A capital idea? Incoming changes to Cayman share capital reduction regime

March 2024

Having exited the consultation stage and been heard and passed by the Cayman Islands' parliament on 23 February 2024, legislative changes to streamline the process by which Cayman companies can effect a reduction in their share capital will be brought into law.

Under the current but soon-to-be-previous regime, **any** reduction in share capital must be approved by special resolution **and** sanctioned by the Cayman Court. This is a costly process, not only due to the requirement to pay Court fees in order to file the sanction application, but also due to the requirement to file both a Summons for Directions and a Petition, and pay the attendant legal costs. The Summons for Directions, which is capable of determination without the need for a hearing, is for the purpose of setting directions (for example, the date of the hearing of the Petition and appropriate means of advertising the hearing of the Petition) up to the hearing of the Petition itself. The Petition is for the Court to determine whether to approve the reduction.

The paramount concern of the Court - which the current regime is designed to address - is that the creditors of a company looking to reduce its share capital should not be prejudiced. That concern is acute where:

1. a company is in, or foresees, financial difficulty; or
2. the reduction will result in a diminution of the company's liability in respect of unpaid share capital; or
3. the reduction entails a payment to shareholders of paid-up capital.

The proposed changes introduce the means for a company, if authorised to do so by its articles of association, to combine the passing of a special resolution with the signing of a "Solvency Statement" by the directors of the company to effect a share capital reduction, without recourse to the Court.

It is proposed that the simplified Solvency Statement-based procedure will be available, even if the reduction would result in a diminution of the company's liability in respect of unpaid share capital or it entailed a payment to shareholders of paid-up capital.

The assumed rationale is that, if the directors are prepared to sign a Solvency Statement stating that the company will be able to pay its debt as they fall due in the ordinary course of business commencing on the date of the statement, then the potential threats to the interests of creditors of a diminution of liability in respect of unpaid share capital, or a payment to shareholders of paid-up capital, are nullified.

The Solvency Statement

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It is defined as a statement made in prescribed form (yet to be drafted) to the effect that a full enquiry into the company's affairs has been made and to the best of the directors' knowledge and belief the company will be able to pay its debts as they fall due in the ordinary course of business commencing on the date of the statement.

Liability for knowingly false statement

As with a knowingly false Declaration of Solvency signed in the context of a voluntary liquidation, it is proposed that a knowingly false Solvency Statement (i.e. one made where the director in question does not have reasonable grounds to believe that the company will be able to pay its debts in full as they fall due in the ordinary course of business) made in support of a share capital reduction will also constitute an offense carrying liability on summary conviction to a fine of ten thousand Cayman Islands dollars and to imprisonment for two years. Directors should also keep in mind their common law and equitable duties.

In the English case of *BTI 2014 LLC v Sequana SA & others [2016] EWHC 1686 (Ch)*, the High Court held that directors must have actually formed the opinions set out in the Solvency Statement and must have applied the correct test. In the context of the Cayman Islands' Solvency Statement, it remains to be seen whether the Cayman Court will apply the cashflow test of insolvency used in the context of winding up petitions, which incorporates consideration of debts that will become due and payable 'in the reasonably near future', as per *Weavering Macro Fixed Income Fund Ltd (in Liquidation)* 2016 (2) CILR 514, or whether a balance sheet test is regarded as an adequate safeguard to the interests of stakeholders.

Timing

The Solvency Statement must be signed no more than thirty days before the date on which the special resolution is passed.

Within 15 days of the passing of the special resolution, the company will need to deliver to the Cayman Registrar of Companies the Solvency Statement and a minute detailing:

1. the amount of share capital of the company;
2. the number of shares into which the share capital is to be divided and the amount of each share; and
3. the amount, if any, deemed to be paid up on each share.

A number of administrative steps are then undertaken by the Registrar, the most significant being the registration of the Solvency Statement and the minute, at which point the resolution passing the share capital reduction takes effect.

The failure to deliver the Solvency Statement and the minute to the Registrar within the fifteen days will mean the Registrar will not register them and the company would need to then apply to the Court for an order confirming the reduction.

Effect on Position of Minority Shareholders

With the Solvency Statement procedure negating the involvement of the Court, the scope for a minority shareholder (or a shareholder without voting rights) to object to a share capital reduction before it is effective is drastically reduced, assuming the company in question has complied with the statutory requirements (for example, by passing a valid special resolution). In England, a minority shareholder in such a position could bring a claim for unfair prejudice, albeit it would be an after-the-event remedy, rather than a contemporaneous obstruction to the reduction.

Unfair prejudice claims are not actionable in the Cayman Islands. A winding up petition could be brought on a just and equitable ground (which includes a breakdown in trust and confidence in the directors), seeking a remedy alternative to winding up, for example an injunction.

A director may breach its duties to the company in respect of the Solvency Statement, and that might open the door to a claim against the director. Subject to the nature of the loss suffered, the rule against reflective loss may not be engaged, however, any commentary on that area of Cayman law is very far outside the scope of this article. It suffices to highlight that there are categories of shareholders (and creditors) for whom the introduction of the Solvency Statement regime is not necessarily cause for celebration.

Conclusion

The proposed changes mean that companies will still be able to use the currently available procedure of passing a special resolution and seeking court approval, and as such the ability of the Courts to protect creditors of companies whose directors are not able to sign a Solvency Statement will not be fettered.

However, it will be possible in appropriate circumstances for Cayman companies to obviate the time and expense of obtaining Court approval of a capital reduction, as is the case in England, Bermuda, Guernsey and Jersey. No doubt companies looking to effect a capital reduction as part of a wider capital reorganization involving, for example, a scheme of arrangement, a redenomination, a consolidation or a subdivision, will be pleased that a layer of complexity and an element of delay will potentially be removed from the process.

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