

Client Memorandum

Cayman Islands implements new Restructuring Regime

The Companies (Amendment) Act 2021 (the “**Amendment**”) introduces, with effect from 31 August 2022, a welcome update to the Cayman Islands restructuring regime as is contained in Part V of the Cayman Islands Companies Act (2022 Revision) (the “**Act**”). The amendment introduces the concept of a Company Restructuring Officer (“**CRO**”), whose mandate is to oversee and implement a restructuring of the company’s debts under the supervision of the Grand Court of the Cayman Islands (the “**Court**”). The Amendment significantly changes the law in relation to debt restructuring in the Cayman Islands by separating it (as far as possible) from the formal insolvency process. The changes apply to exempted companies, exempted limited partnerships and any other company, association or partnership that is liable to be wound up under the provisions of Part V of the Act.

The Old Regime – Light Touch Provisional Liquidations

The CRO regime largely replaces the previous system for a debt restructuring which relied on provisional liquidators (“**PLs**”) appointed on a “light touch” basis under S.104(3) of the Act. That system allowed a company that intended to pursue a debt restructuring, which needed “breathing space” from hostile creditors, to be placed into provisional liquidation with its PLs mandated to work in conjunction with the company’s directors to implement a restructuring of the company’s liabilities. This required a fiction; the presentation of a winding up petition against the company by a ‘friendly’ creditor, and then an *ex parte* application by the company to the Court for the appointment of PLs. That system had a number of flaws, in particular:

1. The process required a ‘friendly’ creditor to present a creditor’s winding up petition because of the rule in Re Emmadart¹ whereby directors cannot present a petition to wind up their company unless that power is expressly given to them by the members of the company, either in the company’s articles or via a members’ resolution. Where no such power existed, and could not be given in time, the company needed to rely on a friendly creditor.
2. Placing the company into provisional liquidation was seen as potentially damaging to the company’s reputation and could trigger a number of unwanted effects such as contractual events of default or change of control provisions (although, as discussed further below, depending on the terms of the company’s contractual arrangements, this risk may still exist under the new CRO regime).
3. The ‘breathing space’ that the company needed to implement the restructuring (i.e. the automatic stay on all legal proceedings against the company) would only arise upon the appointment of PLs, and the company was therefore vulnerable to creditor action during the

¹ [1979] Ch 540, confirmed in confirmed in China Shanshui Cement Group Limited, unreported, Grand Court, 25 November 2015, Mangatal J, FSD 178 of 2015

time between the presentation of the winding up petition and the time the winding up order was made.

Time for change – the new CRO Regime

The CRO Regime has addressed these shortcomings. There are still challenges associated with the new CRO regime, which will be topic for a further article. However, the following features of the Amendments, and their impact on the Act, are welcome:

1. A new section 91B(2) of the Act expressly permits the company to present a CRO petition without a resolution of its members or an express power in its articles of association. This brings the CRO regime outside of the scope of the rule in Re Emmadart and gives companies more flexibility to be able to take advantage of the CRO regime. Similarly, the rule in Re Emmadart has been watered down by an amendment to S.94 of the Act which provides that the directors of a company incorporated after 31 August 2022 may petition the Court to wind up the company on the grounds that it is unable to pay its debts, or where a winding up petition has been presented to apply for the appointment of PLs (i.e. these steps can be taken by the directors without a resolution of the company's members or a provision in the articles giving them the power to do so).
2. In contrast with the old provisional liquidation regime, there is no need for a winding up petition to be presented against the company in order to appoint a CRO. This highlights distinction between restructuring and liquidation in the and should make using the process much more appealing to companies. There is far less stigma and potential commercial risk of entering into a formal restructuring process than a liquidation. Companies will, however, need to be mindful that even a restructuring (as opposed to a liquidation), particularly a restructuring which involves the formal appointment of a CRO, may itself carry commercial risk including the potential to trigger an "event of default" (and a cross-default with other financing) and similar clauses in lending and other agreements. Ultimately, the assessment of such risk is a matter for the directors to consider, having regard to their duties to act in the best interests of the company.
3. The 'breathing space' (i.e. the moratorium on creditor claims) arises immediately upon the presentation of the CRO petition, rather than the making of a PL order. Under S.91G, at any time after the presentation of a CRO petition, *"no suit, action or other proceedings, other than criminal proceedings, shall be proceeded with or commenced against the company, no resolution shall be passed for the company to be wound up and no winding up petition may be presented against the company, except with the leave of the Court"*. This means that, upon presentation of the CRO petition, the company's directors will be free to devote their efforts to working with CRO to implement the restructuring, rather than spending valuable time and resources fending off claims. This should result in restructurings proceeding in a more streamlined and ultimately faster manner.

Other features

It is possible to seek the appointment of an interim CRO “*where it is in the interests of the company to do so*”. These are not defined but may be relevant should there be some urgent action that the CRO is required to take, or the presentation of the CRO petition itself is needed in order to prevent imminent harm to the company. It is envisaged that this may be necessary where, for example, a particularly aggressive creditor is threatening to wind up the company stifle a genuine attempt at restructuring. In such cases, the company can apply *ex parte* for the appointment of a CRO pending the hearing of the CRO petition².

Various parties, including the company by its directors, any creditor or contingent creditor, a contributory, or the Cayman Islands Monetary Authority, may apply to vary or discharge the CRO order.

³ On such an application the Court has a very wide discretion, including to make any order it thinks fit (save for making a winding up order). Hence, if the CRO is not progressing the restructuring as the company’s stakeholders think proper, those stakeholders could apply to have the CRO discharged and could then potentially look to place the company in to liquidation.

Secured creditors are not affected by the CRO process. They may take action to enforce their security without leave of the Court and without reference to the CRO. ⁴

Until it is tested by the Court, there remains a question whether a provision in a company’s memorandum and articles of association limiting the ability of its directors to present a CRO petition will be valid and enforceable. Whereas S.94 of the Act been amended to permit a company’s articles to remove or modify its directors’ authority to present a petition to wind up the company (or to appoint PLs), a similar feature was not included in the amendments creating the CRO regime. Given that: (a) the ability to limit a director’s authority is expressly provided for in the Act in respect of winding up (and PLs) but not in respect of CROs; and (ii) there is a general principle that private individuals may not by their mere agreement curtail their statutory rights, in our view it is more likely than not that a term in a company’s articles prohibiting its directors from petitioning to appoint a CRO would be unenforceable.

Interpretation of the requirements

The test for the appointment of a CRO is substantially the same as the test for appointment of a PL under S.104(3), albeit somewhat more refined.⁵ A CRO may be appointed where: (a) the company is or is likely to become unable to pay its debts as they fall due, and (b) the company intends to present a compromise or arrangement to its creditors (or classes thereof) either, pursuant the Act,⁶ the law of a foreign country, or by way of a consensual restructuring. Given the overlap, case law in relation to S.104(3) will be highly relevant to applications under S.91B.

Relevant case law suggests that in exercising its discretion to stay a winding up petition in favour of a proposed restructuring, the Court will consider:

- (a) That there are ‘tangible grounds’ for an adjournment;

² S.91(C)

³ (S.91F)

⁴ (S.91H)

⁵ The definition of “compromise or agreement” in S.104(3) has been expressly expanded and thus clarified.

⁶ i.e. a statutory scheme of arrangement under s.86.

- (b) the express wishes of creditors⁷;
- (c) whether the refinancing was likely to be more beneficial than a winding-up order;
- (d) that there was a real prospect of refinancing and/or a sale as a going concern being effected for the benefit of the general body of the creditors⁸; and
- (e) the considered views of the board as to the best way forward.

The court has also accepted that it should be cautious and not to abrogate the rights of the majority of the company's creditors who might be better served by exploring a restructuring than an immediate winding up order.⁹

The company is not required to already have a pre-formulated restructuring plan, nor to establish the viability of any such restructuring plan. The proposed restructuring may but is not required to be pursuant to a statutory mechanism or a foreign court order and it may be consensual. However, whether it begins this way or not, in practice, the restructuring will often conclude with a "scheme of arrangement" under S.86, or a "compromise" agreement under the new S.91I. Both are court-sanctioned restructurings, but whereas S.86 is generally a company-led process, the new S.91I is a CRO-led process. The new CRO regime has also expanded the scope of Cayman restructurings to include English law governed debt, thereby avoiding the need for parallel restructuring regimes.

Other changes to the Companies Act

As was mentioned in TTA's client memorandum titled 'Members Schemes of Arrangement', the new provisions in the Act abolish the requirement for shareholder schemes of arrangement to meet a 'headcount test' to approve the proposed scheme. This brings the jurisdiction in line with England and other common law jurisdictions such as Hong Kong, and further facilitates a company's ability to restructure and/or pursue a take private transaction.

⁷ Re ACL Asean Tower Holdco Limited, unreported 8 March 2019, Kawaley J

⁸ Re Evergreen International Holdings Limited, FSD 349 of 2021, unreported 6 January 2022, Ramsay-Hale J

⁹ Re Sun Cheong [2020 (2) CILR 942]