MAY 2024

UPDATE

The pick and choose jurisdiction? Restructuring Officers vs Provisional Liquidators

Update prepared by Simon Dickson (Cayman Islands)

The Grand Court has allowed the appointment of a Provisional Liquidator under section 104(3) of the Companies Act (2023 Revision) (the **Act**) for the purpose of facilitating a restructuring, rather than using the tailor-made Restructuring Officer provisions under section 91(B) of the Act.

Background

Kingkey Financial International (Holdings) Limited (the **Company**) is a holding company for a group which carries out business, ranging from the fur trade to diversified financial services. The Company has its principal place of business in Hong Kong and is listed on the HKSE.

The fact pattern in the case of *In the Matter of Kingkey Financial International (Holdings) Limited* is a well-trodden path.[1] The Company was insolvent and, through its Special Committee, made a number of attempts to raise capital. One of the directors, Mr Chen, opposed the fund raising and brought proceedings in Hong Kong to restrain the Company. To complicate matters, complaints were made against Mr Chen, which were reported to the HKSE leading to a suspension of trading. To cap it off, rival EGM's were requisitioned: one by Mr Chen to remove the current Board and one by a rival shareholder to remove Mr Chen. In the midst of it all, debts fell due, a statutory demand was received and the creditors circled.

Decision

Against this background, management proposed that an independent office holder should be appointed to pursue a restructuring and a moratorium obtained. The usual process is to apply for the appointment of a Restructuring Officer (**RO**) pursuant to section 91(B) of the Act. This allows for an appointment where a company (a) is or is likely to be unable to pay its debts, and (b) intends to present a compromise or arrangement to its creditors.[2] However, in this case the Company sought the appointment of Provisional Liquidators (**PLs**) to fill the RO role. The application was made on two bases:

(i) first a PL allows the Court to remove all powers of the Board of Directors, whereas the RO regime does not. Given the internal divisions, any sort of debtor in possession approach would be doomed to failure; and

(ii) second, there may be difficulties in obtaining recognition of ROs, whereas these difficulties would be lessened if a PL was appointed.

With respect to (i) the Court found that there was a '*built-in presumption*' under the RO regime that directors would retain some powers, whereas there was no such presumption under the PL regime.[3] In this case, where there were internal divisions, it made sense for all powers of the Board to be removed. The Court went on to find that it had jurisdiction to appoint a PL for the purpose of a restructuring because of the expansive language of section 104(3) of the Act, which allows a PL to be appointed where it '*considers it*

[1] (Unreported 12 April 2024)

[2] See our previous legal update, Brave new world: Restructuring Officers in the Cayman Islands, which considers the Restructuring Officer regime in the Cayman Islands.

[3] *In the Matter of Kingkey Financial International (Holdings) Limited* at [35]

appropriate to do so'. The Court also noted that prior to the introduction of the RO regime, section 104(3) expressly allowed the appointment of PLs for this purpose.

With respect to (ii) the Court gave no reasoning.

Analysis

On analysis, the reasons advanced by the Company were open to argument.

As to (i), it is difficult to detect any persuasive foundation for the submissions made to the Court that directors must retain some of their powers under the RO regime. Unlike a Chapter 11 proceeding in the United States, there is no debtor in possession precondition. The Applicant pointed to section 91B(5)(b) and (c) of the Act which requires an order appointing an RO to set out the '*manner and extent to which the powers and functions of the restructuring officer shall affect and modify the powers and functions of the board of directors*' and '*any other conditions to be imposed on the board of directors… in relation to the exercise by the board of directors of its powers and functions*'. However, neither subsection contains any built-in presumption that the powers should continue and, indeed, the wording of sections 91B(4) and (5)(b) would seem to be sufficiently wide to remove all powers if necessary.

As to (ii), as regards recognition, it is unfortunate that no reasoning was given. It is clear that the Company had an eye to recognition, having carved out the Hong Kong proceedings brought by Mr Chen, presumably to avoid any suggestion that the Cayman Court is trying to assert its jurisdiction over the Hong Kong Court. However, it is unlikely that a PL for the purpose of a restructuring will be more likely to be recognised in Hong Kong than an RO. Indeed, it was exactly this sort of PL process that has been at the centre of the various decisions in Hong Kong refusing recognition and developing the COMI test. As a more general point, the RO regime has been carefully drafted to ensure it is capable of recognition and conforms with the UNCITRAL Model Law on Cross Border Insolvency.

Conclusion

The Court was at pains to make clear that this was an unopposed application and that the Court was not making any ruling as to the interaction between the PL regime and the RO regime. It would seem however, that a strong argument can be made that where the legislature has created an RO regime empowering the Court to appoint office holders to facilitate a restructuring, and expressly removed those powers from the PL regime, the intention was that the RO regime should be used. Indeed, the government consultation paper seems to support this, stating that the PL regime would no longer be required to facilitate a restructuring, because the function '*will now be performed by the RO regime*'.

There may be circumstances, however, where there is good reason for a PL to be appointed. For example, in the case of fraud, a PL could be needed to deal with the fraud alongside a restructuring. It is also true that the law as drafted affords the Court a very wide discretion as to when a PL should be appointed. We suspect that if applications for the use of PLs rather than ROs gather pace, the Court will wish to put in guardrails as to when and for what purpose the PL jurisdiction may be used.

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