the Companies Act.
3 [1998] CILR 102.
4 *Re China Milk Products Group Ltd* [2011] (2) CILR 61.
5 *Re Emmadart Ltd* [1979] 1 Ch 540.
6 *In the matter of CHC Group Ltd (Grand Court, unreported, January 24, 2017).*

above), a petition for the appointment of a restructuring officer may be presented by a company acting by its directors without a resolution of its members and/or an express power to present such a petition in its articles of association. This ensures that the company has recourse to the restructuring officer regime in appropriate circumstances in a timely manner, without the need to involve a 'friendly' creditor.

Section 91C of the Companies Act also provides for the company to apply *ex parte* for the appointment of an interim restructuring officer pending the hearing of the company's petition to appoint a restructuring officer, *"where it is in the interest of the company to do so".*

The powers and functions of the restructuring officer will be determined by the Cayman Court in the order pursuant to which they are appointed.

Intention to present a compromise or arrangement to creditors

The meaning of "compromise" or "arrangement" has been interpreted broadly by the Cayman Court, such as to cover almost every type of legal transaction, provided that it involves an element of "give and take", and may include, but is not limited to, a scheme of arrangement or other proceeding under foreign law.[7]

In the context of an application for the appointment of provisional liquidators, it is well-established that, in order to evidence a company's intention to present a compromise or arrangement to its creditors, there is no requirement on the company to already have a pre-formulated plan and the Cayman Court has demonstrated its willingness to appoint provisional liquidators to explore the viability of a restructuring.

However, in determining whether to exercise its discretion, the Cayman Court will also have regard to whether there is a 'real prospect' of the restructuring (e.g. by way of refinancing and/or sale as a going concern) being effected for the benefit of the general body of creditors. Accordingly, there is an inherent tension between the Cayman Court's wish to evaluate the proposed restructuring's prospects of success, and the fact that at the time of the application for the appointment of provisional liquidators, the company needs only an intention to present a compromise or arrangement to its creditors.

In the matter of Midway Resources International,[8] Segal J provided further guidance on the principles governing the exercise of the Cayman Court's discretion – noting that that the rationale underpinning the fact that no pre-formulated restructuring plan is required, is to provide companies with "breathing space" before the actions of creditors might interfere with attempts to reach a consensual restructuring or if that should prove not to be possible, a scheme of arrangement and where an application to appoint provisional liquidators is made some time after the company has entered into financial difficulty, and restructuring proposals are necessarily more advanced, the Cayman Court will want to be satisfied that there is a "real prospect of" those proposals being put to creditors and being approved.

In *Midway Resources*, in determining whether it was appropriate to appoint provisional liquidators to effect a restructuring, Segal J considered the following factors: (i) the level of information in respect of the proposed restructuring presented to the Cayman Court; (ii) the status of discussions with any interested parties; (iii) the process by, and the timetable within, which the restructuring would be considered by creditors and, if approved, implemented; (iv) the level of creditor support; and (v) how the provisional liquidators would be funded and whether they could perform a useful role. That level of information will not be required to satisfy the Cayman Court that it should exercise its discretion in each and every case; rather, each case will turn on its own particular facts.

We expect such case law to be instructive in respect of the interpretation of the statutory requirement of a company's intention to present a compromise or arrangement to creditors in the context of the appointment of restructuring officers.

Automatic moratorium

Upon the presentation of a petition for the appointment of a restructuring officer, a moratorium on unsecured creditor actions shall apply such that no suit, action or other proceeding may be commenced or proceeded with against the company, and no resolution to wind up the company or petition to wind up the company may be presented, except with the leave of the Cayman Court. Notably, secured creditors will still be able to pursue enforcement actions. The moratorium is purported to have automatic extraterritorial effect and will apply to any suit, action or proceeding in a foreign country (subject to recognition of the order appointing the restructuring officer / regime, and the moratorium thereunder, as a matter of applicable foreign law).

The availability of a moratorium on creditor action in respect of a scheme of arrangement promoted by a restructuring officer marks a material difference from the corporate scheme of arrangement process (in respect of which no moratorium will apply) and may serve to provide the company with time to properly develop its restructuring proposal to put forward to creditors.

Recognition of restructuring officer scheme of arrangement

Although untested, a further advantage of the scheme of arrangement promoted by a restructuring officer is that it may be capable of compromising English law-governed debt, which is currently not possible as a result of the so-called Rule in *Gibbs*.

It is expected that the Cayman Islands scheme of arrangement promoted by a restructuring officer would be considered by the English courts to be analogous to an insolvency proceeding under the UK Insolvency Act 1986

7 See for example, *Re NFU Development Trust Ltd* [1972] 1 WLR 1548 and *Re XL Capital Ltd* [2010 (1) CILR 52]

8 (Cause No. FSD 51 of 2021 (NSJ), Unreported, 30 March 2021)

and/or a compromise under English insolvency law. If this is in fact the case, such a scheme may be capable of being recognised and enforced pursuant to Section 426 of the UK Insolvency Act, which would have the effect of overriding the application of the Rule in *Gibbs*.

Conclusion

The introduction of the new restructuring officer regime and the other amendments to the Companies Act have been met with strong support from restructuring and insolvency practitioners given that they address certain of the challenging issues previously experienced by practitioners with the restructuring provisional liquidation regime.

The new restructuring regime is progressive, reflecting a similar approach to that adopted in other jurisdictions, and will facilitate effective cross-border restructurings in the best interests of stakeholders in a way that will be recognised and understood by courts and restructuring professionals around the world.

We expect that introduction of the restructuring officer regime will result in an increased number of companies in financial distress electing to pursue a restructuring of their financial liabilities through the restructuring officer regime in the Cayman Islands, rather than via provisional liquidation. The coming months will allow us to see the Cayman Courts' approach to the new regime and the judicial development of the relevant principles arising from it.