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Directors: “What shall we do?” – *Interplay between the Sequana decision, HSBC v NewOcean Energy Holdings Ltd and the new Cayman restructuring regime*

Authors: Norman Hau, Partner | **Catherine Wong,** Legal Manager

Due to the recent challenging economic environment, the law’s treatment of creditors’ interests in a restructuring or insolvency has been a hot topic. From a creditor’s perspective, its objective will be straightforward: to maximize its recovery as soon as possible when its interests are put at risk by financial challenges facing the debtor. From a shareholder’s perspective, its agenda will generally be quite different: to achieve certainty and stability through a debt restructuring so that the company can stay afloat and carry on business without the risk of a winding up order. The tension between the aims of the creditors and those of the shareholders often put directors in a difficult position. How can they properly fulfil their fiduciary duties to act in the best interests of the company when they have to take into account the conflicting interests of different stakeholders?

Creditors’ interests have always been at the heart of insolvency law. Recently, there have been various amendments to legislation and important judgments in the United Kingdom (the “**UK**”), Bermuda and the Cayman Islands respectively that clarify the link between directors’ duties and creditors’ interests. We have covered some of those developments in recent publications: Directors’ Duties on the Precipice of Insolvency: Brief Overview of BTI 2014 LLC v Sequana SA; BVI Directors’ Duties and Insolvency: The Impact of the Sequana Case; and Cayman Islands Restructuring: Recent Common Law Insights for Directors when Entering the Zone of Insolvency.

In this article, we will explore the interplay between:

1. the UK Supreme Court decision in *BTI 2014 LLC v Sequana SA and others* [2002] UKSC 25, which discusses the scope of a director’s duty to have regard to the interests of creditors and when that duty arises (the “***Sequana*** **Decision**”);
2. the Bermuda Supreme Court decision in *HSBC v NewOcean Energy Holdings Ltd* [2021] CA (Bda) 16 Civ (the “***NewOcean*** **Decision**”), in which the judge remarked that creditors may prefer to have a winding up order with liquidators appointed on a permanent rather than provisional basis to safeguard their interests; and
3. the new Cayman Islands restructuring officer regime, which makes directors of companies subject to the supervision of a restructuring officer appointed by the Cayman courts.

The *Sequana* Decision

Earlier this month, the UK Supreme Court handed down this landmark decision which considers whether the common law duty to act in good faith in the interests of the company includes a requirement that directors consider or act in the interests of the company’s creditors, when it arises, and its scope:

1. The Supreme Court unanimously held that the directors’ fiduciary duty to the company includes a duty to have regard to the interests of creditors. This is emphasised in section 172(3) of the UK Companies Act which provides that section 172(1) is “*subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company.*” Interestingly, while the need to have regard to the creditors’ interests is codified in the UK, there is no equivalent legislative provision in most offshore jurisdictions including the Cayman Islands, Bermuda and the British Virgin Islands.
2. However, the appeal was unanimously dismissed because the risk of insolvency in the case was neither probable nor imminent and therefore the directors did not have a duty to have regard to the interests of creditors. The Supreme Court held that the trigger point for taking account of the interests of creditors is:

   a. when the company is insolvent or bordering on insolvency;

   b. where an insolvent liquidation or administration is probable; or

   c. where a transaction would place the company in either of the two situations mentioned above.

3. The current legal position in the UK is that creditors' interests will only be overriding at the point where insolvent liquidation or administration is inevitable. At this point the shareholders will be considered to have ceased to have any economic interest. Consequently, the company's interests should be interpreted as being equivalent to the interests of its creditors in those circumstances. Up until the time when liquidation becomes inevitable, "*the creditor duty is a duty to consider creditors' interests, to give them appropriate weight, and to balance them against shareholders' interests where they may conflict*".

The *NewOcean* Decision

The Bermuda Court of Appeal handed down a decision late last month that the respondent, a Bermuda company (the "**Company**"), should cease to be subject to a "light touch" order and that it should be wound up with the joint provisional liquidators (the "**JPLs**") being given corresponding full powers pursuant to section 175 of Bermuda's Companies Act. The decision serves as a warning that the courts will not allow the privilege of a "light touch" order to be abused.

In summary, the winding up petition issued against the respondent had been adjourned on numerous occasions to allow time for a restructuring to be completed. The Supreme Court was asked to review the position and decided that a winding up order should be made because the judge when considering the latest request for an adjournment had failed to take into account (amongst others) the following important considerations:

1. The conduct of the Company – during the relevant period, the Company had breached the "light touch" orders in a number of ways, including failing to provide the JPLs with critical financial information including details of the Company's creditors. The JPLs needed this to opine on whether the restructuring proposals were in the interests of creditors, and to discharge their duties and functions.

2. Failure to notify the JPLs – related to the above, the Company failed to inform the JPLs of two significant share pledges and that a winding up petition had been brought by a trade creditor in the Hong Kong courts. The Supreme Court emphasised that "*the maintenance of a light touch order calls for complete transparency and cooperation from the Company, and that the non-disclosure of the Hong Kong petition and the other breaches by the Company of the [light-touch order], was a strong factor (amongst others) in favour of winding up the Company*".

3. The considerable delay and its unfairness to creditors – a "*delay of such an amount justifies the unacceptability of it to a majority of creditors and such delay, together with the failure of the Company to persuade any creditors who oppose the Current Proposal to change their minds and support it (with the result that, in fact, no progress has been made in securing from the bank creditors agreement to the Current Proposal or any other restructuring plan) is a powerful factor in favour of making a winding up order.*"

The *NewOcean* Decision concludes with the following noteworthy remarks:

> "*It is, however material to observe that a light touch order may, in practice not involve much decision making by the JPLs as to what steps shall be taken in the disposal of the company property in order to satisfy its debts. That is a good reason why creditors may genuinely wish to have a winding up order with liquidators appointed on a permanent basis to safeguard their interests, rather than be left in the hands of a company over which the JPLs have, in practice, very limited control, and such wishes should be given significant weight.*"

Typically, the use of "light touch" provisional liquidation would help directors discharge their duties in a distress situation, allowing them to focus on the management of the company under the supervision of the light touch provisional liquidators. However, it is incumbent on the directors to cooperate fully with the JPLs so that they can perform their function effectively. In the unfortunate event that the directors or management fail to do this, as in the *NewOcean* Decision, it will be difficult for the JPLs to offer much assistance to the company, in which case the better option for creditors will be to resort to a winding up order.

The Cayman Islands restructuring officer regime

Effective from 31 August 2022, the Cayman Islands introduced a new restructuring officer regime which provides protection for companies in financial difficulty (by amendments to Part V of the Cayman Islands Companies Act).

Under the new regime, a company may seek the appointment of a restructuring officer, who will be granted specific powers to supervise the restructuring process and give advice to directors. The company will need to demonstrate to the court that (i) it is or is likely to become unable to pay its debts; and (ii) intends to present a compromise or arrangement to its creditors.

The petition seeking the appointment of a restructuring officer may be presented by the directors, based on their belief that there is a realistic prospect of saving the company through a restructuring of its debts. Once the petition is presented, the company benefits from an automatic moratorium.

It should be noted however that directors still owe their usual duties to the company while being subject to the supervision of the restructuring officer appointed by the Cayman courts. It is therefore of paramount importance that directors cooperate with the restructuring officer closely, and consult the restructuring officer on concerns about aspects of the restructuring, for example in relation to transactions yet to be completed which may affect the future viability of the company, or even consult the Cayman court where there are more serious concerns.

This new regime provides important support for directors who are duty-bound to consider the creditors' interests (as explained in the *Sequana* Decision), where a Company is on the verge of insolvency and extra breathing space and protection is required to implement a feasible restructuring plan.

Observations

The "light touch" provisional liquidation regime has been deployed in offshore jurisdictions as a useful tool to facilitate successful debt restructuring. The heart of the regime is genuine cooperation between the company's management and the appointed provisional liquidators in formulating a viable plan acceptable to creditors. Whilst there are numerous successful cases, there are also cases where the debtor in possession regime does not seem to sufficiently serve creditors' interests which are supposed to be paramount. Those unfortunate cases attracted judicial criticism from different courts and questioning of the effectiveness of the light touch provisional liquidation regime.

Following the *NewOcean* Decision, it is expected that "light touch" provisional liquidation applications by a debtor company will be put under even closer scrutiny to ensure that appointments function properly to achieve successful restructuring which gives proper regard to the creditors' "*paramount*" interests in an insolvent company.

The key takeaway from the *Sequana* Decision and the *NewOcean* Decision discussed above is that directors should be mindful of creditors' interests and ensure that there is a clear plan to discharge the company's debts as they fall due. In particular, the *NewOcean* Decision goes further and demonstrates the willingness of the courts to think from the perspective of creditors when faced with lengthy delays. Well planned restructuring taking into account all key stakeholders' interests, including that of the creditors is essential if a company decides to opt for "light touch" provisional liquidation.

The Cayman new restructuring regime is a well-balanced solution. It is designed to address the tension between creditors, shareholders and directors. Practical mechanisms have been incorporated to fix potential shortcomings observed in the "light touch" provisional liquidation regime. In light of the directors' duties now clarified in the *Sequana* Decision, it would be appropriate to deploy the new Cayman restructuring regime where insolvency proceedings are "*probable*" or "*imminent*". The new Cayman restructuring regime is no doubt a very welcome judicial reform, and it is hoped that it can be globally recognised and applied in serving the ideal of modified universalism.

Authors:

Norman Hau
Partner
norman.hau@conyers.com
+852 2842 9548

Catherine Wong
Legal Manager
catherine.wong@conyers.com
+852 2842 9519

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