

An aerial photograph of a tropical island, likely in the Cayman Islands, showing a dense urban area, a large airport terminal, and surrounding turquoise waters. A white commercial airplane is flying in the foreground, viewed from below, showing its wings and tail. The text "The Impact of COVID-19" is overlaid in the upper left corner.

The Impact of COVID-19

on Cayman Islands Restructurings



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The long-term global impact of the COVID-19 pandemic will be far-reaching. It has already led to a significant drop in economic activity across the world, with certain industries, such as aviation, retail, hospitality, and tourism, being particularly affected.

The Cayman Islands is home to one of the world's leading financial centres. Its tax neutral status, stable government, and sophisticated legal system, and the flexibility of its Companies Act make the jurisdiction attractive to investors. Most offshore companies in the Cayman Islands are incorporated for holding or international trading purposes, as opposed to carrying out business directly in the Cayman Islands. As such, the need for significant measures in the Cayman Islands to address business concerns as a result of COVID-19 has been less pressing than elsewhere in the world.

The Cayman Islands continue to be an attractive restructuring jurisdiction. The courts and the dedicated

Financial Services Division have significant experience in managing complex debt restructurings. Such debt restructurings in the Cayman Islands often involve cross-border issues and require recognition in jurisdictions such as the United States and Hong Kong, and they often necessitate co-operation between the various jurisdictions, both at a practitioner and judicial level.

Restructuring work is certainly on the rise within the jurisdiction. Businesses continue to face great pressure given the breakdown of international supply chains, disruptions to manufacturing, cash flow issues, and labour shortages. Practitioners are therefore seeing otherwise viable companies forced to restructure liabilities and business structures to try to salvage ongoing trading and keep ahead of the looming risk of insolvency.

This article discusses the various business sectors that practitioners have noted as being particularly impacted by COVID-19, the modes of restructuring in the Cayman Islands and how they are being used,

proposed legislative reform, and the impact of COVID-19 on court administration in the jurisdiction.

Restructuring and Finance Deals

A considerable number of debt and equity capital markets deals and restructuring transactions have been conducted in the Cayman Islands since the outbreak of COVID-19. Companies in various sectors have sought to increase cash levels to see them through a period of relative uncertainty. Many businesses have sought to address liquidity problems arising due to the crisis with deals covering a wide range of sectors, including retail, banking, aviation, travel and tourism, food and beverage, and technology.

Due to low interest rates and increased market volatility—in part, due to COVID-19—2020 saw a marked increase in the use of special purpose acquisition companies (SPACs) for initial public offerings (IPOs) in the North American and London

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markets. As the Cayman Islands are ideally placed to provide an offshore domicile for these acquisition vehicles, practitioners anticipate that many more companies will continue to go public via SPACs throughout 2021 and beyond.

A marked increase in the number of fund financings was observed in 2020, as entities looked to lock down access to capital to fund acquisitions ahead of an anticipated credit squeeze and, potentially, to take advantage of assets that become available at reduced or distressed prices.

Modes of Restructuring

Debt of Cayman Islands companies, as well as those foreign companies that redomicile to or are registered as foreign companies in the Cayman Islands, can be restructured in this jurisdiction. The principal debt (and equity) restructuring tool is the scheme of arrangement. Cayman schemes of arrangement loosely mirror those in England—and the jurisprudence of the English courts remains highly persuasive in the Cayman Islands—and often take place within a provisional liquidation to take advantage of the statutory moratorium on claims that arises once provisional liquidators are appointed. There has been a significant increase in the number of schemes of arrangement being conducted in the Cayman Islands since the outbreak of COVID-19.

Although there is presently a lack of a legislative corporate restructuring regime other than schemes of arrangement in the Cayman Islands, in contrast to, for example, the U.S. Chapter 11 process and the

administration regime in the UK, the flexible provisional liquidation regime is often used as a means of obtaining a moratorium to prevent creditors from seeking to disrupt a *pari passu* distribution and to enable a company to seek to negotiate the restructuring of its debts with its creditors, whether by scheme of arrangement or a more informal out-of-court negotiation.

The provisional liquidation process is also often used to support a foreign restructuring process where there is a Cayman registered company within the corporate structure. For example, in 2020, a major U.S. clothing store filed for Chapter 11 bankruptcy in the U.S. to facilitate a restructuring plan, and joint provisional liquidators were appointed over the Cayman purchasing company for the group to support the implementation of the plan. Although COVID-19 was not cited as the main factor for the retailer's need to restructure, the pandemic doubtless accelerated the necessity. Practitioners expect to see an increase in provisional liquidations being used in this way as more retailers and other foreign businesses negatively impacted by COVID-19 are forced to restructure.

Chinese, Hong Kong Companies

The COVID-19 pandemic has impacted various Chinese industries, and the knock-on effect has been an increase in corporate reorganisations taking place in the Cayman Islands, given the significant number of China-based companies registered in there.

More than 50% of the companies listed on the Hong Kong Stock Exchange are incorporated in the Cayman Islands. Such companies are able to utilise the

Cayman Islands' "soft touch" provisional liquidation regime to secure a statutory moratorium and present a compromise to their creditors when winding up proceedings have been commenced or threatened in a foreign jurisdiction. The statutory moratorium acts as a protective wrapper and is of critical importance, given that there is no such equivalent process in Hong Kong. It ensures either an effective restructuring or, where that is not possible, an orderly distribution of the company's assets.

Section 104(3) of the Companies Act provides that the Cayman Islands Court may appoint provisional liquidators following the presentation of a winding up petition if that company is or is likely to become insolvent and intends to present a compromise or arrangement to its creditors. The statutory moratorium arises once the provisional liquidation order is made.

Historically, Cayman Islands provisional liquidators had been welcomed in Hong Kong, and throughout 2020, Cayman Islands provisional liquidators were recognised (as, importantly, was the automatic stay) with some regularity. Although the Hong Kong Court has been less willing in recent times to give automatic effect to the statutory moratorium given by the Companies Act,¹ it seems that the benefits to a Cayman Islands' incorporated debtor company of seeking the protective wrapper of an offshore provisional liquidator will outweigh the administrative burden of making an application for a stay in individual actions in Hong Kong.

Whilst beyond the scope of this article, recent decisions have cast doubt on

the future of this process, stating that the automatic stay that accompanies a Cayman Islands provisional liquidation will not automatically be recognised. What this means for modified universalism is something that practitioners are actively debating.

Proposed Legislative Reform

Legislative reform is, in fact, proposed to implement a completely new corporate restructuring regime that will operate outside of the context of liquidation and permit Cayman companies to formally restructure their debts outside of a formal insolvency process under the supervision of a qualified insolvency practitioner acting in the capacity of a "restructuring officer." Once these reforms are enacted, it will be interesting to see how much the new regime is utilised in the restructuring context, and, importantly, given the international nature of such restructurings, whether foreign courts will consider this process to be a collective insolvency proceeding.

Court Administration

Restructuring work often necessitates involvement of the court, especially if a scheme of arrangement is being utilised or provisional liquidation is being used to achieve breathing space for the company to explore a restructuring plan. Social distancing, the associated public health regulations, and remote working impacted the administration of court business, but court administration has been widely regarded as having been dealt with extremely well and efficiently in this jurisdiction. Indeed, many of the forced changes will create long-term efficiencies in the profession. The courts of the Cayman Islands have been conducting hearings remotely since the first lockdown was imposed in March 2020 and have recently introduced an e-filing system for court filings.

The Cayman Islands court system is currently regarded by some practitioners as being ahead of much of the rest of the world when it comes to the conduct of remote court hearings through videoconferencing. There are several reasons for this. Since Hurricane Ivan in 2004, many Cayman Islands law firms have invested significantly in their IT infrastructure. The Cayman Islands' legal profession is also accustomed to interviewing clients, examining witnesses, giving advice, taking instructions, and participating in meetings by telephone and video across



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different time zones. In addition, a number of sitting judges of the Cayman Islands' Grand Court and the Court of Appeal who do not reside full-time in the Cayman Islands are willing to make themselves available by telephone or video for urgent court hearings.

As a result, the COVID-19 pandemic has had only a small adverse impact on the conduct of litigation in the Cayman Islands. As part of the lockdown process, the chief justice of the Cayman Islands immediately published the judiciary's response, stressing that "the use of video-conferencing and teleconferencing will be encouraged and implemented where possible."

Various court practice directions were published, giving guidance as to how remote court hearings should be scheduled and conducted and dealing with important practical issues, such as electronic court filings, electronic court bundles, substituted service of court documents by email, public access, remote court hearing timetables, and virtual notarial procedures.

The Cayman courts will consider, of course, whether a short adjournment is appropriate in the circumstances

of any given case, especially in light of COVID-19, taking into account the impact of the pandemic on the company's creditors, directors, management, employees, legal advisors, and external auditors, and ongoing difficulties associated with completing on-site audit work. However, in cases where a debt is undisputed and a company is admittedly insolvent, especially on both a cash-flow and a balance sheet basis, there can be no expectation of an adjournment of a winding up petition hearing simply on the basis of COVID-19 alone, absent any evidence of a credible restructuring proposal.

Conclusion

In summary, there has been an increased flow of restructuring work in the Cayman Islands as a result of COVID-19, and this is expected to increase as the effects of the pandemic develop. Fortunately, the jurisdiction is well placed, with efficient and flexible procedures, a sophisticated judicial system, and experienced practitioners to assist entities looking to restructure. ■

¹ See the decision of Justice Harris in *FDG Electric Vehicles Limited* [2020] HKCFI 2931, for example.