

INTRODUCTORY CERTIFICATE IN INSOLVENCY LAW AND PRACTICE IN THE CAYMAN ISLANDS

**Comment and Feedback on Self-
Assessment Questions 2023**





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HOW TO USE THIS DOCUMENT

The purpose of this document is to provide comment and feedback on the self-assessment questions contained in the RISA Cayman Course Notes 2023. Please bear in mind that the primary purpose of the self-assessment questions is to assist you, as a candidate on the Introductory Certificate in Insolvency Law and Practice in the Cayman Islands, to understand the various parts of the work as covered in the prescribed notes for the course.

The questions and answers provided in this document follow the same sequence as the notes, so the questions and answers have been arranged by Chapter.

Please note that in addition to the self-assessment questions, you will also have the opportunity of undertaking a formative (practice) assessment (mock examination). Please see the Course Handbook and the course web pages for details of the practice assessment.

CHAPTER 1 - OVERVIEW AND INTRODUCTION TO FUNDAMENTALS**Self-Assessment Questions****Question 1**

In a situation where a liquidator of an open-ended fund engages a firm to maintain its register of shareholders how should the engagement be formalised to ensure compliance with the DPA?

Answer

Whenever a liquidator is deemed to be a data controller and it uses a third party data processor, a formal written contract will need to be placed which includes the requisite provisions per the DPA.

Question 2

Upon appointment, what steps should a liquidator (or equivalent) undertake in relation to the ES regime?

Answer

An assessment of whether the Relevant Entity conducts Relevant Activities should be undertaken to determine whether the entity has any ongoing obligations, including to satisfy the ES Test. This evaluation should be documented and retained on the entity's file and the appropriate reporting made as a result.

Question 3

How could the deregistration of an in-scope regulated entity's licence with CIMA impact the entity's BOR obligations?

Answer

Pursuant to section 245(1)(b) of the Companies Act, prior to liquidation, the regulated entity may have relied on the licensing exemption, however upon the deregistration of its licence, the entity will need to maintain and file a beneficial ownership register. On the basis that the entity is in liquidation, it will also need to undertake the filing every 90 days.

CHAPTER 2 - ETHICS AND PROFESSIONAL PRACTICE**Self-Assessment Exercise 1****Question 1**

You are approached to act as an official liquidator of a company, where your firm has signed an audit agreement letter within the last three years but not conducted any work under that audit agreement. Are you able to consent to act as an official liquidator?

Answer

Strictly speaking pursuant to the Insolvency Practitioners' Regulation 6(2) where you or your firm has acted in relation to the company as its auditor, within 3 years prior to commencement of the liquidation, you are not permitted to act as an official liquidator. The signing of an audit engagement letter, even though work has not been conducted by your audit practice, would likely preclude you from acting as an official liquidator.

Question 2

You have received a referral from a foreign practitioner, who is wanting as a condition of the referral to act as a joint official liquidator with you but does not have the requisite insurance as per the Insolvency Practitioners' Regulations - can the foreign practitioner act as a joint official liquidator with you?

Answer

No - the foreign practitioner must have the same level of insurance as required by regulation 7 of the IPRs, if they are not willing to obtain insurance to meet that requirement they are not permitted to act as an official liquidator of a company.

Question 3

What are the residency requirements and insurance requirements needed before consenting to act as an official liquidator?

Answer

A qualified IP will not be appointed by the Court unless he resides in the Islands and he (or their firm) holds a valid trade and business license which permits them to act as professional insurance practitioners. Insurance - if candidates rehash regulation 7 of the IPRs, that is the correct answer.

Self-Assessment Exercise 2

Question 1

IPs practicing in the Cayman Islands are members of professional associations from around the world, with their own specific codes of ethics.

When acting as Cayman Islands liquidators, which code of ethics is applicable and what institution oversees their conduct?

Answer

When acting as Cayman Island Liquidators' which Code of Ethics is applicable and what institution oversees their conduct?

- The IESBA Code of Ethics
- Cayman Islands Institute of Professional Accountants

Question 2

What are the "fundamental principles"?

Answer

- Integrity
- Objectivity, independence and impartiality
- Professional / technical competence
- Confidentiality and
- Professional behaviour

Question 3

IPs should identify, evaluate and address threats to the fundamental principles. Name the five threats.

Answer

- Self-interest threat
- Self-review threat
- Advocacy threat
- Familiarity threat; and
- Intimidation threat

Question 4

What should IPs do to address threats? Provide examples.

Answer

- See paragraph 2.3.3.1(d) – safeguards
- Other examples not listed.

Question 5

When dealing with ethics and a code of conduct, IPs must _____? (List a minimum of five).

Answer

- See paragraph 2.3.3.1.(e) – Insolvency Practitioners
- Other
- Record-keeping policy
- Breach reporting policy

Question 6

What three types of litigation funding arrangement are permitted in the Cayman Islands?

Answer

Conditional fee arrangements; contingency fee arrangements; third party funding.

Question 7

What is the difference between a conditional fee arrangement and a contingency fee agreement?

Answer

Conditional fee agreements (sometimes referred to as “no win, no fee”) are where lawyers are paid an hourly rate plus a success fee if the claim succeeds, and nothing if the claim fails. Contingency fee agreements (sometimes referred to as damages-based agreements) are where lawyers are paid a percentage of recoveries if the claim succeeds, and nothing if the claim fails.

Question 8

What is the maximum success fee permitted under a conditional fee arrangement?

Answer

100% of standard hourly rates.

Question 9

What is the maximum percentage of recoveries permitted under a contingency fee agreement?

Answer

33.3% of the total amount recovered (can be increased to 40% by application to the Court).

CHAPTER 3 - SECURED PARTIES AND RECEIVERSHIPS**Self-Assessment Exercise 1****Question 1**

Name the common forms of security in the Cayman Islands.

Answer

Cayman Islands law recognises five forms of security interest: a legal mortgage, an equitable mortgage, a charge (either fixed or floating), a pledge and a lien.

Question 2

Describe the priority of a secured claim holder and its right to enforce the same during a Cayman Islands official liquidation.

Answer

A secured creditor's rights in a liquidation are superior to the rights of all other parties once there is an event of default (official liquidation would constitute an event of default), pursuant to section 142 of the Companies Act. This can only ever be subject to the rights (if any) of the liquidators to the costs associated with the care, preservation, and realisation of those assets (assuming this is permitted by the secured creditor).

Question 3

Can a secured creditor be compromised under a Scheme in the Cayman Islands?

Answer

With respect to a scheme of arrangement, the rights of secured creditors can be compromised provided that they are convened to correctly-constituted class meetings, the requisite majorities are obtained, and the Court sanctions the scheme. This would be the case for a scheme proposed during a provisional liquidation appointment, or under the recently introduced Cayman Islands company restructuring officer regime.

Question 4

How is a security interest “perfected” in the Cayman Islands?

Answer

Except for Cayman Islands registered ships and aircraft (The Civil Aviation Authority Law (2005 Revision) and the Mortgaging of Aircraft Regulations, 2015, regulation 4), intellectual property and land (Land Law, section 64.) there is no public security registration regime in the Cayman Islands and no publicly searchable registers. However, where a security interest is created by a Cayman Islands company, the company must enter any security interest created by it in the register of mortgages and charges of the company, regardless of where the asset is located (Companies Act, section 54).

Question 5

If real property is “over-secured” and that property is sold during a liquidation process, describe the process as to how those extra funds are dealt with (starting with the sale), and the priority of payments that would follow.

Answer

If the secured claim is “over-secured” (that is, the value of the collateral exceeds the claim amount), any realisations in excess of the secured debt must revert to the party that provided the security (and, in an insolvency context, to the liquidation estate for the benefit of other unsecured creditors). However, if there are more than one secured creditor in respect of that secured asset, the excess realisations will revert to the next party secured (determined by priority of their security), prior to reverting to the party that provided the security, or to the liquidation estate.

Self-Assessment Exercise 2**Question 1**

Explain the main differences between a privately-appointed and court-appointed receiver.

Answer

Privately-appointed receivers are appointed by the secured lender and owe their primary duties to that lender, whilst court-appointed receivers are appointed by the court and are ultimately answerable to the court. A receiver appointed privately derives its powers from the relevant lending documents, compared to a court-appointed receiver that derives its powers from the court order appointing it or the applicable statutory regime.

Question 2

Indicate whether the following statement is TRUE or FALSE, stating why:

All private receiverships must be registered in the Cayman Islands.

Answer

False. The only registration requirement applies to receivers appointed under the Land Act.

Question 3

In what important ways does the receivership regime applicable to segregated portfolios differ from the winding up regime applicable to companies?

Answer

Your answer should include reference to the different test for insolvency (cash flow vs modified balance sheet), the lack of an equivalent to a just and equitable ground for a receivership order, the lack of a comprehensive statutory remuneration regime for receivers, and the explicit statutory right for a receiver to seek directions from the court. You may also note that a receivership order automatically terminates if a winding up order is made in respect of the SPC.

Question 4

What test will the court apply to determine whether it is appropriate to make a receivership order in respect of a segregated portfolio?

Answer

Pursuant to section 224(1) of the Companies Act, the court must be satisfied that the segregated portfolio's assets are or are likely to be insufficient to discharge the segregated portfolio's liabilities, and that a receivership order would achieve the purposes of an orderly wind down of the segregated portfolio's business and the distribution of its assets to those entitled to them.

CHAPTER 4 - CORPORATE LIQUIDATION**Self-Assessment Exercise 1****Question 1**

List four grounds on which a company may be wound up voluntarily.

Answer:

- (a) On expiration of a period of time fixed by the company's memorandum or articles of association;
- (b) On occurrence of a winding up event, as provided for by the company's memorandum or articles of association;
- (c) If the company resolves by special resolution that it be wound up voluntarily; or
- (d) If the company resolves by ordinary resolution that it be wound up voluntarily because it is unable to pay its debts as they fall due.

Question 2

Within how many days of commencing a voluntary winding up must a declaration of solvency be filed and what are the consequences of failing to file a declaration of solvency?

Answer

Where a company in voluntary liquidation has failed to file a declaration of solvency within 28 days, its liquidator must apply to the Court for the liquidation to continue under the supervision of the Court.

Question 3

What qualifications must a person hold in order to qualify for appointment as a voluntary liquidator?

Answer

There are no qualification requirements for the role of voluntary liquidator. Any person can be appointed as a voluntary liquidator.

Question 4

Other than a voluntary liquidation, who may file the declaration of solvency?

Answer

A director.

Question 5

Is it true or false that a voluntary winding up is deemed to commence by order of the court?

Answer

False. A voluntary liquidation is not a court supervised process and is deemed to commence at the time of the passing of the resolution for winding up or on the expiry of the period or the occurrence of the event specified in the company's memorandum or articles of association.

Question 6

Is it TRUE or FALSE that a voluntary liquidator's remuneration may be based on a combination of an hourly rate, a fixed sum and a commission percentage?

Answer

True.

Question 7

Is it TRUE or FALSE that the remuneration of a voluntary liquidator properly incurred is payable out of the assets of the company?

Answer

True.

Self-Assessment Exercise 2**Question 1**

What are the circumstances in which a company may be wound up under section 92 of the Companies Act?

Answer

A company over which the court has jurisdiction to wind up may be wound up in the following circumstances prescribed by section 92 of the Companies Act:

- (a) The company has passed a special resolution requiring the company to be wound up by the court;
- (b) The company does not commence its business within a year from its incorporation, or suspends its business for a whole year;
- (c) The period, if any, fixed for the duration of the company by the articles of association expires or whenever the event, if any, occurs, upon the occurrence of which it is provided by the articles of association that the company is to be wound up;
- (d) The company is unable to pay its debts; or
- (e) The court is of the opinion that it is just and equitable that the company should be wound up.

Question 2

Who has standing to petition for the winding up of a company?

Answer

Section 94 of the Companies Act states that an application to the Court for the winding up of a company must be by petition presented either by: (a) the company; (b) any creditor or creditors (including any contingent or prospective creditor or creditors); (c) any contributory or contributories; or (d) the Cayman Islands Monetary Authority pursuant to the regulatory laws.)

Question 3

Explain the cash flow test for solvency.

Answer

A cash flow test for solvency considers whether a company is able to pay its debts as they fall due, taking into account debts that are due and payable by the company and debts that will become due in the reasonably near future. This is the legal test for solvency in the Cayman Islands [as opposed to the balance sheet test which considers whether a company's assets are less than its liabilities, taking into account both contingent and prospective liabilities].

Question 4

What is considered the commencement date of a court supervised liquidation?

Answer

Under section 100 of the Companies Act, the winding up of a company by the court is deemed to commence at the time of the presentation of the petition for winding up (subject to certain exceptions).

Question 5

Explain how pre-insolvency (antecedent) transactions can be challenged under sections 145 and 146 of the Companies Act, including any applicable time periods.

Answer

Voidable preference: Section 145 of the Companies Act provides for the setting aside of dispositions that seek to prefer one creditor over other creditors within the six months before the deemed commencement of the company's liquidation, and at a time when the company is unable to pay its debts. Payments made to a related party of the company will be deemed to have been made with a view to giving such creditor a preference and it is therefore not necessary to establish intention in respect of such transactions.

Undervalue transactions: Section 146 of the Companies Act provides that transactions in which property is disposed of at an undervalue with the intention of willfully defeating an obligation owed to a creditor, are voidable on application of the liquidator. The application must be brought within six years of the disposal.

Question 6

Explain the moratorium on proceedings imposed by section 97 of the Companies Act and its effect on secured creditors.

Answer

Section 97 of the Companies Act imposes an automatic stay of proceedings which provides that when a winding up order is made or a provisional liquidator is appointed, no suit, action or other proceedings may be continued or brought against the company without leave of the court. This gives the company, and the appointed officeholders breathing room while the assets are secured and the affairs of the company are investigated. It also avoids a rush of claims against the company and ensures that any debts owed are considered and dealt with in an orderly manner and in accordance with the proof of debt process. While a stay prohibits legal proceedings against the company, it does not prevent secured creditors from enforcing their security.

Question 7

Explain the distinction between the powers of an official liquidator listed in Parts I and II of Schedule 3 of the Companies Act and list three examples of powers listed in each of the Schedules.

Answer

The powers specified in Part 1 of Schedule 3 are only exercisable with the sanction of the court and the Powers listed in Part II of Schedule 3 are exercisable without (or with) the sanction of the court.

Part I Powers include:

- (a) bring or defend any action or other legal proceeding in the name and on behalf of the company;
- (b) carry on the business of the company so far as may be necessary for its beneficial winding up;
- (c) dispose of any property of the company to a person who is or was related to the company;
- (d) pay any class of creditors in full;

- (e) make any compromise or arrangement with creditors or persons claiming to be creditors or having or alleging themselves to have any claim (present or future, certain or contingent, ascertained or sounding only in damages) against the company or for which the company may be rendered liable;
- (f) compromise on such terms as may be agreed all debts and liabilities capable of resulting in debts, and all claims (present or future, certain or contingent, ascertained or sounding only in damages) subsisting, or supposed to subsist between the company and a contributory or alleged contributory or other debtor or person apprehending liability to the company;
- (g) deal with all questions in any way relating to or affecting the assets or the winding up of the company, to take any security for the discharge of any such call, debt, liability or claim and to give a complete discharge in respect of it;
- (h) sell any of the company's property by public auction or private contract with power to transfer the whole of it to any person or to sell the same in parcels;
- (i) raise or borrow money and grant securities therefor over the property of the company;
- (j) engage staff (whether or not as employees of the company) to assist that person in the performance of that person's functions; and
- (k) engage attorneys and other professionally qualified persons to assist that person in the performance of that person's functions.

Part II Powers include:

- (a) take possession of, collect and get in the property of the company and for that purpose to take all such proceedings as that person considers necessary;
- (b) do all acts and execute, in the name and on behalf of the company, all deeds, receipts and other documents and for that purpose to use, when necessary, the company seal;
- (c) prove, rank and claim in the bankruptcy, insolvency or sequestration of any contributory for any balance against that person's estate, and to receive dividends in the bankruptcy, insolvency or sequestration in respect of that balance, as a separate debt due from the bankrupt or insolvent and rateably with the other separate creditors;
- (d) draw, accept, make and indorse any bill of exchange or promissory note in the name and on behalf of the company, with the same effect with the respect of the company's liability as if the bill or note had been drawn, accepted, made or indorsed by or on behalf of the company in the course of its business;

- (e) promote a scheme of arrangement pursuant to section 86 of the Companies Act;
- (f) convene meetings of creditors and contributories; and
- (g) do all other things incidental to the exercise of that person's powers.

Self-Assessment Exercise 3

Question 1

In the absence of any specific contractual provisions, how is liquidation funding treated in the priority waterfall?

Answer

Liquidation funding is deemed to be an expense of the liquidation and is therefore repayable ahead of ordinary unsecured creditors under Order 20 of the CWR.

Question 2

What is the statutory function of a liquidation committee?

Answer

The primary function of a liquidation committee (if one is constituted) is to set the basis of the official liquidator's remuneration and the amount of the remuneration.

Question 3

What factual circumstances might impact an unsecured creditor's statutory priority?

Answer

The primary function of a liquidation committee (if one is constituted) is to set the basis of the official liquidator's remuneration and the amount of the remuneration.

Question 4

What remedies are available to a contractual counterparty in circumstances where an insolvent company fails to perform its obligations in accordance with a contract.

Answer

Unless the contract otherwise specifies, a contract will remain enforceable in the liquidation. An aggrieved party may prove in the liquidation for damages which is deemed a provable debt under section 139(1) of the Companies Act.

Self-assessment Exercise 4**Question 1**

List and describe the statutory tools that official liquidators may avail themselves of in order to investigate a company's affairs and collect information.

Answer

Official liquidators have general powers pursuant to section 102(1) of the Act to investigate if the company failed and if so, the causes of the failure; and generally, to investigate the promotion, business, dealings and affairs of the company, and to make such report, if any, to the court as the liquidator thinks fit.

The Act also prescribes specific powers and tools of which official liquidators may avail themselves to gather information to assist and facilitate their investigations into a company and its affairs.

Firstly, where a winding up order has been made, a liquidator should serve a section 101 notice requiring that some or all of the persons identified in section 101(3) prepare and submit a statement in the prescribed form as to the affairs of the company. These persons include directors or officers of the company, professional service providers to the company and employees of the company, during the period of one year immediately preceding the relevant date. However, professional service providers has been found **not** to include auditors. The content of a statement of affairs should include:

- (a) particulars of the company's assets and liabilities, including contingent and prospective liabilities;
- (b) the names and addresses of persons having possession of the company's assets;

- (c) the assets of the company held by those persons;
- (d) the names and addresses of the company's creditors;
- (e) the securities held by those creditors;
- (f) the dates when the securities were respectively given; and
- (g) such further or other information that the liquidator may require.

Secondly, section 103(3) provides that while a company is being wound up, the official liquidator may at any time before its dissolution apply to the court for an order for the examination of any relevant person; or that a relevant person transfer or deliver up to the liquidator any property or documents belonging to the company. This provision is broad in scope, as a "relevant person" includes any person who, whether resident in the Cayman Islands or elsewhere:

- (a) has made or concurred with the statement of affairs;
- (b) is or has been a director or officer of the company;
- (c) is or was a professional service provider to the company;
- (d) has acted as a controller, advisor or liquidator of the company or receiver or manager of its property;
- (e) not being a person falling within paragraphs (a) to (c), is or has been concerned or has taken part in the promotion or management of the company.

In relation to professional service providers, section 103(1)(c) does not encompass auditors.

Thirdly, the court may require any person, who has in their possession any property or documents to which the company appears entitled, to pay, transfer or deliver such property or documents to the official liquidator pursuant to section 138(1). An official liquidator's right to take possession of, collect and get in the property of the company is also enshrined in Schedule 3 Part II at paragraph 1.

Question 2

Briefly set out the procedure that a creditor must follow if seeking to appeal a proof of debt which has been rejected by the official liquidator.

Answer

If a creditor is dissatisfied with the official liquidator's decision to reject its proof of claim, they may appeal to the court for the decision to be reversed or varied. CWR O.16, r.18 prescribes the procedure for an appeal, which is made by application to the court within 21 days of the date upon which the creditor received the official liquidator's notification under CWR O.16, r.6 that the proof of debt was rejected.

The application is made in the form of a summons in the prescribed form and should be served on the official liquidator. The application should be supported by an affidavit which contain full particulars of the grounds upon which the application is made, as required by CWR O.11, r.4(2)(a).

The appeal shall be treated as a *de novo* adjudication of the creditor's proof and the creditor may rely upon additional evidence in support of his claim, notwithstanding that he failed to make such evidence available to the official liquidator.

Question 3

You are advising the official liquidators of ABC Ltd, having been appointed by order of the court following presentation of a winding up petition on the insolvency ground. You are asked to give advice in relation to the potential statutory and common law remedies that might be available in relation to the transactions listed below. Please also explain the relevant legal tests and any relevant considerations for the court:

- (a) Transfer of shares in ABC Ltd's wholly-owned subsidiary to ABC Ltd's former chief operating officer one week after ABC Ltd was deemed insolvent.**
- (b) A grant of security over real estate owned by ABD Ltd to an existing creditor for nominal consideration three months prior to the commencement of the winding up.**

Answer

In relation to the transfer of shares to ABC's former chief operating officer one week after presentation of the winding up petition, this may amount to a void disposition under section 99 of the Act which provides that when a winding up order has been made, any disposition of the company's property and any transfer of shares or alteration in the status of the company's members made after the commencement of the winding up is, unless the court otherwise orders, void. In particular:

- (a) The transfer of shares in the wholly-owned subsidiary company constitutes a disposition of ABC's property for the purposes of the section 99 test.
- (b) As the winding up in this instance was initiated by presentation of a winding up petition, the commencement of the winding up is deemed to be the date on which the petition was presented pursuant to s 100(1). As the transfer of shares took place between presentation of the petition and the making of the winding up order (that is, "after the commencement of the winding up", the second limb of the section 99 test is also satisfied.

If a disposition is void pursuant to section 99, the official liquidator is entitled to apply for appropriate relief which in this instance will mean the return of the shares / asset. While the court has the power to validate post-petition transactions, because ABC Ltd was wound up on the basis that it was insolvent, and it does not appear that there was any corresponding benefit to the company and / or enhanced value for creditors as a whole, retrospective validation is unlikely to be granted in this instance.

As the grant of security over certain ABD real estate took place prior to the presentation of the winding up petition, this transaction would not be rendered void upon the making of a winding up order under section 99; however, it may be subject to other claw-back mechanisms:

- (a) If the liquidators can identify evidence which suggests that the transfer was carried out with the intent to defraud creditors, or for any fraudulent purpose, a liquidator may apply for an order requiring any persons who were knowingly parties to such conduct to make such contributions to the company's assets as the court thinks proper pursuant to section 147 of the Companies Act.
- (b) As the asset was transferred to one creditor in a better position than it would otherwise have been, section 145 may be engaged, which provides that any payment or disposal of property constitutes a voidable preference if it occurs in the six months before the deemed commencement of the company's liquidation and at a time when it is unable to pay its debts; and the dominant intention of the company's directors was to give the applicable creditor a preference over other creditors. Thus, if ABC's dominant intention in granting the security was to achieve a different purpose (for example, in good faith to pay an essential service provider), it may not be classed a voidable transaction even if the collateral effect is to prefer the creditor in question (unless the creditor was a "related party" in which case the transfer will be deemed to have been made with a view to giving a preference). Upon an application being granted, the creditor may be ordered to return the asset and prove in the liquidation for the amount of its claim. As a liquidator's right to repayment arises under statute and not at common law, common law defences such as 'change of position' are not available to a claim under section 145.

(c) In circumstances where the asset was transferred for “nominal consideration” it may also constitute a disposition at an undervalue under section 146(2) which provides that every disposition of property made at an undervalue by or on behalf of a company with intent to defraud its creditors shall be voidable at the instance of its official liquidator. “Undervalue” means the provision of no consideration or a consideration which in money or money’s worth is significantly less than the value of the property; and “Intent to defraud” means an intention to willfully defeat an obligation owed to a creditor. Therefore, an official liquidator must establish that property has been disposed of at an undervalue and with the intention of willfully defeating an obligation owed to a creditor. The burden of proof to establish an intent to defraud is on the creditor or liquidator seeking to have the disposition set aside, and such an application must be brought within six years of the relevant disposal. The court may require expert evidence on the valuation of an asset in order to establish that it has been disposed of at an undervalue.

Finally, the official liquidator may also consider common law claims against directors in respect of both transactions, such as for breach of the directors’ fiduciary duties. This would be on the basis that these transactions were entered into when ABC was insolvent, and the directors were in breach of their duty to act in the best interests of the company which requires them to have regard to the interests of creditors.

Question 4

The liquidators of ABC Ltd have decided to seek sanction to commence litigation against the former directors arising from the transactions above. Explain what the liquidators will need to demonstrate on an application for sanction and discuss what the court is likely to consider in exercising its discretion.

Answer

The liquidators’ power bring legal proceeding in the name and on behalf of the company is prescribed by section 110(2)(a), Part I of Schedule 3 of the Act. The court will not give “blanket authority” and an application needs to be based on specific circumstances in which the exercise of the relevant power(s) is appropriate, and needs to be supported by relevant evidence. In this context, the court will generally sanction the commencement of a legal action if it has a reasonable prospect of success, and the proposed proceedings are in the best interests of the company’s creditors. The court must consider all the relevant evidence. The court will give the liquidators’ views considerable weight unless the evidence reveals substantial reasons for not doing so, as the court recognises that the liquidators are usually in the best position to take an informed and objective view. In addition, prospective sanction applications are likely to be looked upon more favourably than applications which seek retrospective sanction.

Self-assessment Exercise 5

Question 1

Identify four considerations to which the CIMA may have regard in determining whether it is appropriate to appoint a controller to a regulated entity.

Answer

The full list of considerations to which the Authority will have regard prior to appointing a controller are set out in paragraph 15.6 of the Enforcement Manual, but include the seriousness of any regulatory breaches, the risk of loss to stakeholders, the attitudes of management, broader risk to the financial system, the solvency of the entity, and the availability of other options.

Question 2

Describe the powers vested in a controller immediately following their appointment and explain what additional powers might be obtained from the court.

Answer

The appointment of controllers by the Authority vests in them immediate control of a company's affairs, to the exclusion of shareholders, directors and officers. This includes the power to manage the company and to compel delivery up of books and records by management. A controller does not, however, have powers against the world at large until those powers are confirmed by the Grand Court upon an application for declaratory relief. Such additional powers may include the power to seek recognition from foreign courts and the power to deal with third parties on behalf of the company.

Question 3

What are a controller's reporting obligations?

Answer

A controller must ordinarily report to the Authority within 90 days of their appointment. This time period may be extended by agreement with the Authority or conversely, the Authority may impose a requirement to deliver an interim report if there are concerns as to insolvency or financial crime, among other things.

Self-assessment Exercise 6**Question 1**

What are the two mechanisms by which inspectors may be appointed to a company?

Answer

Inspectors may be appointed by order of the court upon the application by originating motion of members holding not less than one third of the shares of a banking company, or not less than one fifth of the shares of any other company with a capital divided into shares, or members comprising one-fifth of the number of persons registered as members in respect of companies not having a capital divided into shares.

Inspectors may also be appointed extra-judicially by special resolution of the shareholders of a company.

Question 2

What impact, if any, does the appointment of inspectors have on the day-to-day operations of a company?

Answer

The appointment of inspectors pursuant to sections 64 or 67 does not impact the day-to-day operations of the company, save to the extent that the directors may be required to deliver up documents to the inspectors and / or be examined on oath as to the affairs of the company. The powers of the directors are not otherwise suspended or curtailed and there is no statutory moratorium to prevent claims being commenced or continued against the company.

Question 3

Can the report prepared by inspectors be used in subsequent legal proceedings against the company?

Answer

Section 68 expressly provides that any report prepared by an inspector appointed under this Act shall be admissible in subsequent proceedings as evidence of the opinion of the inspector. The Grand Court has confirmed that a member is not estopped from presenting a winding up petition by virtue of having brought an application for the appointment of inspectors, nor does a prior application for the appointment of inspectors render a subsequent petition an abuse of process (see *China CVS*).

Self-Assessment Exercise 7**Question 1**

Briefly set out the duties that a general partner in an ELP owes to the ELP and limited partners.

Answer

A general partner of an ELP has a statutory duty to act in good faith and (subject to any express provisions of the partnership agreement to the contrary) in the best interests of the ELP. In addition to these statutory duties, a general partner owes fiduciary and contractual duties directly to the limited partners and those duties are enforceable directly by the limited partners. Therefore, to the extent that there is a breach by the general partner of those obligations, these claims are vested in the limited partners themselves and may be brought directly.

Question 2

Explain the effect of a limited partner taking part in the business of an ELP.

Answer

A limited partner does not ordinarily owe any fiduciary duty to the ELP or other partners in exercising rights or performing obligations under the partnership agreement, unless the partnership agreement provides otherwise. However, if the limited partner actively engages in the conduct of the business of the ELP and acts in a capacity or takes a step which is not expressly permitted by the safe harbour provisions of section 20(2) of the ELP Act and the ELP subsequently becomes insolvent, the limited partner may become liable for all debts and obligations incurred during the relevant period, to any person who transacts business with the ELP during that period with actual knowledge of that limited partner's participation and who then reasonably believed the limited partner to be a general partner.

Question 3

An aggrieved creditor seeks advice as to whether it is able to petition for the winding up of the ELP to recover debts owed. What do you advise?

Answer

In the decision of *Padma Fund LP* the Court held that it has no jurisdiction to wind up an ELP upon a petition presented by a creditor as this is inconsistent and contrary to the provisions of the ELP Act. Instead, it was held that the appropriate route for an aggrieved creditor was to commence proceedings against the general partner of the ELP on the basis that section 33(1) provides legal proceedings (which necessarily include winding up petitions) are to be brought against the general partner only and that section 36(3) (which renders Part V of the Companies Act applicable to ELPs) cannot be taken to confer upon the court the jurisdiction to wind up an ELP given that this would be inconsistent with section 33(1).

However, subsequently, in *Formation Group (Cayman) Fund I LP* the Court held that a winding up petition may be presented directly against an ELP, and not just against its general partner. The basis for this was that, firstly, section 33(1) does not provide that legal proceedings cannot be brought against an ELP. Rather, it creates a general rule immunizing limited partners from being sued and for that reason emphasised that legal proceedings are generally to be brought against the general partner only, rather than the limited partners. Secondly, section 36(3) expressly provides that Part V of the Companies Act applies to ELPs and that reference to "company" in the Companies Act includes ELPs. Therefore, it is of no significance that section 91 of the Companies Act does not refer to ELPs expressly. Thirdly, the available evidence of the legislative history preceding s 36(3) supports the view that it was intended to provide that an ELP may be wound up in the same manner as a company under Part V of the Companies Act. The court noted that this legislative history was not before the Court in *Padma* and so its effect on the construction of the relevant provisions was not considered. Fourthly, s 36(3) is a specific provision which applies expressly to the winding up of ELPs and cannot be said to be overridden by the more general provision in section 33(1) which refers to legal proceedings against general partners. Fifthly, it is entirely logical for the business of an ELP to be wound up separately and apart from its general partner which may have other entirely separate business concerns. Finally, the court held that the fact that an ELP has no separate legal personality does not prevent it from being a party to legal proceedings given that a traditional partnership can sue and be sued under the firm name under Grand Court Rules, Order 81, rule 1.

You would therefore advise that the limited partner present a petition to wind up the ELP on the grounds of insolvency, naming the ELP as the respondent.

CHAPTER 5 - CORPORATE RESCUE AND OTHER PROTECTIVE MEASURES / MECHANISMS**Self-Assessment Exercise 1****Question 1**

Following the changes brought into effect by the Companies (Amendment) Act (2022 Revision), in what circumstances can an application for the appointment of provisional liquidators be made by creditors or contributories of a Cayman company?

Answer

Provisional liquidators may be appointed under section 104(2) on the application of a creditor, contributory and in certain circumstances CIMA. An application by a creditor or contributory may be made pursuant to section 104(2) of the Companies Act at any time after the presentation of a winding up petition, in order to:

- (i) prevent the dissipation or misuse of the company's assets;
- (ii) prevent the oppression of minority shareholders; or
- (iii) prevent mismanagement or misconduct on the part of the company's directors.

Question 2

In respect of an application brought by a creditor or contributory pursuant to section 104(2) of the Companies Act, which two hurdles must be demonstrated to the satisfaction of the Court, and what evidence is sufficient for each hurdle?

Answer

An applicant must demonstrate a *prima facie* case for making a winding up order (*Prima Facie Hurdle*) and that the appointment of provisional liquidators is necessary (*Necessity Hurdle*). The *Prima Facie Hurdle* can be satisfied to the civil evidential standard on the balance of probabilities that the petition debt is not disputed and that the company is unable to pay its debts within the meaning of section 93 of the Companies Act. The *Necessity Hurdle* requires clear and strong evidence that the appointment of provisional liquidators is necessary in order to prevent the misuse of company assets, oppression of minority shareholders or mismanagement / misconduct of the company's directors.

Question 3

Is the need for investigation into the affairs of the company sufficient to satisfy the statutory test under section 104(2) of the Companies Act?

Answer

No.

Question 4

Where are the powers of provisional liquidators prescribed?

Answer

The powers of provisional liquidators are prescribed by the order of appointment, and are curtailed to the specific circumstances giving rise to the need for provisional liquidators to be appointed.

Question 5

Can a foreign insolvency practitioner be appointed as a provisional liquidator to a company incorporated and registered in the Cayman Islands?

Answer

Yes. A foreign insolvency practitioner can be appointed to act as a provisional liquidator but must be appointed jointly with a qualified insolvency practitioner resident within the jurisdiction.

Question 6

When does the statutory stay commence in the case of a provisional liquidation and does the stay apply to criminal proceedings?

Answer

From the date of appointment of the provisional liquidators.

Self-Assessment Exercise 2**Question 1**

What are the grounds upon which a restructuring officer may be appointed?

Answer

Under section 91B(1) of the Companies (Amendment) Act, a company may present a petition to the Grand Court for the appointment of one or more restructuring officers on the grounds that it (i) is or is likely to become unable to pay its debts, and (ii) intends to present a compromise or arrangement to its creditors. Each of these grounds were recently considered by the Grand Court in *Re Oriente Group Limited (Unreported, Kawaley J, 9 December 2022)*:

- (i) "The solvency test for restructuring purposes is the same as that applicable to winding-up proceedings as well (section 93 of the Act, "Definition of Inability to pay debts")";
- (ii) "The Grand Court followed the dicta of Smellie CJ (as he then was) in *Re Sun Cheong Holdings* [2020 (2) CILR 942] and in doing so noted that the old statutory scheme (being provisional liquidations under section 104(3)) "applies with equal force to the restructuring officer regime".

Question 2

Can a company nominate individuals from a firm which provides financial advisory services to it to act as restructuring officers?

Answer

Yes, provided that:

- (a) The nominee is a qualified insolvency practitioner in the Cayman Islands (see section 91D(1) of the Amendment Act). NB that a company may also nominate a foreign practitioner to act as a restructuring officer in addition to the qualified insolvency practitioner;
- (b) The qualified insolvency practitioner can properly be regarded as independent as regards the Company. A qualified insolvency practitioner may be regarded as independent notwithstanding that he (or the firm of which he is a partner or employee provided advice to the Company as a financial advisor or otherwise.

However, a qualified insolvency practitioner shall not be regarded as independent if, within a period of 3 years immediately preceding the petition to appoint a restructuring officer being filed with the Court, he (or the firm of which he is a partner or employee, or the company of which he is a director or employee) has acted in relation to the company as its auditor (CWR O.1A, r.10).

Question 3

What happens to the powers of the board of directors of a company upon the appointment of a restructuring officer?

Answer

The manner and extent to which the appointment of restructuring officers will modify the function of the board of directors of a company will be defined by the terms of the appointment order. Consequently, the powers of the board do not cease automatically upon the appointment of restructuring officers (but may be modified depending on the circumstances of each case). In *Re Oriente Group Limited* for example, the board of directors was authorised to continue to manage the company's day to day affairs in all respects and exercise the powers conferred on it by the company's articles of association but with some supervision from the restructuring officers.

Self-Assessment Exercise 3

Question 1

Are there any prescribed forms or commercial parameters for arrangements that can be proposed as Schemes?

Answer

No. There are no limits on the commercial terms an arrangement that forms the basis of a Scheme can take. There needs to be a quid pro quo, and the Scheme needs to be free of manipulation or unfairness but, otherwise, the form of the arrangement is entirely for the company to create and the stakeholders to assess.

Question 2

Can a Scheme be a compulsory process (that is, imposed on a company)?

Answer

No. A Scheme can only proceed with the support of the company concerned.

Question 3

Does a Scheme automatically impose a moratorium on creditor action?

Answer

No, not in the Cayman Islands. If a moratorium is required, a filing of a petition for the appointment of a Restructuring Officer will be needed.

Question 4

Is a Scheme required to be applied equally to all of the company's creditors and / or shareholders?

Answer

No. Schemes can be and often are for subsets of the company's creditors or shareholders - for example, 'out-of-the-money' subordinated/junior creditors will not participate in a Scheme due to their lack of any economic interest, and shareholders of only particular series of shares can be schemed if that suits the company's objectives.

Question 5

Is there any difference in the thresholds for approval of a shareholders' Scheme as compared to a Creditors' Scheme?

Answer

Yes. The 2022 amendments to the Companies Act removed the numerosity / headcount test for shareholder Schemes. Both creditor and shareholder Schemes retain the 75% by value test.

Question 6

Is it correct to say that the Cayman Islands, like the United States, allows "cross-class cram-downs"?

Answer

No. In a Cayman Islands Scheme, an affirmative vote is required from every class of stakeholders.

Question 7

If the Scheme is approved at the Convening Hearing, is the judge bound to sanction the Scheme?

Answer

No. The Court retains the discretion to decide whether it is appropriate to sanction or refuse to sanction the Scheme.

Question 8

When is it preferable to effect a Scheme through a like process provided elsewhere in the Companies Act?

Answer

In 2 scenarios - (a) when a moratorium against creditor action is required, and (b) when the company has UK law governed debt. In each instance, a Scheme will be run through or alongside the Restructuring Officer provisions of the Companies Act.

Question 9

On what grounds can the court refuse to sanction a Scheme?

Answer

The most common grounds for refusal of sanction are the presence of some form of manipulation of classes or some other conduct which the court considers unduly prejudicial or unfair to certain stakeholders.

Question 10

What are some common scenarios in which Schemes are used?

Answer

Debt restructurings and reorganisations of capital structure or public / private status are the most common umbrella categories.

CHAPTER 6 - CROSS-BORDER INSOLVENCY**Self-Assessment Exercise 1****Question 1**

Explain the principle of modified universalism.

Answer

Modified universalism is a legal principle that relates to cross-border insolvency cases. In simple terms, it means that when a company goes bankrupt and has assets and creditors in different countries, the courts in those countries should work together and co-ordinate their efforts in order to come up with a fair and efficient solution to the case.

The idea behind modified universalism is that, in order to resolve a cross-border insolvency case, it is important to take into account the interests of all the parties involved, including the company's creditors, employees, and shareholders. This means that the courts in different countries should co-operate with each other and share information, in order to ensure that the case is handled in a way that is fair to everyone.

Under modified universalism, the court in the country where the company is based (the "home country") will take the lead in managing the case, but it will also work with the courts in other countries where the company has assets or creditors (the "host countries"). The courts in the host countries will recognize the authority of the court in the home country, and will cooperate with it to resolve the case.

This co-operation may involve sharing information, co-ordinating legal proceedings, and making decisions that take into account the interests of all the parties involved. By working together in this way, the courts can ensure that the cross-border insolvency case is resolved as efficiently and fairly as possible, and that all the parties involved receive a fair distribution of the company's assets.

Question 2

When the bankruptcy trustee of a US corporation applies for assistance to the Cayman Islands court, what types of assistance are available?

Answer

If the bankruptcy trustee of a US corporation applies for assistance to the Cayman Islands court, there are several types of assistance that may be available, depending on the circumstances of the case. Here are some of the common types of assistance that the Cayman Islands court may provide:

1. Recognition of the bankruptcy proceedings: The Cayman Islands court can recognise the US bankruptcy proceedings and provide assistance to the bankruptcy trustee in relation to the assets of the US corporation in the Cayman Islands.
2. Stay of proceedings: The Cayman Islands court may issue a stay of any legal proceedings in the Cayman Islands against the US corporation, in order to allow the bankruptcy trustee to continue with the US bankruptcy proceedings without interference.
3. Assistance with discovery: The Cayman Islands court can assist the bankruptcy trustee in obtaining relevant documents and information from the US corporation or any Cayman Islands-based affiliates, subsidiaries or branches of the US corporation.
4. Assistance with asset recovery: The Cayman Islands court can assist the bankruptcy trustee in locating and recovering assets of the US corporation that may be located in the Cayman Islands.
5. Co-operation with foreign courts and authorities: The Cayman Islands court can co-operate with US courts and authorities, as well as courts and authorities in other jurisdictions, in order to facilitate the US bankruptcy proceedings.
6. Provision of powers to the bankruptcy trustee: The Cayman Islands court can provide the bankruptcy trustee with certain powers, such as the power to take control of the US corporation's Cayman Islands assets, or the power to bring legal proceedings in the Cayman Islands on behalf of the US corporation.

Question 3

What are some of the key considerations for the Cayman Islands court when dealing with a situation where winding up petitions have been filed against a Cayman Islands company in both the Cayman Islands and Hong Kong?

Answer

When dealing with a situation where winding up petitions have been filed against a Cayman Islands company in both the Cayman Islands and Hong Kong, the Cayman Islands court will need to consider a number of key factors in order to determine how to proceed. Some of the key considerations may include:

1. Jurisdictional issues: The court will need to consider whether it has jurisdiction to hear the matter and whether the Hong Kong court has jurisdiction to hear the case as well. This will depend on factors such as the location of the company's assets and the location of its registered office. The starting point is that where the company is incorporated in the Cayman Islands, the Cayman courts consider that the main winding up proceeding should occur in the Cayman Islands.
2. Priority of claims: The court will need to consider the priority of claims and the ranking of creditors in each jurisdiction. This may involve determining the order in which creditors should be paid and the extent to which the company's assets in each jurisdiction are available to satisfy the claims of creditors.
3. Co-ordination with the Hong Kong court: The Cayman Islands court will need to consider whether it is appropriate to co-ordinate with the Hong Kong court in order to ensure that the winding up proceedings in both jurisdictions are carried out in a co-ordinated and efficient manner.
4. Recognition of the Hong Kong winding up proceedings: The court will need to consider whether to recognize the winding up proceedings in Hong Kong and the extent to which the winding up order made in Hong Kong should be given effect in the Cayman Islands.
5. Cooperation with the liquidators: The court will need to consider the extent to which it can cooperate with the liquidators appointed in Hong Kong and whether it can provide assistance to those liquidators in order to facilitate the winding up process.
6. Comity between the Cayman Islands and Hong Kong: the Cayman courts are keen to ensure that they maintain good relations with key jurisdictions in which Cayman companies operate, such as Hong Kong, and will therefore strive to tailor its orders to accommodate the Hong Kong courts procedures if possible.

Overall, the key considerations for the Cayman Islands court will be to ensure that the winding up proceedings in both jurisdictions are carried out in a fair and efficient manner, and that the interests of all the parties involved, including the company's creditors and employees, are taken into account. The court will need to balance the interests of the various stakeholders in each jurisdiction and work to ensure that the winding up process is as smooth and effective as possible.

Self-Assessment Exercise 2**Question 1**

What are the recognised grounds for declining to enforce a foreign judgment in the Cayman Islands?

Answer

- (a) The foreign judgment is not final and conclusive in the foreign court;
- (b) The judgment was obtained in a court of law which did not have jurisdiction over the judgment debtor;
- (c) The judgment was in respect of taxes, fines or penalties;
- (d) The enforcement of the judgment would contravene the public policy of the Cayman Island;
- (e) The rules of natural justice were not observed in the foreign proceedings.

CHAPTER 7 - PERSONAL / CONSUMER BANKRUPTCY

Self-Assessment Questions

Question 1

Which law governs personal bankruptcy in the Cayman Islands?

Answer

The Bankruptcy Act (Cap 7) (1997 Revision).

Question 2

Which debtors may be subject to the jurisdiction of the bankruptcy court?

Answer

See section 2 of the law - persons present, resident, having a place of residence, carrying on business in the Cayman Islands.

Question 3

Name five acts or defaults which can be alleged by a petitioner as the grounds of a personal bankruptcy petition?

Answer

There are 12 acts of bankruptcy set out in the legislation.

Question 4

Is all the debtor's property available to creditors?

Answer

No, there are exceptions for the support of the debtor's family (see sections 100 and 137, for example).



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