The Rise of Consensual Restructuring Through Cayman Islands Companies

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Introduction

Against the background of increasing costs of capital in global markets, over the last 12 months many publicly listed Cayman Islands companies have successfully deployed consensual restructuring measures to manage their debt levels, cash flow and funding needs. The tools available in the Cayman Islands Companies Act provide quick and cost effective means of corporate reorganisation; these tools are due to be further streamlined this year thanks to amendments introduced by the Companies (Amendment) Bill 2024, directed to enhancing the Cayman Islands' financial services offering.

Contentious Restructuring

On 31 August 2022, the Cayman Islands welcomed the introduction of much-anticipated reforms to the jurisdiction's restructuring regime (**Restructuring Amendments**), which enabled debtor companies to petition the court for the appointment of restructuring officers on the grounds that they were or were likely to become unable to pay their debts, and intended to present a compromise or arrangement to creditors.

While the Restructuring Amendments brought with them numerous benefits for both creditors and debtor companies, their introduction coincided with the most significant central bank interest rate rises globally since the 2008 financial crisis. In the UK, interest rates increased from 0.1% in December 2021 to 5.25% in August 2023, while the US Federal Reserve raised rates from 0-0.25% in March 2022 to 5.25-5.5% in July 2023[1]. As a result, the cost of capital that is often required to facilitate a debt restructuring has put external financing beyond the reach of many global enterprises in distress.

Consequently, in its first year of operation, only five applications were made for the appointment

of Restructuring Officers[2]'; of those applications, only two resulted in the appointment of restructuring officers and only one resulted in a confirmed plan. Given the economic climate, we have, however, seen many Hong Kong stock exchange listed companies turn to consensual restructuring options as a means of procuring private funding or internally reorganising their existing capital structure.

Consensual Restructuring

The Cayman Islands Companies Act provides for a scheme of arrangement to be agreed between a company and its members (or any class of them) and sanctioned by the Court. In addition to streamlining the process for creditor schemes of arrangement, the Restructuring Amendments also dispensed with the need for member schemes of arrangement to comply with the "headcount test". A members' scheme of arrangement will now therefore be deemed to be binding on the members of a company if the scheme is approved by a majority of 75% of members in value and no longer also requires the approval by the majority of members in number. This is particularly helpful for listed companies where shares are held through custodians and by many smaller shareholders.

Capital Reduction

As an alternative to, or in conjunction with, a members' scheme of arrangement, there has been significant capital reduction activity among Cayman Islands listed companies. A company may seek to reduce its capital in order to, among other things: (i) increase distributable reserves, for example, to pay a dividend or to buy back or redeem its own shares; (ii) reduce or eliminate accumulated realised losses in order to be able to make distributions in the future; (iii) return surplus capital to shareholders; and/or (iv) reduce the par value of shares in line with the trading value of shares.

Applications to reduce share capital are made by Petition under section 15 of the Companies Act. The Court, subject to being satisfied the interests of creditors will not be prejudiced (or where there is no diminution of any liability in respect of unpaid share capital or the payment to any shareholder of any paid-up share capital) may make an order confirming the reduction on such terms and conditions as it thinks fit.

In *Re Santiago Pipelines Company and New Santiago Pipelines Company* [2012] (2) CILR 343, the Court identified four criteria that the Court will apply in determining whether or not to confirm a capital reduction: (a) Whether the shareholders will be treated equitably by the capital reduction; (b) Whether proper information has been provided to shareholders; (c) Whether the interests of creditors have been safeguarded; and (d) The court being satisfied that the capital reduction was for a "discernible purpose" (which requires more than demonstrating a company had some actual objective in mind; the Court should be given a proper understanding of the commercial rationale for the overall transaction of which the capital reduction formed part). These principles have been considered more recently by Segal J in *China Agrotech Holdings Limited (in Liquidation)* [2019] (2)

CILR 356 who incorporated an additional requirement from the judgment of Mr Justice Snowden in *Re Man Group plc* [2019] EWHC 1392, to confirm that the resolution reducing capital must be a validly passed special resolution. Doyle J adopted Mr Justice Segal's expanded test in *Re Nature Home Holding Company Limited* (Unreported, 19 October 2021).

While the requirements for a capital reduction order have been capable of being streamlined by virtue of commercial Practice Directions issued by the Grand Court (enabling the Court to dispense with the need for a directions hearing and proceed to final hearing where certain creditor interests have been satisfied or are unlikely to be affected), the Companies (Amendment) Bill 2024 seeks to further ease the obligations on companies who wish to reduce their capital as part of a corporate reorganisation by removing the requirement for Court approval altogether, in appropriate circumstances.

The Companies (Amendment) Bill 2024

The Companies (Amendment) Bill 2024 was gazetted on 26 January 2024 and will be presented to Parliament on 26 February 2024. The most significant amendment means that, pursuant to a new section 14A, a company, if so authorised by its articles may reduce its share capital by special resolution supported by a solvency statement and without the need for a confirmation hearing before the Grand Court. Section 14A will require that (i) the solvency statement be made by the directors no more than thirty days before the date on which the special resolution for reducing the share capital was passed; (ii) where the special resolution has been approved in writing pursuant to s60(1)(b) of the Companies Act, a copy of the solvency statement must be sent / submitted to every member before the time at which the proposed special resolution referred to above is provided to them; and (iii) a director must not knowingly make a solvency statement without having reasonable grounds to believe that the company will be able to pay its debts in full as they fall due.

After the passage of the special resolution:

- The solvency statement and minute of reduction (which must set out the amount of share capital of the company, the number of shares into which the share capital is to be divided and the amount of each share; and the amount, if any, deemed to be paid up on each share) must then be delivered to the Registrar within 15 days after the special resolution pursuant to section 14B.

- The Registrar will register the solvency statement and minute, issue a certificate stating that the solvency statement and minute have been registered and publish a notice in the Gazette of the registration.

- The certificate issued by the Registrar shall be conclusive evidence that all of the requirements of the Act in relation to reduction of share capital have been complied with and that the share

capital is as stated in the minute and the minute, when registered, is deemed to be substituted for the corresponding part of the memorandum of association.

- The special resolution for reducing the share capital takes effect on the date of registration.

The effect of these changes is that the capital reduction process for solvent companies will become more cost effective and time efficient. Where a company cannot provide the solvency statement outlined in section 14A, it may still reduce its share capital by special resolution and confirmation by the court, consistent with the existing process.

Conclusion

As Companies continue to grapple with challenging economic conditions and seek to position themselves for fundraising or lending opportunities in the year ahead, the flexible and efficient consensual restructuring tools available under the Cayman Islands Companies Act ought to be borne in mind.

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About

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Footnotes

[1] Interest Rates and Monetary Policy: Key Economic Indicators - House of Commons Library (parliament.uk)

[2] In the matters of Aubit International (FSD 240 of 2023), Differ Group Auto Limited (FSD 173 of 2023), Rockley Photonics Holdings Limited (FSD 16 of 2023), Carbone Holdings Limited (FSD 218 of 2022) and Oriente Group Limited (FSD 221 of 2022).

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Key Contacts

Gemma Bellfield (nee Lardner)

Partner

Cayman Islands

E: gemma.bellfield@ogier.com

T: +1 345 815 1880

Oliver Payne 彭奥礼

Partner 合伙人

Hong Kong

E: oliver.payne@ogier.com

T: +852 3656 6044

Rachel Huang

Partner

Hong Kong

E: rachel.huang@ogier.com

T: +852 3656 6073

Cecilia Li

Partner 合伙人

Hong Kong

E: cecilia.li@ogier.com

T: +852 3656 6010

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