Conyers Dill & Pearman

A Matter of Class: Determining Creditor Classes in a Scheme of Arrangement

Authors:
Ben Hobden, Partner
Spencer Vickers, Associate

When a scheme of arrangement involving compromise or arrangement is proposed between a company and its creditors under Section 86 of the *Companies Law*, the Court will consider whether it is appropriate to convene one or more meetings of creditors (the "Court Meetings") for the purpose of voting on the compromise (the "Class Issue"). The Court must ensure that the rights of creditors attending each Court Meeting are not so dissimilar as to make it impossible for them to consult together with a view to their common interest. Given the variety and complexity of ways in which creditors and companies may structure their affairs, this task is not one which is always straightforward.

If at the Court Meetings the creditors vote to approve the scheme, the Court must then consider whether it is appropriate to sanction the scheme (the "Sanction Issue"). The judgment in *Re Ocean Rig UDW Inc (in provisional liquidation)* concerned a US$3.7 billion restructuring of debt, which is the largest ever seen in this jurisdiction, and provides helpful guidance on how the Grand Court will approach both the Class Issue and the Sanction Issue.

Background

Ocean Rig UDW Inc (in provisional liquidation) ("UDW"), formed part of a group of companies (the "Group") carrying on business as an offshore ultra-deep water drilling contractor. The Group fell into severe financial distress due to the sustained depression in the price of oil. UDW and the other Group companies proposed a scheme of arrangement to their creditors seeking to compromise the Group's US$3.7 billion debt (the "UDW Scheme" and collectively, the "Schemes"). UDW and three other entities in the Group proposing schemes were formerly incorporated in the Marshall Islands but transferred their country of incorporation to the Cayman Islands before the Schemes were proposed, presumably to take advantage of the favourable restructuring regime in the Cayman Islands. As part of the restructuring, the Group also filed for Chapter 15 bankruptcy protection in the US.

A group of creditors with secured claims against various companies in the Group and substantial claims against UDW pursuant to guarantees (the "Guarantee Creditors") supported the Schemes and considered that a single class of creditors (and therefore a single Court Meeting) was appropriate in respect of UDW. However, Highland, which held notes in UDW (and held claims only against UDW) opposed the UDW Scheme and considered that the noteholders of UDW had different rights to the Guarantee Creditors and did not share a common interest. Accordingly, Highland submitted that the noteholders in UDW should form a separate class of creditors from the Guarantee Creditors and attend their own Court Meeting.

Given the substantial claims by the Guarantee Creditors against UDW, it was clear that if a single Court Meeting was convened to vote on the Scheme, the Guarantee Creditors would have a sufficient majority to approve the Scheme, regardless of Highland's opposition. However, if the UDW noteholders were deemed to form a separate class, (and a separate Court Meeting was held accordingly) the value of Highland's claims relative to the other UDW noteholders' claims would give Highland a blocking vote. If Highland continued its opposition it could therefore defeat the Scheme as a majority must be achieved at all Court Meetings under the *Companies Law*.

Class Issue

At the convening hearing, Highland referred the Court to a number of issues it considered should fracture the single class of creditors including, for example:

- the Guarantee Creditors had secured claims against other members of the Group while the UDW noteholders only had an unsecured claim against UDW;
- the Guarantee Creditors were to receive inducements to vote for the Schemes including consent fees and professional fees and expenses, however, Highland was not to receive any such inducements; and
- Highland had prepared a draft complaint against the management of UDW under the New York Debtor and Creditor Law, however under the UDW Scheme Highland would not be able to continue this claim. Instead, pursuant to the terms of the UDW Scheme all creditor claims would be vested to an independent trustee.

Notwithstanding the position taken by Highland, the Grand Court found that a single class of creditors was appropriate. In coming to its decision the Grand Court considered a number of English and Cayman Islands authorities and concluded:

- in relation to the Guarantee Creditors' claims against other members of the Group, the test to be applied is as to rights against the scheme company (ie UDW), not as against third parties and not as to interest;
- in relation to the alleged inducements, they were immaterial given the almost US$4 billion debt and did not make consultation impossible in one single Court Meeting; and
- no unfairness would result from creditors' claims being pursued by an independent trustee.

Court Meeting

At the UDW Court Meeting, the Scheme was approved by 96% of UDW's creditors. The only creditor to vote against the UDW Scheme was Highland.

The other Schemes were approved unanimously.

Sanction Issue

Highland objected to the sanctioning of the UDW Scheme on several grounds, including objections previously advanced at the convening hearing. The Court considered all arguments afresh at the sanction hearing, noting that it was not encumbered by its earlier decision in relation to the Class Issue.

In coming to the conclusion to reject Highland's objections and sanction the UDW Scheme, the Court considered that:

- UDW had complied with the terms of the convening order and the statutory requirements of the *Companies Law*;
- at the Court Meeting, the classes of creditors were fairly represented and the majority acted in a bona fide manner; and
- the UDW Scheme was one that an intelligent and honest scheme creditor, acting in respect of its interests, might reasonably approve, such that the Court should exercise its discretion to sanction the scheme.

Conclusion

The judgment in the matter of *Ocean Rig UDW Inc (in provisional liquidation)* confirms that the Grand Court will follow the long line of English authority pertaining to schemes of arrangement in relation to Class Issues and Sanction Issues.

Insolvency practitioners, creditors and proponents of schemes generally will be comforted that the Grand Court will not readily allow minority creditors to hold to ransom the majority to prevent a reasonable scheme from proceeding. Furthermore, facilitating a restructuring of this size shows that the Cayman Islands is a flexible jurisdiction and worldwide leader in debt restructuring.

Ben Hobden, Paul Smith and Spencer Vickers of Conyers Dill & Pearman acted on behalf of the UDW noteholders' Indenture Trustee.

AUTHORS:

BEN HOBDEN
PARTNER
ben.hobden@conyersdill.com
+1 345 814 7366

SPENCER VICKERS
ASSOCIATE
spencer.vickers@conyersdill.com
+1 345 814 7757

OTHER CONTACT:

PAUL SMITH
PARTNER
paul.smith@conyersdill.com
+1 345 814 7777

GLOBAL CONTACTS:

FAWAZ ELMALKI
DIRECTOR
HEAD OF DUBAI OFFICE
fawaz.elmalki@conyersdill.com
+9714 428 2900

NIGEL K. MEESON QC
PARTNER
HEAD OF ASIA DISPUTES & RESTRUCTURING
nigel.meeson@conyersdill.com
+852 2842 9553

LINDA MARTIN
DIRECTOR
HEAD OF LONDON OFFICE
linda.martin@conyersdill.com
+44(0)20 7562 0353

ALAN DICKSON
DIRECTOR
HEAD OF SINGAPORE OFFICE
alan.dickson@conyersdill.com
+65 6603 0712

ABOUT CONYERS DILL & PEARMAN

Conyers Dill & Pearman is a leading international law firm advising on the laws of Bermuda, the British Virgin Islands, the Cayman Islands and Mauritius. Conyers has over 130 lawyers in eight offices worldwide and is affiliated with the Conyers Client Services group of companies which provide corporate administration, secretarial, trust and management services.

For further information please contact: media@conyersdill.com