

## Financing considerations for take-private transactions in the Cayman Islands

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In the last few years there has been a resurgence in listed companies incorporated in the Cayman Islands, with links to Asia, de-listing from global stock exchanges. The majority of these transactions - whether they are sponsored by a founder/majority shareholder, a trade buyer or a private equity fund - are financed by a mix of equity and debt funding.

There are broadly three ways to take private a Cayman Islands incorporated listed company: statutory merger, tender offer and scheme of arrangement. Different considerations apply to the financing of transactions affected by each different method.

We have previously examined the [different ways to take private](#) a Cayman Islands incorporated listed company, provided a [case study](#) on the dissenting shareholder issues that emerged in the privatisation of eHi Car Services Limited by way of a statutory merger, and looked at developments in the [dissenting shareholder fair value process](#) in privatisations by Cayman Islands statutory merger. In this article, we will set out the main financing considerations for each method from a Cayman Islands law perspective only. Other considerations will also apply, notably the rules of the stock exchange where the relevant Cayman Islands company is listed.

### Statutory merger

A take-private transaction by way of statutory merger usually involves the incorporation by the sponsor of a new company in the Cayman Islands (**MergerCo**), which will merge into the existing listed entity incorporated in the Cayman Islands (**Target**) pursuant to the procedure set out in the Companies Act (Revised) of the Cayman Islands (the **Companies Act**), with Target being the single surviving company of the merger.

A secured financing of this type of transaction (the **Merger Financing**) would typically involve the lenders taking security over (before the merger has taken effect) the shares in MergerCo and the assets of MergerCo and (on and from the effective time of the merger - the **Effective**

**Time)** the shares in Target, as surviving company, and its assets.

It is possible to take security over future assets as a matter of Cayman Islands law, as long as those assets are sufficiently identifiable for the security to attach to them at the relevant time. Therefore, it is possible for the sponsor to provide security over both the currently owned shares in MergerCo and the shares in Target it will own on and from the Effective Time, as a condition precedent to the Merger Financing. The relevant security documents may express that the security over the shares in MergerCo will be automatically released on the Effective Time (reflecting the legal reality under Cayman Islands law, given MergerCo will cease to exist from that time) and that the security over the shares in Target will take effect on and from the Effective Time, so that there can be a seamless transition of the security package once the merger has taken effect.

Section 236(1) of the Companies Act provides that as soon as a merger becomes effective, the rights, property and business of MergerCo shall immediately vest in Target (as the surviving company) and Target shall be liable for, and subject to, all mortgages, charges or security interests, and all contracts, obligations, claims, debts, and liabilities of MergerCo. Therefore, if MergerCo is the borrower, its obligations under the Merger Financing will automatically pass to Target by operation of Cayman Islands law. Pursuant to this provision of the Companies Act, it is also possible, as a matter of Cayman Islands law, for the Merger Financing lenders to rely on the security granted by MergerCo over its assets prior to the Effective Time, to secure the assets of Target on and from the Effective Time, without the need for Target to grant new security. However, consideration will need to be given as to the legal effectiveness of such approach under the governing law of the security documents and the law of the place where the secured assets are situated and to practical considerations, such as any change of bank account details or the need for delivery of updated notices to third parties, to reflect that the account holder and security provider has changed from MergerCo to Target.

Each of MergerCo and Target must obtain the prior consent to the merger from any secured creditors it has pursuant to section 233(8) of the Companies Act. Given the Merger Financing lenders will likely take security over the shares in and assets of MergerCo as a condition precedent to the Merger Financing, they will technically need to give consent to the merger. This consent is normally included in one of the finance documents for the Merger Financing. If Target has any existing secured creditors at the time of the merger, then consent will also need to be obtained from those creditors.

A certificate of merger issued by the Registrar of Companies in the Cayman Islands is prima facie evidence of compliance with the Companies Act requirements, and so, effectiveness of the merger. Delivery of a copy of this certificate is therefore usually a condition subsequent under the Merger Financing. The terms of the Merger Financing also usually require delivery to the lenders of the new memorandum and articles of association and register of members of Target, reflecting its status as a private company wholly owned by the sponsor, within a specified time

period after the Effective Time. The Merger Financing lenders also typically require, as a condition precedent to funding, copies of the near final plan of merger and connected documents that will be filed with the Registrar of Companies to effect the merger, together with evidence that the merger has been approved by the directors and requisite majority of shareholders of each of MergerCo and Target.

## | Tender offer

A take-private transaction by way of tender offer involves a general offer by an offeror (the **Offeror**) to buy the shares held by the public shareholders of a listed company at a specific price at a specific time. Pursuant to section 88 of the Companies Act, the Offeror needs to obtain the approval of 90% of the independent shareholders (holders of those shares not already owned by the Offeror or its affiliates (the **Requisite Shareholder Approval**)) in a listed target incorporated in the Cayman Islands (**Listco**) to enable it to require the compulsory sale by the remaining shareholders of their shares in Listco.

In many cases, the Offeror will require available financing for the tender offer (the **Tender Financing**) prior to it achieving the Requisite Shareholder Approval, to assist the Offeror in the acquisition of shares in Listco through the general offer, in order to obtain the Requisite Shareholder Approval. In such instances, the conditions to funding under the Tender Financing that relate to the tender offer will be commercial and aimed at ensuring the Offeror has a minimum ownership percentage in Listco prior to funding and that the terms of the tender offer, as reviewed by the Tender Financing lenders, may not be materially changed. Lenders financing this type of transaction would typically take security over the shares in Listco already held by the Offeror and those shares acquired by the Offeror during the tender offer process.

It may not be the case that all of the issued shares in Listco that are acquired by the Offeror through the tender process are held through a clearing system in dematerialised form (**unregistered form shares**). Sometimes the shares have not been dematerialised and the title to them remains evidenced by an entry in the register of members of Listco (**registered form shares**). In this case, the Tender Financing lenders should be advised to ensure the security documents create effective security over both registered form shares (prior to their conversion) and unregistered form shares (following any conversion into this form). The requisite deliverables under the security documents may be heavily negotiated, given that at the time the security is created, the Offeror does not own 100% of the shares in Listco. Some of the questions that arise are: how will security be taken over shares that arrive in batches and how will any conversion of registered form shares into unregistered form shares during the tender offer process (if any) be dealt with? Where any secured shares are registered form shares, additional questions will arise, such as is there any share certificate relating to those shares and how will that certificate be collected (to enable any conversion to unregistered form shares), where is the register of members of Listco located and how much assistance will be offered by Listco to

complete steps which lenders would typically require when taking security over registered form shares in a wholly owned private company (such as placing a security annotation on the register of members of Listco and giving an instruction to the registered office provider or share registrar of Listco in respect of the share security granted by the Offeror)? A balance will need to be struck between securing adequate protection for the Tender Financing lenders and making realistic proposals to the Offeror that allow some room for it to adjust its strategy in response to the acceptances of its offer.

Lastly, we would also advise the Tender Financing lenders to obtain evidence from the Offeror of its receipt of the Requisite Shareholder Approval and a copy of the new memorandum and articles of association and the new register of members (showing the Offeror as the 100% owner and the annotation of the security in favour of the lenders on completion of the privatisation) as condition subsequent deliverables.

## **Scheme of arrangement**

A take-private transaction by way of scheme of arrangement (a **Scheme**) normally involves a proposal by an offeror (the **Scheme Offeror**) to reduce the issued share capital of the relevant listed company incorporated in the Cayman Islands (the **Scheme Target**) by cancelling all of the shares of the public shareholders held in the Scheme Target. Each public shareholder is paid an agreed amount of consideration per share so cancelled. Upon the capital reduction and share cancellation, the issued share capital of the Scheme Target is concurrently increased to the former amount by the issue to the Scheme Offeror of a number of shares in the Scheme Target equal to the total number of shares so cancelled. The reserve created in the Scheme Target's books of account as a result of the capital reduction and share cancellation is applied in paying up in full the new shares so issued to the Scheme Offeror.

Pursuant to sections 14 and 15 of the Companies Act, a special resolution of the shareholders of the Scheme Target, followed by confirmation by the Grand Court of the Cayman Islands (the **Cayman Court**), will be required to effect the capital reduction mentioned above. The extraordinary general meeting of the Scheme Target's shareholders to obtain this special resolution will be convened for the same date as the Scheme Meeting(s) referred to below. The confirmation of the capital reduction by the Cayman Court will be sought in the Sanction Hearing referred to below.

Pursuant to section 86(2A) of the Companies Act, such a shareholders' Scheme will require the approval of shareholders representing 75% in value of the shareholders of each class of shares (the **Requisite Scheme Approval**) issued by the relevant Scheme Target. There will be at least two Cayman Court hearings (or more, where Scheme Target has multiple classes of shares in issue). The first is a convening hearing to apply to the Cayman Court to convene a meeting of each requisite class of shareholders in the Scheme Target, to consider the Scheme and pass the Requisite Scheme Approval (the **Scheme Meeting(s)**). The second, held if the Requisite Scheme

Approval is obtained at the Scheme Meeting(s), is a sanction hearing (the **Sanction Hearing**) at which the Cayman Court will decide whether to approve the Scheme. Once the Cayman Court so approves the Scheme, it will be binding on all the members of Scheme Target. The order of the Cayman Court sanctioning the Scheme (the **Court Order**) will not take effect until a copy of it is delivered to the Registrar of Companies in the Cayman Islands for registration.

Where the Scheme Target is listed on HKEX, the public announcement made in respect of the Scheme must confirm that the financial adviser to the Scheme Offeror is satisfied that sufficient financial resources are available to the Scheme Offeror for discharging its obligations in respect of the Scheme. This means that the terms of any debt financing must be in place (subject to the satisfaction of the relevant conditions precedent to utilisation thereunder), before the public announcement of the Scheme is made. Therefore, the scheme related mechanics and provisions in the facility agreement for the Scheme are based on the form of the draft public announcement most recently submitted to the stock exchange. The facility agreement will customarily contain undertakings through which the lenders can control the Scheme Offeror's conduct of the Scheme and monitor and the status and progress of the Scheme.

Because of the "all or nothing" nature of a Scheme, lenders would typically require the Scheme to be effective as a condition precedent to funding. This can be evidenced by the delivery of a copy of the Court Order, stamped by the Registrar of Companies. Again, the lenders would customarily obtain a copy of the new memorandum and articles of association and the new register of members of Scheme Target (showing Scheme Target as a wholly owned private company) as conditions subsequent to funding.

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