Insolvent Cayman companies: will the Court wind up or allow an opportunity to restructure?

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Introduction

In its January 2022 decision of *In the matter of Evergreen International Holdings Limited*, [1] the Grand Court of the Cayman Islands (the **Court**) ordered the immediate winding up of Evergreen International Holdings Limited. Evergreen is a Cayman Islands holding company listed on the Hong Kong Stock Exchange that operates a manufacturing and retail clothing business through its subsidiaries in both Mainland PRC and Hong Kong SAR. In making an immediate winding up order, the Court refused Evergreen's last-minute application to appoint restructuring provisional liquidators and adjourn the winding up petition on the basis that there was insufficient evidence before the Court to demonstrate that the restructuring was viable or in the best interests of creditors.

Background

The petitioner originally acted as Evergreen's placing agent for two bond issues and was the registered holder of some of the bonds. In 2019 and 2021, Evergreen defaulted on both interest and principal payments due on the bonds held by the petitioner. The amounts due were not fully repaid and, in September 2021, the petitioner served a statutory demand on Evergreen for HK$67 million. Evergreen failed to comply with the statutory demand and, in December 2021, the petitioner presented a winding up petition against Evergreen on the ground that it was unable to pay its debts as and when they fall due.

Evergreen did not dispute that the debt to the petitioner was owing, but instead (on the eve of the hearing of the winding up petition) applied to appoint provisional liquidators and adjourn the winding up petition so that it could explore the possibility of restructuring its debts. The application was made on the basis that Evergreen was balance sheet solvent, and had valuable real estate assets in the PRC that could be sold to pay its debts and return Evergreen to trading profitably.

The petitioner opposed Evergreen's application and sought an immediate winding up order on the basis that Evergreen was cash flow insolvent, and further that:

- The petitioner had serious concerns about Evergreen's management – two of Evergreen's current directors had previously approved a spurious loan transaction which caused Evergreen's then auditors to resign and which was subject to an independent investigation (which remained ongoing after more than a year), the preliminary findings of which included that the loan appeared to have no proper commercial purpose
- Evergreen, in breach of HKSE rules, had failed to produce consolidated audited accounts since 2018. This failure was one factor leading to the suspension of trading in Evergreen's shares on the HKSE in March 2020. Trading in Evergreen's shares has not resumed since
- Evergreen's optimistic claim regarding its financial future was not supported by the documentary evidence, which on a close analysis instead suggested Evergreen's financial position was dire. Evergreen's evidence did not reveal any possibility that a viable restructuring proposal could be formulated or was supported by any of Evergreen's creditors, and the facts of this case were therefore materially different to others where the Court had been prepared to appoint restructuring provisional liquidators

The Court's decision

The Court started with the well-settled principle that a creditor is entitled to a winding up order if the Court is satisfied that the company is unable to pay its debts, unless there are special reasons not to make a winding up order. [2] Any adjournment of a winding up petition must have a "rational basis", and the burden is on the insolvent company to persuade the Court not to make a winding up order. [3]

The Court considered the three broad categories where the Court has exercised its discretion to adjourn a winding up petition:

- Where the adjournment will facilitate a restructuring of the company's indebtedness. But such an adjournment will only be made where it is in the best interests of, and may provide a better return to, the company's stakeholders [4]
- Where the company is balance sheet solvent and there is a reasonable prospect of the company returning to cash flow solvency (including, for example, as a result of a proposed asset sale) [5]
- Where the debt underlying the petition is genuinely disputed on substantial grounds (and the Court elects not to strike out the petition on this basis)

In relation to the first category of cases, an adjournment is more likely to be granted where (a) it is supported by a majority of creditors, the proposed joint provisional liquidators and/or the

relevant listing authority (if applicable) and (b) the company has taken proactive restructuring steps. [6]

In this case, Evergreen failed to persuade the Court that there was a rational basis for adjourning the winding up petition. Instead, the Court concluded that Evergreen's application was a last minute attempt to avoid a winding up order (of which the Court should be wary) and observed that:

- Despite having supposedly engaged a restructuring advisor in April 2021, Evergreen put forward no proper evidence that a restructuring was supported by any of its creditors and was unable to offer even an outline of a restructuring proposal. The only proposal put forward was the sale of Evergreen's real estate assets which, the Court determined, were fully encumbered
- Evergreen's optimistic statements as to its net asset value were unsupported by documentary evidence. Evergreen was unable to produce any recent audited consolidated accounts, and the available documentary evidence suggested that the Evergreen's financial position had deteriorated rapidly since 2017
- No explanation was given by Evergreen as to why it made no effort to sell its assets for approximately one year after it defaulted on bond payments due to the petitioner
- While Evergreen also asserted that the appointment of provisional liquidators would assist with its efforts to avoid being delisted, it did not appear to the Court that Evergreen would otherwise be able to meet the listing resumption requirements imposed by the HKSE
- Some of the current directors (who would be working with the provisional liquidators) had been implicated in the mismanagement of Evergreen, and in particular the loan transaction

Commentary

The issue of whether to order an immediate winding up or instead adjourn a petition for the purpose of appointing restructuring provisional liquidators is typically fact specific, and involves the Court exercising a wide discretion. Caution should therefore be exercised before placing too much weight on individual decisions. However, *Evergreen* builds on a consistent thread running through the cases: while the Cayman Court remains willing to support genuine efforts by companies to restructure, when an insolvent company fails to be proactive and take tangible steps for a restructuring in the face of undisputed creditor claims, the Court will enforce the creditors' rights to an immediate winding up order. [7] We expect that this approach to balancing the interests of both creditors and companies will continue following the introduction of Cayman's new restructuring regime in the coming year.

Ogier acted for the successful petitioner in this matter.

[1] (FSD 349 of 2021 (MRHJ), unreported, 11 January 2022).

[2] *Re Lummus Agricultural Services Ltd* [2001] 1 BCLC 137 and 141; Re Sun Cheong Creative Development Holdings Limited (FSD 169 of 2020 (ASCJ), unreported, 26 September 2020).

[3] *Re ACL Asean Tower Holdco Limited* (FSD 171 of 2018 (IKJ), unreported, 8 March 2019).

[4] See, eg, *Re Sun Cheong*.

[5] See, eg, *Re Minrealm* [2008] 2 BCLC 141 and Byblos Bank SAL v Al-Khudhairy [1987] BCLC 232.

[6] *ACL Asean* [29].

[7] For more information, read our briefing Recent trends: provisional liquidation in the Cayman Islands

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