AMERICAN BANKRUPTCY INSTITUTE
JOURNAL
The Essential Resource for Today's Busy Insolvency Professional

The International Scene

BY TIMOTHY "TAD" DAVIDSON II, TONY HEAVER-WREN AND EDWARD A. CLARKSON, III[1]

Cayman Islands and Bermuda Restructuring Laws vs. U.S. Code

Timothy "Tad" Davidson II
Andrews Kurth Kenyon, LLP; Houston

Tony Heaver-Wren
Appleby Global Cayman Islands

Edward A. Clarkson, III
Andrews Kurth Kenyon, LLP; Houston

Economic headwinds continue to exert downward pressure on many different industries around the world. It is a reality that some of these international companies will not be able to weather the storm. As such, these international companies may have to make the difficult decision to reorganize their business operations and restructure their capital structure.

With the help of restructuring professionals both in the U.S. and other countries, these companies and their creditors must analyze the certain country's restructuring laws in which the company operates in order to determine which country's laws provide the greatest advantages to the restructuring process where a restructuring is commenced is a hotly negotiated matter. In recent years, a few jurisdictions have become increasingly popular venues for international restructurings, namely the U.S., the Cayman Islands and Bermuda.

This article addresses Cayman and Bermuda restructuring laws and certain issues that should be compared and considered when determining whether to reorganize in the Cayman Islands or Bermuda, or to file for bankruptcy protection in the U.S. and utilize chapter 11 of the U.S. Bankruptcy Code.

Cayman and Bermuda Restructuring Laws and Chapter 11

Restructuring laws in both the Cayman Islands and Bermuda do not have a directly analogous statutory reorganization regime to the U.S. Bankruptcy Code. Instead, restructuring in the Cayman Islands and Bermuda consists of a combination of statutes, common law and agreements between the interested parties and creditors. Both Cayman and Bermuda law, including restructuring law, grew from the British common law.

Restructuring options in Cayman and Bermuda consists of three broad categories: (1) consensual agreements with creditors to rearrange debts without court involvement; (2) schemes of arrangement or formal corporate rescue; and (3) the appointment by a Cayman or Bermuda court of a provisional liquidator to impose a moratorium (a stay on unsecured creditor enforcement) in order to allow restructuring options of various kinds to be pursued, including a sale of the assets or the business itself as a going concern. Savvy restructuring professionals will utilize a combination of all three categories in varying degrees to effectuate an effective reorganization.

The U.S. Bankruptcy Code is generally regarded as the most debtor-friendly reorganization regime in the world. More often than not, debtor companies will heavily favor filing in the U.S. in order to utilize a variety of restructuring tools available under the U.S. Bankruptcy Code, not the least of which are the ability to avoid liquidation and imposition of the automatic stay. However, recent application of schemes of arrangement, in combination with chapter 15 proceedings in the U.S., have allowed restructuring companies to specifically target and restructure specific debts within the capital structure instead of subjecting the entire company and all of its creditors and equityholders to a chapter 11 bankruptcy.

Schemes of Arrangement

The Cayman schemes of arrangement may be found under §§ 86 and 87 of the Companies Law (2016 Revision)[2] and the Companies Winding Up Rules 2018.[3] The Bermuda schemes of arrangement

1 Mr. Davidson was an expert witness on U.S. bankruptcy law in the Bermuda *Archer Ltd.* main proceeding. Both he and Mr. Heaver-Wren are serving as counsel to the coordinating committee of banks (CoCom) in the *Seadrill Ltd.* chapter 11 proceeding.

2 Cayman Companies Law.

3 Cayman Companies Winding Up Rules.

may be found under §§ 99-101 of the Companies Act 1981[4] and the Companies (Winding Up) Rules 1982.[5] These legislative provisions for schemes of arrangement are substantially the same as the relevant provisions of the English Companies Act 2006 and are also substantially the same as sections of a number of commonwealth company statutes. Cayman and Bermuda courts routinely regard British case law (and sometimes Australian and Hong Kong case law) as persuasive authority in schemes of arrangement cases filed in the Cayman Islands or Bermuda.

Generally speaking, Cayman and Bermuda laws are regarded as benefiting secured lenders more so than the U.S. Bankruptcy Code does. Of significant importance is the fact that a scheme of arrangement does not impose an automatic stay on creditors, although mechanics for obtaining a stay do exist. Specifically, the restructuring company may seek the court appointment of a provisional liquidator in order to afford the restructuring company a stay on enforcement by unsecured creditors. The stay that arises under Cayman and Bermuda laws upon the appointment of provisional liquidators differs in important respects from the blanket automatic stay imposed by the U.S. Bankruptcy Code.

Tad Davidson is a bankruptcy/ restructuring partner and Edward Clarkson is an associate with Andrews Kurth Kenyon LLP in Houston. Tony Heaver-Wren is a partner with Appleby Global in the Cayman Islands.

In the Cayman Islands and Bermuda, notwithstanding the stay being in effect, secured lenders might still enforce their security and take actions to realize on their collateral at any time. This is in direct contradiction to the U.S. Bankruptcy Code. As such, consensus must be reached between secured lenders and reorganizing companies in order to effectuate a successful reorganization under Cayman and Bermuda law. The mere fact that at any time a secured lender can exercise its security rights shifts much of the negotiating power in the secured parties' favor.

One of the most appealing features of a scheme of arrangement is its ability to target only certain problematic debts in the company's capital structure instead of subjecting the entire company to a restructuring process under the U.S. Bankruptcy Code. In that regard, a scheme of arrangement is not a formal insolvency process, nor does it necessarily affect all creditors. Instead, a scheme of arrangement is a process that can be used in a host of other scenarios, including completing corporate transactions, group restructurings, specific debt restructurings, and mergers and acquisitions. Because a scheme of arrangement is not a formal insolvency process, reorganizing companies and secured lenders can be much more targeted in how to address specific debts in the company's capital structure.

One of the key components in a scheme of arrangement is the composition of creditor classes. Under both Cayman and Bermuda laws, classes must be confined to those persons whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interests. Compare this to § 1122 of the U.S. Bankruptcy Code, which states that "a plan may place a claim or an interest in a particular class only if such claim or interest is substantially similar to the other claims or interests of such class."[6] These are similar conditions of the formation of creditors' classes.

The U.S. Bankruptcy Code allows debtors a wider discretion in their classification of creditors, potentially allowing the debtor to have more classes of creditors in its reorganization plan. On the other hand, in Cayman and Bermuda law, the trend is for the courts to approve very few and often a single class of creditors, provided that their rights are sufficiently similar. Companies promoting a Cayman or Bermuda scheme of arrangement will often seek to bring greater certainty to the outcome of the creditors' vote by seeking lock-up agreements with creditors, pursuant to which creditors commit to vote in support of the scheme. As part of the lock-up process, inducements might be paid to creditors, but they are relatively insignificant in value compared to the company's debt; the inducements provide some consideration for advance commitment to support the scheme, but they should not be so significant in amount as to be likely to influence the vote of the creditors concerned.

Under Cayman and Bermuda laws, there are typically two court hearings involved in order to implement a scheme. At the first hearing, the court must decide whether a meeting of creditors should be convened and whether the debtor's proposed classification of the voting classes is correct. At the second hearing, the court determines whether it should sanction the scheme. Generally, unopposed schemes of arrangement could take approximately eight to 12 weeks. The timing of chapter 11 cases varies from case to case, and can range from just a few weeks to much longer depending on the facts and the legal issues presented during the case.

Following the first hearing, in order for a meeting of a particular class of creditors to resolve to approve the proposed scheme of arrangement, an affirmative vote must be returned by the creditors representing a majority in number and 75 percent in value of the claims of those creditors present at the meeting (whether in person or by proxy) and entitled to vote. The approval of the scheme of arrangement by the creditors in each class does not bring the restructuring into effect, as the Cayman or Bermuda court retains discretion as to whether to sanction the restructuring at the final court hearing.

The voting requirements for a scheme of arrangement are not unlike the voting requirements found in the U.S. Bankruptcy Code, with two important exceptions. First, pursuant to § 1126(c),

4 Bermuda Companies Act.
5 Bermuda Companies (Winding Up) Rules.

6 11 U.S.C. § 1122(a).

a class of claims is considered to have accepted a plan if the plan is accepted by creditors of such class that it holds at least two-thirds in amount and more than one-half in number of the allowed claims of that class that actually voted on the plan.[7] Therefore, the requisite majority by value is higher in the Cayman Islands and Bermuda than in the U.S.; the value threshold being three quarters, compared with two thirds.

Second, under a scheme of arrangement, all classes must vote to accept the scheme of arrangement in order for it to be sanctioned by the court, and a debtor can only "cram down" creditors (force dissenting creditors to accept the scheme of arrangement) within an accepting class. There is no "cram-down" of the proposed restructuring on other classes that have not voted to approve the scheme of arrangement. However, the lack of intra-class cramdown in schemes of arrangement is offset by a further contrast with chapter 11 reorganizations, namely that class composition in Cayman Islands and Bermuda schemes is radically different, with the majority of schemes having only one class of creditors.

Under the U.S. Bankruptcy Code, cramdown could be utilized to force an entire rejecting class to accept a plan when certain Code requirements are met.[8] Much to the chagrin of secured lenders, cramdown (or cram-up) might also be used to force a secured lender into accepting a debtor's reorganization plan where these is a separate class of impaired creditors voting to accept the plan. Compare this to Cayman and Bermuda law, where at any time a secured lender can exercise its security right. This is a significant difference and must be considered when negotiating where to seek a restructuring.

Examples of Recent Schemes of Arrangement

An example of how parties have utilized the targeted benefits of a scheme of arrangement is *Archer Ltd*.[9] Archer filed a proceeding seeking the court's sanctioning of its scheme of arrangement in the Supreme Court of Bermuda, Commercial Division. Archer is an exempted limited liability company incorporated under the laws of Bermuda, whose shares trade on the Oslo Børs in Norway. Archer utilized its scheme of arrangement under Bermuda law in order to restructure only its then-outstanding secured term and revolving credit facility. None of Archer's other debts or equity interests were affected by the scheme.

Archer then sought chapter 15 recognition in the U.S. Bankruptcy Court for the Southern District of Texas to effectuate and make its reorganization enforceable in the U.S. By utilizing a scheme of arrangement under Bermuda law, Archer was able to specifically target its existing senior secured lenders and restructure its secured credit facility without infringing upon the rights of its other creditors or equityholders. A key advantage of a scheme of arrangement is its surgical ability to restructure only certain portions of a company's capital structure.[10]

A recent case from the Cayman Islands addressed similar issues. The companies that were the subject of *In re Ocean Rig UDW Inc*. (in provisional liquidation), being UDW and three of its subsidiaries (the "scheme companies"),[11] were each incorporated and registered in the Marshall Islands, a sovereign state in free association with the U.S. The Marshall Islands had no restructuring regime; therefore, it was necessary for the companies to consider other jurisdictions with formal restructuring mechanisms.

The scheme companies met certain requirements under Cayman law to allow the scheme companies access to Cayman law and reorganize using Cayman schemes of arrangement and provisional liquidation. UDW, the parent company of the group, redomiciled to the Cayman Islands. The rest of the scheme companies undertook a shift of their center of main interests to the Cayman Islands and registered as foreign companies in the Cayman Islands. With the required nexus with the Cayman Islands established, the scheme companies applied for and were granted chapter 15 foreign main proceeding recognition in the U.S. Bankruptcy Court for the Southern District of New York.

The scheme companies then proceeded to implement four interlocking schemes of arrangement, restructuring US$3.8 billion of debt without compromising the tax neutrality of the companies by keeping them and the restructuring offshore. The schemes were approved by the creditors and sanctioned by the court, notwithstanding that one creditor who actively objected to the schemes at the initial and final court hearings.

Provisional Liquidation

Because a scheme of arrangement is not a formal restructuring procedure and does not enjoy the benefits of an automatic stay as found in the U.S. Bankruptcy Code, companies will often seek a "provisional liquidation" concurrently with a scheme of arrangement. Provisional liquidators pursuant to Cayman law are appointed under § 104(3) of the Companies Law (2016) Revision, and provisional liquidators pursuant to Bermuda law are appointed under §§ 170-180 of the Companies Act 1981. A court order approving a provisional liquidation also carries with it a stay against all unsecured creditors of the restructuring company under both Cayman and Bermuda law. In applying to the court for a provisional liquidation and also seeking a scheme of arrangement in parallel, the debtor might enjoy a stay as to unsecured creditors, and the use of a statutory scheme that will enable the debtor to restructure.

A provisional liquidation is often referred to as a "light" or "soft touch" restructuring tool. A provisional liquidator's powers are set out in the court order approving the appointment and are often tailored to encourage the provisional liquidators to work with the existing directors and management to develop and propose a restructuring without replacing current management. Conceptually, this is not wholly unlike a receiver appointed outside of bankruptcy or an "examiner" appointed under § 1104 of the U.S. Bankruptcy Code, but with more authority.

Chapter 11 Under the U.S. Bankruptcy Code

While some companies may only require targeted relief to restructure certain specific debts in their capital structures,

7 *See* 11 U.S.C. § 1126(c).

8 *See* 11 U.S.C. § 1129(b).

9 Andrews Kurth Kenyon, LLP represented Archer in its chapter 15 proceeding.

10 Another example: DTEK Finance BV, which issued a $200 million, 9.5 percent senior note governed by New York law to the Ukraine's largest privately owned energy group, was able to utilize a scheme of arrangement under British law in order to restructure only the terms of the note, but the scheme of arrangement did not affect other creditors. *In re DTEK Finance BV*, [2015] EWHC 1164 (Ch).

11 Appleby Global represented Ocean Rig UDW Inc.

at other times a top-to-bottom restructuring must take place. In those cases, the U.S. Bankruptcy Code provides many powerful tools to restructure a company's balance sheet and entire capital structure.

For example, Seadrill Ltd. filed for chapter 11 in the Southern District of Texas.[12] Seadrill, organized under the laws of Bermuda, is a publicly traded company with common shares traded on the New York Stock Exchange and Oslo Børs. The Seadrill debtor group has 12 different secured credit facilities.

For two years, Seadrill negotiated with its secured lenders over many matters, not the least of which was where best to effectuate any agreed-to restructuring. As negotiations continued, the coordinating committee (CoCom) of secured lenders was formed to participate in the restructuring negotiations on behalf of the lenders in the secured credit facilities.

Ultimately, Seadrill and CoCom agreed on a U.S. chapter 11 filing to effectuate a prearranged restructuring. Under the restructuring support agreement filed by Seadrill, the multi-faceted transaction (1) re-profiled the existing bank debt to eliminate near-term amortization obligations and extend maturities; (2) had certain unsecured bondholders providing "new value" to Seadrill and becoming equityholders; (3) provided a $1.06 billion new capital injection; (4) left employee, customer and ordinary trade claims largely unimpaired; and (5) reorganized Seadrill's corporate structure to support the new debt structure and capital injection. It is likely the debtors wanted a U.S. filing because the U.S. Bankruptcy Code provided the most tools available to them to effectuate the proposed restructuring of its entire capital structure.[13]

Chapter 15: Foreign Recognition

While restructuring in foreign jurisdictions might provide relief for a company or benefit secured lenders in foreign jurisdictions, for companies that have assets in the U.S., foreign restructurings must still be approved in a chapter 15 case in order to make the terms of the restructuring binding and enforceable in the U.S. Restructuring companies must consider that injunctions issued by a Cayman or Bermuda court against unsecured creditors might not apply in the U.S. As such, many foreign restructuring companies doing business in the U.S. or with assets in the U.S. will need to consider applying for relief under chapter 15 of the U.S. Bankruptcy Code if they require the benefit of the automatic stay to protect U.S. assets. Thus, where a company has assets in multiple jurisdictions, it is important to ensure that foreign recognition proceedings in the relevant jurisdictions are coordinated with the proceedings in the jurisdiction where the restructuring takes place.

Conclusion

Where an international company seeks to commence a reorganization proceeding is a critical decision in any international restructuring case. Debtors and secured lenders, and their advisors, must be keenly aware of the pros and cons of each jurisdiction. abi

Reprinted with permission from the ABI Journal, Vol. XXXVII, No. 4, April 2018.

12 Case No. 17-60079.

13 This case is still pending, and the proposed plan has not yet been set for confirmation. Andrews Kurth Kenyon, LLP is co-counsel with White & Case for the Coordinating Committee of Senior Secured Credit Facility Agents ("CoCom") in the *Seadrill* bankruptcy proceedings, and Appleby with White & Case advises the CoCom with respect to Bermuda law.