

GUIDE TO SCHEMES OF ARRANGEMENT IN THE CAYMAN ISLANDS

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PREFACE

The information contained in this Guide is for informational purposes only and should not be treated as constituting legal advice. Readers are encouraged to consult their professional advisers before making decisions or taking actions on the numerous and complex issues involved in schemes of arrangement in the Cayman Islands.

If any such questions arise in relation to the contents, they may be addressed to Appleby using the [contact information](#) provided at the end of this Guide.

Appleby
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1. WHAT IS A SCHEME OF ARRANGEMENT?

A scheme of arrangement is a court approved compromise or arrangement entered into between a company and its creditors or members or any classes of them in accordance with section 86 Companies Law (2013 Revision).

A further category of compromise or arrangement is an amalgamation, as contemplated by section 87 Companies Law (as revised), by which the Grand Court can order transfers (between the companies to be amalgamated) of assets and liabilities (including legal proceedings), the dissolution (without winding up) of the transferring company and incidental matters.

An arrangement is construed sufficiently widely to permit almost any kind of internal arrangement in the company, but there is required to be an element of accommodation on both sides in order for the scheme to be considered and approved as a scheme of arrangement. For example, expropriation of shares without any form of compensating advantage would not be a compromise or arrangement for the purpose of section 86.

Although Cayman's legislative provisions for schemes of arrangement are substantially similar to equivalent provisions in the UK and other Commonwealth countries, there is significant difference between the range of common uses of schemes in Cayman and those other jurisdictions. The principal difference is that creditor schemes are far more prevalent in Cayman than in other jurisdictions.

Creditor schemes are relatively rare in the UK and Australia (for example) because of the well-established and heavily used administration and company voluntary arrangement regimes in those countries. Each of those administration and arrangement regimes impose a statutory moratorium, allowing breathing space from creditor action while the company's position is assessed and rescue measures are implemented. In UK, Australia and like jurisdictions, creditor schemes of arrangement are unpalatable because their procedural requirements and degree of court involvement are substantially greater than the administration/arrangement based processes available in those jurisdictions.

In Cayman, creditor schemes represent the only formal means of imposing corporate rescue of a distressed and insolvent company. Such schemes are often used in conjunction with the appointment of provisional liquidators. This enables the company to take advantage of the statutory moratorium on claims, so allowing the provisional liquidators and the company's principal creditors to assemble the restructuring proposal.

A scheme of arrangement is a process driven by the target company, rather than the bidding company. A scheme can therefore only be used where there is agreement between a target and a bidder. A scheme could not be used, for example, where a hostile bid is planned. The bidder in a scheme may, however, seek to retain some control of the process through an implementation agreement with the target company that imposes certain consultative obligations on the target throughout the scheme approval process.

2. HOW ARE SCHEMES USED?

Uses of member schemes include:

- Mergers and demergers
- Privatisations/de-listings and other friendly takeovers
- Share exchanges and purchases
- Top-hattings (parent company replaced with new holding company)

- Demutualisations and spin-offs
- Simplification of entitlements in liquidations of funds

Uses of creditor schemes include:

- Debt-for-debt, debt-for-equity and debt-for-assets swaps
- Distribution of assets and payment of debts without liquidation
- Simplification of entitlements in liquidations
- Giving effect to debt moratoriums
- Insurance run-offs
- The compromise of class action or group litigation.

A review of such uses and the particular technical and practical considerations they involve will be the subject of a further note.

3. WHAT PROCEDURES MUST BE FOLLOWED?

The procedure required to obtain member/creditor and court approval of a scheme of arrangement is outlined in Grand Court Rules Order 102 rule 20 and in the Grand Court's Practice Direction 2/2010.

An application for a scheme of arrangement is commenced by petition, filed at the Grand Court. The application may be commenced by the company or a member, creditor or liquidator of the company. The petition seeks the court's sanction of a proposed scheme of arrangement or compromise.

An interlocutory summons is filed with the petition, seeking an order for the convening of the member/creditor meetings (referred to in the Rules as the **Court meetings**).

The interlocutory summons is supported by an affidavit which describes the purpose and effect of the proposed scheme, contains sufficient information to enable the court whether to convene class meetings and the appropriate composition of the classes. The affidavit must also contain enough information to enable the court to determine whether the proposed time and place of the Court meetings and the method of giving notice is appropriate in all the circumstances. The affidavit must have annexed to it, the proposed scheme with all supplementary documents, draft notices of the Court meeting and draft proxy forms and voting instructions, together with the draft explanatory statement said to contain all the information reasonably necessary to allow members/creditors to make an informed decision about the proposed scheme.

Separate affidavit evidence is required if the scheme involves a listed company, demonstrating to the court that the company has complied with relevant listing and practice rules. If it is an incident of the scheme that the company is to transfer its duties as a trustee, a separate application is required under the Trust Law to transfer a company's duties as a trustee because section 86 is only effective to transfer property and liabilities of the transfer company: *In re Chemical International Trust Corp. Ltd.* 1997 CILR N-6. If the scheme is an amalgamation (effectively, a merger using the scheme mechanism rather than the merger provisions of the Companies Law) a director of the transferee company will also need to swear an affidavit, supporting the petition for sanction of the scheme.

At the first hearing the court will determine the constitution of the relevant classes for voting purposes. The court will convene separate meetings where the persons' legal rights (as opposed to interests arising from those rights) are so dissimilar that they cannot sensibly consult together with a view to their common interest: *In re Euro Bank Corp.* 2003 CILR 205.

The court will also decide at the first hearing whether the explanatory statement gives adequate information to allow members/creditors to reach an informed decision on the proposals and whether the meetings should proceed given any evidence concerning the level of opposition to the scheme. The question of fairness of the scheme is reserved for consideration at the hearing of the petition at which the Grand Court considers whether to sanction the scheme. The court sets the final hearing date for the petition at the first hearing on the interlocutory summons.

The meetings of the classes of members/creditors are convened in accordance with the Grand Court's orders. At the meeting of each class of member/creditor, a majority in number representing 75% in value of those voting must approve the scheme if it is to proceed.

If the required majority is obtained in each meeting, within seven days of the meetings the petitioner files an affidavit sworn by the chairman of the meetings verifying that the convening notices were sent in accordance with the court's directions and that the meetings were duly held, and setting out full particulars of the voting.

The petitioner appears before the Grand Court seeking approval of the scheme. Dissident members/creditors are entitled to appear and be heard. At the hearing, the Grand Court considers (in light of any opposition) whether:

- approval of the scheme was reasonable (whether a reasonable member would have approved it);
- each class was fairly represented at the meeting;
- the majority acted bona fide;
- all notice periods were complied with;
- the resolutions carried by the requisite majority.

The court may provide its sanction of the scheme conditional upon certain variations being made to take account of justified objections to the scheme raised at the first or final hearing.

The scheme takes effect upon the filing of the Grand Court's order approving the scheme with the Registrar of Companies.

An indicative timetable for the preparation and determination of a petition for a scheme of arrangement is set out in the Appendix to this note.

4. **WHAT ARE THE BENEFITS OF USING A SCHEME?**

The benefits of using a scheme are:

- once effective, the scheme binds all members/creditors, including dissentients (whether or not they had notice of the meeting), so removing any minority and giving the bidder 100% of the target company;
- at the member/creditor meeting, the company is only required to have approval from a majority in number attending the member/creditor meeting, representing 75% of the value of the votes cast at that meeting. This differs from a takeover in which the bidder must obtain 90% of acceptances from the bid class and then is required to take steps to compulsorily acquire the remaining shares of the company;
- turn-outs at meetings for approval of schemes tend to run at about 40% of those to whom notice of the meeting was sent, so the threshold for approval of a scheme of arrangement is often, in practice, relatively low;

- lost and untraceable members are unlikely to be relevant or require specific orders;
- the key issue of the constitution of the relevant class of parties entitled to vote is treated as a preliminary issue for determination at the first court hearing;
- the meeting(s) to approve the scheme may be held overseas;
- no stamp duty is payable if the shares of the target company are cancelled rather than transferred (new shares being issued to the bidder from the capitalised reserve);
- in most cases, there are no prospectus requirements;
- schemes generally do not trigger overseas securities requirements (for example US Securities & Exchange review) because they involve a member's vote rather than an individual investment decision;
- the Grand Court has experience in dealing with a very large number of scheme applications from diverse industries and for diverse purposes;
- the Grand Court ensures that its directions are consistent with any relevant listing rules and/or takeover codes;
- the Grand Court facilitates swift resolution of the scheme process, requiring that the entire court timetable is established at the outset.

5. WHAT ARE THE DRAWBACKS OF USING A SCHEME?

Some of the drawbacks of using a scheme are:

- the need for court sanction gives a potential public forum for objections in addition to the meeting of members/creditors;
- once the explanatory memorandum has been dispatched to members/creditors, there is little flexibility to change the terms of the scheme (with the exception of price) without restarting the full scheme timetable;
- market purchases of shares in the target company by the bidder are of no effect as the bidder's shares are not counted. Further, the more shares the bidder holds the greater the risk of a small number of members/creditors having sufficient numbers and value to oppose the scheme;
- if any class of members/creditors that is affected by the scheme does not approve the scheme with the requisite double majority (headcount and value) at the meeting of the relevant class, that outcome constitutes a veto vote that defeats the scheme;
- a scheme that involves a reduction of capital will require separate member approval of that reorganisation;
- the court has a discretion to refuse to approve the scheme if it considers it to be unfair or otherwise subject to a sufficiently serious and justifiable objection.

6. WHAT CAYMAN SCHEMES HAS APPLEBY BEEN INVOLVED WITH?

Appleby has been involved with a number of recent high profile schemes of arrangement in the Cayman Islands. Examples include:

- *In The Matter Of Alibaba.Com Limited 2012 (1) CILR 272* – a members scheme in respect of an exempted limited company, incorporated in the Cayman Islands and listed on the Hong Kong stock exchange, being an investment holding company that, through its subsidiaries, carried on business facilitating activities for suppliers and buyers through online marketplaces. Appleby sought and

successfully obtained for approval of a scheme to privatise the company, following which the company would apply to be delisted from the Hong Kong Stock Exchange;

- *In The Matter Of Little Sheep Group Limited* 2012 (1) CILR 34 – a members scheme that made new law in respect of headcount procedures, in respect of the majority in number, where shares are held by nominees or in clearing houses such as the Central Clearing and Settlement System of the Hong Kong Securities Clearing Co. Ltd;
- *In The Matter Of The Sphinx Group Of Companies* 2010 (1) CILR 452 – a creditors scheme in which the Cayman Court affirmed that it did have the jurisdiction to sanction schemes involving compulsory releases of claims against third parties, in this case the release of further claims against indemnity claimants who were not parties to the scheme (being parties involved in the running of the SPhinX funds against whom allegations of fraud were made and proceedings were brought and who, accordingly sought to rely on contractual indemnities from those funds).

For more specific advice on schemes of arrangement in the Cayman Islands, we invite you to contact:

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For the convenience of clients in other time zones, a list of contacts available in each of our jurisdictions may be found [here](#).

APPENDIX

Indicative Timetable for a Scheme

The following indicative timetable reflects the expected progress of a straight-forward scheme of arrangement without any variations or share reduction elements.

Day	Events	Note
1 (assuming approx 4 weeks for preparation of documents)	Begin preparation of documents (i.e. Petition, Scheme of Arrangement, Explanatory Statement, Voting and Proxy Forms, Notice to Shareholders, Notice of Meeting, Summons for Directions and Affidavit in support). Apply to the court for provisional hearing date.	To confirm which director will affirm the Affidavit, and co-ordinate the logistics. An original of the signed Affidavit must be filed with the Cayman Court. Scanned copy with the original to follow, may be acceptable to the court.
14-21 (Weeks 2-3)	File Petition and Summons for Directions.	
28-35 (Weeks 4-5)	Board meeting to approve Notices of Scheme Meeting, Proxy and Voting forms and to approve despatch of documents to shareholders. File Amended Petition (if required), Scheme of Arrangement documents and Affidavit in support.	
42 (Week 6, 3-4 weeks from filing of Petition and Summons)	Hearing of Summons for Directions. Court Order granted to convene Scheme Meeting and Directions given.	Information to enable court to make determination of class and give directions for holding of Scheme Meeting, set out in Affidavit. Latest date to revise court date for hearing of Petition.
49 (Week 7)	Notices of Scheme Meeting given and documents distributed to shareholders (approx. 6 weeks' notice). Submit notice of Scheme Meeting to newspapers in Cayman Islands and in accordance with Directions from the court (if so directed by the court).	

Day	Events	Note
51-56	Notice appears in Cayman and otherwise directed by the court.	
80	Begin preparation of Chairman's Report on Scheme Meeting and Affidavit in support of Petition.	
94 (approx. 6 weeks from date of Notice of Shareholders' Meeting)	Scheme Meeting.	
101 (7 days to finalise and file the required Affidavit and Chairman's Report etc.)	Chairman of Meeting to complete report to Cayman Islands Grand Court and to swear and file Affidavit.	
104 (3 days from date of filing of Chairman's report, date obtained at the date of filing the Petition)	Hearing of Petition. Order granted approving the Scheme.	
105	File Order at court.	
107	File sealed Court Order with the Registrar of Companies. Effective date of the Scheme.	