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Corporate rescue and protective measures / mechanisms: provisional liquidation (test / who can apply, procedure, appointment, creditor / shareholder rights, case studies

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Introduction

1. The benefits and risks of informal creditor workouts – efficiency and cost v exposure
2. INSOL International's International Statement of Principles for a Global Approach to Multi-Creditor Workouts (INSOL Principles)
3. **Provisional liquidation**
 - *Introduction*
 - *Purpose and standing to apply*
 - *Procedural requirements*
 - *Appointment*
 - *Termination*
4. **Restructuring Officers**
 - *Introduction*
 - *Who can apply? What is the test?*
 - *Procedure*
 - *Appointment*
 - *Stakeholder rights*
 - *Termination*

Section 5.3.1 Provisional Liquidation

- Section 104(3) Companies Act (as revised)
- Formal process available under Part V of the Companies Act
- Any corporate vehicle liable to be wound up under the jurisdiction of the Grand Court
- Requires the prior filing of a winding up petition
- Primary focus of asset protection, but no prohibition against use of provisional liquidation for the purpose of restructuring if appropriate.

Section 5.3.1.2 – Standing

- Creditors, contributories and where relevant the Cayman Islands Monetary Authority (CIMA) may seek the appointment of provisional liquidators.
- *Prima Facie Hurdle* – there must be a prima facie case for making a winding up order.
- *Necessity Hurdle* – the appointment of provisional liquidators must be necessary to prevent:
 - *The misuse or dissipation of assets of the company*
 - *The oppression of minority shareholders of the company*
 - *Mismanagement or misconduct on the part of directors of the company*

Section 5.3.2.1 – Standing II

- The Necessity Hurdle is strictly applied, and the Court requires clear and strong evidence showing the need to appoint provisional liquidators.
- The requirement of a need to investigate certain affairs of the company is not itself sufficient to warrant the appointment of provisional liquidators (*In the Matter of Al Najah Education Limited* Cause No. FSD 119 of 2021 (unreported, 9 August 2021, para. 9).
- It is not sufficient to demonstrate an historic need for the appointment of provisional liquidators (*In the Matter of ICG I* Cause no FSD 192 of 2021 (DDJ) (Unreported, 4 August 2021, paras. 23 and 36).
- Option to make alternative orders

Section 5.3.2.1 – Standing III

- Company is not limited by the Prima Facie or Necessity Hurdle
 - Directors must provide evidence and be of the view that the appointment of provisional liquidators is in the best interests of the company
 - Court has a discretion to appoint provisional liquidators where the Court considers it necessary
 - Statutory language does not stipulate or provide guidance as to when the appointment of provisional liquidators may be appropriate, or not appropriate
 - Revised language of the Companies Act (2023) does not preclude the appointment of provisional liquidators to support or facilitate a restructuring.

Section 5.3.2 – Procedural requirements

- All applications must be made by Summons and include a supporting affidavit outlining the basis for the appointment of provisional liquidators.
- Unless expedited, the application is generally listed to be heard immediately prior to the winding up petition. Should provisional liquidators be appointed, the winding up petition will be adjourned.
- Creditors may make the application on an *ex parte* basis if giving notice of the application would defeat the purpose of that application (*In the Matter of Principal Investing Fund I Limited*).

Section 5.3.2.3 – Appointment and Orders

- Provisional liquidation is inherently flexible and the terms of appointment can be curtailed to address the requirements of a case.
- Provisional liquidators do not:
 - have the ability to bring antecedent transaction actions on behalf of a company's estate.
 - Have an obligation to adjudicate proofs of debt
- Appointment of provisional liquidators takes effect from the date of appointment, and a stay of proceedings under Section 97 of the Companies Act takes effect from that same date.

Section 5.4.1 - Restructuring Officers

1. On 31 August 2022, amendments to Part V of the Companies Act became effective which were intended to facilitate the efficient restructuring of distressed companies.
2. Under the Companies (Amendment) Act, 2021 and the Companies Winding Up (Amendment) Rules, 2022 a company may now petition the Court for the appointment of a restructuring officer under the supervision of the Court.
3. First formal restructuring regime in the Cayman Islands where (a) presentation of a winding up petition is not required; (b) automatic stay takes effect as soon as the petition is presented; and (c) no need for the company to pass any special resolutions.
4. Section 91B (1)

A company may present a petition to the 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 within the meaning of section 93; and (b) intends to present a compromise or arrangement to its creditors (or classes thereof) either, pursuant to this Act, the law of a foreign country or by way of a consensual restructuring

Section 5.4.2 – Test/who can apply?

1. **Who can apply?** the Company.

2. **Test?**

- Satisfaction of a two-limb test; that (a) a 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.
- In interpreting the test, the court has confirmed that it will consider the authorities with respect to the repealed section 104(3).
- *In the Matter of Oriente Group Limited* (FSD 231 of 2022 (IKJ), 8 December 2022):
 - “*The jurisdiction to appoint restructuring officers is a broad discretionary jurisdiction to be exercised where the Court is satisfied that:*”
 - *the statutory preconditions of insolvency or likely to become insolvent are met by credible evidence from the company or some other independent source;*
 - *the statutory precondition of an intention to present a restructuring proposal to creditors or any class thereof is met by credible evidence of a rational proposal with reasonable prospects of success; and*
 - *the proposal has or will potentially attract the support of a majority of creditors as a more favourable commercial alternative to a winding-up of the company petitioning for the appointment of restructuring officers”*

Section 5.4.3 – Procedure

1. Documents

- Petition and filing fee
- Supporting Affidavit
- Affidavit by persons nominated for the appointment as restructuring officers

2. Process

- Advertisement and timing

3. Hearing

- Within 21 days of presentation unless ordered otherwise
- Relief that the Court may grant upon hearing

5.4.4 - Appointment

1. Qualifications

- Insolvency Practitioner's Regulations
- Independence requirements

2. Powers

- Flexible and defined by the terms of the appointment order
- Certain requirements are however set out in the Amendment Rules and include:
 - entry into an international protocol
 - convening meetings of creditors and members;
 - validation of dispositions, and
 - the provision of reports about the financial condition of the company

5.4.5 – Creditor/shareholder rights

1. Creditors and contributories have standing to appear on the hearing of a Restructuring Petition
 - Variation or discharge of an order appointing RO
 - Removal or replacement of an RO
 - Rights of secured creditors remain unchanged and can be exercised without reference to the ROs
2. Concurrent Petitions

5.4.6 – Termination

1. Successful – where the order has served its purpose
2. Unsuccessful – viability and procedure