Client Memorandum

Going Private: Shareholder Schemes of Arrangement in the Cayman Islands

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The Cayman Islands Grand Court has seen an increase in applications for the approval of shareholder schemes of arrangements as a mechanism to take a Cayman company private. This advisory sets out the law on Schemes and looks ahead to the changes that will be brought in by the Companies (Amendment) Act, 2021 to make the process more straight forward.

The party that plans to take the Company private, which is normally already a substantial or majority shareholder (or consortium of shareholders and management), presents an offer to the Company and other shareholders (the "Scheme Shareholders") whereby the Scheme Shareholders have their shares either cancelled or transferred in return for cash, normally at a premium to the trading price of the Company's shares. The Scheme Document that is prepared is voluminous and detailed and includes information such as the timetable, board approval and confirmations, and advice from independent financial advisers as to the nature and benefits of the proposed scheme.

Stage 1 – Directions on Scheme

Once the proposed scheme is put together, the Company issues a Petition and has to obtain Court approval to put the scheme to its shareholders at a general meeting (the "First Hearing"). At the First Hearing, the Company must show that the appropriate classes of shareholders are being given sufficient material for them to make an informed decision about the merits of the proposed scheme.

The Petition is presented under s.86(1) of the Companies Act, which provides as follows:

"Where a compromise or arrangement is proposed between a company and its creditors or any class of them, or between the company and its members or any class of them, the Court may, on the application of the company or of any creditor or member of the company, or where a company is being wound up, of the liquidator, order a meeting of the creditors or class of creditors, or of the members of the company or class of members, as the case may be, to be summoned in such manner as the Court directs."

Arrangement has been construed by the Courts as a word of very wide import, and effectively covers most types of legal transaction. Practice Direction No. 2 of 2010 relating to Schemes of Arrangement sets out the matters to be determined at the directions hearing[1], and there is a four stage test to be applied:

(a) The Arrangement Issue: Is the Scheme an arrangement?

(b) The Classes Issue: Do the Ordinary shareholders comprise the relevant class of shareholder affected by the Scheme?

(c) The Scheme Documents Issue: Do the Scheme Documents satisfy Order 102, r.20 of the Grand Court Rules (which contains specific requirements in relation to the documents to be filed in support of an application under section 86 of the Companies Act).

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[1] These have also been neatly summarized by Justice Segal in *In the matter of Uni-Asia Holdings Limited – FSD 34 of 2017 (Unreported, 16 May 2017)*

(d) The Scheme Process Issue: is the Court satisfied with the manner in which the Petitioner proposes to seek the approval of the Scheme Shareholders including the reasonableness and appropriateness of the timetable for the Scheme set out in the Scheme Circular; the dispatch of the Scheme Documents; the time, date and place of the Court Meeting; the chairperson of the Court Meeting; and whether there should be advertisement of the notice of the Court Meeting?

Stage 2 – General Meeting

Following the First Hearing, the Court will (if approved) give directions as to the progress of the Scheme, including when notice of the general meeting must be sent out, the forms of proxies for shareholders to complete, and the date and time of the shareholder meeting around advertisement requirements.

At the general meeting, the shareholders (or each affected class thereof) must approve the proposed scheme on two levels – by at least 75% of the votes, and by a simple majority in number. The latter 'Headcount test' is an issue that Court has had to grapple with in a number of cases involving Hong Kong listed companies where a number of shareholders have their shares held through HKSCC Nominees Limited (known as the CCASS Participants). In some proposed schemes, the CCASS Participants have only been permitted to have one vote in favour and one vote against the scheme, regardless of the number of underlying shareholders who supported or opposed the scheme. The Courts have therefore in appropriate cases[2] allowed the CCASS Participants to have multiple votes for the headcount test in order to avoid the potential for a small number of scheme shareholders to be able to push through a scheme based upon their votes reaching the 75% threshold, even if a larger number of minority scheme shareholders were opposed to the scheme. Limiting the number of votes in the headcount test had the potential to therefore prejudice minority shareholders, and there was the possibility of abuse of process if the CCASS votes were limited to one in favour and one against.

The Court has also demonstrated its flexibility in limiting the CCASS Participants' votes where the potential for any abuse or prejudice can be limited, and where it is not commercially feasible to impose the headcount test[3].

In *Re PFC Limited (FSD 357 of 2021, unreported)*[4], Justice Doyle distinguished the principles from *Little Sheep* and allowed the proposed scheme to proceed with the CCASS Participants only having one vote for and one vote against for the purposes of the headcount test. As part of his decision, Justice Doyle noted that the headcount test is going to be shortly abolished in Cayman in any event through the changes to be implemented by the Companies (Amendment) Act, 2021 which will come into force later this year (and which has been gazetted but is simply awaiting a commencement order). This will bring Cayman in line with other jurisdictions such as Hong Kong and England & Wales where the headcount test was abolished some time ago. Under the amended Act, only creditor schemes will be subject to the headcount test, and member schemes will only require 75% in value of the members or class of members as the case may be.

Stage 3 – Sanction of Scheme

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[2] *In Re Little Sheep 2012 (1) CILR 34*

[3] *In the matter of Alibaba.com Limited, FSD 38 of 2012 (judgments of Hon Sir Peter Cresswell dated 1 May 2012 and 1 June 2012)*

[4] Bhavesh Patel of Travers Thorp Alberga successfully appeared on behalf of PFC in this matter to obtain the Court's sanction for both the Scheme and a Capital Reduction, and Justice Doyle was particular to note the assistance to the Court provided by TTA's written and oral submissions for both this and future Schemes of Arrangement.

Presuming that the statutory majorities are attained at the general meeting pursuant to s.86(2) of the Companies Act, the Scheme progresses to an application for Sanction by the Court (the "Sanction Hearing"). Shareholders who voted at the general meeting are entitled to attending the Sanction Hearing and can raise objections to the Scheme.

Normally, as long as the relevant procedure has been followed and statutory criteria has been met, the Court will approve the Scheme on the basis that the stakeholders best understand their own commercial interests. As was noted by Smellie CJ in Re the Sphinx Group of Companies [2014 (2) CILR 152]:

"At the third stage of the process, it is apparent that the role of the court is a limited one. Although it is often referred to as the stage at which the court will consider issues relating to the "fairness" of the proposed scheme, the task of the court at the sanction stage is not to pass its own subjective judgment on the merits of a scheme. The court takes the view that in commercial matters, members or creditors are much better judges of their own interests than the court."

The Honourable CJ identified three elements that the Court addresses in sanctioning a scheme:

1. The compliance issue: have the provisions of statute been complied with?
2. The voting issue: was the class fairly represented and were the statutory majorities obtained by members acting bona fide?
3. The fairness issue: is the arrangement once that an intelligent and honest man might reasonable approve?

Once a scheme has been approved by the Court and the appropriate order filed with the Company Registrar, it is effective and binding against all the creditors and shareholders of the Company, even those who may have voted against it.

Whilst a company can consider mergers and tender offers as alternative ways to effect a privatisation, Schemes of Arrangement have been increasingly popular, particularly for entities listed in Hong Kong. The Cayman Courts flexible approach to assist companies in executing a scheme, and the ability to ensure that all creditors and shareholders are bound by it, gives more certainty to those looking to take control and privatise companies. The changes to the Companies Act (once implemented) will make this process easier still and should result in more member schemes of arrangement being presented to the Cayman Courts in the near future.