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CAYMAN COURT FACILITATES CHAPTER 11 RESTRUCTURING OF PARENT COMPANY OF WORLDWIDE GROUP

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The Cayman Islands has long been a leading offshore jurisdiction in the area of creative and practical cross-border restructuring and insolvency. A rich vein of these cases have involved enterprises with a US base, a Cayman holding company and operating subsidiaries worldwide. The number of such cases has increased in recent times, given that participants in, and service providers to, the distressed oil and gas sector often have Cayman entities in their group structure.

One recent example with which the writers were heavily involved was the cross-border restructuring of CHC Group Ltd (**CHC Parent**). CHC Parent was the ultimate holding company of the CHC Group (the **Group**), being one of the world's largest commercial helicopter services providers, primarily engaged in servicing the offshore oil and gas industry.

By coordination of restructuring processes in the US and Cayman, the Group was able to continue as a going concern, throughout the world, saving a large number of jobs and the Group's enterprise value.

The Cayman piece involved a number of interesting issues, some of which are explored in this article.

THE RESTRUCTURING PLAN

On 5 May 2016, CHC Parent and 43 companies within the Group (the **Debtor Group Companies**) petitioned for relief under Chapter 11 of the US Bankruptcy Code (**Chapter 11**) in the US Bankruptcy Court for the Northern District of Texas, with outstanding debt obligations of approximately $1.6 billion and proposed a debt for equity arrangement as a plan of reorganization (the **Plan**).

The Group's proposals were supported by key stakeholders but required the transfer of the business of the Group (the **Transfer**) from CHC Parent to a new company (**NewCo**). In exchange for the Transfer, NewCo agreed to issue new equity interests to the creditors of CHC Parent who participated in the Plan. Although NewCo would receive substantial additional financing to allow the business to continue, CHC Parent was to receive no tangible consideration from the transfer and CHC Parent would be reduced to a shell company.
The Chapter 11 proceedings gave the Debtor Group Companies breathing space in the US (where the majority of its creditors were based) to continue negotiations and would enable the companies to reach a compromise as a matter of US law. However, whilst claims governed by the law of a state of the United States or by United States Federal law would be discharged by the Plan, claims by those who did not participate in the Plan or who were governed by the law of another jurisdiction would not necessarily be compromised as a matter of Cayman Islands law.[1]

Therefore, although the Plan represented a better return for creditors than if CHC Parent simply went into insolvent liquidation, it was vulnerable to challenge by any dissenting creditor that was not bound by the Plan and was left with claims against a company that had divested itself of the entirety of its assets. The Group therefore had to augment the Plan with proceedings in the Cayman Islands in order to provide a firmer assurance to convince those financing the restructuring.

THE CAYMAN PROCEEDINGS

To effect a solution that provided certainty, CHC Parent needed to seek the Cayman Court's approval of the Transfer. Although not a complete defense against challenge by a non-US, non-Cayman creditor left with a claim against a company made devoid of assets, the Cayman Court's approval of the Transfer would provide a layer of protection against such challenge.
In general, it is not the Cayman Court's function to make an order for the purpose of removing or minimising litigation risk, and so it was necessary to invoke the practice of international co-operation by the courts of the Cayman Islands and expand upon a line of authority from *Kilderkin v Player*[2], *Re Fruit of the Loom Ltd*[3], *Grupo Torras SA v Bank of Butterfield*[4] and *Re Arcapita*[5].

In order to put the Transfer before the Cayman Court, it was first necessary to alter the status of the Transfer as vulnerable to being a nullity and then seek the Cayman Court's sanction of the Transfer pursuant to Cayman statutory provisions. That is, a winding up petition was filed against CHC Parent with the effect that the Transfer would be caught by section 99 of the Cayman Islands Companies Law that provides, "*When a winding up order has been made, any disposition of the company's property and any transfer of shares or alteration in the status of the company's members made after the commencement of the winding up is, unless the Court otherwise orders, void.*"

Once a winding up order was made against CHC Parent, any disposition of the company's property (including the Transfer) would be void unless the Cayman Court validated the transaction.
Jurisprudence has developed whereby the Court will consider a prospective application for validation pursuant to section 99 to validate a proposed transaction if there is some special circumstance which shows that the disposition in question will be for the benefit of the general body of unsecured creditors[6].
The ability to make a prospective application for validation provides greater certainty than hoping that a dissenting creditor will not challenge the Transfer after the event (when additional financing would have been provided), however, there is no way to obtain this protective order without presenting a winding up petition.

ISSUES IN THE CAYMAN PROCEEDINGS

Directors of Cayman companies (even if they are insolvent) are not authorized to petition for their own winding up unless expressly authorized to do so in the articles of the company or by the shareholders of the company in general meeting[7]. The Directors of CHC Parent were not so authorized and so a creditor was identified that was

supportive of the restructuring process and a petition was presented seeking an order that CHC Parent be wound up.

In order to extend the moratorium beyond the Chapter 11 proceedings, and provide an additional layer of comfort to the Cayman Court (which does not recognize the concept of "Debtor in possession" in liquidation proceedings), CHC Parent also planned to make an application for the appointment of provisional liquidators to oversee and advise in relation to the implementation of the Plan.

Under Cayman Islands law, liquidators may be appointed provisionally on the application of a creditor or contributory to protect the assets of the company, or by the company itself if the company is or is likely to become unable to pay its debts and intends to present a compromise or arrangement to its creditors[8]. Creditors cannot apply for the appointment of provisional liquidators to promote a compromise.

The classic compromise or arrangement that will be proposed by a Cayman Islands company is a scheme of arrangement pursuant to section 86 of the Companies Law and section 104(3) has been used for this purpose in the Cayman Islands since the decision of *Fruit of the Loom*[9]. However, the Companies Winding-Up Rules 2008, which adds procedural flesh to the bones of the Companies Law, provides that an application for the appointment of provisional liquidators must be supported by a statement of the directors of the company that "*the directors intend to formulate or assist the provisional liquidator to formulate a compromise or arrangement which can be presented to the company's creditors, either pursuant to section 86 of the Law or otherwise.*" Facilitating a compromise pursuant to Chapter 11 falls clearly within this purpose[10].

Accordingly, on 9 January 2017 a creditor's petition was presented in respect of CHC Parent and CHC Parent immediately sought the appointment of joint provisional liquidators (**JPLs**) on a "soft touch" basis. The Plan would be continued by CHC Parent, subject to the directors reporting to the JPLs and the JPLs would support the Plan if they considered it was in the best interests of the creditors of CHC Parent to do so, and would report to the Cayman Court on their findings in this regard.

On 10 January 2017 Justice McMillan appointed the JPLs on the requested basis, distinguishing such a power from the power to seek the termination of the company which required the approval of the shareholders in general meeting or in the articles of association and the *Fruit of the Loom* line of authority supported the ability of the company to make such an application. The first stage of the process was therefore achieved and the Transfer was potentially void, giving grounds to apply for its prospective validation.

THE SECTION 99 VALIDATION APPLICATION

Following their appointment, the JPLs conducted a rigorous stress test of CHC Parent's liquidation analysis, comparing the outcome for creditors following an implementation of the Plan against the outcome for creditors upon a liquidation of the Group. The JPLs concluded that the Plan was clearly in the best interests of CHC Parent's, and the Group's, creditors and that but for the Plan there would have been no return to unsecured creditors of CHC Parent. The creditors also approved the Plan in sufficient numbers that it stood to be approved by the Texas Court barring any objections.

A potential sticking point, however, was that not all of the creditors were to receive equal treatment under the Plan, given the *pari passu* distribution of assets is a fundamental principle of insolvency law. The potentially unequal treatment of creditors was due to the fact that certain creditors committed to additional funding post-restructuring by taking part in rights issues, or providing additional finance. The return on these additional elements meant that they stood to receive more than creditors who wouldn't (or in some cases due to regulatory reasons, couldn't) participate in the additional aspects of the Plan.

This unequal treatment posed a risk that the Cayman Court may not approve the Transfer. On one argument, the disposition of the assets of CHC Parent could be viewed as a remittal of its assets for distribution in a foreign insolvency proceeding. That was the approach taken in *Re Arcapita Investment Holdings Ltd* [11]. In the *Arcapita* case, the Company had received consideration for a transaction disposing of its assets pursuant to the

restructuring and remitted this consideration to the Chapter 11 proceedings for distribution. Although there was no written judgment in *Arcapita* the arguments were presented on the basis of modified universalism, that the Cayman proceedings were ancillary to the Chapter 11 proceedings and that there was no significant divergence from the scheme for distributing the proceeds of the transaction pursuant to Chapter 11 of the US Bankruptcy Code, or pursuant to the Cayman Islands' priority of payments in insolvency. Chief Justice Smellie accordingly made an order validating the transaction pursuant to section 99 and recognized the Chapter 11 Plan, such that Arcapita was permitted to remit the consideration to the disbursing agent to be distributed in accordance with the Plan.

The remittal of assets from one insolvency regime to another was the subject of significant debate in the split decision of the England and Wales House of Lords (which is highly persuasive on the Cayman Courts) in *Re HIH Casualty and General Insurance Ltd*[12]. The House was split as to whether remittal would be allowed if it did not prejudice creditors generally (the position taken by Lords Neuberger and Scott) or whether it would only be allowed by the English courts if they were to be remitted to a place that had the same rules of distribution, thereby ensuring that the effect of remitting was not to prejudice creditors in the ancillary liquidation (the position supported by the remainder). If the latter argument prevailed, then it may not be permissible for a Cayman Court to grant the remittal of assets from a Cayman liquidation if they were to be distributed in a manner that was inconsistent with Cayman law. The position given the terms of the present Plan was untested. CHC Parent argued that there was no remittal of assets in its case, it was simply seeking authority to dispose of all of its assets in order to achieve a better result for its creditors than would be achievable in a winding up in the Cayman Islands. CHC Parent asserted that, in any event, such an approach would be consistent with the speeches of Lords Neuberger and Scott in *HIH Casualty*, as the remittal would generally benefit the unsecured creditors.

Unlike the issue of common law assistance, the line of authority where a Cayman company seeks to dispose of its assets when subject to a petition for its winding up is well established[13]:

- The power to make a validation order is at the discretion of the Court and to be exercised consistent with the policy of *pari passu* distribution;
- The Court may validate a particular transaction where it is beneficial for the company and its unsecured creditors;
- The Court must be satisfied that unsecured creditors are not prejudiced and the company should be allowed to proceed if the Court is sufficiently satisfied that the interests of the creditors are that the company should be enabled to proceed;
- The Court should be inclined to validate a transaction which would increase the return to the company's creditors or which is not detrimental to the creditors of the company.

Upon CHC Parent's application for the validation of the Transfer, the Judge hearing the section 99 application, also McMillan J, was satisfied not only that the Plan stood to benefit the creditors, but that if it failed, that would not be in the interests of the creditors who otherwise stood to increase their return by participating in the Plan and that the creditors of CHC Parent would otherwise stand to receive nothing in its insolvent liquidation. McMillan J was therefore prepared to approve the Transfer and the Plan was met with the subsequent approval of the Texas Court on 3 March 2017. The Debtor Group Companies successfully exited Chapter 11 on 24 March 2017, enabling the business to continue without the specter that the restructuring would be unraveled in Cayman.

ALTERNATIVE APPROACHES

Of course, it is open to corporate groups with holding or other group companies in Cayman to promote restructurings through the Cayman Courts with the appointment of Joint Provisional Liquidators to promote a scheme of arrangement under section 86 of the Companies Law[14], or with seeking full powers for Joint Provisional Liquidators to enter into arrangements to compromise claims or dispose of assets[15]. However as the CHC Parent restructuring demonstrates, the Cayman Court is increasingly prepared to be practical and assist in corporate cross-border restructurings. The appropriate approach to take will depend upon the geographic footprint of the group, the desire of management to continue to manage the process and the level and manner of creditor support.

Whichever approach is taken, it is important to recognize the risks in each jurisdiction and make sure that these are suitably provided for.

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1 *Antony Gibbs & Sons v Societe Industrielle et Commerciale des Metaux* (1890) 25 Q.B.D. 399
2 [1984 CUKR 63]
3 Judgment of Chief Justice Smellie, 30 October 2000, unreported
4 [2002 CILR 550]
5 Order of Chief Justice Smellie, 31 May 2013, unreported
6 *Express Electrical Distributors Ltd v Beavis*
7 Re China Shanshui Cement Group Limited [2015] (2) CILR 258, with Mangatal J applying the principles of Re Emmadart Ltd [1979] Ch 540 in preference to the decision of Jones J in Re China Milk Products Group Ltd [2011] (2) CILR 61
8 Section 104 of the Companies Law (2016 Revision)
9 Judgment of Chief Justice Smellie, 30 October 2000, unreported, following the English case of Re English and American Insurance Co Ltd [1994] 1 BCLC 649
10 See also Trident Microsystems (Far East) Ltd, Cresswell J, 1 June 2012)
11 Unreported, Order of Smellie CJ, dated 31 May 2013, and "Recognition of foreign restructuring proceedings: Arcapita Bank", *South Square Digest*, February 2014, pp 36-43, A Zacaroli QC and S Dickson
12 [2008] 1 WLR 852
13 *Re Gray's Inn Construction Ltd* [1980] 1 WLR 711, *Re Freerider Ltd* [2010 (2) CILR 154] and *Scotiabank (Cayman islands) Ltd v Treasure Island Resort (Cayman) Ltd* [2004–05 CILR 423]
14 See LDK Solar, with concurrent Cayman Islands and Hong Kong schemes of arrangement.
15 See for example Suntech Power Holdings