'A Comparative Look at Pre-Packs in Selected Jurisdictions' - Cayman Islands

Briefing Summary: Partner Peter Sherwood discusses 'pre-packs' in the Cayman Islands in this Special Report with INSOL International.

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1. What measures are available in your jurisdiction to allow struggling businesses to enter into a "pre-pack"?

There is no bespoke legislation dealing with "pre-pack" restructuring or sale of the business or assets of an insolvent Cayman Islands company. However, the existing insolvency legislation is sufficiently flexible to allow transactions approximating an English "pre-pack" to take place in the appropriate case, albeit there will be limitations compared with the English regime.

One of the limitations of the Cayman Islands insolvency regime is that there is no out-of-court method for putting a company into an insolvency process equivalent to administration in England. Broadly speaking, there are three forms of insolvency procedures in the Cayman Islands:

- Voluntary liquidation: A company may be placed into voluntary liquidation on the resolution of its shareholders (that is without a court application). However, if the company is insolvent, the voluntary liquidator is required to apply to have the liquidation placed under the supervision of the court (which is akin to official liquidation, discussed below). It is therefore unlikely to be an appropriate procedure for implementing a "pre-pack".

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- Official liquidation: The court may order a company to be placed into official liquidation on the petition of the company itself, or any one of its creditors or shareholders. This is a terminal procedure, in which official liquidators are appointed to wind up the affairs of the company and distribute its assets, before applying for the company to be dissolved. It could therefore in theory be used to implement a "pre-pack" in which all of the assets of the company were to be sold. However, the route into official liquidation is not quick (the statutory steps, including advertising the hearing of the petition, usually takes at least three months), meaning this is unlikely to be a suitable procedure.
- Restructuring Officer: A company may apply for the appointment of a restructuring officer on the grounds that it is (or is likely to become) insolvent and "intends to present a compromise or arrangement to its creditors".1 This bespoke restructuring regime was introduced in 2022 and is the process used to give effect to facilitate attempts at a rescue or restructuring of an insolvent company.

Where there are grounds for urgency, and subject to court availability, an appointment of a restructuring officer can be made within a few days. The application can also be made ***ex parte***, without notice to creditors. Therefore, in the appropriate case, the process could be used to meet the urgency and secrecy requirements that typically drive the need for a pre-pack.

The application to appoint a restructuring officer triggers a moratorium on proceedings and creditor enforcement action against the company.2 Licensed insolvency practitioners are appointed as provisional liquidators, but their powers are derived from the court order appointing them. Restructuring officers are typically appointed on a "light touch" basis, in which control of the day-to-day operations of the company remains with the directors and the restructuring officer focuses on the restructuring.

There are no reported or unreported cases of the restructuring officer regime (or the previous provisional liquidation regime) being used to implement a true "pre-pack" - that is, one in which restructuring officers (or provisional liquidators) are appointed to immediately give effect to a pre-arranged sale of the company's business and assets. Court sanction would be required for the restructuring officer to undertake such a sale at any time, and while in theory the application for sanction could be made immediately following the appointment (that is at the same hearing), there are a couple of obstacles that would be difficult to overcome:

- firstly, it is not clear that the purpose of the appointment of the restructuring officer, that is to "present a compromise or arrangement to its creditors",3 would be met where an immediate sale with no creditor consultation is proposed. While the court has in the past interpreted this phrase flexibly in the past, a "true pre-pack" may be one step too far; and
- secondly, the court would need to be willing to permit the restructuring officer to forego the usual creditor consultation process that is usually expected before a substantial sale is sanctioned.

These obstacles are not necessarily insurmountable, but it is likely the court would need to be satisfied that there was an overwhelmingly strong case that the "pre-pack" was in the interests of creditors.

2. How do pre-packs work in practice in your jurisdiction? What are the advantages and disadvantages of pre-packs when compared with other options that are available?

As discussed above, there are no reported or unreported cases of the restructuring officer regime (or its predecessor, provisional liquidation regime) being used to implement a true "pre-pack".

Prior to the implementation of the new restructuring officer regime in 2022, provisional liquidation was however often used to implement restructurings and / or business or asset sales by insolvent companies, including in cases where urgency is required, and the new regime will continue to facilitate this. If the restructuring officer can demonstrate that there is broad creditor support for sale, there is no reason why court sanction could not be obtained very quickly following the appointment, particularly if much of the work (that is negotiating sale documents, liaising with key creditors) has begun prior to the appointment. Therefore, while the lack of creditor consultation makes a true "pre-pack" difficult, in cases where creditor consultation will not defeat the proposed transaction, the Cayman Islands regime is sufficiently flexible that transactions can be implemented relatively quickly with limited cost.

Provisional liquidation has also been used to implement a restructuring or sale that predominantly takes place under an overseas insolvency regime. While the Cayman Islands Court will not recognise and give effect to insolvency appointments by foreign courts over Cayman Islands companies (except in extremely limited circumstances), it will cooperate with overseas attempts to rescue or restructure Cayman Islands companies. This was usually achieved by the appointment of provisional liquidators on a "light touch" basis to cooperate with and give effect to the overseas restructuring efforts. For example, in the case of CHC Group Ltd,4 the court appointed "light touch" provisional liquidators on the application of a Cayman Islands holding company that was the subject of Chapter 11 proceedings in the United States of America, and shortly thereafter sanctioned the sale of the whole of the company's holdings to a Newco to give effect to the Chapter 11 restructuring. Going forwards, restructuring officers will perform this function.

3. What duties must directors of the debtor consider when deciding whether to proceed with a pre-pack?

The duties owed by directors of Cayman Islands companies include the duty to act for a proper purpose, in what they believe to be in the best interests of the company, to avoid conflicts of interest, and to act with due care and attention when exercising their powers.

While these duties are owed to the company, in circumstances where the company is insolvent or is doubtful of its solvency, the directors are required to have primary regard to the interests of creditors in discharging their duties.

Therefore, in determining whether to proceed with a pre-pack restructuring (or similar), the directors should be primarily concerned with maximising returns to creditors.

4. What level of involvement does a court have in a pre-pack?

There will be significant court involvement in a Cayman Islands pre-pack. As noted above, the appointment of a restructuring officer involves an application to court, and any decision by the restructuring officer to implement a sale (whether by way of a pre-pack or otherwise) will also require a court order.

In exercising its discretion in these matters, the court will be concerned with: (i) whether it has jurisdiction to grant the relief sought (for example are the statutory requirements for the appointment of provisional liquidators met), and (ii) the interests and wishes of creditors.

5. What duties must officeholders comply with when deciding whether to enter into a pre-pack?

Restructuring officers' duties will depend on the court order appointing them. As noted above, it is likely that the directors will retain day-to-day control and that the restructuring officer will be directed to focus on the restructuring. In the case of a pre-pack, the restructuring officer may be specifically directed to consider and, if thought appropriate, implement, a specific transaction.

Restructuring officers must act with skill and care in the performance of their duties. They are required to act impartially, in good faith, with the interests of all stakeholders in mind. In considering any sale, particularly one in which the opportunity for creditor consultation may be limited, these duties must be at the forefront of their mind.

In a pre-pack situation (or similar), to a certain extent it is possible to discuss the terms of the proposed transaction with the prospective provisional liquidators prior to their appointment. However, restructuring officers are required to be independent, and so great care must be taken that this is not compromised (or seen to be compromised) by any pre-appointment discussions. For example, the selection of prospective restructuring officers should not be conditional upon their approval of the proposed transaction. However, the legislation expressly provides that the fact that an insolvency practitioner has advised the company on a potential restructuring does not prevent their appointment.

6. How does the officeholder comply with their duties in practice? Can they rely on valuations? If so, what is regarded as an acceptable methodology?

There are no hard-and-fast rules for the procedure that must be followed by restructuring officers in conducting a sale. For example, there is no requirement to obtain a formal valuation, or to conduct an open market sale, as there are in certain jurisdictions. Restructuring officers must simply satisfy themselves and the court that the proposed transaction is in the interests of creditors, and the appropriate methodology will therefore vary from case to case.

In the ordinary course, the court places a good deal of faith in the commercial judgment of the restructuring officers as well as the wishes of creditors. However, in a pre-pack situation where there has been little or no creditor consultation, the court is likely to heavily scrutinise the restructuring officers' reasons for the transaction. If the proposed sale is to a related party, the reasons would need to be extremely compelling.

There is no specific guidance on a pre-pack situation equivalent to SIP 16 (Statement of Insolvency Practice 16) in England. However, a restructuring officer may choose to adopt this guidance in order to demonstrate to the court that the process is justified.

7. What measures, if any, have been taken or are proposed to be taken to ensure that pre-packs are properly scrutinised?

None.

1. Companies (Amendment) Act 2021, s 91B(1)(b).
2. Although a crucial difference between a Cayman Islands provisional liquidation and English administration is that provisional liquidation does not prevent secured creditors enforcing their security.
3. Ibid.
4. Unreported, 24 January 2017.

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