

Cayman Islands Schemes of Arrangement and Russian Sanctions

Maples and Calder, the Maples Group's law firm, advised E-House (China) Enterprise Holdings Limited (the "Company") on the restructuring of its New York law-governed notes by way of a Cayman Islands scheme of arrangement (the "Scheme"). The implementation of this Scheme gave rise to a number of novel and complex issues arising from international financial sanctions imposed on Russia, which are likely to be increasingly prevalent and important while such sanctions remain in force.

The sanctions affect not only those individuals and companies specifically targeted by the sanctions regimes (directly sanctioned) but also those individuals and firms who may bank with or access the financial markets through sanctioned institutions (indirectly sanctioned). Addressing the position of such indirectly sanctioned creditors, Segal J in the Cayman Islands Grand Court (the "Court") provided important guidance, including that:

- unless it is unlawful for such "indirectly sanctioned" scheme creditors to vote, they must be given the right to vote;
- it may be fair and reasonable, depending on the circumstances, for the scheme consideration due to such scheme creditors to be held on trust for them pending applicable sanctions being lifted; and
- the impact of sanctions on some (but not all) scheme creditors (in particular that their scheme consideration would be held on trust

as set out above) did not fracture the class – the impact of sanctions goes to the affected scheme creditors' interests and not legal rights.

Background

The Company is the Cayman Islands incorporated holding company of a group of companies providing real estate-related services in the PRC. The Company issued New York law-governed notes in the total principal amount of US\$598,200,000 (the "Old Notes"), guaranteed by subsidiaries of the Company incorporated in the BVI and Hong Kong (the "Subsidiary Guarantors"). The Old Notes were held in global form through Euroclear Bank S.A./N.V. and Clearstream Banking, S.A. (together, the "Clearing Systems").

The Company fell into financial difficulties due to the downturn in the PRC property market, and defaulted on payments due under the Old Notes. The Company therefore proposed restructuring its debt under the Old Notes via the Scheme. This was an "amend and extend" scheme, whereby holders of the Old Notes (the "Scheme Creditors") were asked to exchange the Old Notes for new notes with a maturity date pushed out by three years and a slightly higher rate of interest (the "New Notes"), as well as some cash consideration.

Russian Financial Sanctions

The impact of financial sanctions posed significant challenges for the structuring of the Scheme and the voting process. More specifically, it was estimated that approximately 6.65% of Scheme Creditors, by value, held their Old Notes via Russia's National Settlement Depository (the "NSD"), which was blocked from accessing the Clearing Systems due to financial sanctions. Therefore, these Scheme Creditors (the "Blocked Scheme Creditors"), although not directly sanctioned themselves, were unable to send instructions, trade their Old Notes, or receive payments through the Clearing Systems.

Holding Period Trust

The Clearing Systems would not permit scheme consideration to be distributed outside of their systems and payments could not be made to the Blocked Scheme Creditors through the Clearing Systems because the NSD was subject to financial sanctions. Therefore, under the Scheme, the Blocked Scheme Creditors' scheme consideration would be held on trust for them until applicable financial sanctions were lifted (or altered) so that the scheme consideration could be paid to the Blocked Scheme Creditors.

The trust structure took the form of a Holding Period Trust (for a period of three years – the maturity date of the New Notes) and, if required, a "successor trust", which would continue to hold the scheme consideration (wholly in the form of cash as the New Notes would have matured), until applicable sanctions permit payment to Blocked Scheme Creditors or until the end of the perpetuity period under New York law.

The Court held that it was reasonable and fair for the Blocked Scheme Creditors' scheme consideration to be held on trust in the above manner. The position of the Blocked Scheme Creditors adopted, mirrored and responded to the block currently imposed by the Clearing Systems

(in that no payments could flow until applicable sanctions were lifted) and the Company had gone to considerable efforts to find a way to distribute scheme consideration to Blocked Scheme Creditors outside of the Clearing Systems, none of which had been permitted or acceptable to the Clearing Systems or certain service providers.

Further, the trust structure did not split the single class. The same legal rights were conferred on all Scheme Creditors (all Scheme Creditors received the same consideration). The fact that Blocked Scheme Creditors were not able to enjoy those rights immediately was because of the impact of sanctions on those creditors which was a personal characteristic. This involved a difference in interests and not rights.

Voting

Voting by Blocked Scheme Creditors presented a further challenge. The Company initially concluded that it was unable to facilitate voting on the Scheme by Blocked Scheme Creditors, in light of their inability to submit custody instructions through the Clearing Systems, the difficulty engaging providers to service voting by Blocked Scheme Creditors and concerns expressed by the Clearing Systems as to voting outside of their processes.

However, at the hearing to convene a meeting of a single class of the Scheme Creditors, the Court required amendments to the voting process, to allow voting by Blocked Scheme Creditors, as a prerequisite to granting the convening order. With this guidance from the Court, the Company was able to work with its service providers to devise a novel "dual voting" procedure, whereby Blocked Scheme Creditors would submit voting instructions entirely outside of the Clearing Systems, and all other Scheme Creditors would submit voting instructions through the Clearing Systems in the usual way. This process was successfully implemented, with a turnout of over 93% of Scheme Creditors, by value, including

almost all known Blocked Scheme Creditors, none of whom voted against the Scheme. The Scheme was approved by 99.96% by value of those present and voting at the scheme meeting.

This novel approach to this unusual challenge provides other companies in similar positions with a new tool for dealing with these kinds of situations. However, it may not prove to be a 'one-size-fits-all' solution – and as always, each case will need to be carefully assessed on its merits.

International Effectiveness

The Company's expert evidence addressed the comments of the Hong Kong Court (Harris J) in *In re Rare Earth Magnesium Technology Group Holdings Limited* [2022] HKCFI 16896, that Chapter 15 recognition is not effective to discharge US law-governed debt. The resulting concern being that if there is no discharge of the debt under its governing law, the scheme will not be substantially effective in jurisdictions which require debt to be compromised pursuant to the governing law of that debt – here Hong Kong and the BVI.

Segal J noted the comments of Harris J (acknowledging that it was for the Hong Kong Court to determine matters of Hong Kong law), but nonetheless determined, based on the Company's expert evidence, that there were good grounds for concluding that a properly drafted order granting Chapter 15 recognition would discharge, as a matter of US law, the liabilities of the Company and the Subsidiary Guarantors under the Old Notes. This would therefore be a discharge pursuant to the governing law. Following the sanction of the Scheme, the US Bankruptcy Court made an order recognising the Scheme as a foreign main

proceeding, and discharging, as a matter of US law, any claim discharged pursuant to the Scheme.

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November 2022

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