INSOL INTERNATIONAL

GLOBAL INSOLVENCY PRACTICE COURSE

Offshore jurisdiction practice

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Context

Cayman Islands, BVI and Bermuda restructuring and the
interaction with Hong Kong and China

- *China Agrotech[2019] HKCFI 2531*

- Incorporated in the Cayman Islands, registered in Hong Kong as an overseas company and listed on the Hong Kong Stock Exchange.
- The Company was liquidated with its only remaining substantial asset being its Hong Kong listing status.
- Value of listing through two parallel schemes of arrangement.

Sun Cheong Creative Development Holdings

- ✓ The company was a Cayman Islands incorporated company listed on the Hong Kong Stock Exchange that was the holding company of a group operating in the PRC.
- ✓ A creditor of the company had commenced winding up proceedings in Hong Kong.
- ✓ Debt not disputed. An order for the winding up of the company appeared imminent at the time that the company applied to the Cayman Islands Court for the appointment of provisional liquidators so it could attempt a restructure of its debts.
- ✓ The Cayman Islands Court appointed "light touch" restructuring provisional liquidators to the Cayman Islands company.
- ✓ The Court confirmed that, in considering whether the Cayman Islands or Hong Kong was the more appropriate jurisdiction to assume the role of supervising the primary insolvency proceeding, the starting position is that the place of incorporation will be the more appropriate.
- ✓ This is typically the jurisdiction that the company's stakeholders legitimately expect to govern the company's internal affairs.
- ✓ A foreign jurisdiction may be more appropriate where there is a particularly strong nexus between that jurisdiction and the company.

Century Sunshine Group Holdings Limited

- ✓ Justice Parker in the Cayman Islands, Chief Justice Hargun in Bermuda and Justice Jack in the British Virgin Islands
- ✓ "light touch" provisional liquidators were appointed across Century Sunshine Group Holdings Limited (the Company) and group companies.
- ✓ A Cayman Islands company listed on the main board of the Hong Kong Stock Exchange.
- ✓ The Company had defaulted on certain bonds that were guaranteed by various subsidiaries in the British Virgin Islands, which would trigger cross-defaults in other debt instruments across the group.
- ✓ In addition, Rare Earth Magnesium Technology Group Holdings Limited, a subsidiary of the Company incorporated in Bermuda, which is also listed on the main board of the Hong Kong Stock Exchange, was additionally in danger of defaulting on its own debts.
- ✓ To effect a group-wide restructuring, "light touch" provisional liquidators were appointed to the Company with a view to similar appointments being made to subsidiaries in Bermuda and in the British Virgin Islands.
- ✓ Throughout the process of the appointment of provisional liquidators, each of the Courts in the Cayman Islands, Bermuda and the British Virgin Islands were informed of the Company's plans for the holistic restructuring and kept appraised of the progress of the proceedings in the other jurisdictions.

The place of incorporation and its significance

Dicey & Morris – *"the status of a company is determined by its place of incorporation"*

vs

COMI, governing law of debt, assets, location of creditors, jurisdiction of a foreign Court (sufficient connection)

The Cayman Islands Restructuring Officer Regime – a judicial rescue process

- https://www.harneys.com/insights/a-guide-to-the-cayman-islands-insolvency-reform/

Restructuring Officer Regime – a judicial rescue process

- In a highly welcomed modernisation, the Cayman Islands Government has introduced the Companies (Amendment) Act 2021, which came into force on 31 August 2022, allowing a debtor to seek the appointment of restructuring officer(s), supported by a worldwide moratorium (viz. unsecured creditor action), with a view to restructuring its debts through a "refined" scheme of arrangement.
- As a result, the Cayman Islands now has a restructuring regime separate from its statutory corporate liquidation regime – a debtor will no longer be required to file a winding up petition just for purposes of obtaining a stay on unsecured creditor action.
- Refined scheme available to both Cayman Islands and foreign debtors (with qualifications) and will, so long as "efficacy" is likely, compromise both Cayman Islands and foreign law governed debt.
- Can be described as an "hybrid debtor in possession" regime – has features of an automatic moratorium and the possibility for a board of directors to remain but unlike "pure" DIP jurisdictions, it is nevertheless mandatory to have a RO appointed.

Entry requirement – insolvency

- Whilst the new regime has been decoupled from the winding up regime, and is set out in a dedicated restructuring part of the Companies Act:
- Still a “financial difficulty test” - “is or is likely to become unable to pay its debts”.
- Still a “collective insolvency proceeding” for purposes of the Model Law.
- Insolvency practitioner must be appointed as RO.

Refined Scheme of Arrangement

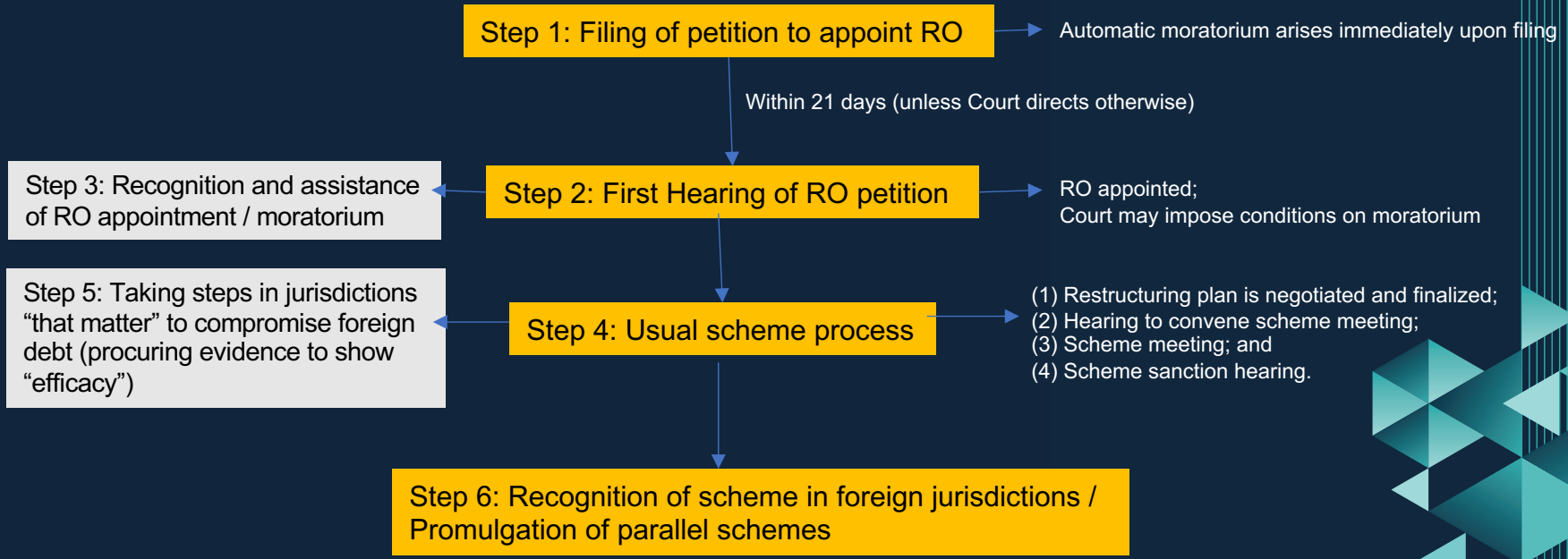
The commercial effect of the Companies (Amendment) Act 2021 is to create a "refined" scheme of arrangement:

i. for a company that is or is likely to become unable to pay its debts and intends to present a compromise or arrangement to its creditors;
ii. protected by an extraterritorial automatic moratorium;
iii. "supervised" by a Court appointed restructuring officer;
iv. removing the "numerosity" or "headcount" test for members' schemes; and
v. which is hoped will obtain Chapter 15 and/or other "recognition and assistance", thereby having "efficacy" (even when, and especially when, foreign law debt is schemed).

Overview – Key changes

Pre-amendment rescue regime ("Light-touch Regime")	Post-amendment rescue regime ("RO Regime")
Debtors, if insolvent or facing insolvency, were **required to file a winding up petition**, then seek the appointment of provisional liquidator on a 'light-touch' basis in order to avail themselves of the accompanying moratorium on the basis that the company will attempt to facilitate a restructuring.	The RO Regime seeks to decouple rescue from liquidation such that the debtor now seeks an appointment of a "restructuring officer" and there is **no need to file a winding up petition** in order to stay unsecured creditor action.
The application to convene a scheme meeting in and of itself does not avail the debtor of an automatic statutory moratorium. As such, an application for the appointment of provisional liquidators is typically filed in conjunction with the promulgation of the scheme to create the necessary breathing space for debtors and a statutory moratorium is triggered **upon the appointment of provisional liquidators** viz unsecured creditor action.	An automatic moratorium (with express worldwide effect) arises in support of the rescue process **upon filing of the RO petition.** Scope of moratorium protection similarly only covers unsecured creditor action.
Both creditor and member schemes of arrangements are subject to the numerosity / headcount (majority present and voting) and value (representing at least 75% in value) tests	Removal of the headcount / numerosity test for member schemes; Creditor schemes still subject to both the numerosity / headcount and value tests (s86)

Summary of procedural steps



Case Study – China Agrotech

- parallel schemes of arrangement;
- Contentious EGMs;
- Case management between Cayman Islands and HK Courts.

China Agrotech Holdings Ltd

Discussion

- The epic journey of China Agrotech Holdings Ltd, that saw it re-listed on the SEHK on 26 July 2019, some five years after its shares were suspended from trading, China Agrotech Holdings Limited (now Da Yu Financing Holdings Limited) effected a successful restructuring of its HK$1,677.9 million of debt by way of a capital reorganisation and parallel schemes of arrangement in the Cayman Islands and Hong Kong.
- The Company is incorporated in the Cayman Islands, listed on the Hong Kong Stock Exchange and was subject to liquidation under the laws of Hong Kong at the time of its restructuring.
- The ultimate objective of the restructuring was to realise the value of the Company's listing status on the SEHK for the benefit of its creditors, shareholders and stakeholders. Absent a restructuring, creditors were not expected to recover anything in the liquidation.

There were a number of novel elements to this restructuring including:

- Unique challenges posed by the Company being subject to a foreign liquidation but not an equivalent regime in its place of incorporation.
- The validity of Company resolutions necessary to effect the restructuring (including a reduction of the Company's capital) were challenged by a shareholder. To address that challenge, the Company successfully sought a declaration regarding the validity of those resolutions. The Grand Court's ruling (In re China Agrotech Holdings Limited, unreported, 16 July 2019) contains a thorough analysis of English and other common law authorities regarding the finality of decisions of a chairperson in general meetings and the power of a chairperson to reject shareholder votes.
- The Grand Court made a conditional scheme sanction order to address the uncertainty about whether the Hong Kong court would sanction the Hong Kong scheme given that scheme was subject to opposition. This appears to be the first occasion that a conditional sanction order has been made in the Cayman Islands and the Grand Court observed that a conditional order would allow it to retain control over the scheme process (In re China Agrotech Holdings Limited, unreported, 22 July 2019).
- Case management issues.

Case management

Perfect Gate’s application for an adjournment or stay pending the determination by the Hong Kong court on the basis that:

Hong Kong was the proper forum for the resolution of the dispute as the company’s shares were listed on the Hong Kong Stock Exchange, the company’s principal place of business was in Hong Kong, the alleged meetings took place in Hong Kong, and the EGM took place in Hong Kong.

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Case Management cont'd

An adjournment or stay would not be appropriate or justified for the following reasons:

(a) Particular weight was to be given to the fact that the dispute related to the conduct of a meeting of shareholders of a Cayman company. The rights and responsibilities of shareholders and the chairman of the EGM were subject to and governed by the company's constitution and by Cayman law. The Grand Court was usually the most appropriate forum for dealing with such disputes.

(b) Also of particular weight was the connection between the dispute and the confirmation petition which was pending in this court. The summons should be viewed as part of or arising out of the confirmation petition.

(c) Weight was also given to the fact that the purpose of the proceedings in this jurisdiction was to provide assistance to the Hong Kong liquidators and it was they who had presented the confirmation petition, issued the summons and sought to have the dispute determined in this court.

(d) There were strong grounds for believing that the risk of inconsistent judgments was low. To avoid any discourtesy to or conflict with the Hong Kong court, had the Hong Kong court expressed the wish to do so, the Grand Court would have been prepared to defer giving judgment pending further discussions between the parties and the courts regarding the need for steps to be taken to coordinate the Cayman and Hong Kong proceedings. However, no such request had been made.

(e) Perfect Gate could have applied for the cross-examination of witnesses but it did not do so, and in any event the summons could properly be disposed of without the need for cross-examination (para. 11; para. 68).

Parallel Schemes of Arrangement

- *Risk assessment- be pragmatic and commercial*

- https://www.harneys.com/our-blogs/offshore-litigation/position-paper-on-parallel-schemes-of-arrangement-the-harneys-schemario-rules/

The Drax Point - When do I need a parallel scheme?

- When you need to bind dissentient creditors (obviously!).
- The *locus classicus* on the issue : *Re Drax Holdings* [2004] 1 WLR 1049, which concerned parallel Cayman Islands, Jersey and English schemes in respect of Cayman and Jersey incorporated entities. As Lawrence Collins J (as he then was) explained at [30]:
- "In the case of a creditors' scheme, an important aspect of the international effectiveness of a scheme involving the alteration of contractual rights may be that it should be made, not only by the court in the country of incorporation, but also where (as here) by the courts of the country whose law governs the contractual obligations. Otherwise dissentient creditors may disregard the scheme and enforce their claims against assets (including security for the debt) in countries outside the country of incorporation".
- A parallel scheme is unnecessary when the compromise is not at risk from dissentient creditors.
- It's that simple.

- Risk assessment - How and when will you know?

  - You may not know whether a parallel scheme is necessary until the final hour.

  - Creditors and stakeholders jockey in negotiations for better terms, reluctant to make a binding commitment through increasingly complicated "lock-up letter" arrangements. Creditor "hold-out" is the norm and the demands for "sweeteners" go to the wire. On the day of the vote, and even the day of a scheme sanction hearing, the wrecking ball can hang over the restructuring professional team.

  - The *Drax* point is the incontrovertible foundation of this exercise. Any assessment as to whether the parallel scheme was necessary should apply a legal test in "real-time", based on evidence adduced for the dedicated purpose of determining that issue.

Deputy HCJ William Wong SC

Da Yu Financial Holdings Limited [2019] HKCFI 2531

See also In the Matter of Grand Peace Group Holdings Limited "parallel schemes of arrangement in both the company's place of incorporation and Hong Kong, where the offshore company is listed in Hong Kong, would seem generally to be unnecessary"

At paragraphs [49] – [53].

"I am of the view that the idea that parallel schemes are needed in such circumstances appears to be an outmoded way of conducting cross-border restructuring. Requiring foreign office-holders to commence parallel proceedings is the very antithesis of cross-border insolvency cooperation. A crucial feature of cross-border insolvency cooperation is the recognition of foreign proceedings…"

China Oil Gangran Energy Group Holdings Limited

- Harris J: "Clearly if a creditor, whose debt is governed by Hong Kong law, agrees to the terms of a scheme there is no need to be concerned about enforcement in another jurisdiction and, if the Rule in *Gibbs* is applied in that other jurisdiction, participation in the scheme process provides an exception to the Rule".
- This is of course correct only as far as those creditors who submit to the jurisdiction by voting in favour are concerned. This is the effect of the *Gibbs* rule on the *Drax* point. It may nevertheless be desirable for the scheme company to take additional steps in the Cayman Islands for commercial or strategic reasons.
- *See also In the Matter of Grand Peace Group Holdings Limited* which noted that practitioners should, citing *Re Da Yu Financial Holdings Limited*, be cognisant that parallel schemes of arrangement in both the company's place of incorporation and Hong Kong, where the offshore company was listed in Hong Kong, would seem generally to be unnecessary. The real answer is that it depends on the facts of every case, and the level of creditor support in a scheme. In turn, the point in time in which the risk assessment is made as to whether a parallel scheme is necessary is a notorious crystal ball gazing exercise.
- https://www.harneys.com/our-blogs/offshore-litigation/the-wrecking-ball-vs-the-crystal-ball-planning-a-parallel-scheme-of-arrangement/

Scenario 1

A Hong Kong scheme of arrangement seeks only to vary the Hong Kong law governed contractual obligations of a company incorporated in the Cayman Islands.

Scenario 2

A Hong Kong scheme of arrangement seeks only to vary the New York law governed contractual obligations of a company incorporated in the Cayman Islands and the company obtains recognition of the scheme in New York pursuant to Chapter 15 of the US Bankruptcy Code.

Scenario 3

A Hong Kong scheme of arrangement includes a variation of English law governed contractual obligations of a company incorporated in the Cayman Islands.

Scenario 4

A Hong Kong scheme of arrangement includes a debt for equity swap in relation to a company incorporated in the Cayman Islands.

Scenario 5

A Hong Kong scheme of arrangement seeks to vary or compromise the rights of members of a company incorporated in the Cayman Islands.

Effective advocacy before an Offshore Judge

A discussion

Some top tips

Don't:

- alienate local counsel by trying to run the case from onshore;
- assume offshore practice is the same as onshore;
- overlook the need to explain the offshore proceeding adequately in a parallel proceeding such as Chapter 11 Plan;
- ignore the need for an offshore proceeding altogether to give effect to an onshore restructuring;
- cite persuasive case law and ignore offshore judge own local decisions.