Article

Cayman Islands Restructuring: What amounts to a "Rational Basis"?

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In the recent decision of Evergreen International Holdings Limited, delivered on 11 January 2022, the Grand Court of the Cayman Islands made an order for the immediate winding up of a company notwithstanding the company's cross-applications for an adjournment of the winding up petition and the appointment of "light-touch" provisional liquidators for restructuring purposes. The Court dismissed the company's cross-applications on the basis that there was no credible evidence which supported the company's assertion that a viable restructuring was imminent.

Background

Evergreen International Holdings Limited (the "Company") is an exempted Cayman Islands company listed on the Hong Kong Stock Exchange ("HKSE"), whose principal places of business are the People's Republic of China (the "PRC") and Hong Kong. On 23 September 2021, a creditor served the Company with a statutory demand in respect of an outstanding debt of HK$67,233,452.05. Upon the Company's failure to satisfy the statutory demand, the creditor presented a winding up petition against the Company.

The Company did not dispute the debt but asserted that its cash flow was limited given that it was in the process of selling certain real estate in the PRC, which would purportedly realise substantial value sufficient to repay all creditors. The Company therefore cross-applied for the adjournment of the winding up petition and for the appointment of light-touch provisional liquidators ("PLs") who would oversee a restructuring of the Company.

The Company submitted that while there was no restructuring proposal before the Court, this was not a bar to the appointment of PLs given the Court's wide discretion to make such appointments under section 104(3) of the Companies Act. The Company also cited the Chief Justice's decision in Sun Cheong Creative Development Holdings Limited where a winding up petition was adjourned, in very different circumstances, in order to facilitate a restructuring which was deemed to be in the best interests of all stakeholders.

Court's Ruling

Mrs Justice Ramsay-Hale dismissed the Company's cross-applications and ordered the immediate winding up of the Company on the basis that there was no "rational basis" to grant an adjournment. The Court found that:

(a) the Company's assertions as to value of its real estate assets in the PRC were unsupported by any evidence;

(b) the Company had been unable to produce any audited accounts since December 2018 to support its assertion that it was solvent;

(c) the financial statements before the Court showed that the Company's financial position deteriorated rapidly in 2019; and

(d) the Company had not offered even the outline of a restructuring proposal, despite a restructuring advisor being engaged since April 2021.

In light of the above findings, the Court dismissed the Company's cross-applications which it held had all the hallmarks of a last minute application by an insolvent company of which the Court should be wary.

As per Kawaley J's guidance in Harlequin Hotels and Resorts Limited, "unconvincing … brave last-ditch battles" are unlikely to succeed and "serious applications" tend to be advanced in the following ways:

1. A petition is adjourned while a stay or strike-out application is pending;
2. Substantial evidence of a dispute is put forward by the date of the hearing of the petition;
3. Out-of-court negotiations result in an adjournment by consent; or
4. There are extenuating circumstances and the outline of a legitimate defence to the petition which justify an adjournment.

Comment

However, while a detailed restructuring plan is not required, in exercising its discretion, one factor which the Court will take into account is whether there is a "real prospect" of recovery and whether the proposal is likely to be more beneficial than a winding-up (as per the Chief Justice's guidance in Sun Cheong). Segal J applied this guidance more recently in Midway Resources International in granting the appointment of PLs. Whilst recognising that a fully formulated restructuring plan was not required, Segal J did go on to assess whether there was a "rational basis" for the draft proposals which were then before the Court.

It is therefore clear that the Court has a wide discretion under section 104(3) and, in appropriate cases, the Court will no doubt grant an adjournment in order to facilitate restructuring where this is found to be in the best interests of all creditors (as demonstrated in cases such as Re Sun Cheong and more recently in Silver Base Group Holdings Limited).

Recently passed amendments to the Companies Act are designed to facilitate a restructuring outside the context of winding up proceedings. The amended legislation includes similar language to the current section 104(3) test. As a prerequisite to the appointment of a restructuring officer under the new regime, the company must show that it "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 consensual restructuring". It is therefore likely that the principles established in the case law under section 104(3) will continue to be applicable under the new regime.

The Court will no doubt continue to remain astute to carefully scrutinize whether there is (at the very least) a "real prospect" or "rational basis" for a viable restructuring while at the same time recognizing that a detailed, final plan is not required.

The decision in Evergreen serves as a useful reminder of the importance of advancing credible evidence which establishes, at a minimum, a rational basis for any proposed restructuring and, where possible, consulting with creditors and other key stakeholders to gauge support in advance of an application to appoint officeholders to promote a restructuring.

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