Walkers

The latest developments in Mergers and Acquisitions in the Cayman Islands

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KEY TAKEAWAYS:

- There has been increased activity in take-private transactions and equity recapitalisations
- SPACs continue to occupy a unique place in the Cayman M&A transaction environment
- The constitutional flexibility offered by Cayman Islands entities has been key to facilitating recapitalisations

The Cayman Islands is well established as one of the world's largest international investment hubs.

Introduction

The business-friendly environment, with legislation developed over the years to adjust to the requirements of the industry, is a key strength of the jurisdiction.

With companies, partnerships and limited liability companies all commonly used in structuring transactions, clients are able to choose the most appropriate constitutional form for their needs. The availability of these structures has meant that the Cayman Islands has consistently been an attractive jurisdiction in which to establish investment funds. For the same reasons, the Cayman Islands has increasingly become a jurisdiction of choice for corporate transactions including mergers and acquisitions (M&A), joint ventures, corporate reorganisations, insurance-related arrangements, as well as financing deals involving debt, equity and other capital markets.

Mergers and acquisitions – the global market

In 2023, global deal activity remained under pressure. Global M&A deal values decreased from USD3.8 trillion announced during the course of 2022, to USD2.5 trillion announced during the course of 2023. This continued a reduction in deal values from their peak of more than USD5 trillion in 2021.

In line with these global trends, the Cayman Islands experienced a decrease in deal volume and value in cross-border M&A transactions during 2023. However, there has been increased activity in some areas

such as take private transactions and equity recapitalisations. The authors have seen a number of trends emerging in these areas as the jurisdiction adapts to the changing market.

Take-private transactions

While the IPO market was subdued during 2023 take-private deals were an important component of deal activity during this period. Given the number of Cayman Islands entities listed on global exchanges, take-private transactions have been a lasting part of the legal landscape in the Cayman Islands.

Take-private transactions under Cayman Islands law are structured through statutory mergers, schemes of arrangement or tender offers, with the geographical market often determining which route is chosen. In Hong Kong, where the majority of companies listed on the main board of the Hong Kong Stock Exchange are Cayman Islands incorporated, the structure of the transaction would often be by way of a scheme of arrangement. Conversely, in the United States, parties typically prefer a statutory merger rather than a court-supervised scheme. In part due to the utility of these acquisition methods, tender offers are rarely used.

Mergers under Cayman Islands law

The Cayman Islands statutory merger regime allows two or more companies to merge, with the rights and obligations of each merging party vesting in one of them as the surviving company. The merger provisions of the Cayman Islands Companies Act (The “Companies Act”) were introduced in 2009 and operate in a substantially similar manner to the equivalent Delaware statute. The merger process is therefore attractive for both companies and investors due to its familiarity and flexibility.

The Companies Act gives shareholders a statutory right to dissent in the merger of a Cayman Islands incorporated company and to be paid a judicially determined fair value for their shares in lieu of the merger consideration being offered by the merging company. The rights of a dissenting shareholder are not available in certain limited circumstances, for example, to shareholders holding shares for which an open market exists on a recognised stock exchange where certain forms of consideration are received.

As the Cayman Islands merger regime has become more established, there has been an increase in the number and value of dissenting shareholders claims. Arbitrage investors who purchase positions in companies involved in Cayman Islands mergers with a view to exercising dissention rights have become a more common feature. While it is often the case that a dissenting shareholder will agree the fair value of the shares with the company prior to the matter being determined by the Cayman Islands court, an increasing number of merger cases have been determined by the courts, providing useful guidance for practitioners. A recent development includes a decision that dissention rights do apply to “short form” mergers where a parent company holding at least 90% of the voting rights of its subsidiary merges with the subsidiary.

Shareholder schemes of arrangement

In certain situations a court-supervised scheme of arrangement will be a more appropriate method of consummating a take-private transaction. Although shareholder schemes of arrangement involve court supervision, higher requisite majorities and typically higher deal costs, they do not allow for dissenter rights and may, therefore, be an attractive alternative in certain circumstances.

Until August 2022, it was the case that a shareholder scheme required both (i) the approval of a majority in number of shareholders or class of shareholders, and (ii) 75% in nominal value of the shareholders, or class of shareholders (in each case present and voting either in person or by proxy at the requisite scheme meeting). The "headcount test" was often cited as a concern for those undertaking a transaction by way of a scheme. The headcount requirement was removed in August 2022, and as a result companies contemplating a shareholder scheme of arrangement only require the approval of 75% in nominal value of the shareholders, or class of shareholders, present and voting either in person or by proxy at the requisite scheme meeting.

Special Purpose Acquisition Companies

"SPAC mania" has settled down since the height of its popularity in 2021, where the first quarter of 2021 alone saw the creation of 295 SPACs with a value of close to USD96 billion. This is compared with a total of 86 SPAC IPOs in all of 2022, raising a combined USD13 billion. Notwithstanding the major downturn in the use of SPACs in global deal-making, they still continue to occupy a unique place in the M&A transaction environment in the Cayman Islands where many SPACs are formed.

While 2024 has seen the launch of a small number of new SPACs, most of the trends that the authors have observed in the SPAC market relate to those that have already launched and are seeking a de-SPAC transaction or are liquidating.

- Term extensions for existing SPACs – a central trend throughout 2023 was for SPACs to seek to extend their terms. A significant number of SPACs nearing the date that they would otherwise be required to liquidate have sought shareholder approval to allow more time to consummate a business combination. This requires an amendment to the SPAC's constitutional documents to extend the term and make any other required updates to ancillary provisions. The approach to such extensions will depend on the particular circumstances of the SPAC, including how close the SPAC is to completing a business combination. Such term extensions could be in the form of one-off extensions, rolling extensions or extensions based on certain conditions. An extension will almost always require some additional funding of the SPAC's trust account by the sponsor or its affiliates in order to incentivise public shareholders to stay invested.
- New management teams – the authors have seen an increasing number of instances where new management teams have been appointed to existing SPACs. Acquiring a sponsor interest in an existing SPAC and appointing a new management team can be an efficient and effective way for a new sponsor to enter the SPAC market while allowing an existing sponsor and management to exit the structure without liquidating the SPAC. Such management takeovers often occur simultaneously with an extension of the SPAC term. These transactions usually involve the transfer of the outgoing sponsor's shares and private placement warrants issued by the SPAC to the new sponsor, change in the directors and officers of the SPAC, and commonly, the injection of new working capital into the SPAC.

Equity recapitalisation transactions

Cayman Islands entities are often used in venture capital and series financing structures. While there was an abundance of venture capital financing available to these entities during 2021 and the first part of 2022 the number of series financing and venture transactions decreased significantly during 2023.

With the cost of capital at much higher levels, and the scarcity of financing, the authors have seen increasing numbers of equity recapitalisation transactions. The structure of these transactions reflects the of current market conditions and often involves new or existing investors being empowered to dictate terms. The authors have seen an increase in “cram down” recapitalisations, whereby new or existing investors providing new or additional equity finance impose strict terms on the other existing investors for not participating in a funding round or recapitalisation, also commonly known as “pay to play” terms. In the current market, the constitutional flexibility offered by Cayman Islands entities has been key to facilitating recapitalisations.

Conclusion

Cayman Islands entities are increasingly used in global deal making. While the activity in the Cayman Islands will reflect broader global market trends, the jurisdiction’s reputation as a sophisticated business environment with a full range of experienced service providers and a mature legal system will continue to see growth in the use of these entities in M&A transactions and corporate structuring.