INSOL INTERNATIONAL

RISA CAYMAN

INTRODUCTORY CERTIFICATE IN INSOLVENCY LAW AND PRACTICE IN THE CAYMAN ISLANDS

COURSE NOTES 2023

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CHAPTER 1

OVERVIEW AND INTRODUCTION TO FUNDAMENTALS

1.1 Introduction to the study of insolvency law and practice in the Cayman Islands

In 2019, RISA Cayman and INSOL International entered into informal discussions about the possibility of presenting a jurisdiction-specific course in insolvency law and practice in the Cayman Islands. These discussions eventually led to a more formal proposal to present a course on Cayman Islands insolvency law, culminating in 2022 with agreement being reached on the format and other details regarding the course.

The course itself, and the notes contained within these pages, are the result of years of planning and the selfless contribution made by many members of RISA Cayman, especially those on the Board who also represent RISA Cayman on the Course Committee for this course. This has truly been a collective effort by all concerned.

The underlying objective with this course is to provide an academic yet practical course on insolvency law and practice in the Cayman Islands, which can be attended by those already on the islands as well as by those who plan to move to the islands in future. With 2023 being the first time this course is being presented, it would be fair to state that initially there will no doubt be some teething problems as the lecturers, administrators and candidates on the course come to grips with the manner in which the course is presented with the use of modern technology. However, in time (and as the course progresses) lessons learned will be fed back into the various aspects of the course, including the manner in which it is presented, the notes and the manner in which candidates on the course are assessed. In time it is hoped that the notes will grow into a very practical and useful "body of knowledge" that all practitioners on the islands will be able to use on a continuous basis. The most important aspect of this course is that the notes have been written by, and the lectures presented by, local experts who work on the islands.

The course is well-timed in the sense that it captures the most recent (2022) amendments to insolvency legislation on the islands. As legal precedent and insolvency practice develop, the course will reflect these changes in the notes and through the presentations of the lecturers.

1.2 Aims / objectives of the course

The programme focuses on providing a sound theoretical understanding of the basic principles of Cayman insolvency law. While the emphasis is on providing a sound theoretical understanding of the principles of Cayman insolvency law, the course will also provide candidates with a practical understanding of the issues at play, though at an introductory level.

While the course is presented entirely online, where necessary support and guidance will be provided to candidates registered on the course.

The aims and objectives of the course can be set out as follows:

Aims

After having completed the programme, candidates should have a good understanding of the following:

- the background to the development of insolvency law in the Cayman Islands;
- the application of the various pieces of primary and secondary legislation governing insolvency law in the Cayman Islands;
- the operation of all primary and secondary legislation as well as case law governing bankruptcy, liquidation and corporate rescue in the Cayman Islands;
- the rules relating to cross-border insolvency in the Cayman Islands.

Objectives

After having completed the course, candidates on the course should be able to:

- answer direct and multiple-choice type questions relating to the content of the course;
- be able to write an essay on any aspect of insolvency law in the Cayman Islands;
- be able to answer questions based on a set of facts relating to insolvency law in the Cayman Islands.

1.3 Introduction to the Cayman Islands

1.3.1 General

The Cayman Islands is located in the western Caribbean Sea to the south of Cuba and Miami. The territory comprises three islands: Grand Cayman, Cayman Brac and Little Cayman.

Grand Cayman is by far the largest and most populous of the three islands and it is where the Islands' financial services industry is based. The total population of the three islands is approximately 65,000.

1.3.2 Government

The Cayman Islands is a British Overseas Territory.

England took formal control of the Cayman Islands, along with Jamaica, as a result of the Treaty of Madrid of 1670. The Islands continued to be governed as part of the Colony of Jamaica until 1962 when Jamaica became independent of England.

Since 1962 the Islands have been directly overseen by the UK. The UK Foreign and Commonwealth Office appoints a Governor. The Governor has responsibility for matters such as National Security, Foreign Affairs, Policing, and Immigration.

For all matters not falling within the province of the Governor, the Cayman Islands has a democratically elected local government. The insolvency laws of the Cayman Islands are within the remit of the local government. The local government works closely with the private sector and judiciary to ensure such laws serve the needs of the Cayman Islands financial services industry and the local population.

1.3.3 Tax and financial services

The Cayman Islands has always been a tax-exempt jurisdiction and has never levied income tax, capital gains tax, or any wealth tax.

This tax "neutrality", coupled with business-friendly laws and a wealth of experienced professionals practicing in Grand Cayman, has been largely credited with helping the Islands to become a thriving offshore financial centre.

At the time of writing there are some 117,000 companies and 35,000 partnerships registered in the Cayman Islands. The Cayman Islands also has its own stock exchange which was opened in 1997.

The US remains the largest source of foreign direct investment followed by Hong Kong, Europe, the Middle East, and Brazil. Outward direct investment from the Cayman Islands goes to jurisdictions such as Luxemburg, the US, Hong Kong, Europe, and the People's Republic of China.

1.3.4 Tourism

The pristine beaches and coral reefs of all three islands mean that tourism is the second pillar of the Cayman Islands economy. The tourist industry is aimed at the luxury market and caters mainly to visitors from North America.

The Cayman Islands offers the highest standard of living in the Caribbean (reputedly comparable to that of Switzerland).

1.4 Cayman Islands judicial system

The Cayman Islands is a British Overseas Territory. Although some laws from the United Kingdom (UK) are adopted in the Cayman Islands, the local legislature and courts are independent from the UK.

The courts of the Cayman Islands administer justice in keeping with the Cayman Islands Constitution, legislation enacted by the Cayman Islands Government, and the well-established principles of common law which are based heavily upon English law.

Criminal proceedings for breaches of legislation are taken before the courts to be heard by a magistrate (in the case of proceedings before the Summary Court) or a judge, or judge and jury (at the election of the defendant) in the case of proceedings in the Grand Court. Generally, the more serious offences are tried on indictment in the Grand Court, although the Summary Court has jurisdiction to try serious drug charges and to impose very severe penalties in respect of such offences. Civil disputes having a subject matter of up to KYD 20,000 are also taken in the Summary Court.

The Grand Court, as a court of unlimited jurisdiction, tries all other types of civil disputes, including the most complex commercial and trust disputes which often arise in respect of Cayman Islands corporate or trust entities.

The Financial Services Division (FSD) of the Grand Court was created in 2009, recognising the need for special procedures and skills in dealing with the more complex civil cases that arise out of the financial sector in the Cayman Islands. Most matters relating to insolvency and restructuring will be commenced in the FSD.

The procedures of the FSD reflect the need for urgent action to be taken in some cases; for there to be special processes for balancing the need for justice to be administered in public with the potential harm to businesses if sensitive information is publicly available at too early a stage; and for the need to be able to adjust judicial resources to the changes in patterns of workload in this highly specialised area of work.

The judiciary is comprised of the following jurisdictions in ascending order within the hierarchy of the courts, namely the:

(a) Summary Court, that hears civil and criminal matters, including Family, Youth and Coroner's Courts;

(b) Grand Court, that hears applications for judicial review, cases on criminal, civil, family and estate matters and appeals from the Summary Courts. In addition to the general Civil and Criminal Divisions, it has three specialist Divisions: the Admiralty Division, the Family Division and the FSD (as mentioned above);

(c) Court of Appeal, the highest court in the Cayman Islands in which civil and criminal appeals from the Grand and Summary Courts can be heard; and

(d) Judicial Committee of the Privy Council, the highest court from which an appeal from the Court of Appeal can be heard. The Judicial Committee of the Privy Council is also the highest appellate court of a number of Commonwealth nations, Crown dependencies and other overseas territories.

1.5 Sources of law

The main sources of law in the Cayman Islands pertinent to insolvency and restructuring procedures lie within the following documents:

(a) The Companies Act (2023 Revision),[1] in particular Part V of the Act;

(b) The Companies Winding Up Rules, 2018 (as amended);[2]

(c) The Insolvency Practitioners' Regulations, 2018 (as amended);[3] and

(d) The Financial Services Division Guide (Second Edition, August 2015).[4]

1.6 Cayman Islands Regulations

The sections below provide a broad summary of certain legal and regulatory framework(s) that may apply to insolvency professionals, practitioners and / or the entities to which they are appointed.

Notwithstanding that firms will have their own compliance teams (internally or outsourced), along with dedicated policies and procedures that deal with these matters, an overview of the regulatory frameworks has been provided so that, at a high level, professionals and practitioners have an appreciation of the relevant laws and regulations, how they might interact with them, what obligations might be imposed and what implications there could be for non-compliance.

Over time we are seeing more guidance notes being issued by the relevant competent authorities specific to our sector; however, more often than not these laws and regulations do not specifically deal with companies in a form of process (insolvency, receivership, *etcetera*). On the basis that many of the Cayman Islands laws and regulations have been modelled on international standards, as a consequence other jurisdictions may provide helpful guidance in the absence of specific Cayman Islands provisions.

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1 Hereinafter referred to as the Companies Act.
2 Hereinafter referred to as CWR.
3 Hereinafter referred to as the Insolvency Practitioners' Regulations.
4 Copies of these documents (along with other Cayman Islands legislation) are available online at https://legislation.gov.ky/cms/.

Adhering to best practices in respect of these laws and regulations is not only in the best interest of the individuals involved, but more broadly the promotion of our sector.

1.6.1 AML (anti-money laundering) and KYC (know your customer) regulations

The Cayman Islands anti-money laundering framework (the AML Framework) comprises:

- The Proceeds of Crime Act (2020 Revision);
- The Anti-Money Laundering Regulations (2020 Revision);
- The Terrorism Act (2018 Revision);
- Proliferation Financing (Prohibition) Act (2017 Revision) (PCA);
- The Anti-Corruption Act (2019 Revision).

The AML Framework requires that all relevant financial businesses have in place anti-money laundering, terrorist financing and proliferation policies, procedures and practices. "Relevant financial business" is defined in schedule 6 of the PCA.

CIIPA has assumed responsibility for monitoring non-public practice accountancy firms, which includes those offering the following services:

- Insolvent and solvent liquidation services; and
- business advisory and planning for clients engaged in relevant financial business.

The Cayman Islands Government appointed the Cayman Islands Legal Practitioners Association (CILPA) as the designated Supervisory Authority for monitoring AML compliance by firms of attorneys-at-law within the Cayman Islands. CILPA delegated this supervision function to its operationally independent regulatory arm, the Cayman Attorneys Regulation Authority (CARA). CARA's supervisory AML responsibility include counter-terrorism financing, counter-proliferation financing and targeted financial sanctions.

Not only will firms offering these services have obligations under the AML Framework, certain appointments, to entities which engage in relevant financial business, may give rise to obligations under the AML Framework.

Below is an abridged list of steps that an officeholder of a relevant financial business should consider to ensure compliance with the AML Framework:

- Maintain various procedures in relation to the business, including in relation to identification and verification procedures (for example relating to onboarding, sale of assets, distribution of funds, *etcetera*).

- Implement record-keeping in relation to information collected in order to discharge AML Framework obligations.

- Implement systems and procedures to enable knowledge and suspicion of money laundering and / or criminal activity (SAR) to be properly and confidentially reported to the Financial Reporting Authority (the FRA). The FRA has provided an example of a SAR filed by a liquidator.[5]

- Appointment of natural persons at managerial level to the following roles (i) Anti-Money Laundering Compliance Officer (AMLCO); (ii) Money Laundering Reporting Officer (MLRO); and (iii) Deputy MLRO (DMLRO).

- Training of employees in relation to the AML Framework (training needs to occur annually and be documented).

The AML Framework includes provisions for offences under the relevant laws to give rise to both criminal (including imprisonment) and civil (legal and administrative) liability. Employees should be cognisant of the fact that certain provisions under the AML Framework could make them personally liable for such breaches, for example the failure to submit a SAR.

Whilst the AML Framework is mentioned briefly within this course, it is a complex area which is under increasing regulatory focus. As such, insolvency professionals and practitioners should consider undertaking specialised training in this area.

1.6.2 FATCA (Foreign Account Tax Compliance Act) and CRS (common reporting standard) regulations

"The Common Reporting Standard (CRS) was developed by the OECD on the mandate of the G20. It is the global standard for the automatic exchange of financial account information for tax purposes".[6] Over 100 jurisdictions have committed to exchanging information with each other under the CRS. Comparatively, the United States Foreign Account Tax Compliance Act (FATCA) is a bilateral regime that requires financial institutions to report only those customers who qualify as US persons.

The Cayman Islands framework governing FATCA and CRS are set out in the:

- Tax Information Authority Act (2021 Revision);

- Tax Information Authority (International Tax Compliance) (Common Reporting Standard) Regulations (2021 Revision);

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[5] Guidance on Preparing and Submitting High Quality Suspicious Activity Reports. Issued by the Financial Reporting Authority 21 February 2020, p 18, example 5.

[6] Department for International Tax Cooperation (ditc.ky).

- Tax Information Authority (International Tax Compliance) (United States of America) Regulations (2021 Revision),

and are collectively referred to as the AEOI Framework.

As the Cayman Islands has committed to CRS, Cayman Islands Financial Institutions (FI - defined below) are obligated to identify non-resident account holders and collect and report certain information to the Tax Information Authority (TIA) for its dissemination to other tax authorities, as appropriate. In relation to FATCA, information is to be collected and reported on US persons only. The Department for International Tax Co-operation (DITC) is responsible for administering the AEOI Framework, and has issued guidance notes for both the CRS and FATA. The Tax Information falls under the DITC.

Pursuant to the CRS and FATCA, a FI can be custodial institutions, depository institutions, investment entities, or specified insurance companies.[7]

Once an entity has been classed as FI[8] (this includes reporting and non-reporting FIs), it must collect certain information from its account holders in accordance with the certification form(s) available on the DITC's portal[9] and undertake the requisite filings prior to the deadlines set out in the below table:

Deadline	Filing	Comments
30 April (as required)	Registration for FIs	Given the AEOI Framework has been in force for a number of years, most FIs will already be registered; although a prudent practitioner will undertake an independent assessment upon appointment to confirm historic compliance with the AEOI Framework.
1 July (annually)	CRS Return for FIs in respect of its reportable accounts	Filed annually by all FIs relating to the year ending 31 December for the year prior
15 September (annually)	CRS Compliance for all FIs	The CRS Compliance Form must also be filed annually by FIs (in addition to the CRS Return) and requires certain certifications to be made regarding compliance with the AEOI Framework

[7] CRS definitions, see s VIII: Defined Terms of the Tax Information Authority (International Tax Compliance) (Common Reporting Standard) Regulations: FATCA s VIII: Defined Terms of the Tax Information Authority (International Tax Compliance) (Common Reporting Standard) Regulations.

[8] An "Entity Classification Flow Chart" is provided at p 4 of the CRS Guidelines V 4.1, date of Issue: 31 March 2022.

[9] There are two different forms, one to be used by individuals and the other for entities. The self-certification forms are available for download at the following link: https://www.ditc.ky/?s=certification.

A FI will, so long as it exists, continue to have the obligations which the CRS regulations impose on it as a FI, or a non-reporting FI, as the case may be.[10] The FI is responsible for ensuring compliance with the AEOI Framework. These obligations extend to the officeholder and, consequently, the appointed liquidator (in its capacity as officeholder).

Comparatively, in contrast to the CRS position under FATCA, upon the formal appointment of a liquidator, a FI, classed as an investment entity, will cease to be FI; although a final return for the relevant financial year must be submitted.

The AEOI Framework and guide notes issued by the DITC, confirm that breaches or failures to comply with the AEOI Framework may result in monetary penalties and criminal liabilities which can be imputed on the officeholders.

A non-exhaustive list of practical points for insolvency practitioners to consider in circumstances where they are appointed to a FI, are as follows:

- As part of the company's books and records, collect in the relevant registration information (login and password for the DITC and IRS, if applicable) and information relating to the FI's previous filings;
- Change the Principal Point of Contact (PPoC) and an Authorising Person (AP) to allow filings and deregistration to occur;
- Ensure there are written policies and procedures in place;
- Undertake an exercise to confirm the accountholder information is complete (and that to the extent possible, review the controls that were in place to validate the information provided by the account holders);
- Seek to remediate any accounts where information has not been provided by the accountholder;
- Ensure to deregister from the DITC and IRS at the appropriate time;
- Retain the records for a period of six years (seek approval to destroy the records in due course from the relevant authorising parties as appropriate, which might be the shareholder or court, as the case might be).

1.6.3 Economic Substance

The Cayman Islands, together with other major offshore jurisdictions, introduced economic substance laws as a result of collaboration with the OECD's Forum on Harmful Tax Practices and the European Union Commission Services to implement the standard on substantial activities

[10] The Common Reporting Standard for Automatic Exchange of Financial Account Information in Tax Matters, V 3.0, Guidance Notes issued 15 March 2018 VI. Guidance on technical Issues B Entity specific Issues 1. b), p 36.

requirements. The overriding objective of the enactment of this legislation is to promote fair tax and transparency practices.

The Cayman Islands legislative framework governing economic substance comprises of the following (this is collectively referred to as the ES Regime):

- The International Tax Co-operation (Economic Substance) Act (2021 Revision);
- The International Tax Co-operation (Economic Substance) (Prescribed Dates) Regulations 2021;
- The International Tax Co-operation (Economic Substance) (Amendment of Schedule) Regulations 2021; and
- The International Tax Co-operation (Economic Substance) Regulations 2020.

The ES Regime came into force on 1 January 2019 and, in summary, imposes economic substance requirements on (1) relevant entities (First Limb) which (2) engage in one or more of the relevant activities (Second Limb), to comply with the law by maintaining an appropriate level of economic substance in the Cayman Islands, unless exceptions apply.

The First Limb is an assessment of whether the entity is a Relevant Entity. A Relevant Entity includes Cayman Island incorporated companies (including locally registered foreign companies), limited liability companies and partnerships.

The Second Limb is an assessment of the activities undertaken by the Relevant Entity. Relevant Activities means one or more of the following nine relevant activities:

- Banking business;
- Distribution and service centre business;
- Financing and leasing business;
- Fund management business;
- Headquarters business;
- Holding company business;
- Insurance business;
- Intellectual property business; and
- Shipping business.

Regardless of its activities, all Relevant Entities are required to submit an annual Economic Substance Notification (ESN) for the previous year, confirming whether or not they are performing one or more of the above mentioned Relevant Activities by 31 January. This filing must be made through the Registry Corporate Administration Portal (CAP)[11] as a pre-requisite to the submission of an entity's annual return.

Once it is determined that the Relevant Entity has performed one or more Relativity Activities, it must satisfy the relevant Economic Substance Test (the ES Test). Advice should be sought as to whether the entity is compliant, as the ES Test will vary as between businesses. The Relevant Entity must then submit an Economic Substance Return (ES Return) within 12 months of the end of their financial year, confirming their compliance with the ES Test during the previous financial year.

The ES Test and requirement to file the ES Return will apply so as long as the Relevant Entity conducts Relevant Activities. If a Relevant Entity is in liquidation, it must satisfy the ES Test and file an ES Return in respect of any period in which it carries on a relevant activity.

Guidance notes issued by the Authority[12] clarify that liquidators have duties pursuant to the ES Regime. "Any liquidators (or equivalent) or other representatives of a Relevant Entity who were responsible for the liquidation, winding up or dissolution of the Relevant Entity have duties to maintain the relevant entity's records and to respond to the Authority's information requirements under the ES Act for six years after final dissolution".[13]

Financial penalties can be levied on a Relevant Entity for failure to file an ESN. Further, where a Relevant Entity, conducting Relevant Activities, fails to satisfy the ES Test in a financial year, remedial actions or penalties (financial and strike-off) could be imposed for breaches.

1.6.4 Data Protection Act

The Data Protection Act (2021 Revision) (DPA) came into full force on 30 September 2019 and "introduces globally recognized principles about the use of personal data to the Cayman Islands. The DPA aligns the Cayman Islands with other major jurisdictions around the world, notably the European Union, and thereby facilitates the free flow of data – a pre-requisite for the Cayman Islands being an equal and competitive participant in today's globalized economy".[14]

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[11] The Department for International Tax Cooperation has issued a user guide "DITC Economic Substance Notification (User Guide) - CAP 10/2021"

[12] The Cayman Islands Tax Information Authority is the "Authority" for the purposes of the ES Regime and its function includes administering and monitoring compliance with the ES Regime and sharing information with other competent authorities.

[13] Cayman Islands Economic Substance Guidance, V 3.2, July 2022, II c (2), p 14.

[14] https://ombudsman.ky/data-protection-organisation/introduction.

"Personal data" means data relating to a living individual who can be identified and includes data such as:

(a) the living individual's location data, online identifier or one or more factors specific to the physical, physiological, genetic, mental, economic, cultural or social identity of the living individual;

(b) an expression of opinion about the living individual; or

(c) any indication of the intentions of the data controller or any other person in respect of the living individual."[15]

Sensitive personal data, defined in section 3 of the DPA, is a subset of personal data which carries increased risks (for example, medical data and the data subject's commission, or alleged commission, of an offence).

The DPA governs to data controllers and processors of personal data who, from a territorial perspective, must be:

- established in the Cayman Islands, and the personal data is processed in the context of that establishment; or

- not established in the Cayman Islands, but the data is being processed in the Cayman Islands (otherwise than for transit purposes).

There are six legal bases for processing personal data which are set out in Schedule 2 of the DPA. At least one of these conditions must apply whenever you process personal data. These are, in summary –

(1) consent has been provided;

(2) the processing is necessary for performance of a contract;

(3) legal obligation;

(4) vital interests;

(5) public functions; and

(6) legitimate interests.

There are additional conditions for processing sensitive personal data.

[15] Data Protection Act (2021 Revision), defined term, p 10.

In accordance with the DPA, individuals have rights in relation to their personal data; however, these rights are not absolute and there are exemptions to certain obligations in order to ensure that personal data can be used in appropriate circumstances, for example, law enforcement.

Liquidators (or the equivalent) may be considered to be a data controller by virtue of their appointment and exercising control over how an entity's data is processed. Insolvency practitioners, providing *inter alia* insolvency and restructuring services, directorship, liquidation and forensic services, may in the course of their engagement process personal data (as a data processor).

At a minimum, to ensure compliance with the DPA, the following should be undertaken by liquidators (or equivalent) upon their appointment:

- An assessment of the personal data held and collected by the entity in liquidation and how it is used by that entity.
- Issuance of data protection notice, particularly where personal data is being collect. This notice should provide the data subject with information concerning their rights as required in accordance with the DPA.
- Implementation of a complaints handling process to ensure that a data subject's complaints and requests can be dealt (ie set up a dedicated email address).
- Where personal data is being transferred to a third party data processor, ensure that the engagement is formalised byway of a written document (the DPA specifies the minimal requirements of this contract).
- Implementation of appropriate policies and procedures (relating to the security of the data being stored and the retention of the same).

The Cayman Islands Ombudsman (Ombudsman) is the supervisory authority for data protection-related matters. Failure to comply with the DPA may result in investigations from the Ombudsman, penalties and claims by a harmed party.

1.6.5 Beneficial Ownership

The framework governing the beneficial ownership regime (BOR) is set out in the:

- Companies Act;
- Beneficial Ownership (Companies) Regulations (2019 Revision);
- Limited Liability Companies Act (2021 Revision);
- Beneficial Ownership (Limited Liability Companies) Regulations (2019 Revision);

- Limited Liability Partnerships Act (2021 Revision);
- Beneficial Ownership (Limited Liability Partnership) Regulations (2022 Revision).

The BOR came into force on 1 July 2017. The overriding objective of the BOR, as articulated by the competent authority,[16] is "to ensure transparency of the beneficial ownership of Cayman Islands registered entities. In circumstances where the first tier in the ownership chain is a legal entity, the Corporate Service Providers (CSP) or the Trust and Corporate Service Providers (TCSP)] are required to pierce through the structure and determine the details for the natural persons who ultimately own and control the entity."[17]

The following Cayman Islands vehicles are in scope entities for the purposes of the BOR:

- Companies incorporated under the Companies Act;
- Limited liability companies formed under the Limited Liability Companies Act;
- Limited Liability Partnerships formed under the Limited Liability Partnership Act.

The BOR requires that in scope entities make reasonable steps to identify the individuals who are the beneficial owners[18] of the entity and maintain required particulars of the individual (for example, the individual's full legal name, residential address, date of birth and information identifying the individual from a government issued identification document) on its beneficial ownership register. Unless exempted, the entities are then required to file the register with the with the Cayman Islands General Registry (Registry) through the Corporate Administration Platform (CAP).

Where an entity is exempt from maintaining a register, as set out in the relevant Act, they must file confirmation of their exemption with the Registry. The filed information is held on a secure, non-public search platform. Currently, all information lodged under the BOR will continue to be secure and only accessible by the competent authority requesting access to the register.

The liquidation of an entity does not preclude it from adhering to the BOR and there are penalties associated with knowingly and wilfully contravening certain obligations imposed by the BOR. Whilst the filing requirements of an in-scope entity in liquidation is ongoing, the filing period is reduced from at least monthly to every ninety days.[19]

In practice, the liquidator's firm will ordinarily assume the responsibility of the registered office. Accordingly, where the officeholder is appointed to an in-scope entity, they need to ensure continued compliance with the BOR, otherwise the obligation will remain with appointed CSP or TSCSP.

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[16] The Cayman Islands Registrar of Companies

[17] Guidance Notes on Complying with Beneficial Ownership Obligations in the Cayman Islands Issued by the Competent Authority for Beneficial Ownership on 18 July 2022, at p 9, para 4.3.

[18] Beneficial Owners is defined in s 247(3), (4) and (5) of the Companies Act; s 73(3), (4) and (5) of the Limited Liabilities Act; and s 54(3), (4) and (5) of the Limited Partnerships Act.

[19] Beneficial Ownership (Companies) Regulations (2022 Revision), reg 7C(3)(b).

Prior to undertaking any filings, the liquidator should satisfy themselves that the particulars of the beneficial ownership register are accurate and current.

Self-Assessment Questions

Question 1

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

Question 2

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

Question 3

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

For feedback on these self-assessment questions, see the document "Comment and Feedback on Self-Assessment Questions", which is made available to you as a separate document

CHAPTER 2

ETHICS AND PROFESSIONAL PRACTICE

2.1 Institutional framework

2.1.1 Court system

The structure of the court system is hierarchical, with appeals made to the court above at each stage. The Summary Court is the first in the hierarchy, followed by the Grand Court, the Court of Appeal and finally, His Majesty's Judicial Committee of the Privy Council. There is a separate right of petition to the European Court of Human Rights for persons who reside in the Cayman Islands having regard to the extension of the European Convention on Human Rights to the Islands.

2.1.2 Oversight of the insolvency process

Insolvency practitioners (IPs) appointed by the Court (for example official liquidators) will be subject to the oversight of the Court. The Insolvency Practitioners' Regulations set out the necessary professional qualifications for individuals appointed as official liquidators to any company. However, there is no independent regulatory body whose purpose is to oversee the insolvency process in the Cayman Islands in the same way as might be found in other jurisdictions. For instance, IPs are not subject to the same type of regulatory body inspections and approvals as required in the UK.[20]

There is, however, an independent Insolvency Rules Committee comprising of the members who are empowered to do such things as contained within sections 154 and 155 of the Companies Act.[21] The main purpose of the Insolvency Rules Committee is to make new rules and prescribe new statutory forms relevant to the insolvency and restructuring profession in the Cayman Islands.

Those powers are set out below:

> "**Section 154. Insolvency Rules Committee**
>
> (1) There shall be established an Insolvency Rules Committee comprising-
>
> (a) the Chief Justice or other judge nominated by the Chief Justice in that person's place who shall be chairperson;
> (b) the Attorney General or that person's nominee;

[20] Also see the discussion in para 2.3.1 below.

[21] The current members of the Insolvency Rules Committee comprise: The Honourable Nicholas Segal (Chairman), The Honourable Samuel Bulgin KC (Attorney General), Colin McKie QC (legal practitioner), Colette Wilkins KC (legal practitioner), Eleanor Fisher (insolvency practitioner), Jude Scott (CPA, Public Accountant), and Martin Trott (insolvency practitioner).

(c) two attorneys-at-law appointed by the Chief Justice on the recommendation of the Cayman Islands Legal Practitioner's Association;

(d) a qualified insolvency practitioner appointed by the Chief Justice upon the recommendation of the Cayman Islands Institute of Professional Accountants;

(e) a person appointed by the Chief Justice who, in that person's opinion, demonstrates a wide knowledge of law, finance, financial regulation or insolvency practice; and

(f) a qualified insolvency practitioner appointed by the Chief Justice on the recommendation of the Recovery and Insolvency Specialists Association.

(2) The quorum of the Insolvency Rules Committee shall be the chairperson and three other members of the Committee; and the chairperson shall have a casting vote.

155. Powers of the Insolvency Rules Committee

(1) The Insolvency Rules Committee shall have power-

(a) to make rules and prescribe forms for the purpose of giving effect to Parts IV, V and XVI;

(b) to prescribe court fees to be paid in connection with –
(i) applications under Part IV;

(ii) winding up proceedings under Part V;

(iii) applications under Part XVI; and

(c) to make rules for the purpose of specifying –

(i) the qualifications which must be held by a person appointed to the office of official liquidator;

(ii) persons who are disqualified from holding office as official liquidator either generally, or in relation to a particular company which is not in liquidation before the court;

(iii) the nature and scope of professional indemnity insurance, if any, required to be held by persons appointed to the office of official liquidators; and

(iv) the nature and scope of security bonds, if any, required to be posted by persons appointed to the office of official liquidator.

(2) The Insolvency Rules Committee, after consultation with the Authority and with any organisation representing insolvency practitioners in the Islands, shall make rules prescribing the rates of fees which may be charged by an official liquidator."

2.2 Insolvency practitioners

In this section the licensing, qualification, eligibility and regulation of IPs in the Cayman Islands will be discussed.

In addition, the standing of foreign-based practitioners in regard to their ability to be appointed as either a provisional, official or voluntary liquidator in the Cayman Islands, will be briefly outlined.

2.2.1 Licensing and regulation

There is no formal licensing or regulation (in the sense of an industry regulator) of IPs in the Cayman Islands.

There are, however, regulations set out in the Insolvency Practitioners' Regulations that set out who may act as an official liquidator of a company.[22]

The term "official liquidator", as defined in section 89 of the Companies Act, "means the liquidator of a company which is being wound up by order of the Court or under supervision of the Court and includes a provisional liquidator". The Insolvency Practitioners' Regulations therefore also apply to provisional liquidators.

2.2.2 Eligibility

As set out in the Insolvency Practitioners' Regulations[23] it provides a number of tests that need to be met in order for a person to be eligible to act as an official liquidator. These eligibility tests include:

- qualification;
- residency;

[22] The criteria will be discussed in para 2.2.2 below.
[23] Insolvency Practitioner Regulations, regs 4 to 7.

- independence; and
- insurance requirements.

Below are the requirements to be met as set out in the Insolvency Practitioners' Regulations:

"**Regulation 4. Professional Qualification**

(1) A person shall be qualified to accept appointment by the Court as official liquidator of any company only if –

(a) he is licensed to act as an insolvency practitioner in a relevant country; or

(b) he is qualified as a professional accountant by a relevant institute, is in good standing with such institute, has a minimum of five (5) years' relevant experience and is credited with not less than 2,500 chargeable hours of relevant work; or

(c) he has been appointed by the Court as an official liquidator of a company at any time within the five (5) years immediately preceding the commencement date.

(2) For the purposes of paragraph (1)(a) of this Regulation the relevant countries are –

(a) England and Wales;

(b) Scotland;

(c) Northern Ireland;

(d) The Republic of Ireland;

(e) Australia;

(f) New Zealand; and

(g) Canada.

(3) For the purposes of paragraph (1)(b) of this Regulation the relevant institutes are those specified from time to time in the Schedule 2 to The Public Accountants Law, 2004.

(4) The expressions "relevant experience" and "relevant work" shall have the same meaning as in Part A of the Schedule to these Regulations.

Regulation 5. Residency Requirement

(1) A qualified insolvency practitioner shall not be appointed by the Court as official liquidator of any company unless –

(a) he is resident in the Islands; and

(b) he, or the firm of which he is a partner or employee, holds a trade and business licence which authorises him or his firm to carry on business as professional insolvency practitioners.

Regulation 6. Independence Requirement

(1) A qualified insolvency practitioner shall not be appointed by the Court as official liquidator of a company unless he can be properly regarded as independent as regards that company.

(2) A qualified insolvency practitioner shall not be regarded as independent if, within a period of 3 years immediately preceding the commencement of the liquidation, he, or the firm of which his is a partner or employee, has acted in relation to the company as its auditor.

Regulation 7. Insurance Requirement

(1) A qualified insolvency practitioner shall not be appointed by the Court as official liquidator of any company unless he and the firm of which he is a partner or employee or the company of which he is an employee, has professional indemnity insurance (up to a limit of at least US$10 million in respect of each and every claim and at least US$20 million in the aggregate, with a deductible of not more than US$100,000) applicable to the negligent performance or non-performance of his duties as an official liquidator generally.

(2) Nothing in these Regulations shall prevent the Court from making an order in respect of a particular company that its official liquidator shall –

(a) procure professional indemnity insurance covering him in respect of the negligent performance or non-performance of his duties to the company with a limit of coverage in excess of US$10 million in respect of each and every claim or with an aggregate limit in excess of US$20 million; or

(b) procure the issue of a security bond to cover acts of fraud or dishonesty committed by the official liquidator or any of his staff, in which case the premium shall be paid out of the assets of the company as an expense of the liquidation.

(3) An insolvency practitioner who has professional indemnity insurance complying with the policy limit specified in Practice Direction No 1/2003 shall continue to be treated as being compliant with this Regulation until 31st March 2009, notwithstanding that the aggregate limit under such policy is less than $20 million."

2.2.3 Foreign insolvency practitioners

In respect of a voluntary liquidation, any person may be appointed as a voluntary liquidator of a Cayman Islands company.[24]

In terms of official liquidations, the ability and criteria for the appointment of a foreign practitioner is laid out in accordance with the Insolvency Practitioners' Regulations and the Companies Act.

Section 108 (1) of the Companies Act states as follows: "A **foreign practitioner** may be appointed to act jointly with a **qualified insolvency practitioner**" (emphasis added).

The terms "foreign practitioner" and "qualified insolvency practitioner" are set out in the definitions contained at section 89 of the Companies Act that states as follows:

"'**foreign practitioner**' means a person who is qualified under the law of a foreign country to perform functions equivalent to those performed by official liquidators under this Act."

"'**qualified insolvency practitioners**' means a person holding the qualifications specified in the regulations[25] made by the Insolvency Rules Committee under section 155 or such other qualifications as the Court considers appropriate for the conduct of the winding up of a company."

Regulation 8 of the Insolvency Practitioners' Regulations states:

"**Regulation 8. Foreign practitioners**

(1) A foreign practitioner who meets the independence and insurance requirements of Regulations 6 and 7 may be appointed by the Court as an official liquidator of a company jointly with a qualified insolvency practitioner (but not as sole official liquidator).

[24] Companies Act, s 120.
[25] The regulations referred to in the definition above are the Insolvency Practitioners' Regulations.

(2) A foreign practitioner need not meet the residency requirement of Regulation 5."

It is important to note that a foreign practitioner cannot act as a sole official liquidator (including provisional liquidator) of a Cayman Islands company.

Self-Assessment Questions

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?

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 IPRS – can the foreign practitioner act as a joint official liquidator with you?

Question 3

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

For feedback on these self-assessment questions, see the document "Comment and Feedback on Self-Assessment Questions", which is made available to you as a separate document

2.3 Code of ethics / professional conduct

2.3.1 Introduction

The practice of insolvency and restructuring is often complex and varied, involving distressed parties with competing demands and complex legal, financial and factual issues. This brings many threats to the conduct of IPs and the importance of promoting high standards of practice in relation to work undertaken.

The regulation of the insolvency profession varies in different jurisdictions, and the conduct of IPs may be subject to review by disciplinary tribunals and governed by statute and secondary legislation and in many cases is subject ultimately to the control of the courts, in accordance with local requirements.

As discussed previously, it is important to note that the Cayman Islands does not have its own regulator that oversees the conduct of IPs.[26]

The conduct / practice of IPs whilst formally appointed, is monitored and controlled by the Grand Court, in accordance with the Cayman Islands Insolvency Laws, namely the:

- Companies Act;
- CWR; and
- Insolvency Practitioners' Regulations.

IPs will also be members of other professional associations, dependent upon their professional qualifications. Relevant and specific codes of ethics may be used by the Grand Court to assist with the identification and enforcement of acceptable insolvency practices and professional standards.

The Cayman Islands Institute of Professional Accountants (CIIPA) requests that all their members must comply with the IESBA Code of Ethics (ICoE).

Where applicable, IPs should comply with applicable regulatory guidance propagated by local law and judicial authorities.

The ICoE is based on the code of ethics produced by the Joint Insolvency Committee (UK) which has been adopted in substantially similar term by all bodies recognised under the relevant legislation in England and Wales, Scotland and Ireland to grant licences to IPs.

2.3.2 Cayman Islands Legal Practitioners Association (CILPA) Code of Conduct

The Cayman Islands Legal Practitioners Association (CILPA) provides governance of the legal profession. Full membership of CILPA is voluntary, but encouraged for all practising attorneys.

CILPA also acts as supervisory authority for the legal profession under the Anti-Money Laundering (Designated Non-Financial Business and Professions) (No1) Regulations 2017. It has delegated its functions in this regard to its operationally independent regulatory arm, the Cayman Attorneys Regulation Authority (CARA).

CILPA's Code of Conduct for Cayman Islands Attorneys-at-Law provides guidance in the form of rules and commentary.

[26] See the discussions in paras 2.2.1 and 2.3.1 above.

Rule 1.06 provides that:

> "Except in the specific circumstances contemplated by statute, an attorney has a duty to hold in strict confidence all information concerning the business and affairs of the client acquired in the course of the professional relationship, and may not divulge such information except where:
>
> (1) the attorney is reasonably seeking to establish or collect his or her fee; or
>
> (2) the attorney is defending himself or his partners or employees against an allegation by the client of malpractice or misconduct or against a criminal charge; or
>
> (3) the information is or has become public knowledge; or
>
> (4) disclosure is required by law; or disclosure to the attorney's professional indemnity insurer is required in order to maintain or secure the attorney's cover; or
>
> (5) the attorney forms the view that there is a serious and imminent risk to the health or safety of the client; or
>
> (6) the attorney has an overriding duty to a court or tribunal."

Rules 1.11 to 1.13 deal with conflicts of interest. Rule 1.11 provides that:

> "An attorney must not without the informed consent of such person act or continue to act for any person where there is a conflict of interest between the attorney on the one hand and an existing or prospective client on the other hand; nor similarly may the attorney agree to act for any such person when, at the time he takes instructions, it is reasonably foreseeable that such a conflict may arise during the course of his doing so."

Rule 3.03 provides that:

> "An attorney shall keep accounts which clearly and accurately distinguish the financial position between himself and his client."

Chapter 6 governs relations between attorneys. Rule 6.08 provides that there is an obligation on every attorney who has grounds to suspect improper acts by another practitioner to make a confidential report to the Chief Justice.

Chapter 7 governs relations with third parties. Rule 7.03 provides that "[a]n attorney must make all reasonable efforts to ensure that legal processes are used for their proper purposes only and

that their use is not likely to cause unnecessary embarrassment, distress or inconvenience to another person's reputation, interests or occupation".

The commentary gives the following examples of the operation of this rule:

> "(1) An attorney should not issue a statutory demand under Section 93 of the Companies Law (2010 Revision) knowing that or being reckless as to whether the debt is *bona fide* disputed, and should make reasonable inquiry from the client as to the existence of any such dispute.
>
> (2) *Ex parte* applications should be made by an attorney only if he is satisfied that to do so is both permitted by the Grand Court Rules and that it is impractical or inappropriate to give notice to the persons likely to be affected by the order being sought in the application."

Rule 1.10 incorporates by reference the International Principles on Conduct for the Legal Profession promoted by the International Bar Association (the International Principles), which are set out in Appendix 1 to the Rules. The International Principles consist of 10 principles common to the legal profession worldwide, and comprise the general principle and an explanatory note. Those principles are:

(1) Independence.

(2) Honesty, integrity and fairness.

(3) Conflicts of interest.

(4) Confidentiality/ professional secrecy.

(5) Clients' interests, which are to be treated as paramount.

(6) Lawyers' undertaking, which shall be honoured in a timely manner.

(7) Clients' freedom to be represented by a lawyer of their choice.

(8) Protection of property of clients and third parties.

(9) Competence.

(10) Fees, which are to be reasonable. Lawyers should not generate unnecessary work.

2.3.3 Cayman Islands Institute of Professional Accountants

2.3.3.1 The Code of Ethics

(a) Introduction

The ICoE sets out fundamental principles of ethics for IPs, promoting high standards of practice in relation to work undertaken.

The fundamental principles are:

- integrity;
- objectivity, independence and impartiality;
- professional / technical competence;
- confidentiality; and
- professional behaviour.

The ICoE provides a conceptual framework that IPs are to apply in order to identify, evaluate and address threats to compliance with the fundamental principles:

- self-interest threat;
- self-review threat;
- advocacy threat;
- familiarity threat; and
- intimidation threat.

(b) Fundamental principles

There are five fundamental principles of ethics for IPs:

Integrity

Integrity entails being straightforward and honest in all professional and business relationships. Integrity implies fair dealing and truthfulness.

Objectivity

Objectivity entails not to compromise professional or business judgements because of bias, conflict of interest or undue influence of others. Objectivity is the state of mind which has regard to all considerations relevant to the task in hand, but no other.

Professional competence and due care

Professional competence requires the exercise of sound judgement in applying professional knowledge and skill when undertaking professional activities. An IP must comply with the principle of professional competence and due care, which requires an IP to:

- attain and maintain professional knowledge and skill at the level required to ensure that a competent professional service is provided, based on current technical and professional standards and relevant legislation; and

- act diligently and in accordance with applicable technical and professional standards.

Confidentiality

The principle of confidentiality is not only to keep information confidential, but also to take all reasonable steps to preserve confidentiality. Whether information is confidential or not will depend on its nature.

An IP must comply with the principle of confidentiality, which requires an IP to respect the confidentiality of information acquired as a result of professional and business relationships. An IP must:

- be alert to the possibility of inadvertent disclosure, including in a social environment, and particularly to a close business associate or an immediate or a close family member;

- maintain confidentiality of information within the firm or employing organisation;

- not disclose confidential information acquired as a result of professional and business relationships outside the firm or employing organisation without proper and specific authority, unless there is a legal or professional duty or right to disclose;

- not use confidential information acquired as a result of professional and business relationships for the personal advantage of the IP, or for the advantage of a third party;

- not use or disclose any confidential information, either acquired or received as a result of a professional or business relationship, after that relationship has ended; and

- take reasonable steps to ensure that personnel under the IP's control, and individuals from whom advice and assistance are obtained, respect the IP's duty of confidentiality.

Professional behaviour

An IP must comply with the principle of professional behaviour, which requires an IP to comply with relevant laws and regulations and avoid any conduct that the IP knows or should know might discredit the profession. An IP must not knowingly engage in any business, occupation or activity that impairs or might impair the integrity, objectivity or good reputation of the insolvency profession, and as a result would be incompatible with the fundamental principles.

Conduct that might discredit the insolvency profession includes conduct that a reasonable and informed third party would be likely to conclude adversely affects the good reputation of the profession.

Professional behaviour also includes complying with relevant laws and regulations and avoiding any conduct that the IP knows or should know might discredit the profession.

(c) Conceptual framework

The conceptual framework specifies an approach for an IP to:

- identify threats to compliance with the fundamental principles;
- evaluate the threats identified; and
- address the threats by eliminating or reducing them to an acceptable level.

Identifying threats

Threats to compliance with the fundamental principles fall into one or more of the following categories:

Self-interest threat

The threat that financial or other interests of the firm, an individual within the firm or a close or immediate family member of an individual within the firm will inappropriately influence the IP's judgement or behaviour.

Self-review threat

The threat that the IP will not appropriately evaluate the results of a previous judgement made or service performed by an individual within the firm, on which the IP will rely when forming a judgement as part of providing a current service.

Advocacy threat

The threat that an individual within the firm will promote a position or opinion to the point that the IP's objectivity is compromised.

Familiarity threat

The threat that due to a long or close relationship, an individual within the firm will be too sympathetic or antagonistic to the interests of others or too accepting of their work.

Intimidation threat

The threat that an IP will be deterred from acting objectively because of actual or perceived pressures, including attempts to exercise undue influence over the IP.

Evaluating threats

An acceptable level is a level at which an IP using the reasonable and informed third party test would likely conclude that the IP complies with the fundamental principles.

The consideration of qualitative as well as quantitative factors is relevant in the IP's evaluation of threats, as is the combined effect of multiple threats, if applicable.

Addressing threats

If the IP determines that the identified threats to compliance with the fundamental principles are not at an acceptable level, the IP must address the threats by eliminating them or reducing them to an acceptable level. The IP will do so by:

- eliminating the circumstances, including interests or relationships, that are creating the threats;
- applying safeguards, where available and capable of being applied, to reduce the threats to an acceptable level; or
- declining or ending the insolvency appointment.

(d) Safeguard examples

Safeguards are actions, individually or in combination, that the IP takes that effectively reduce threats to compliance with the fundamental principles to an acceptable level.

Safeguards vary depending on the facts and circumstances. Examples of actions that in certain circumstances might be safeguards to address threats include:

- assigning additional time and qualified personnel to required tasks when an insolvency appointment has been accepted, might address a self-interest threat;

- having an appropriate reviewer who was not a member of the team review the work performed or advise as necessary, might address a self-review threat;

- involving another IP to perform or re-perform part of the engagement might address self-interest, self-review, advocacy, familiarity or intimidation threats; and

- disclosing any referral fees or commission arrangements received for recommending services or products, might address a self-interest threat.

(e) Insolvency practitioners

An IP must:

- use professional judgement in applying this framework;

- ensure that the ICoE is always applied in relation to the conduct of an insolvency appointment or circumstances which might lead to an insolvency appointment;

- follow the fundamental principles, apply the conceptual framework and specific requirements of the ICoE in all their professional and business activities whether carried out with or without reward, and in other circumstances where to fail to do so would bring discredit to the insolvency profession;

- be guided not merely by the terms, but also by the spirit of the ICoE;

- not knowingly engage in any activity that impairs or might impair integrity, objectivity or the good reputation of the profession and as a result would be incompatible with the fundamental principles;

- exercise judgement to determine how best to deal with threats that are not at an acceptable level, whether by applying safeguards to eliminate the threat or reduce it to an acceptable level or, where possible, by refusing to remain associated with the matter creating the conflict;

- comply with the provisions of statute or secondary legislation where it deals with relevant circumstances;

- also comply with any relevant judicial authority relating to their conduct and any directions given by the court;

- act in a manner appropriate to their position (as an officer of the court, where applicable) and in accordance with any *quasi*-judicial, fiduciary or other duties that the IP might be under; and

- comply with standards or regulations issued by their authorising body.

2.4 Litigation / liquidation funding

2.4.1 Introduction

Litigation funding agreements are expressly permitted by section 16(1) of the Private Funding of Legal Services Act 2020 (PFLSA), which came into force on 1 May 2021.

Previously, the use of litigation funding had been permitted by the Cayman Islands courts on a case-by-case basis. The factors taken into account included consideration of the long-outdated principles of champerty and maintenance, which were abolished by PFLSA.

PFLSA expressly permits three different types of funding arrangements, as discussed below:

2.4.1.1 Third-party funding agreements

Third-party funding agreements are where a third party (usually a commercial litigation funder or, in a liquidation context, a stakeholder) agrees to fund all or some of the client's legal costs and / or other costs in exchange for payment based on contractual terms.

Section 16(2) of the PFLSA provides that a litigation funding agreement must be in writing and must comply with prescribed requirements, if any.

There are as yet no prescribed requirements for funding agreements and it appears that, for now, they are intended to be largely self-regulated between stakeholders and commercial funders.

2.4.1.2 Conditional fee agreements

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.

Section 4 of the PFLSA provided that the maximum success fee permitted cannot exceed 100% of normal hourly rates.

All agreements must be in writing, include a cooling-off period, deal with the impact on costs and be signed by the client.

2.4.1.3 Contingency fee agreements

Contingency fee agreements (sometimes referred to as damages-based agreements) are permitted under section 3 of the PFLSA, and find application where lawyers are paid a percentage of recoveries if the claim succeeds, and nothing if the claim fails.

Regulations in terms of the PFLSA provide that the maximum percentage of recoveries permitted to be paid under such an arrangement is 33.3% of the total amount awarded. This percentage can be increased to 40% via application to the Cayman Islands courts.

All agreements must be in writing, include a cooling-off period, deal with the impact on costs and be signed by the client.

Agreements signed by a client in a fiduciary capacity (for example an official liquidator) must be approved by the Cayman Islands court.

2.4.2 Liquidators' court sanction

Liquidators will require court sanction to enter into a funding agreement, and if such agreement involves a disposition of the company's property (for example, by way of payment of interest or granting of security) then a validation order will be required to ensure it is not void pursuant to section 99 of the Companies 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."

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

2.5 Case studies dealing with ethics

Below are examples of specific circumstances and relationships that will create threats to compliance with the fundamental principles.

2.5.1 Significant professional relationship

2.5.1.1 Insolvency appointment following audit related work

Previous relationship:

The firm or an individual within the firm has completed audit-related work.

Response:

A significant professional relationship will normally arise where the audit-related work was completed within the previous three years. An IP must not take the insolvency appointment as it is unlikely that appropriate action can be taken to reduce the threat to compliance with the fundamental principles to an acceptable level.

Where audit-related work was completed more than three years before the proposed date of the appointment of the IP, a threat to compliance with the fundamental principles could still arise. The IP must evaluate any such threat and consider whether the threat can be eliminated or reduced to an acceptable level by the use of safeguards.

This restriction does not apply where the insolvency appointment is in a members' voluntary liquidation – an IP may normally take an appointment as liquidator in these circumstances. However, the IP must consider whether there are any other circumstances that give rise to an unacceptable threat to compliance with the fundamental principles. Further, the IP must satisfy themself that the directors' declaration of solvency is likely to be substantiated by events.

2.5.1.2 Appointment as investigating accountant at the instigation of a creditor

Previous relationship:

The firm or an individual within the firm was instructed by, or at the instigation of, a creditor or other party having a financial interest in an entity, to investigate, monitor or advise on its affairs.

Response:

A significant professional relationship would not normally arise in these circumstances provided that:

- there has not been a direct involvement by an individual within the firm in the management of the entity;
- the firm had its principal client relationship with the creditor or other party, rather than with the company or proprietor of the business; and
- the entity was aware of this.

An IP must, however, consider all the circumstances before accepting an insolvency appointment, including the effect of any discussions or lack of discussions about the financial affairs of the company with its directors, and whether such circumstances give rise to an unacceptable threat to compliance with the fundamental principles.

Where such an investigation was conducted at the request, or at the instigation, of a secured creditor who then requests an IP to accept an insolvency appointment as an administrator or

administrative receiver, the IP must satisfy themself that the company, acting by its board of directors, does not object to them taking such an insolvency appointment. If the secured creditor does not give prior warning of the insolvency appointment to the company, or if such warning is given and the company objects but the secured creditor still wishes to appoint the IP, the IP must consider whether the circumstances give rise to an unacceptable threat to compliance with the fundamental principles.

2.5.2 Previous or existing liquidation appointment

2.5.2.1 Conversion of voluntary liquidation to official liquidation

Previous appointment:

An individual within the firm has been the liquidator of a company in voluntary liquidation.

Proposed appointment:

Liquidator in an official liquidation following an application to the Grand Court for the company's liquidation to continue under the supervision of the Grand Court.

Response:

Where there has been a significant professional relationship, an IP may continue or accept the appointment if there are no circumstances that give rise to an unacceptable threat to compliance with the fundamental principles.

All threats, whether actual or perceived, should be brought to the attention of all creditors and the Grand Court as part of the Grand Court application.

An IP should in no way promote their own appointment.

Self-Assessment Questions

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?

Question 2

What are the "fundamental principles"?

Question 3

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

Question 4

What should IPs do to address threats? Provide examples.

Question 5

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

Question 6

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

Question 7

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

Question 8

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

Question 9

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

For feedback on these self-assessment questions, see the document "Comment and Feedback on Self-Assessment Questions", which is made available to you as a separate document

CHAPTER 3

SECURED PARTIES AND RECEIVERSHIPS

3.1 Forms of security

3.1.1 Overview

3.1.1.1 Types of security interests

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.

Legal mortgage

A legal mortgage is the most comprehensive form of security, often taken with respect to real property and / or shares. A legal mortgage is the transfer by conveyance or assignment of the whole of the legal ownership of an asset by way of security to the secured creditor. This transfer is, however, subject to an equity of redemption, which is an express or implied obligation to re-transfer ownership of the asset to the debtor if the debtor discharges his debt or obligations to the secured creditor.

Equitable mortgage

An equitable mortgage is the transfer of a beneficial interest in the relevant asset to the secured creditor while the legal interest remains with the debtor, and it is unregistered and not a charge on the secured property.

For this reason, an equitable mortgage is weaker than a legal mortgage (and a pledge) because a *bona fide* third-party purchaser can without notice acquire legal title in the asset, free from an equitable mortgage.

Charge

Under a charge, specific property (either real or personal) of the debtor is expressly or constructively appropriated to or made answerable for payment of a debt. The secured creditor has a right to resort to the asset in order to realise it towards payment of the debts that it is owed. However, a charge does not transfer legal or equitable interests in the asset subject to the charge, nor does it confer on the secured creditor a right to possession.

Charges can either be granted with respect to a fixed asset or a floating pool of assets. Generally speaking, a secured creditor will take a fixed charge over specific assets and then a floating charge over all assets which are not already covered by that fixed charge.

Pledge

A pledge (also known as a bailment) is a legal form of security that is created by delivery of possession of an asset to the secured creditor. Such delivery can be actual or constructive.

Lien

A lien is similar to a pledge. The distinction is that with a pledge, the owner delivers possession to the creditor as security, whereas in the case of a lien, the creditor retains possession of assets which have previously been delivered to it for some other purpose.

3.1.1.2 Security over personal or moveable property

Intangible property

The most common type of intangible property over which security is granted in the Cayman Islands are shares. With respect to shares, the most commonly taken security interests are legal mortgages and equitable mortgages.

A legal mortgage is granted through contract (a mortgage agreement between the secured creditor and the debtor) with respect to those shares.

An equitable mortgage can be created through contract or law. As to the latter, an equitable mortgage with respect to shares can be created by:

(a) an agreement to create a legal mortgage;

(b) a transfer of shares that is not registered by entering the secured creditor in the company's register of members as holder of the shares; or

(c) the deposit of the relevant share certificate with the secured creditor.

Tangible property

A security interest over tangible moveable property will most commonly be created by way of either a fixed or floating charge. These charges are created through contract.

More uncommonly, however, security over moveable property will be created through a pledge or lien, which is created by either contract or the operation of law.

Security over real property

Security over real property (being freehold and leasehold land) is usually granted by way of a legal or equitable mortgage.

A legal mortgage over real property is granted by way of a contract (a mortgage agreement between the secured creditor and the debtor).

An equitable mortgage can be created through contract or the operation of law. The former will generally be created through an agreement to create a legal mortgage. The latter can result from:

(i) a transfer of land which is not perfected by registering the secured creditor;[27] or

(ii) the deposit of the title deeds with the secured creditor.

3.1.2 Enforcement of security

3.1.2.1 Mortgages over real property

Legal mortgage

A legal mortgage is perfected by a transfer of the land into the name of the secured creditor.[28]

A secured creditor's right of enforcement with respect to the secured property will be outlined in the relevant agreement between the secured creditor and the debtor. Generally speaking, these provisions will provide that if the debtor defaults on its payment obligations, a secured creditor holding a legal mortgage will be permitted to take the following actions with respect to the secured real property:

(a) take possession and exercise its power of sale with respect to the real property; or

(b) appoint a receiver to realise the real property.

In the context of a liquidation of the underlying debtor, the secured creditor may also permit the liquidator to sell the property on its behalf.[29]

Equitable mortgage

Generally speaking, a secured creditor that enjoys the benefit of an equitable mortgage does not have a right to take possession of the underlying collateral.

However, if the agreement giving rise to the equitable mortgage contains power of attorney provisions in favour of the secured creditor, then the secured creditor will be able to execute a transfer of land document (and any ancillary documents) to transfer the property into its name on default by the debtor for the purpose of exercising its power of sale.

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[27] Pursuant to the Registered Land Act (2018 Revision) (hereinafter referred to as the Land Act), s 64.
[28] Which occurs when the Register of Lands is updated in accordance with the Land Act.
[29] The liquidator's costs in the care, preservation and realisation of the property will be recoverable in priority to the payment to the secured creditor.

In circumstances where power of attorney provisions are not in place, a secured creditor will need to make an application to the court seeking specific performance. On a successful application, the secured creditor will either have its equitable mortgage converted to a legal mortgage or be granted the right to enter into possession of the secured property for the purpose of realising it in discharge of the outstanding debt. On conversion of an equitable mortgage into a legal mortgage, the (former) equitable mortgagee will then have the rights and options of enforcement conferred on a legal mortgage holder (as outlined above).

3.1.2.2 Mortgages over shares

Legal mortgage

A legal mortgage over shares is perfected by a transfer of title to the shares into the name of the secured creditor (or its nominee). The transfer is effective when the company's register of members is updated. A company's articles of association will often give its directors the discretion to accept or decline the registration of share transfers. The secured creditor should therefore require the mortgagor (the borrower) to obtain either (i) the removal of such discretion by way of an amendment of the articles of association, or (ii) evidence of approval of the transfer (such as a signed board resolution) before entering into the transaction being secured.

In order to sell the shares, an express power of sale must be granted to the secured creditor in the relevant mortgage agreement. The secured creditor is under an obligation to the mortgagor to act in good faith and to obtain the best price reasonably obtainable for the shares at the time it decides to exercise its power of sale, and cannot merely aim to recover the amount of the debt due. Any surplus proceeds must be remitted to the mortgagor. In the absence of such a power or a breach of the duty of good faith, the mortgagor may apply to the Court to prevent or reverse the sale.

Alternatively, on a default, the secured creditor may apply to the Court for a foreclosure order, which will result in the secured creditor (or its nominee) becoming the absolute owner of the shares (in other words, no longer subject to any rights of the mortgagor). A foreclosure order will usually only be granted after the Court has first ordered a sale of the shares which has proved unsuccessful.

Equitable mortgage

An equitable mortgage is not capable of true perfection, but certain steps are available to a secured creditor to improve the quality of the security. This includes (without limitation) the secured creditor obtaining a power of attorney from the debtor enabling it to execute a share transfer form in circumstances of default.

If the secured creditor has been granted a power of attorney, on a default it will be able to deliver the executed share transfer to the company and, subject to any discretion of the directors to refuse to register the transfer, the creditor will be registered as the legal owner of the shares. At

this point it will be in the position of a legal mortgagee and may take the enforcement steps set out above with respect to a legal mortgage.

If the secured creditor does not have a power of attorney or executed share transfer form, the secured creditor under an equitable mortgage may apply to the Court for an order for sale or foreclosure (that is, vesting of absolute title to the shares in the secured party).

3.1.2.3 Charge

A secured creditor holding a charge (either fixed or floating) over asset(s) of the debtor does not have a right of foreclosure in respect of those assets. However, the secured creditor can seek the appointment of a receiver or sell the property, either pursuant to the express terms in the charge document or by application to Court.

3.1.2.4 Pledge

With respect to a pledge, a secured creditor has a right of sale in relation to the secured property in the event of default of the debtor's payment obligations.

3.1.2.5 Lien

A secured creditor holding a lien over the debtor's property does not have a right of sale in respect of that secured property but, rather, a possessory right to the collateral until such time as the underlying debt is discharged.

3.1.3 Enforcement of security rights (official liquidation, provisional liquidation and company restructuring officer)

In an official liquidation, provisional liquidation or during a company restructuring officer appointment over a Cayman Islands company, secured creditors rank in priority to all other creditors and can realise their security outside of the liquidation / restructuring process as they see fit (as set out above).

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.

This assumes that a secured creditor is not able to enforce its security on an individual basis and instead needs majority consent of the group of secured creditors, for example in the context of security for a syndicated loan or a global note held through a trustee.

3.1.4 Priority of secured creditors' rights

A secured creditor's rights in a liquidation are superior to the rights of all other parties.[30]

The laws of the Cayman Islands provide for a very limited class of preferential unsecured creditors.[31] Preferred creditors rank ahead of unsecured creditors and ahead of secured creditors where the secured creditor's security is in the form of a floating charge, but behind the liquidator's remuneration and expenses.

Unsecured creditors rank *pari passu* in respect of their claims in the liquidation, subject to the priorities of payment out of the assets of a company in liquidation.[32] The quantum of any distribution made to unsecured creditors will be determined by the value of any realisations achieved by the liquidator.

Any amounts due to shareholders *qua* shareholder rank below unsecured creditors. For example, redemption creditors (that is, shareholders that have redeemed their shares in accordance with a company's governing documents prior to the date of liquidation but have not been paid the redemption proceeds), rank behind ordinary unsecured creditors of the company, but before the return of capital to the company's shareholders.[33]

In the Cayman Islands, secured creditors are always permitted to take enforcement actions against the collateral once there is an event of default.[34] There is no stay on enforcement by secured creditors that is similar to the impact of Chapter 11 proceedings in the United States.

However, there is a stay on all other proceedings commenced against the debtor in liquidation (provisional, official or court-supervised) subject to obtaining leave of the Court.[35]

3.1.5 Security deemed as void or preferential

A grant of a security interest can be challenged by a liquidator (or other parties with a sufficient interest) on the following bases:

(1) avoidance of dispositions of property from the date of the winding up order;

(2) voidable preferences; and

(3) fraudulent dispositions at an undervalue.

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30 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).

31 Companies Act, Sch 2 (for example, certain amounts due to employees and by way of taxes due to the Cayman Islands Government).

32 CWR, O 20.

33 Companies Act, s 49(g).

34 *Idem*, s 142 expressly permits this.

35 *Idem*, s 97(1).

These are outlined further below. However, as a general proposition, if security is granted by a debtor in exchange for a further advance of funds in an arms-length transaction with a third-party, the validity of the grant of security will be difficult to challenge.

3.1.5.1 Avoidance of dispositions from the date of the winding up order

Where a winding up order has been made, any grant of security with respect to a company's property made after the commencement of the winding up order is void[36] unless the Court orders otherwise.[37] The commencement of the winding up will be deemed to be the date on which the winding up petition was filed, rather than the date on which the order is made. This means there can be a period of time, after a petition is filed but prior to a liquidator being appointed, during which any grant of security will be void.

The Court has the power to validate post-petition grants of security. It can do so prospectively or retrospectively. A company that is the subject of a winding up petition can therefore seek orders on an urgent basis to validate the grant of security in exchange for new funds being advanced, in an arms-length transaction.

The Court will only make a validation order in a retrospective validation application if the post-petition grant of security enhanced value for the creditors as a whole.[38] As a corollary, where the company is potentially insolvent, a grant of security with no corresponding benefit to the company will almost never be sanctioned.

The Court will usually validate the grant of security interests to creditors where the company is clearly solvent, provided that the Court is satisfied that an "intelligent and honest" director acting reasonably would come to that decision.[39]

If there is no winding up petition pending at the time of the transaction, the transaction is not at risk of being void on this basis, but it may be caught by other claw-back actions should the company subsequently be placed into liquidation.

3.1.5.2 Voidable preferences

The granting of security in favour of a purportedly secured creditor will be invalid (as opposed to voidable at the election of the liquidator) if the Court can be satisfied of the following, namely that it is made:[40]

(1) at a time when the company is unable to pay its debts;[41]

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[36] *Idem*, s 99.

[37] This provision is identical to s 127 of the Insolvency Act 1986 (UK) and decisions of the courts of England and Wales regarding this provision will be persuasive authority in the Cayman Islands.

[38] See the decision of the Court of Appeal of England and Wales in *Express Electrical Engineers Ltd v Beavis* [2016] EWCA Civ 765.

[39] *In the matter of Fortuna Development Corporation* [2004-5 CILR 533].

[40] Companies Act, s 145.

[41] *Idem*, s 93. On a cash flow basis, within the meaning of this section.

(2) with a view to giving such creditor a preference over the other creditors; and

(3) within the six months immediately preceding the commencement of a winding up. (The commencement of the winding up will be deemed to be the date on which the petition seeking the winding up order was filed, rather than the date on which the Court's order was ultimately made.)

A grant of security will be made "with a view" to giving a preference if it can be established that the transferor's dominant intention was to prefer the creditor – that is, to put the creditor in a better position than it would otherwise have been.[42] A dominant intention may be inferred by the Court in accordance with the general principles of inference from the available evidence.[43] If the company's primary purpose in granting the security was to achieve something else, then it will not be a voidable preference, even if preferring the creditor was an obvious collateral effect of that transaction. For example, if the security was granted to an existing creditor in good faith under legitimate commercial pressure to prevent the company from being sued or wound up, or in order to benefit the company by keeping on good terms with an essential supplier or service provider, the security is unlikely to be a voidable preference.

Security provided to a related party of the company will be deemed to have been made with a view to giving such creditor a preference.[44] A creditor will be treated as a "related party" for this purpose if it has the ability to control the company or exercise significant influence over the company in making financial and operating decisions.[45]

3.1.5.3 Transactions at an undervalue

The granting of security, made (i) with an intent to defraud and (ii) at an undervalue, will be voidable at the instance of a creditor prejudiced as a result of the purported grant of /security (regardless of whether the company is in liquidation) or the official liquidator of the company.[46] The burden of establishing an intent to defraud rests with the creditor or liquidator seeking to have the grant of security set aside.

In this regard:

- "intention to defraud" means an intention of a transferor to wilfully defeat an obligation;[47] and

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42 This has most recently been accepted by the Judicial Committee of the Privy Council in *Skandinaviska Enskilda Banken AB v Conway & Shakespeare (as joint official liquidators of Weavering Macro Fixed Income Fund Ltd) (Cayman Islands)* [2019] UKPC 36.

43 *Ibid*.

44 Companies Act, s 145(2), which is not rebuttable.

45 *Idem*, s 145(3).

46 *Idem*, s 146 in relation to companies only and the Fraudulent Dispositions Law (1996 Revision), s 4, which is not limited to companies.

47 Companies Act, s 146(1)(b).

- "undervalue" is defined to mean the provision of no consideration or a consideration which in money or money's worth is significantly less than the value of the property, the subject of the grant of security.[48]

The existence of a transaction at an undervalue with respect to a grant of security is not enough on its own to invalidate the transaction. The intention to defraud is a pre-requisite of a claim under this provision.

There are saving provisions to protect a purported secured creditor that was granted the security in good faith and was unaware of the position that the transferor was in before the transaction.[49] These provisions are intended to put the innocent creditor back in the same position that it was in before the transaction giving rise to the grant of security took place.

Any proceeding to avoid a transaction at an undervalue must be commenced within six years from the date of the relevant grant of security.

3.1.6 Rights of a creditor against a non-debtor guarantor

In the context of an official liquidation, the rights of a creditor against a non-debtor guarantor cannot be impacted through the proceeding with respect to the primary obligor, unless the underlying debt to the creditor is satisfied.

If the non-debtor guarantor discharges the debt, it will give rise to a right of subrogation for the guarantor to "step into the shoes" of the creditor in the liquidation prior to the discharge of the debt.

However, with respect to a scheme of arrangement, a Court can sanction a scheme which includes a provision for the release of a guarantee provided by a non-debtor guarantor.[50]

3.1.7 Perfection of secured interests and non-compliance

There is no statutory regime in the Cayman Islands that requires perfection of security interests. Provided that the security interest granted in the contract is valid, and not voidable for any other reason,[51] it will be enforceable.

Except for Cayman Islands registered ships and aircraft,[52] intellectual property and land,[53] 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

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48 *Idem*, s 146(1)(e).
49 *Idem*, s 146(5) and the Fraudulent Dispositions Law, s 5.
50 *Re La Seda de Barcelona SA* [2010] EWHC 1364 (Ch).
51 Companies Act, ss 99 and 145 to 147.
52 The Civil Aviation Authority Law (2005 Revision) and the Mortgaging of Aircraft Regulations, 2015, reg 4.
53 Land Act, s 64.

of the company, regardless of where the asset is located.[54] However, the failure of the company to update the register of mortgages and charges does not, in and of itself, invalidate any security interest.

While no statutory priority is afforded to the security holder by registering its security interest in the company's register of mortgages and charges, it does put third parties that are provided with a copy of the register of mortgages and charges on actual notice of the existence of the security. As priority of competing security interests over the same assets would be determined on the basis of common law principles, and there are no express statutory limits within which the security must be registered in the company's register of mortgages and charges, it is prudent for creditors taking floating charges to require that brief particulars of any other security granted by the company in respect of the secured assets are included in the register of mortgages and charges.

3.1.8 Sale of collateral in which a secured creditor has an interest

In the Cayman Islands, the secured creditor's interests in the secured property are "king", subject to any issues of subordination to other secured creditors' interest over the same collateral. This means that the property in which the secured creditor has an interest cannot be sold without the secured creditor's consent (within or outside of an insolvency context).

As a matter of practice, in the context of liquidations, a secured creditor may, but is not obliged to, permit the liquidator to sell the secured property on its behalf. The costs associated with the care, preservation and realisation of the secured asset incurred by the liquidator will be recoverable from the proceeds of sale in priority to the payment to the secured creditor. The proceeds of such a sale, however, are returned to the secured creditor and only the surplus (if any) can be used for the benefit of the liquidation estate.

3.1.9 Additional liens on a secured creditor's collateral

Subject to obtaining the approval of the Court, official liquidators and provisional liquidators can raise new finance and grant security over the company's assets.[55] However, that security cannot be granted in violation of the existing contractual arrangements between the company and the secured creditor.

3.1.10 Distribution to secured creditors

A secured creditor will receive the full value of the secured property (to the extent of the secured debt) if it elects to stand outside of the liquidation and enforce its security.

With respect to a scheme of arrangement, and to the extent that the secured creditors can be schemed, the secured creditors must receive a better distribution than they would in a liquidation or the Court will likely not sanction the terms of that scheme.

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[54] Companies Act, s 54.
[55] *Idem*, s 110(2)(a).

3.1.11 Over- / undersecured claims

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.

If the secured claim is "under-secured" (that is, the value of the collateral falls short of the claim amount), after realisation of the underlying assets the previously secured creditor has an unsecured claim against the security provider for the balance (in the context of a liquidation, it can file a proof of debt in the liquidation for that shortfall).

Self-Assessment Questions

Question 1

Name the common forms of security in the Cayman Islands.

Question 2

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

Question 3

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

Question 4

How is a security interest "perfected" in the Cayman Islands?

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.

For feedback on these self-assessment questions, see the document "Comment and Feedback on Self-Assessment Questions", which is made available to you as a separate document

3.2 Receivership

In general, there are two kinds of receiverships:

(a) private appointments; and

(b) Court appointments.

A privately appointed receiver is appointed by a secured creditor under their contractual rights found in the relevant security documentation. A Court-appointed receiver is appointed under a Court order that may be made pursuant to various statutes and rules, depending on the purpose of the receivership.

Regardless of the method of appointment, a receiver is usually appointed to take possession of and deal with all or some of the assets of the target of the receivership. As discussed further below, this process can be used to assist a secured creditor enforce against collateral, preserve or prevent dissipation of assets that are subject to a freezing injunction, enforce a judgment against a debtor, or liquidate assets and distribute the proceeds to creditors or shareholders according to their rights. The aforementioned are examples only, as receivership is a flexible remedy that can be deployed and tailored for various uses so long as a proper contractual or jurisdictional grounding can be made out.

In the Cayman Islands, appointed receivers are typically professional insolvency practitioners, although there are no statutory requirements to appoint such persons.

3.2.1 Privately appointed receiverships

Private receivership is a self-help remedy available to secured creditors. Save for charges on real property, discussed further below, there are no specific statutory provisions under Cayman Islands law to govern receivership appointments arising pursuant to security documentation. There is further generally no statutory requirement to register the appointment of a receiver in the Cayman Islands.

The power to appoint receivers will be set out in the lending documents between a lender and a borrower where security has been granted over the assets of a borrower.

The receiver's primary duties are owed to the appointing secured creditor, but secondary duties may be owed to other parties in certain circumstances.

The powers of a receiver to deal with the secured property will be as expressly provided for in the security documents. The powers may only be exercised for the specific purpose for which they were granted, and the receiver must therefore only deal with the secured property as expressly provided for in the lending documents. Often, security documents will also include terms empowering the receiver to act in the name of the borrower where it will facilitate the receivership, and that the receiver is deemed to act as the agent of the borrower and not of the secured lender. The purpose of the latter is to create a layer of protection for the secured lender against any liabilities that could otherwise be incurred by the receiver's actions in dealing with the secured property.

The general role of a receiver is to take custody and control of, collect income from, and (if necessary) sell, on behalf of the secured creditor, an asset over which the secured creditor has taken security. It is an alternative to direct enforcement of a power of sale by the secured creditor and is useful where the assets may be difficult to physically acquire, as controlling the assets during the sales process may raise practical or legal issues for the secured creditor (for example, if taking control of pledged shares would put a lender offside of a regulatory requirement or there are environmental liabilities associated with an asset), or the timeframe for realisation will require the borrower's business to be operated in the interim period.

Subject to the terms of the security documents, the receiver is generally not obliged to exercise any power of sale and realise the secured property within a defined time period following his appointment. If and when the receiver does decide to exercise his power of sale over the secured property, the receiver must take steps to obtain the best price reasonably obtainable for the secured property at the time that he decides to sell. If, having regard to his duties, the receiver decides not to sell the secured property immediately following his appointment, the receiver then has a duty to act diligently when carrying on the business or management of the company in the case of a debenture, or when exercising the rights in respect of the secured shares in the case of a share mortgage.

Secured creditors exercising their rights under real property security (known as a charge) have a statutory right to appoint a receiver under the Land Act. Where there has been a payment or other default of an obligation which is secured by the charge, and that default continues for one month, the chargee (the secured creditor) may give a written notice to the chargor (the borrower or other landowner who has granted the charge to secure borrowing) to pay the money or perform / observe the agreement.[56] If the default is not cured within three months from service of that notice, the chargee may appoint a receiver over the income of the charged property.[57] The appointment must be in writing and filed with the Registrar of Lands.[58] The receiver's powers and duties are set out in section 73 of the Land Act and provides that the receiver:

- is deemed to be the agent of the chargor, and unless the charge document provides otherwise the chargor is solely responsible for the receiver's acts and defaults;

[56] Land Act, s 72(1).
[57] *Idem*, s 72(2)(a).
[58] *Idem*, s 73(1).

- may demand and recover all income over which he is appointed; and

- may retain out of any money received by him his costs, charges, and expenses. The receiver's own remuneration may be a commission of no more than 5%, or another rate that the chargee and chargor have agreed or that the Court allows on an application made by the receiver.

3.2.2 Court-appointed receiverships

3.2.2.1 General power to appoint a receiver

The Grand Court may appoint a receiver "in all cases in which it appears to the Court to be just and convenient to do so".[59] This broad jurisdiction is tempered by the relevant case law that has more clearly defined when it will be appropriate for the Court to order what has consistently been described as a very intrusive remedy. In practice, the most common uses of a Court-appointed receiver in the Cayman Islands are to support a freezing injunction or to aid in judgment enforcement.

The purpose of a receivership in aid of a freezing injunction is to buttress the mandatory powers of the freezing injunction, which prohibits the defendant from dealing with or dissipating his assets by appointing a third party to take possession and control of the assets to "hold the ring" and preserve the assets. Like any court-appointed receiver, a receiver in these circumstances will derive their powers from the Court order, which may be drafted widely or narrowly depending on the Court's view as to what is required and proportionate. A receiver may thus be limited to merely taking possession and control of certain assets, or may be empowered to deal with the assets in a more active way in order to preserve their value.

In *JSC BTA Bank v Ablyazov (No 3)*,[60] the English Court of Appeal considered the law on appointing receivers in support of interim freezing injunctions. On the existing authorities, the Court held that (i) the appointment of a receiver will only be appropriate where an injunction is insufficient on its own, and (ii) in cases where there is a measurable risk that, if a receiver is not appointed, a defendant will act in breach of the injunction or otherwise seek to ensure that his assets will not be available to satisfy any judgment which may in due course be made against him. Whether that measurable risk exists is primarily a matter of judgment in light of the ascertainable facts. The Court will consider evidence as to whether the defendant has already breached or is about to breach the freezing injunction. The Court's jurisdiction is wider than that, such as in *JSC BTA Bank* where the applicant relied on the defendant's inadequate disclosure of his assets under the freezing injunction.

Once a money judgment is obtained and becomes enforceable, a Court-appointed receiver may be used to aid in the enforcement.[61] Receivership is a useful remedy for judgment enforcement where the assets require ongoing management in order to realise them, and then

[59] Senior Courts Act 1981, s 37(1), as applied by Grand Court Act (2015 Revision), s 11(1).
[60] [2010] EWCA Civ 1141.
[61] Grand Court Rules, O 45, r 1(d).

a more involved enforcement process will be required,[62] or enforcement will be aided by compelling the exercise of a power of the debtor that he refuses to exercise. When considering whether to appoint a receiver by way of equitable execution,[63] the Court must have regard to the amount claimed by the judgment creditor, the amount likely to be obtained by the receiver, and the probable costs of the receiver's appointment.[64] In effect, the Court must consider whether it is proportionate to appoint a receiver in all the circumstances.

An interesting illustration of the flexibility of a receiver for so-called equitable execution is found in *Tasarruf Mevduati Sigorta Fonu v Merrill Lynch Bank and Trust Co (Cayman) Ltd*,[65] a decision of the Privy Council originating from the Cayman Islands. In that case, after the judgment creditor had obtained a money judgment against the defendant from the Turkish court, it discovered that the judgment debtor had settled two discretionary trusts in the Cayman Islands. Under the terms of the trust, the debtor had a power of revocation, which if exercised would re-vest in the debtor an amount that would satisfy a very large proportion of the Turkish judgment. The creditor took steps to have the Turkish judgment recognised in the Cayman Islands, and then sought the appointment of a receiver by way of equitable execution with a view to having the power of revocation exercised.

While the Grand Court and the Court of Appeal refused the relief sought by the judgment creditor, the Privy Council found that there was jurisdiction to make the order. The Board noted that a previous decision of the English Court of Appeal confirmed or established principles that a receiver may be appointed over an asset whether or not the asset is presently amenable to execution at law, and that the jurisdiction to appoint receivers by way of equitable execution can be developed incrementally to apply old principles to new situations. Because the judgment debtor's power of revocation could be regarded in equity as being tantamount to ownership, it was in the interests of justice that an order be made to make effective the Cayman Court's recognition of the Turkish judgment. The Board held that the appropriate order was for the judgment debtor to delegate his power of revocation to the receivers, so that the receivers could exercise it.

In any case, the application for a court-appointed receiver may be made by summons or motion.[66] The Court may order the receiver to give security,[67] but where the appointees are professional insolvency practitioners it is usual for the Court to dispense with that requirement. The receiver may apply to the Grand Court for directions on matters which arise during the

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62 For example, a receiver may be appointed over a judgment debtor's shareholding in a holding company so that the receiver may take control of that holding company and, through the holding company, any operating subsidiaries.

63 Equitable execution is a term used to describe judgment enforcement using remedies derived from equity, such as receivership. It is distinct from legal execution, and can extend to remedies and assets that are not available in law but would be in equity.

64 Grand Court Rules, O 51, r 1.

65 [2011] UKPC 17.

66 Grand Court Rules, O 30, r 1(1).

67 *Idem*, O 30, r 2.

receivership,[68] and it is common for receivers to do so when a matter is controversial or concerns a significant decision.

The receiver's remuneration will be as authorised by the Grand Court, which may have reference to scales or rates of professional charges as it thinks fit.[69] In practice, where the receivers are professional insolvency practitioners, the Court will have regard to the guidance established in the Insolvency Practitioners' Regulations.[70] Additionally, a receiver must submit accounts to the Grand Court as the Court may direct,[71] which accounts will cover the receipts and disbursements of the receivership.

3.2.2.2 Power to appoint a receiver over a segregated portfolio

A segregated portfolio company (SPC) is a type of an exempted Cayman Islands company that can be incorporated in the Cayman Islands. The regime governing SPCs is set out at Part XIV of the Companies Act. Its relevance here is that a specific statutory receivership remedy exists that can be sought against a segregated portfolio (SP) of a SPC.

The concept of an SPC is that a company, which remains a single legal entity, may create one or more SPs in order to segregate the assets and liabilities of the SPC amongst various SPs or the general assets and liabilities of the SPC. The assets and liabilities of a SP are effectively ring-fenced. Assets of a SP may only be used to meet liabilities of creditors and shareholders of the SPC who are creditors or shareholders of that SP. The assets of a SP are not available, and may not be used, to meet liabilities to creditors of the SPC who are not creditors of that SP.[72]

In addition, a SPC may issue shares that relate solely to a particular SP. As with creditors, dividends or other distributions on shares that relate solely to a particular SP may only be paid from the assets of that SP, and those shareholders may not have recourse to the assets of any other SP as regards their equity interests.[73]

The ability to create SPs under the umbrella of the SPC makes SPCs a popular vehicle for use by investment funds, captive insurance and structured-finance vehicles.

While a SPC itself may be wound up in accordance with the general winding up process set out in the Companies Act:

- the official liquidator of a SPC may only deal with the SPC's assets in a manner consistent with the SP structure (that is, an official liquidation of a SPC must respect the ring-fencing of the SPs);[74] and

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68 *Idem*, O 30, r 8.
69 *Idem*, O 30, r 3.
70 *Lea Lilly Perry v Lopag Trust Reg* (Grand Ct, 20 April 2020, unreported), para 23(c).
71 Grand Court Rules, O 30, r 5.
72 Companies Act, s 220.
73 *Idem*, s 217.
74 *Idem*, s 223.

- a bespoke statutory receivership regime applies to individuals SPs.

Accordingly, the receivership regime found at sections 224 to 228 of the Companies Act allows a SP to be liquidated without the SPC itself or any other SPs being impacted. In many ways, the statutory receivership is similar to, and based on, the winding up procedure for companies. Indeed, in *In re JP SPC 1* the Grand Court said that the purpose of appointing a receiver of a SP is "effectively the same as the purpose of the appointment of a liquidator in respect of the whole company but confined to the creditors of or shareholders in that portfolio".[75]

An application for a receivership order in respect of a SP may be brought by the SPC itself, the SPC directors, a creditor of the SP, a shareholder of the SP, or, where the SP is licensed under the relevant regulatory laws, the Cayman Islands Monetary Authority (CIMA).[76] While there is no special definition in Part XIV of the term "creditor", the Grand Court has interpreted it as embracing both actual and contingent creditors,[77] so the position is effectively the same as for winding up petitions.

The application is made by petition,[78] which at the time of issue must be accompanied by a summons for directions.[79] The petition and the summons must be served on the SPC at the same time[80] and at the hearing of the summons the Court will consider and may give directions as to how the proceedings are to unfold, including if any further parties should be served or other notices published before the petition is heard.[81] No receivership order may be made if the SPC itself is in winding up.[82]

On the hearing of the petition, the Court may make a receivership order if it is satisfied that:

- the SP's assets are or are likely to be insufficient to discharge the claims of the SP's creditors;[83] and

- the making of a receivership order would achieve the orderly closing down of the SP's business and the distribution of the SP's assets to the persons so entitled.[84]

The impact of this dual test is that an applicant must not only show that the insolvency test is met, but that the business of the SP as a whole should be brought to end.[85] Notably, there is no equivalent to the just and equitable ground for a winding up – so even a shareholder of a SP

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75 *In re JC SPC 1*, 2013 (1) CILR 330 at para 9. Kawaley J put the concept more colourfully in *In re Green Asia Restructure Fund SPC* (Grand Ct, 3 August 2022, unreported), para 6: "Other segregated portfolios will be unaffected by this failure and can carry along their merry way, assuming that the SPC itself continues to be viable".
76 Companies Act, s 225(1).
77 *In re Green Asia Restructure Fund SPC* (Grand Ct, 3 August 2022, unreported), para 8.
78 Grand Court Rules, O 102, r 4(e).
79 *Idem*, O 102, r 6(1).
80 *Idem*, O 102, r 6(2).
81 *Idem*, O 102, r 6(3).
82 Companies Act, s 224(4)(a).
83 *Idem*, s 224(1)
84 *Idem*, s 224(3).
85 *In re Green Asia Restructure Fund* (Grand Ct, 3 August 2022, unreported), para 9.

appears to be required to rely on insolvency if he wants a receiver appointed. Whether that result is by design or oversight, and whether it is appropriate, are academic questions at this stage.[86]

The nature of the insolvency test was considered by the Grand Court in *In re Obelisk Global Fund SPC*[87] and *In re Green Asia Restructure Fund SPC*.[88] In these cases, the Court rejected that section 224(1)(a) created a cashflow insolvency test as used for winding up companies. Rather, the section mandates the use of a flexible balance sheet test. The Court must make "a determination on the available evidence of whether the assets are sufficient now, or are likely to be in the reasonably near future, when assessed against its liabilities (as well as its prospective and contingent liabilities), and are held in a form where they may be used to pay the claims of creditors".[89]

The Court also acknowledged in both cases that there may be practical difficulties for creditors in accessing information to demonstrate balance sheet insolvency. This acknowledgment leads to the flexible nature of how the balance sheet test is applied in SP receivership applications. An applicant is entitled to show that either it is probable that the assets are insufficient to meet the liabilities, akin to the normal civil burden of proof, or that the available evidence establishes a cogent and real risk of the balance sheet deficiency.[90] In practice, as noted by Kawaley J, how this test operates will be fact-sensitive and dependent upon the nature and extent of the known creditors' claims and the extent to which the application is opposed by the SPC or other stakeholders.[91]

If a receivership order is made –

- the order must direct that the business and SP assets be managed by the receiver for the purposes of the orderly closing down of the SP's business and the distribution of the SP assets to those entitled to have recourse to them;[92]

- no resolution for the voluntary winding up of the SPC will be effective without leave of the Grand Court;[93]

- there is a general stay of proceedings against the SP, except with leave of the Grand Court;[94]

- the powers of the directors cease as regards the business and assets of the SP;[95] and

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86 The legislation governing the Bermuda equivalent to a SPC, a segregated account company, does provide a just and equitable ground for the making of a receivership order in respect of a segregated account.
87 (Grand Ct, 12 August 2021, unreported).
88 (Grand Ct, 3 August 2022, unreported).
89 *In re Obelisk Global Fund SPC* (Grand Ct, 12 August 2021, unreported).
90 *In re Green Asia Restructure Fund SPC* (Grand Ct, 3 August 2022, unreported).
91 *Idem*, para 20.
92 Companies Act, s 224(3).
93 *Idem*, s 224(5).
94 *Idem*, s 226(5).
95 *Idem*, s 226(6)(a).

- the receiver is entitled to be present at all meetings of the SPC and entitled to vote as a director of the SPC in respect of the SPC's general assets (that is, the assets not attributable to a particular SP), so long as any creditors of the SP in receivership are entitled to have recourse to the SPC's general assets.[96]

The receiver of a SP, like any other court-appointed receiver, derives their powers from the Court order appointing them, but also from the statute. Section 226(1) of the Companies Act provides that the receiver may "do all such things as may be necessary for the purposes set out in section 224(3)" and will have the functions and powers of the directors in respect of the business and assets of the SP. These are broad provisions that likely cover the entire range of actions that a receiver may wish to take. Unlike for official liquidators, there is no provision for mandatory sanction applications before the receiver exercises a particular power, although the receiver is permitted at any time apply to the Grand Court for directions as to the extent or exercise of any power.[97] As a practical matter, it is often helpful to have specific powers or rights set out in a Court order when third parties are concerned, so the statutory right to seek directions is welcome.

The receiver's fees and other receivership expenses are paid in priority to all other claims from the SP assets. While there is no reference to the Insolvency Practitioners' Regulations or other statutory provisions on the receiver's fees, it is likely that the Court would have regard to those rules as guidelines if a receiver's fees were challenged by a stakeholder.

Only when the purposes for which the receivership order was made have been achieved, substantially achieved, or become incapable of being achieved, may the Court discharge the receivership order.[98] If the discharge is because the purposes have been achieved or substantially achieved, the Court may make an order that the claims of any SP creditor are deemed fully satisfied by any payment made by the receiver to the creditor.[99] This power ensures that there is finality to the process, as a receivership does not conclude with the termination of dissolution of a SP (compared to a winding up which concludes with the dissolution of the company).

Additionally, a receivership order will cease to have effect if a winding up order is made in respect of the SPC.[100]

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96 *Idem*, s 226(6)(b).
97 *Idem*, s 226(2)(a).
98 *Idem*, s 227(1).
99 *Idem*, s 227(3).
100 *Idem*, s 224(4)(b).

Self-Assessment Questions

Question 1

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

Question 2

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

All private receiverships must be registered in the Cayman Islands.

Question 3

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

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?

For feedback on these self-assessment questions, see the document "Comment and Feedback on Self-Assessment Questions", which is made available to you as a separate document

CHAPTER 4

CORPORATE LIQUIDATION

This chapter covers corporate liquidations, including both voluntary (solvent) liquidations and official liquidations which occur under the supervision of the Grand Court. As set out below, a company may be wound up voluntarily where a company is solvent. A company that is being wound up voluntarily can continue under the supervision of the court (in official liquidation) upon application to the court. In contrast to a voluntary liquidation, an official liquidation is a court-supervised process and can be applied for by a creditor or contributory of the company, amongst others. The Cayman Islands insolvency regime provides a procedure for an official liquidator to wind up a company by collecting in and liquidating its free assets and distributing the proceeds to the company's unsecured creditors (and, if the company is solvent so that its creditors can be paid in full, distributing any remainder to its shareholders). The Grand Court also has jurisdiction to appoint a provisional liquidator prior to the making of a winding up order in order to provide a distressed or mismanaged company with an immediate period of breathing space and protection, in the period before the winding-up petition is determined.

4.1 Voluntary liquidation (solvent)

Voluntary liquidation, or voluntary winding up of a company, is governed primarily by sections 116-130 of the Companies Act, and Order 13 of the Companies Winding Up Rules.

4.1.1 Grounds, commencement, effects

4.1.1.1 Grounds

A company may be wound up voluntarily:[101]

(a) when any duration or period of the company fixed by its memorandum or articles of association expires;

(b) if any event of winding up, as set by the memorandum or articles of association, occurs;

(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.

[101] Companies Act, s 116.

4.1.1.2 Commencement

A voluntary winding up is deemed to commence:[102]

(a) at the time of the passing of the resolution for winding up; or

(b) on the expiry of the period or the occurrence of the event specified in the company's memorandum or articles of association, as the case may be.

4.1.1.3 Effects

The company must, from the commencement of its winding up, cease to carry on its business except so far as it may be beneficial for its winding up.[103]

4.1.2 Appointment / resignation / removal / release of voluntary liquidators

4.1.2.1 Appointment

One or more voluntary liquidators must be appointed for the purpose of winding up the company's affairs and distributing its assets.[104]

Persons designated as liquidators in the company's memorandum or articles of association will become such liquidators automatically from the commencement of the winding up. Where persons have not been designated, or the person designated is unable or unwilling to act, the directors must convene a general meeting of the company for the purpose of appointing a liquidator.[105]

Except where a person has been designated in the company's memorandum or articles of association to act as liquidator (in which case the appointment is automatic from the date of the commencement of the winding up), the appointment of a voluntary liquidator will not take effect until that person's consent to act has been filed with the Registrar of Companies (the Registrar).

If a vacancy of the voluntary liquidator occurs by death, resignation or otherwise, the company may fill the vacancy in a general meeting or, alternatively, the Court may fill the vacancy on the application of any contributory or creditor.

On the appointment of a voluntary liquidator, all the powers of the directors cease automatically. This is except to the extent of any power expressly reserved to the directors by a resolution passed at a general meeting, or where the liquidator expressly delegates or sanctions the continuance of any powers of the directors.

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[102] *Idem*, s 117.
[103] *Idem*, s 118.
[104] *Idem*, s 119.
[105] *Idem*, s 119(2).

When two or more persons are appointed as voluntary liquidators jointly, they must be authorised to act jointly and severally and both must sign the consent to act filed with the Registrar.

4.1.2.2 Qualifications

There are no qualification requirements to be appointed as a voluntary liquidator. Any person, including a director or officer of the company, may be appointed as its voluntary liquidator.[106]

4.1.2.3 Removal

A voluntary liquidator may be removed by the passing of an ordinary resolution at a general meeting convened especially for that purpose. Such meeting may be convened by any shareholder or shareholders holding not less than one-fifth of the company's issued share capital.[107]

Alternatively, any contributory may apply to the Court for an order that a voluntary liquidator be removed from office on the grounds that that person is not a fit and proper person to hold office.[108]

4.1.2.4 Resignation

Where two or more persons are appointed as joint voluntary liquidators, a voluntary liquidator may resign by filing a notice of resignation with the Registrar, as long as at least one voluntary liquidator remains in office.[109]

Where there is only one voluntary liquidator appointed, in order to resign, the voluntary liquidator must:

(a) prepare a report and accounts; and

(b) convene a general meeting of the company for the purpose of approving the report and accounts, to accept the resignation, release the voluntary liquidator from the performance of any further duties, and to appoint a successor.

In the event that the company fails to pass a resolution accepting the liquidator's resignation, the voluntary liquidator may apply to the Court for an order that that person be released from the performance of any further duties.[110]

[106] *Idem*, s 120.
[107] *Idem*, s 121.
[108] *Idem*, s 121(3).
[109] *Idem*, s 122.
[110] *Idem*, s 122(3).

4.1.3 Notice of voluntary winding up

Within 28 days of the commencement of a voluntary winding up, the liquidator or, in the absence of any liquidator, the directors must:[111]

(a) file notice of the winding up with the Registrar;[112]

(b) file the liquidator's consent to act with the Registrar;[113]

(c) file the directors' declaration of solvency with the Registrar (if the supervision of the Court is not sought);[114]

(d) in the case of a company carrying on a regulated business, serve notice of the winding up upon the Cayman Islands Monetary Authority (the Authority);[115] and

(e) publish notice of the winding up in the Gazette.[116]

A director or liquidator who fails to comply with these provisions commits an offence and is liable to a fine of KYD 10,000.[117]

4.1.4 Declaration of solvency

4.1.4.1 What is a declaration of solvency?

A declaration of solvency means a declaration or affidavit in the prescribed form[118] to the effect that a full enquiry into the company's affairs has been made and that to the best of the directors' knowledge and belief the company will be able to pay its debts in full together with interest at the prescribed rate, within such period, not exceeding 12 months from the commencement of the winding up, as may be specified in the declaration.[119]

4.1.4.2 Requirements of a declaration of solvency

The requirements of a declaration of solvency are set out in Order 14, Rule 1 and Rule 2 of the Companies Winding Up Rules. They are as follows:

- a declaration of solvency must be in CWR Form No 21 and signed by each person who was a director of the company on the date on which its voluntary winding up was commenced;

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[111] *Idem*, s 123.
[112] CWR, Form No 19.
[113] *Idem*, Form No 20.
[114] *Idem*, Form No 21, to be signed by all current directors.
[115] Providing stamped copies of CWR Form No 19 and Form No 20.
[116] *Idem*, Form No 19.
[117] Companies Act, s 123.
[118] CWR, Form No 21.
[119] Companies Act, s 124(2).

- a declaration of solvency must state the full name and address of each director by whom it is signed and the date upon which person was appointed as a director;

- the voluntary liquidator may assist the company's directors to make the enquiries necessary to enable them to prepare and sign a declaration of solvency, for which purpose they must provide them with access to all the company's books and records;

- the voluntary liquidator may pay to the company's directors the expenses reasonably and properly incurred by them in preparing a declaration of solvency.

In order to comply with the requirements of sections 123(1) and 124(1) of the Companies Act, a declaration of solvency, duly signed by all the directors, must be delivered to the voluntary liquidator and filed with the Registrar within 28 days of the date upon which the voluntary liquidation is deemed to have commenced under section 117(1) of the Companies Act.[120]

A declaration of solvency that has been transmitted to the voluntary liquidator electronically is in compliance with the requirements under the Companies Winding Up Rules.[121]

If, having received a declaration of solvency, the voluntary liquidator fails to file it with the Registrar, any director may do so.[122]

4.1.4.3 What are the consequences of a false declaration of solvency?

A person who knowingly makes a declaration under this section without having reasonable grounds for the opinion that the company will be able to pay its debts in full, together with interest at the prescribed rate within the period specified, commits an offence and is liable on summary conviction to a fine of KYD 10,000 and to imprisonment for two years.[123]

4.1.4.4 What are the consequences of failing to file a declaration of solvency and when is it required?

A declaration of solvency should be filed within 28 days of the commencement of a voluntary winding up. The declaration of solvency can be filed by the liquidator or, in the absence of any liquidator, the director must file the director's declaration of solvency with the Registrar.[124]

The liquidation of a company that has commenced voluntarily may continue as a voluntary liquidation if, and only if, a declaration of solvency has been made by all its directors and filed with the Registrar in accordance with Order 14 of the Companies Winding Up Rules.[125]

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[120] CWR, O 14, r 2(1).
[121] *Idem,* O 14, r 2(2).
[122] *Idem*, O 14, r 2(3).
[123] *Idem*, s 124(3).
[124] *Idem*, s 123(1)(c).
[125] CWR, O 13, r 1(3).

Where a company being wound up voluntarily has failed to file a declaration of solvency within 28 days, its liquidator must apply to the Court for an order that the liquidation continue under the supervision of the Court within seven days thereafter.[126] Additionally, in the absence of any declaration of solvency, a notice in CWR Form No 22 must be filed stating that a supervision petition has been presented to the Court.[127]

An application for a supervision order must be made by a company's voluntary liquidator in accordance with section 124 of the Companies Act.[128] A petition under section 124 of the Companies Act must contain a statement that the voluntary liquidator did not receive, within 28 days of the commencement of the liquidation, a declaration of solvency in the prescribed form signed by all of the company's directors.[129] The various other requirements of a petition under section 124 of the Companies Act are contained in Order 15, rule 2 of the Companies Winding Up Rules, and are discussed in more detail at paragraph 4.1.7.2 below.

4.1.5 Remuneration / expenses of a voluntary liquidation

4.1.5.1 Applying for remuneration and expenses

The basis of the voluntary liquidator's remuneration and the amount of remuneration must be authorised by resolution of the company.[130]

The voluntary liquidator's account must be presented in the company's functional currency and include details of the amount of the liquidator's remuneration.[131]

In accordance with section 126 of the Companies Act, in the event of a voluntary winding up continuing for more than one year, the voluntary liquidator must summon a general meeting of the company at the end of the first year from the commencement of the winding up and at the end of each succeeding year thereafter, for the purpose of considering and, if thought fit, approving the voluntary liquidator's remuneration for the period up to the date of their interim accounts.[132]

As soon as the company's affairs are fully wound up, the voluntary liquidator must convene a final meeting of the company for the purpose of (amongst other things) considering and, if thought fit, approving the voluntary liquidator's remuneration (including provision for work still to be done).[133]

Having delivered the final report and accounts, the voluntary liquidator may apply (but is not obliged to apply) to the Court for an order that their accounts (including the amount of their

[126] Companies Act, s 124(1) and CWR, O 13, r 1(4).
[127] CWR, O 13, r 2.
[128] *Idem,* O 15, r 1(1).
[129] *Idem,* O 15, r 2(3)(d).
[130] *Idem*, O 13, r 9(1).
[131] *Idem*, O 13, r 8(3)(g).
[132] *Idem,* O 13, r 11(1).
[133] *Idem,* O 13, r 12(1)(b).

remuneration) be approved and that the voluntary liquidator be released from the performance of any further duties.[134]

In the case of a liquidation that commences voluntarily and is subsequently brought under the supervision of the Court, the remuneration of the voluntary liquidator ranks equally with the expenses and disbursements incurred by the official liquidator, but in priority to the remuneration of the official liquidator.[135]

4.1.5.2 Methods of charging remuneration

The company may resolve to remunerate the voluntary liquidator on the basis of –

- an hourly rate (or scale of rates) for the time reasonably and properly devoted to the liquidation;
- a fixed sum;
- a commission or percentage of the assets distributed or realised; or
- a combination of these methods.[136]

Furthermore, the voluntary liquidator is not entitled to receive payment of any remuneration out of the company's assets without the prior approval of a resolution passed at a general meeting of the company except that –

- the amount of remuneration specified in the voluntary liquidator's final report and accounts may be paid if the final general meeting has been duly convened but no member attends and votes either in person or by proxy; and
- any remuneration may be paid with the Court's approval.[137]

4.1.5.3 Disbursements and expenses

The expenses properly incurred in the winding up, including the remuneration of the voluntary liquidator, are payable out of the company's assets in priority to all other claims.[138]

The rate and amount of the voluntary liquidator's remuneration must be fixed and payment authorised by resolution of the company.

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[134] *Idem*, O 15, r 6(4).
[135] *Idem,* O 20, r 1(2)(c).
[136] *Idem*, O 13, r 9(2)(a)-(d).
[137] *Idem,* O 13, r 9(3).
[138] Companies Act, s 130.

Each report and account laid before the company in general meeting by its voluntary liquidator must contain all such information, including the rate at which the voluntary liquidator's remuneration is calculated and particulars of the work done, as may be necessary to enable the members to determine what expenses have been properly incurred and what remuneration is properly payable to the voluntary liquidator.

If the company fails to approve the voluntary liquidator's remuneration and expenses, or the voluntary liquidator is dissatisfied with the decision of the company, the person may apply to the Court which must then fix the rate and amount of that person's remuneration and expenses.

4.1.6 Reporting requirements / meetings

4.1.6.1 Voluntary liquidator's reporting obligations

The voluntary liquidator is required to prepare reports and accounts in regard to their conduct of the liquidation and the state of the company's affairs.[139]

The voluntary liquidator is required to prepare annual reports and accounts for general meetings at year's end (discussed further at paragraph 4.1.6.3 below).[140] At each meeting, the liquidator is required to present before the meeting a report and account of the liquidator's acts, dealings and conduct of the winding up during the preceding year. A liquidator who fails to comply with this obligation commits an offence and is liable on conviction of a fine of KYD 10,000.[141]

As soon as the company's affairs are fully wound up, the voluntary liquidator is required to make a report and an account of the winding up (discussed further at paragraph 4.1.6.4).[142]

In addition to the statutory reporting requirements, the voluntary liquidator is required to prepare and send to the company's members such other reports and accounts as the liquidator considers appropriate.[143]

The voluntary liquidator's reports and accounts are required to be sent to the company's members by whatever means is authorised by the articles of association, together with notice of a general meeting convened for the purpose of considering and approving (if thought fit) such report and accounts.[144]

On request, the voluntary liquidator is required to send copies of their reports and accounts to any creditor of the company whose debt has not been paid in full.[145]

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[139] CWR, O 13, r 7.
[140] Companies Act, s 126(2).
[141] *Idem*, s 126(3).
[142] *Idem*, s 127(1).
[143] CWR, O 13, r 7(2).
[144] *Idem,* O 13, r 7(3).
[145] *Idem,* O 13, r 7(4).

4.1.6.2 Form and content of reports

The form and content of the voluntary liquidator's report is set out at Order 13, Rule 8 of the Companies Winding Up Rules.

The voluntary liquidator's report must constitute a narrative description and analysis of the steps taken and, in the case of an interim report, the further steps intended to be taken in the liquidation.[146]

In addition, the voluntary liquidator's report and accounts are required to be provided to the company's members with all the information necessary to enable the members to make informed decisions about the company's financial condition.[147]

Finally, the voluntary liquidator's accounts are required to be presented in the company's functional currency and are required to include details of the following:[148]

(a) the nature of the company's assets;

(b) any security over the company's assets;

(c) the amount realised upon sale of the company's assets and the estimated realisable value of any unsold assets;

(d) the nature of the company's liabilities, including contingent liabilities, the amounts paid in satisfaction of the liabilities and the amount remaining unpaid;

(e) the nature and amount of the company's income;

(f) the expenses of the liquidation;

(g) the amount of the liquidator's remuneration; and

(h) the amount distributed and the amount available for distribution to members.

4.1.6.3 General meetings of the Company

In the event of a voluntary winding up continuing for more than one year, the voluntary liquidators are required to summon a general meeting of the company at the end of the first year from the commencement of the winding up.[149]

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[146] *Idem*, O 13, r 8(1).
[147] *Idem*, O 13, r 8(2).
[148] *Idem*, O 13, r 8(3).
[149] Companies Act, s 126.

The voluntary liquidators are also required to summon a general meeting at the end of each succeeding year, with such meetings required to be held within three months of each anniversary of the commencement of the liquidation.[150]

The purpose of the general meetings are to consider, and if thought fit:[151]

(a) approving the voluntary liquidator's interim reports and accounts;

(b) approving the voluntary liquidator's remuneration for the period up to the date of their interim accounts; and

(c) resolving upon any other matters upon which the voluntary liquidator considers that it is necessary or appropriate for the company to resolve.

Notice of every general meeting of the company convened by the voluntary liquidator is required to be given in accordance with the company's articles of association, except that:[152]

(a) every notice of a general meeting must be accompanied by the voluntary liquidator's report and accounts;

(b) at least 21 days' notice must be given of the final general meeting; and

(c) notice of the final general meeting must be published in the Gazette.

Notice of a general meeting convened by the voluntary liquidator may be given by any method authorised by the company's articles of association.[153]

As discussed at paragraph 4.1.6.1 above:

(a) at each general meeting, the liquidator is required to present before the meeting a report and account; and

(b) a liquidator who fails to comply with section 126 of the Companies Act commits an offence and is liable on conviction to a fine of KYD 10,000.

4.1.6.4 Final meeting of the company

As soon as the company's affairs are fully wound up, the liquidator is required to make a report and an account of the winding up showing the following:[154]

[150] *Idem,* s 126(1).
[151] CWR, O 13, r 11(1).
[152] *Idem,* O 13, r 11(2).
[153] *Idem,* O 13, r 11(3).
[154] Companies Act, s 127(1).

(a) how the winding up has been conducted;

(b) how the company's property has been disposed of; and

(c) is required to call a general meeting of the company for the purpose of presenting an account and giving an explanation for the winding up.

The purpose of the final meeting convened by the voluntary liquidator is considering, and if thought fit:[155]

(a) approving the voluntary liquidator's final report and accounts (including the provisions for any unpaid expenses);

(b) approving the voluntary liquidator's remuneration (including provision for work still to be done);

(c) resolving upon the retention and destruction of the company's books and records; and

(d) resolving upon the method of dealing with the proceeds of any dividend cheques which remain uncleared for more than six months (together, referred to in this section at the "final resolutions").

In the event that the final resolutions are passed but no quorum is present (in person or by proxy), the voluntary liquidator must file a "final return" with the Registrar in CWR Form No 37 with the result that the company is deemed to be dissolved after the expiry of three months from the date upon which the final return is registered.[156]

In the event that a quorum is present at the final meeting of the company and the final resolutions are not passed, the liquidation is required to continue.[157]

Notice of the final meeting is required to be sent at least 21 days before the final meeting, specifying the time, place and object of the meeting to each contributory in any manner authorised by the company's articles of association.[158] The notice of the final meeting is required to be published in the Gazette.[159]

No later than seven days after the final meeting, the liquidator is required to make a return to the Registrar in the prescribed form specifying:[160]

[155] CWR, O 13, r 12(1).
[156] *Idem*, O 13, r 12(2).
[157] *Idem*, O 13, r 12(3).
[158] Companies Act, s 127(2).
[159] *Ibid*.
[160] *Idem*, s 127(3).

(a) The date upon which the final meeting was held; and

(b) If a quorum was present, particulars of the resolutions, if any, passed at the final meeting.

A voluntary liquidator who fails to call a general meeting of the company as required by section 127(1) of the Companies Act, or fails to make a return as required by section 127(3) of the Companies Act, commits an offence and is liable on conviction to a fine of KYD 10,000.

4.1.7 Court supervision – when, process, consequences

4.1.7.1 Requirements and timing for application for supervision order (section 124, Companies Act)

Where a company is being wound up voluntarily, its liquidator is required to apply to the Court for an order that the liquidation continue under the supervision of the Court unless, within 28 days of the commencement of the liquidation, the directors have signed a declaration of solvency in the prescribed form (as discussed at paragraph 4.1.4 above).[161]

Under section 124(2) of the Companies Act, a declaration of solvency means a declaration or affidavit to the effect that a full enquiry into the company's affairs has been made and that to the best of the directors' knowledge and belief, the company will be able to pay its debts in full (together with interest at the prescribed rate) within such period, not exceeding the 12 months from the commencement of the winding up.

As noted at paragraph 4.1.4.3 above, a person who knowingly makes a declaration under section 124 of the Companies Act without having reasonable grounds for the opinion that the company will be able to pay its debts in full (together with interest at the prescribed rate) within the period specified, commits an offence and is liable on summary conviction to a fine of KYD 10,000 and to imprisonment for two years.[162]

Every petition must be presented within 35 days of the date upon which the liquidation is deemed to have commenced under section 117(1) of the Companies Act.[163]

4.1.7.2 Form and content of application for supervision order (section 124, Companies Act)

An application for a supervision order under section 124 of the Companies Act must be made by petition[164] and is required to contain the following:[165]

(a) particulars of the company's incorporation;

(b) particulars of the method by which the company was put into voluntary liquidation;

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[161] Companies Act, s 124(1).
[162] *Idem*, s 124(3).
[163] CWR, O 15, r 2(4).
[164] *Idem*, O 15, r 2(2).
[165] *Idem*, O 15, r 2(3).

(c) particulars of the persons who are or were directors of the company on the date on which its voluntary liquidation commenced;

(d) a statement that the voluntary liquidator did not receive, within 28 days of the commencement of the liquidation, a declaration of solvency in the prescribed form signed by all the company's directors; and

(e) if the voluntary liquidator is a qualified insolvency practitioner, a statement that they consent to being appointed as official liquidator; or

(f) if the voluntary liquidator is not a qualified insolvency practitioner or is unable to comply with the independence requirements of the Insolvency Practitioners' Regulations, 2018 (as amended), or is unwilling to be appointed as official liquidator, the name and address of a qualified insolvency practitioner nominated for appointment as official liquidator.

Unless the voluntary liquidator is a qualified insolvency practitioner who is willing and properly able to accept appointment as official liquidator, the voluntary liquidator must give notice of the petition to the company's members by whatever means is provided in its articles of association for giving notice of a general meeting of the company.[166]

A petition is required to be verified by an affidavit that the statements in the petition are true, or are true to the best of the deponent's knowledge, information and belief[167] and must be sworn by the voluntary liquidator personally.[168]

Unless the voluntary liquidator is a qualified insolvency practitioner who is willing and properly able to accept appointment as official liquidator, a petition must also be supported by an affidavit sworn by the person or persons nominated for appointment as official liquidator and containing the information required by Order 3, Rule 4 of the Companies Winding Up Rules.[169]

If the voluntary liquidator is a qualified insolvency practitioner who has sworn as affidavit verifying that they are willing and properly able to accept appointment as official liquidator, a Judge may make a supervision order without the need for any hearing if the Judge is satisfied that:[170]

(a) notice of the petition has been given to the company's creditors and, if it appears to the voluntary liquidator that the company may in fact be solvent, to its shareholders; and

(b) there is no reason to believe that any creditor or, if applicable, any shareholder objects to the appointment of the voluntary liquidator as official liquidator.

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[166] *Idem,* O 15, r 2(5).
[167] *Idem*, O 15, r 4(1).
[168] *Idem*, O 15, r 4(2).
[169] *Idem,* O 15, r 4(4).
[170] *Idem*, O 15, r 5(1).

In any other case, the voluntary liquidator must apply to fix a date for hearing the petition in open court and:[171]

(a) give notice of the hearing of the petition to the company's creditors and, if applicable, to its shareholders in whatever manner is likely to bring it to their attention; and

(b) advertise[172] the hearing of the petition once in a newspaper having a circulation within the Cayman Islands and, if the company is carrying on business outside the Cayman Islands, once in a newspaper having a circulation in a country in which the company appears most likely to have creditors, in which case the advertisement must be published in the official language of such country.

Any member or creditor of the company may appear on the petition and be heard upon the question of who should be appointed as official liquidator, provided that they have given notice of their intention to do so and have complied with the requirements of Order 3, rule 8(3), of the Companies Winding Up Rules.[173]

4.1.7.3 Requirements and timing for application for supervision order (section 131, Companies Act)

Pursuant to section 131 of the Companies Act, when a resolution has been passed by a company to wind up voluntarily, the liquidator or any contributory or creditor may apply to the Court for an order for the continuation of the winding up under the supervision of the Court, notwithstanding that the declaration of solvency has been made in accordance with section 124 of the Companies Act, on the grounds that:

(a) the company is or is likely to become insolvent; or

(b) the supervision of the Court will facilitate a more effective, economic or expeditious liquidation of the company in the interests of the contributories and creditors.

An application for a supervision order under section 131 of the Companies Act is required to be made by petition (as discussed in detail at 4.1.7.4 below) and can be presented at any time.[174]

4.1.7.4 Form and content of application for supervision order (section 131, Companies Act)

An application by a voluntary liquidator, contributory or creditor for a supervision order is required to be made by petition which contains full particulars of the grounds upon which it is presented.[175]

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[171] *Idem,* O 15, r 5(2).
[172] *Idem,* O 15, r 5(3). An advertisement under O 15, r 5 must be in CWR Form No 22.
[173] *Idem*, O 15, r 5(4).
[174] *Idem,* O 15, r 3(5).
[175] *Idem,* O 15, r 3(1)-(2).

Upon presentation of the petition for a supervision order, the petitioner must at the same time issue a summons for directions in respect of the matters contained in Order 15, Rule 3 of the Companies Winding Up Rules.

Upon hearing the summons for directions, the Court must either:[176]

(a) make a supervision order, if the Court is satisfied that the company's members consent or do not object to an order being made; or

(b) fix a hearing date and make such directions as the Court thinks appropriate in respect of the following:

(i) whether the petition should be served and, if so, upon whom it should be served;

(ii) whether the petition should be advertised and, if so, in what manner it should be advertised;

(iii) the manner in which further evidence is to be given; and

(iv) such other procedural matters as the Court thinks fit.

A petition is required to be verified by an affidavit that the statements in the petition are true, or are true to the best of the deponent's knowledge, information and belief.[177]

An affidavit verifying the petition is required to be sworn by:[178]

(a) the petitioner; or

(b) the voluntary liquidator; or

(c) any director, officer or agent of the petitioner who has been concerned in and has personal knowledge of the matters giving rise to the petition.

Unless the voluntary liquidator is a qualified insolvency practitioner who is willing and properly able to accept appointment as official liquidator, a petition must also be supported by an affidavit sworn by the person or persons nominated for appointment as official liquidator and containing the information required by Order 3, rule 4 of the Companies Winding Up Rules.[179]

Any member or creditor of the company may appear on the petition and be heard upon the question of who should be appointed as official liquidator, provided that they have given notice

[176] *Idem,* O 15, r 3(4).
[177] *Idem,* O 15, r 4(1).
[178] *Idem,* O 15, r 4(3).
[179] *Idem,* O 15, r 4(4).

of their intention to do so and have complied with the requirements of Order 3, rule 8(3), of the Companies Winding Up Rules.[180]

4.1.7.5 Effect of supervision order (section 131, Companies Act)

A supervision order will take effect for all purposes as if it were an order that the company be wound up by the Court, with the exception that:[181]

(a) the liquidation commenced in accordance with section 117 of the Companies Act; and

(b) the prior actions of the voluntary liquidator will be valid and binding upon the company and its official liquidator.

On the making of the supervision order, all powers of the directors cease, save that directors retain residual powers to allow them to initiate an appeal against the supervision order.[182]

When making a supervision order, the Court:[183]

(a) must appoint one or more qualified insolvency practitioners; and

(b) may, in addition, appoint one or more foreign practitioners as liquidators of the company,

and section 105 of the Companies Act will apply as if the Court had made a winding up order.

Unless a voluntary liquidator is appointed as an official liquidator, that person will cease to hold office automatically upon the making of the supervision order.[184]

When the voluntary liquidator ceases to hold office:

(a) that person is required to prepare a final report and accounts for the period from the commencement of the voluntary liquidation until the date of the supervision order;[185]

(b) such reports and accounts are required to be delivered within 28 days from the date of the supervision order and the official liquidator must:[186]

(i) file the report and accounts in Court; and

[180] *Idem*, O 15, r 5(4).
[181] Companies Act, s 133.
[182] CWR, O 15, r 8(3).
[183] Companies Act, s 132(1).
[184] CWR, O 15, r 6(1).
[185] *Idem,* O 15, r 6(2).
[186] Companies Act, s 132(2) and CWR, O 15, r 6.

(ii) publish the report and accounts to the company's members and creditors in such manner as they think fit;[187]

(c) having provided the final report and accounts, the voluntary liquidator may apply (but is not obliged to do so) to the Court for an order that their accounts (including the amount of their remuneration) be approved and that they be released from the performance of any further duties;[188] and

(d) the voluntary liquidator is required to deliver to their successor the company's books and a copy of their liquidation files (maintained in accordance with Order 26, rule 2, of the Companies Winding Up Rules).[189]

The official liquidator is required to allow the voluntary liquidator to have unrestricted access to the company's books and records for the purpose of preparing their report in compliance with Order 13, rule 8 of the Companies Winding Up Rules.[190]

Self-Assessment Questions

Question 1

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

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?

Question 3

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

Question 4

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

Question 5

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

[187] CWR, O 15, r 6(3).
[188] *Idem,* O 15, r 6(4).
[189] *Idem,* O 15, r 7(1).
[190] *Idem,* O 15, r 7(2).

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?

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?

For feedback on these self-assessment questions, see the document "Comment and Feedback on Self-Assessment Questions", which is made available to you as a separate document

4.2 Official liquidation (OL) – getting in, consequences and getting out

4.2.1 Petitions – who may petition, grounds, practical mechanics and considerations

The purpose of an official liquidation is to wind up the company and distribute its assets to its creditors and shareholders.

Official liquidation is a court-supervised process. The Court decides to appoint official liquidators, considers whether to sanction certain actions of the liquidators (for example the sale of assets, leave to commence litigation, compromising of claims) and also retains control of the liquidation process by approving payment of the liquidators' remuneration and expenses.

4.2.1.1 Jurisdiction of the Court

The Grand Court has jurisdiction to make winding up orders in respect of companies which are either:[191]

(a) incorporated in the Cayman Islands;
(b) incorporated elsewhere but subsequently registered in the Cayman Islands; or

(c) in respect of a foreign company which –

(i) has property located in the Islands,

(ii) is carrying on business in the Islands;

[191] Companies Act, s 91.

(iii) is the general partner of a limited partnership; or

(iv) is registered under Part IX (a so-called "overseas company").

4.2.1.2 Circumstances in which a company may be wound up by the Court

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 (commonly referred to as a "just and equitable winding up petition").

4.2.1.3 Who may petition and standing (section 94 of the Companies Act)

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 Authority pursuant to the regulatory laws.

The Companies Act was recently amended to provide for a director to have authority to present a winding up petition on behalf of a company. Sections 94(2) – 2B provide, in summary:

(a) in relation to a company incorporated before 31 August 2022, the directors of a company have the authority, where it is expressly provided for in the articles of association of a company, to:

(i) present a winding up petition; or

(ii) where a winding up petition has been presented, apply for the appointment of a provisional liquidator, without the sanction of a resolution passed at a general meeting.

(b) In relation to a company incorporated after 31 August 2022, the directors of a company may present a winding up petition on behalf of the company on the grounds that the company is unable to pay its debts within the meaning of section 93 or, where a winding up petition has been presented, apply on behalf of the company for the appointment of a provisional liquidator.[192]

However, this is subject to the provision in the articles of association of the relevant company which may expressly remove or modify the directors' authority to present a winding up petition or apply for the appointment of a provisional liquidator on the company's behalf.[193]

In relation to a contributory's petition, section 94(3) provides that a contributory is not entitled to present a winding up petition, unless either:

(a) the shares in respect of which that person is a contributory, or some of them, are partly paid; or

(b) the shares in respect of which that person is a contributory, or some of them, were either –

(i) originally allotted to that person, or have been held by that person and registered in that person's name for a period of at least six months immediately preceding the presentation of the winding up petition; or

(ii) have devolved on that person through the death of a former holder.

Lastly, a winding up petition may be presented by the Authority in respect of any company which is carrying on a regulated business in the Islands upon the grounds that it is not duly licensed or registered to do so under the regulatory laws, or for any other reason as provided under the regulatory laws or any other law.[194]

4.2.1.4 Grounds for winding up petition

Inability to pay debt

A company is deemed to be unable to pay its debts if:[195]

(a) a creditor to whom the company owes a sum exceeding KYD 100 has served on the company a demand requiring the company to pay the sum due and the company has not been paid for 21 days after the demand (this demand is referred to as a "statutory demand");

[192] *Idem*, s 94(2A).
[193] *Idem*, s 94(2B).
[194] *Idem*, s 94(4).
[195] *Idem*, s 93.

(b) execution of other process issued on a judgment, decree or order obtained in the Court in favour of any creditor in any proceedings instituted by such creditor against the company is returned unsatisfied in whole or in part; or

(c) it is proved to the satisfaction of the Court that the company is unable to pay its debts.

It is normally a creditor that brings a winding up petition on grounds that a company is unable to pay its debts. As a general rule, shareholders cannot apply on these grounds because if the company is insolvent, such shareholders will no longer have any economic interest in the company.

The onus is on the party petitioning for the winding up of the company to prove that it is insolvent, not on the company to prove its solvency.

If the debt forming the basis for the winding up petition is disputed on substantial grounds by the company, then the debt cannot form the basis of a winding up petition. A creditor's petition based on a disputed debt is normally dismissed, although the Court retains a discretion to allow a creditor with a disputed debt claim to succeed in certain circumstances.[196]

Statutory demand

A statutory demand is a formal written demand for payment of a debt made by a creditor to a debtor.

A statutory demand provides a method by which a creditor, to whom a company is indebted in a sum exceeding KYD 100, if not paid within a three week period, can have the company deemed unable to pay its debts as grounds for seeking the winding up of the company.[197] If the company neglects to pay the sum, or to secure or compound it to the satisfaction of the creditor, it is, at the end of that period, deemed to be unable to pay its debts.

If a creditor is confident as to the validity of the debt, a statutory demand can be an expedient method to obtain prompt payment, or to invite settlement proposals given the consequences that follow if the statutory demand is left unsatisfied. However, a creditor who issues a statutory demand should intend to follow through with a winding up petition if the debt remains unsatisfied, as otherwise the creditor could be seen to be abusing the petition jurisdiction by using the threat of winding up as a means to coerce the company into making payment.

The Companies Winding Up Rules, Order 2, rule 2 provides guidance as to the form and content of a statutory demand, namely that:

(a) it must be in CWR Form No 1;

[196] *Parmalat Capital Fin Ltd* [2006] CILR 480 and *In re GFN Corp Ltd* [2009] CILR 650.
[197] Companies Act, s 93(a).

(b) it must be signed by the creditor, or if the creditor is a firm, any partner of the firm; or if the creditor is a body corporate, any director or officer who is duly authorised to make the demand;

(c) it must sate the amount, the date on which the debt fell due, the currency of the debt and the consideration for it;

(d) it must state the grounds upon which the company is liable to pay such interest or charges and contain particulars of the way in which such interest or charges are calculated if the amount claimed included –

(i) any charges by way of interest not previously notified to the company as included in its liability; or

(ii) any other charge accruing from time to time;

(e) it must contain the creditor's address and, if it is signed by anyone other than the creditor himself, the contact details of the partner, director or officer who signed it on behalf of the creditor.

Importantly, under Order 2, rule 2(6) of the Companies Winding Up Rules, a statutory demand must also include a statement that if payment is not made within 21 days of the date upon which it was served on the company, the company will be deemed to be insolvent and a winding up petition may be presented against the company in accordance with section 92(d) of the Companies Act.

Section 93(a) of the Companies Act prescribes that a statutory demand must be served on a company at its registered office. Order 2, rule 3 of the Companies Winding Up Rules further prescribes the method which must be used to serve a statutory demand on a creditor. The original hard copy of a statutory demand must be delivered by hand to the company's registered office. Transmission of a copy by fax or email will not, by itself, be sufficient to constitute good service. There is no requirement that a copy of the statutory demand must be drawn to the attention of the company's directors by the creditor, nor will the statutory demand be invalidated by failure of the company's service provider to draw it to the attention of the directors. Failure to take any other appropriate steps on behalf of the company in response to the receipt of the statutory demand will also not invalidate it.

There is no statutory mechanism by which a debtor can apply to set aside a statutory demand. Instead, the remedy available to the debtor is to apply for and obtain either an injunction or an undertaking against the creditor within 21 days from the date of service of the statutory demand. The Court is likely to grant an injunction preventing the presentation of a winding up petition if it appears that the debtor is solvent and the presentation of the winding up petition will be an abuse of process, for example if one of the following applies:

(a) the debt is genuinely disputed on substantial grounds;

(b) the debtor has a cross claim or right of set-off that exceeds the amount claimed or reduces the disputed debt to less than KYD 100;

(c) the debtor has a reasonable excuse for not paying the debt claimed.

Additionally, a debtor can apply to the Grand Court for a declaration that a statutory demand is invalid and should be set aside.[198]

Cash flow test

It is well established in the Cayman Islands that the legal test for solvency for the purposes of section 94(c) of the Companies Act is on a cash flow basis (and not a balance sheet basis).[199]

This test has been held to not be confined to consideration of debts that were imminently due and payable; it also permitted consideration of debts that would become due in the reasonably near future.[200]

A recent and authoritative statement on the nature of the test was found in the Cayman Islands Court of Appeal judgment in *Weavering Macro Fixed Income Fund Limited*[201] where, at paragraph 40, Martin JA said:

> "In my view, the cash flow test in the Cayman Islands is not confined to consideration of debts that are immediately due and payable. It permits consideration also of debts that will become due in the reasonably near future. The approval of *In re European Life Assur. Socy.* by this court in *Strategic Turnaround* does not prevent that conclusion: that case was primarily concerned with winding up on the just and equitable basis, not on the basis of inability to pay debts and the headnote quoted by this court refers to debts resulting from future business, not to future debts resulting from existing business. Nor does para. 42 of this court's judgment in *Strategic Turnaround* (quoted in para. 34 above) suggest otherwise. If, as this court erroneously thought, the suspension of redemptions was valid, the petitioner's debt would not be payable for an indeterminate period and if the period could not be determined it was impossible to say that the debt would fall due in the reasonably near future. I do not regard the words "as they fall due" as adding anything of substance. In *Eurosail*, Lord Walker, after noting that the words "as they fall due" were introduced for the first time in the Insolvency Act 1985, said ([2013] 1 W.L.R. 1408, at para. 37) that despite the difference in form they made little significant change in the law and served to underline that the cash flow test was concerned

[198] See eg, *MNC Media Investment Ltd* (unreported, 4 August 2015), upheld on appeal in *MNC Media Investment Ltd* (unreported, 18 January 2016 (CA)).
[199] *In the matter of Oryx Natural Resources* [2007] CILR Note 6 and *In the matter of Weavering Macro Fixed Income Fund Limited (in liquidation)* [2016] (2) CILR 514.
[200] *In the matter of Weavering Macro Fixed Income Fund Limited (in liquidation)* [2016] (2) CILR 514.
[201] *In the matter of Weavering Macro Fixed Income Fund Limited (in liquidation)* [2016] (2) CILR 514.

> both with presently due debts and with debts falling due in the reasonably near future. Any other conclusion leads to artificiality: if a company is able to pay a small debt due on a particular day, but will inevitably be unable to pay a much larger debt due on the following day, it is artificial to say that on the first day it is not unable to pay its debts…"

Just and equitable winding up petitions

A just and equitable winding up petition is typically brought by minority shareholders. Such applications will also rarely be brought in respect of an insolvent company because a petitioning shareholder will need to demonstrate to the Court that it has an economic interest in the company in order to have the necessary standing to petition. It will only be able to do so where there will be a surplus of assets after the company's debts and the expense of the winding up have been paid.

Although the categories of "just and equitable" grounds are not closed, commonly petitions under this heading rely on the following:

(a) loss of substratum;

(b) deadlock;

(c) mismanagement; and / or

(d) exclusion from management.

The Cayman Islands does not have an unfair prejudice remedy for minority shareholders as is available in a number of other jurisdictions. Instead, a shareholder may present a just and equitable winding up petition and then apply for a form of alternative relief under section 95(3) of the Companies Act.

Section 95(3) of the Companies Act provides that, if a petition is presented by contributories on grounds that it is just and equitable that the company should be wound up, the Court will have jurisdiction to make the following orders, as alternative to a winding up order (the alternative relief):

(a) an order regulating the conduct of the company's affairs in the future;

(b) an order requiring the company to refrain from doing or continuing an act complained of by the petitioner, or to do an act which the petitioner has complained it has omitted to do;

(c) an order authorising civil proceedings to be brought in the name and on behalf of the company by the petitioner on such terms as the Court may direct; or

(d) an order providing for the purchase of the shares of any members of the company by other members or by the company itself and, in the case of a purchase by the company itself, a reduction of the company's capital accordingly.

A precondition for the alternative relief under section 95(3) is the establishment of grounds sufficient to justify a winding up.[202]

A petition will not succeed if there is an adequate alternative remedy which the petition has unreasonably failed to pursue. If it is clear at an early stage that a petition would fail on this ground, it can be struck out as an abuse of process.[203]

Powers of Court on hearing a winding up petition

Upon the hearing of the winding up petition, the Court may:

(a) dismiss the petition;

(b) adjourn the hearing conditionally or unconditionally;

(c) make a provisional order (see the section on provisional liquidators); or

(d) any other order that it thinks fit.[204]

The Court must not refuse to make a winding up order on the ground only that the company's assets have been mortgaged or charged to an amount equal to or in excess of those assets or that the company has no assets.[205]

Parties are free to contractually exclude the ability for one party to petition for the winding up of the other party. The Court must dismiss a winding up petition or adjourn the hearing of a winding up petition on the ground that the petitioner is contractually bound not to present a petition against the company.[206]

Practical mechanics and considerations

A winding up petition must comply with the requirements as to form and content as contained in the Companies Winding up Rules and be verified by affidavit.[207]

There are specific provisions for the presentation and service of a creditor's winding up petition provided for in the Companies Winding up Rules and Practice Direction 4 of 2017.

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[202] *CTRIP Investment Holding Limited v EHi Car Services Ltd* [2018] (1) CILR 641.
[203] *Tianrui (International) Holding Company Limited v China Shanshui Cement Group Limited* [2019] (1) CILR 481.
[204] Companies Act, s 95(1).
[205] *Idem*, s 95(1).
[206] *Idem,* s 95(2).
[207] CWR, O 3, r 1 – 3.

A creditor's winding up petition, together with the verifying and supporting affidavits and notice of hearing (if the hearing date is not endorsed upon the petition itself), must be served upon the company by delivering them to the company's registered office immediately after the petition has been presented. An affidavit of service is required to be filed within seven days of the presentation of every creditor's petition.[208]

Every creditor's petition must be advertised once in a newspaper having a circulation in the Islands, unless directed otherwise by the Court. If the company is carrying on business outside of the Islands, every creditor's petition must also be advertised once in a newspaper having a circulation in the country or countries in which it is most likely to come to the attention of the company's creditors.

There are specific timeframes for the advertisement of the winding up petition. The advertisement must be made to appear not less than seven business days after service of the petition upon the company and not less than seven business days before the hearing date.[209]

4.2.2 Winding up orders, alternative orders and commencement

4.2.2.1 Winding up orders

Section 92 of the Companies Act provides that a company may be wound up by the Court if:

(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.

Accordingly, section 92 provides the gateway upon which the Court may grant a winding up order. Order 3, rule 22 of the Company Winding Up Rules states that the winding up order itself must take the form of CWR Form No 6. The winding up order will typically reflect the basis upon which the company is to be wound up, along with any further specific directions which follow from the hearing of the petition. The order may also include specific powers granted to the Official Liquidator, such as specific powers contained in Part I of Schedule 3 to the Companies

[208] *Idem*, O 3, r 5.
[209] *Idem*, O 3, r 6.

Act (that is powers of a liquidator requiring sanction of the Court). It will also detail how the costs of the winding up proceedings are to be dealt with.

Every winding up order must be drawn up and filed in accordance with Order 42, rule 5 of the Grand Court Rules (2022 Revision) (as amended).[210] The responsibility for ensuring that the winding up order is drawn up and filed immediately after the hearing rests with the petitioner, who must thereafter serve copies of the winding up order upon the company at its registered office, on every person who appeared and was heard at the hearing, on the Official Liquidator and, if applicable, the regulator. Service is required within two business days after the order is made.[211]

Within seven business days after the order is made, the official liquidator must file the order with the Registrar of Companies, seek publication in the Gazette and send copies of the order to every person who appears to him to have been a director or professional service provider of the company at the time the winding up petition was presented.[212]

Separate service and filing requirements apply where an order is made in respect of a foreign company to ensure that the relevant foreign authorities, court and insolvency practitioner receive copies of the winding up order.[213]

On the appointment of an official liquidator, all the powers of the directors cease, save that directors retain residual powers to allow them to initiate an appeal against the winding up order.[214]

4.2.2.2 Alternative orders

Under section 95(1)(d) of the Companies Act, upon hearing the winding up petition, as an alternative to a winding up order, the Court can make "any other order that it thinks fit". This leaves a doorway for an alternative relief other than winding up itself. Where the winding up is sought by a shareholder on just and equitable grounds, the Court has specific jurisdiction under section 95(3) to make various alternative orders, including:

(a) an order regulating the conduct of the company's affairs in the future;

(b) an order requiring the company to refrain from doing or continuing an act complained of by the petitioner or to do an act which the petitioner has complained it has omitted to do;

(c) an order authorising civil proceedings to be brought in the name and on behalf of the company by the petitioner on such terms as the Court may direct; or

[210] *Idem*, O 3, r 23.
[211] *Idem*, O 3, r 23(3).
[212] *Idem*, O 3, r 23(4).
[213] *Idem*, O 3, r 23(5).
[214] *Idem*, O 3, r 22(4).

(d) an order providing for the purchase of the shares of any members of the company by other members or by the company itself and, in the case of a purchase by the company itself, a reduction of the company's capital accordingly.

4.2.2.3 Commencement

Section 100 of the Companies Act provides that the winding up of a company by the Court is deemed to commence:

- at the time of passing of a resolution by the company for voluntary winding up;
- at the expiry of any period fixed for the duration of a company by its articles of association;
- at the date of an even upon the occurrence of which it is provided by its articles of association that the company is to be wound up; or
- if a restructuring officer has been appointed pursuant to section 91B or 91C of the Act and has not been discharged, at the date of the presentation of the petition to appoint the restructuring officer pursuant to section 91B.

If none of the above apply, then section 100(2) of the Act provides that 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.

4.2.2.4 Dissolution

Once the affairs of a company in compulsory liquidation have been fully wound up, the Court will make an order, on the liquidator's application, that the company is dissolved.[215]

4.2.3 Stay, avoidance of property dispositions

Upon the granting of a winding up order, there is an automatic stay on fresh proceedings being commenced and proceedings that are already afoot may only proceed with leave of the Court. The purpose of the stay is to provide the company a period of "breathing space" while the liquidator takes control of the company and to avoid company funds being wasted on litigation that ought to be dealt with through the proof of debt process.

In furtherance of maintaining the *status quo* and protecting the company's assets, pre-insolvency transactions can be challenged if they constitute –

(a) a voidable preference;[216]

[215] Companies Act, s 152.
[216] *Idem*, s 145.

(b) a disposition made at an undervalue;[217] or

(c) fraudulent trading or a fraudulent disposition.[218]

As such, the Cayman insolvency regime protects the assets for the benefit of the creditors and to ensure that the eventual distribution of the company's property is in accordance with the order of priorities under the law and the principle of *pari passu*.

4.2.3.1 Stay of proceedings (section 97 of the Companies Act)

One of the benefits of a winding up order being made, or a provisional liquidator being appointed, or of a restructuring officer being appointed, is that all existing proceedings against the company are automatically stayed and no fresh proceedings or actions can commence without leave of the Court. Further, any execution or enforcement measures against the company are also unable to proceed without the Court's permission. This allows the company, and the appointed officeholders a period of "breathing space" 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".

A stay is automatically imposed by operation of section 97 of the Companies Act,[219] which states as follows:

> "(1) When a winding up order is made or a provisional liquidator is appointed, no suit, action or other proceedings, including criminal proceedings, shall be proceeded with or commenced against the company except with the leave of the Court and subject to such terms as the Court may impose.
>
> (2) When a winding up order has been made, any attachment, distress or execution put in force against the estate or effects of the company after the commencement of the winding up is void."

While a stay prohibits legal proceedings against the company, it does not prevent secured creditors from enforcing their security, as discussed below in the recent decision of *Adenium Energy Capital Limited*.[220]

For an automatic stay to take affect outside of the Cayman Islands, the liquidators will normally need to apply for recognition and enforcement of the stay in the relevant foreign jurisdictions

[217] *Idem*, s 146.
[218] *Idem*, s 147; Fraudulent Dispositions Act (1996 Revision).
[219] And, where a petition for the appointment of a restructuring officer is presented, s 91G.
[220] *Adenium Energy Capital Limited (in official liquidation)* (unreported, 26 April 2022).

where such relief is required. It will then be a matter for the foreign Court to determine whether the stay is recognised and upheld in that jurisdiction.[221]

Legal test to grant leave for lifting the moratorium

In the decision of *BDO Cayman Ltd v Ardent Harmony Fund Inc*,[222] the Court considered the statutory moratorium against commencing proceedings against a Cayman Islands company that had been placed in liquidation. The Court identified that the rationale for requiring leave to bring proceedings was set out in the Australian Federal Court decision of *Vagrand Pty Ltd (in liq) v Fielding*[223] which in turn had quoted the decision of Manning J of the New South Wales Supreme Court in *Thompson v Mulgoa Irrigation Co Ltd*[224] as follows:

> "All that s 140 [section 97] means is that a company in liquidation is not be harassed and its assets wasted by unnecessary litigation, and the leave of the Court is therefore required as a safeguard. Before any action can be brought or continued against a company, the Court must investigate the intended litigation."[225]

In its decision, the Grand Court recognised that the principles to be extracted from the case law governing leave being granted under section 97, are as follows:

> "(1) The applicant for leave must first establish an arguable case to be litigated;
>
> (2) If it establishes an arguable case, the Court then has to consider whether it would be fair in the context of the liquidation as a whole, for the JOLs to have to deal with the burden of that litigation. The Court's discretion is wide and unfettered – there is no presumption in favour of or against giving leave – and each case turns on its own facts;
>
> (3) In deciding what would be fair, the Court can give s. 97 leave subject to conditions subject to a consideration of what would be fair, in the context of the liquidation as a whole."[226]

While in the case of *Ardent* leave was declined by the Court, in some circumstances the Court will grant leave to continue with existing proceedings or will allow fresh proceedings to be commenced.

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[221] But note that s 91G(3), in relation to restructuring officer petitions, has specific wording seeking to cover overseas proceedings.
[222] *BDO Cayman Ltd and BDO Trinity LTD v Ardent Harmony Fund Inc (in Official Liquidation)*, (unreported, 19 November 2020).
[223] (1993) 113 ALR 128.
[224] (1893) 4 BC (NSW).
[225] *Idem*, at para 33.
[226] *BDO Cayman Ltd and BDO Trinity LTD v Ardent Harmony Fund Inc (in Official Liquidation)*, (unreported, 19 November 2020) *at* para 24.

Where leave to commence proceedings may be granted

In the decision *Adenium Energy Capital Limited,*[227] leave was granted to a secured creditor to pursue proceedings. The Court confirmed that when the claimant company is in liquidation, the defendants to the proceedings are entitled to take defensive steps without requiring leave to continue under section 97 of the Companies Act. However, where the action taken is no longer "defensive" in nature, it was held that leave will be required. In this instance, the defendant had filed two applications which the Court found went beyond defensive steps and which would therefore require the leave of the Court.

Notwithstanding the above, because the applicants were secured creditors seeking to assert a proprietary interest, the Court considered that where a secured creditor seeks leave to enforce a claim in respect of what is their own property, leave to proceed ought to be granted as a matter of course, subject to the following two narrow circumstances:

(a) where the applicant for leave is offered everything to which they are entitled without needing to bring an action; and

(b) where the applicant could obtain identical protection of its position in the winding up.

4.2.3.2 Avoidance of property dispositions (section 99 of the Companies Act)

Section 99 of the Companies Act makes provision for the avoidance of any disposition of the company's property after the commencement of winding up. The provision provides:

> "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."

The purpose of the section is to preserve the *status quo*.[228]

Once the Court grants a winding up order, any disposition of the company's property is void and the liquidator is able to seek relief from the Court to allow the property to be claimed back. Further, the transfer of shares or any alteration in status of the company's shareholders made after the commencement of the winding up, which is normally deemed to be at the point that the petition was originally presented, is also void, unless the Court orders otherwise.

Validation Orders

A company is able to apply for a validation order under this section to ensure certain dispositions are not rendered void under section 99 of the Companies Act. This allows a company to continue to operate until the company is wound up, which in turn helps provide a degree of

[227] *Adenium Energy Capital Limited (in official liquidation)* (unreported, 26 April 2022).
[228] *Tianrui (International) Holding Company Limited v China Shanshui Cement Group Limited* [2020] (1) CILR 417.

commercial certainty to those trading with the company.[229] That being said, a validation order must not be exercised in manner that undermines the fundamental purpose of section 99 of the Companies Act, being to preserve the *status quo*.

The authorities suggest that a validation order may be granted if the following conditions are satisfied:[230]

(a) The proposed disposition must appear to be within the powers of the directors.

(b) The evidence must show that the directors believe that the disposition is necessary and expedient in the interests of the company.

(c) It must appear that in reaching the decision the directors have acted in good faith.[231]

(d) The reasons for the disposition must be shown to be ones which an intelligent and honest director could reasonably hold.

However, the above-mentioned conditions are increasingly seen as guidelines and are somewhat flexible.[232] For example, *Re Cybervest Fund*[233] added the condition that, even if the company is clearly solvent, payment may not be validated where irregularities in the conduct of the affairs of the company can be shown.

4.2.3.3 Voidable preference (section 145 of the Companies Act)

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.

The provision provides:

> "(1) Every conveyance or transfer of property, or charge thereon, and every payment obligation and judicial proceeding, made, incurred, taken or suffered by any company in favour of any creditor **at a time when the company is unable to pay its debts within the meaning of section 93 with a view to giving such creditor a preference** over the other creditors shall be voidable upon the

[229] *Ibid.*
[230] *Fortuna Development Corporation* [2004] CILR 533, subsequently approved in, *Re Torchlight Fund LP* [2018] (1) CILR 290.
[231] The burden on establishing bad faith is on the party opposing the application.
[232] *Re Cybervest Fund* [2006] CILR 80.
[233] *Ibid.*

application of the company's liquidator if made, incurred, taken or suffered within **six months immediately preceding the commencement of a liquidation**.

(2) A payment made as aforesaid to a **related party of the company shall be deemed to have been made with a view to giving such creditor a preference**.

(3) For the purposes of this section a creditor shall be treated as a 'related party' if it has the ability to control the company or exercise significant influence over the company in making financial and operating decisions."

The leading authority on the application of section 145 is *Skandinaviska Enskilda Banken AB (Publ) v Conway and Another (as Joint Official Liquidators of Weavering Macro Fixed Income Fund Limited.*[234] The joint official liquidators of a company had applied to the Grand Court for a declaration that a number of redemption payments made to the appellant were invalid as they constituted preferential payments contrary to section 145(1) of the Companies Act (2013 Revision). The joint official liquidators sought an order that the sums paid to the appellant be repaid to the company.

The case ultimately went to the Judicial Committee of the Privy Council, which examined the consequences of a transaction being a fraudulent preference under section 145. It held that section 145 invalidated any conveyance or payment which fell within its scope but was silent as to the consequences of that invalidation.

Section 145 did not create a statutory right to recover the property or payment which was the subject of the preference, but merely rendered the relevant transfer or payment voidable. In that case, the effect of the order under section 145 was to avoid the company's payment in question. The consequence of the avoidance was to deprive the transferee of their title. The liquidator therefore had a claim to recover the property on the basis of the company's title. That claim would be based in common law restitution on the ground of unjust enrichment, and would not be subject to a change of position defence – because the Court could not override the intention of the legislature by providing a common law defence.

The language of section 145 has changed since the Privy Council decision. Now, instead of the transaction being "invalid", it is "voidable upon the application of the company's liquidator".

4.2.3.4 Avoidance of dispositions made at an undervalue (section 146 of the Companies Act)

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.

[234] Before the Grand Court [2015 (2) CILR 278]; the Court of Appeal [2016 (2) CILR 514]; and the Privy Council [2019 (2) CILR 245].

The provision states:

> "**146**. (1) …
>
> (2) 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.
>
> (3) The burden of establishing an intent to defraud for the purposes of this section shall be upon the official liquidator.
>
> (4) No action or proceedings shall be commenced by an official liquidator under this section more than **six years after the date of the relevant disposition**.
>
> (5) In the event that any disposition is set aside under this section, then if the Court is satisfied that the transferee has not acted in bad faith –
>
> (a) the transferee shall have a first and paramount charge over the property, the subject of the disposition, of an amount equal to the entire costs properly incurred by the transferee in the defence of the action or proceedings; and
>
> (b) the relevant disposition shall be set aside subject to the proper fees, costs, pre-existing rights, claims and interests of the transferee (and of any predecessor transferee who has not acted in bad faith)."

What constitutes a "disposition" is widely defined, by reference to the Cayman Islands Trusts Act, to mean every form of conveyance, transfer, assignment, lease, mortgage, pledge or other transaction by which any legal or equitable interest in property is created, transferred or extinguished.

"Undervalue" is defined to mean, in relation to a disposition, either the provision of no consideration for the disposition, or the provision of consideration for the disposition the value of which in money or money's worth is "significantly less" than the value of the property subject to the disposition.

An "intent to defraud" is defined to mean an intention to willfully defeat an obligation owed to a creditor. In turn, an "obligation" is defined to mean an obligation or liability (which includes a contingent liability) which existed on or prior to the date of the relevant disposition.

A "transferee" is defined to mean the person to whom a relevant disposition is made, including any successor in title (which would include subsequent transferees). In the event that any disposition is set aside under section 146, then, if the Court is satisfied that the transferee has not acted in bad faith, the transferee (i) will have a first and paramount charge over the property,

the subject of the disposition, of an amount equal to the entire costs properly incurred by the transferee in the defence of the action or proceedings; and (ii) the relevant disposition will be set aside subject to the proper fees, costs, pre-existing rights, claims and interests of the transferee (and of any predecessor transferee who has not acted in bad faith). The unwinding of the disposition will also be subject to any other pre-existing rights and interests of the transferee which have accrued following the disposition itself.

Section 146 imposes a burden on the liquidators to demonstrate an intention to defraud.[235] For instance, in *Raiffeisen International Bank AG v Scully and Ors*,[236] the Grand Court held at paragraph 114 that there is a requirement –

> " . . . to show that it was a purpose of the transferor to defeat its creditors. It need not [be] show[n] that this was the dominant purpose or the sole purpose. It follows that the court may be presented with a number of purposes which motivated transfers and that this in itself would not preclude the conclusion that a transfer was made willfully to achieve the purpose of defeating creditors. The court should look closely at each of the transfers to see if the test was satisfied in each case assuming there is evidence to show that the transfer would have been made in any event or was made for a different and legitimate purpose."

If a Court finds that there has been a disposition of the company's property at an undervalue with an intention to defraud creditors pursuant to the Fraudulent Dispositions Act (1996 Revision) (the FDA) it will set aside that disposition only to the extent necessary to satisfy the obligation to a creditor at whose instance the disposition has been set aside together with such costs as the Court may allow. In the event that a transaction is held to be voidable under section 146 of the Companies Act, the disposition may be set aside in its entirety. Accordingly, a lender must make sure that he is providing good consideration for the security interest. If it does not, it risks its security coming under attack at the instance of a liquidator or other creditors. Before a disposition will be set aside the Grand Court must be satisfied that there was an element of bad faith in the transaction.

The applicable limitation period for actions brought under Section 146 is six years from the date of the relevant disposition.

A disposition of a company's property at an undervalue with an intent to defraud a creditor is also voidable at the instance of a creditor thereby prejudiced under the FDA, subject to such creditor also satisfying the tests set out above.

If a Court finds that there has been a disposition of the company's property at an undervalue with an intention to defraud creditors pursuant to the FDA, it will set aside that disposition only to the extent necessary to satisfy the obligation to a creditor at whose instance the disposition has been set aside, together with such costs as the Court may allow. In the event that a transaction is held to be voidable under section 146, the disposition may be set aside in its

[235] Companies Act, s 146(3).
[236] Unreported, 7 July 2020.

entirety. Accordingly, a lender must make sure that it is providing good consideration for the security interest. If it does not, it risks its security coming under attack at the instance of a liquidator or other creditors. Before a disposition will be set aside the Grand Court must be satisfied that there was an element of bad faith in the transaction. Any application under the Companies Act or the FDA must be commenced within six years of the date of the relevant disposition.

4.2.4 "Traditional" provisional liquidators (briefly dealt with)

4.2.4.1 Overview and purpose

In the Cayman Islands, the appointment of a provisional liquidator provides a distressed or mismanaged company with an immediate period of breathing space, while investigations are undertaken and rehabilitation of the business is explored (and where possible, implemented). During this period, there is a moratorium on claims and enforcement action against the company (save to the extent secured creditors may still enforce their security in the usual way), and the provisional liquidators have various powers to, amongst other things, take control of and safeguard the assets of the company.

The appointment of a provisional liquidator is governed by section 104 of the Companies Act. The regime replaced the Court's broad discretion to appoint, which sometimes was sought to be abused by applicants by making *ex parte* applications for the appointment of their own provisional liquidators, with the intention that it would then be difficult for remaining stakeholders to appoint an official liquidator of their choice.[237]

The Companies Act provides two separate mechanisms for the appointment of provisional liquidators, depending on the status of the applicant. The first mechanism is available to certain limited third parties and is commonly referred to as a "full powers" appointment.[238] The second mechanism is only available to the company.[239]

The discretion to appoint provisional liquidators under either mechanism has been described as a "serious step" that will likely result in considerable adverse consequences for the company.[240] It "should be exercised in accordance with the overriding principle that a court should take whichever course seems likely to cause the least irremediable prejudice to one party or the other".[241]

The appointment of a provisional liquidator was formerly used on a regular basis by companies to facilitate a restructuring. However, on 31 August 2022, the Companies (Amendment) Act 2021 introduced a new corporate restructuring regime into the Companies Act, which will

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[237] *Orchid Development Group Limited* [2012] (2) CILR Note 14 at para 5.
[238] Companies Act, s 104(2).
[239] *Idem,* s 104(3).
[240] *Re ICG I* (unreported, 4 August 2021) at para 21 and *Re Al Najah Education Limited* (unreported, 9 August 2021) at para 33.
[241] *Re Al Najah Education Limited* (unreported, 9 August 2021) at para 34.

substantially replace the use of provisional liquidators for restructurings. For a detailed discussion on the restructuring regime see 5.4 below.

4.2.4.2 Statutory requirements

When can one apply?

An application for the appointment of provisional liquidators can only be made after the presentation of a winding up petition, but before the making of a winding up order.[242]

Who may apply?

An application for the appointment of provisional liquidators can be made by –

(a) a creditor of the company;

(b) a contributory of the company (that is, a shareholder); or

(c) the Authority, provided the company is purporting to carry on a regulated business on the Islands that it is not licensed or registered to do or is in contradiction with the law.[243]

Alternatively, the company may apply for the appointment of provisional liquidators on an *ex parte* basis.[244]

The grounds for an application under section 104(2) and 104(3) of the Companies Act differ, as discussed below.

The grounds for an application under section 104(2) of the Companies Act

Provided the temporal and standing requirements are met, a Court may appoint provisional liquidators if:

(a) there is a *prima facie* case for making a winding up order; and

(b) the appointment of provisional liquidators is necessary 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.[245]

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[242] Companies Act, s 140(1).
[243] *Idem,* s 104(2) and (6).
[244] *Idem,* s 104(3).
[245] Companies Act, s 104 (2)(a) and (b).

(a) Prima facie case

It is not necessary to establish that a winding up order will be granted,[246] but there must at least be a *prima facie* case for a winding-up. A *prima facie* case will often be established if the allegations made in the petition for the appointment of provisional liquidators are "supported by the evidence and have not been disproved".[247] That being said, the Court will not accept spurious, unsubstantiated, or otherwise irrelevant evidence. In a recent decision, *Re Al Najah Education Limited*,[248] minority shareholders relied on the historic and unrelated findings of a market regulator in Dubai in support of an application to appoint provisional liquidators. The Court refused to accept that the evidence demonstrated a current and relevant risk that company management were, amongst other things, prejudicing shareholders for their own benefit.

Any conflicts of evidence are to be resolved at a substantive hearing, with the benefit of cross-examination.

(b) Necessity

The necessity requirement has been described as a "heavy burden" to satisfy in which "clear or strong evidence" is needed that there is a serious risk that one or more of the matters described in section 104(2)(b) of the Companies Act will occur if provisional liquidators are not appointed.[249] Some examples of evidence which has resulted in the necessity requirement being met are as follows:

(a) The assets of the company are being, or are likely to be, dissipated to the detriment of the petitioners.[250] This not only covers a dissipation in the asset-freezing sense (that is, a deliberate making away with the assets), but also situations in which there is a serious risk that assets may not continue to be available to the company.[251]

(b) Mismanagement amounting to "culpable behaviour involving breach of duty" or "improper behaviour".[252]

(c) There are serious issues with the company's record keeping, including evidence that records may be lost or destroyed.[253]

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246 *In re Asia Strategic Capital Fund* [2015] (1) CILR Note 4.
247 *In re Asia Strategic Capital Fund* [2015] (1) CILR Note 4.
248 Unreported, 9 August 2021.
249 See *Ex parte Nyckeln* [1991] BCLC 539; *CW Group Holdings Limited* (unreported, 3 August 2018) and *Re Al Najah Education Limited* (unreported, 9 August 2021).
250 *Re Asia Strategic Capital Fund LP* (unreported, 30 April 2015) at para 45.
251 *Re ICG I* (unreported, 4 August 2021) at para 23.
252 *Re Asia Strategic Capital Fund LP* (unreported, 30 April 2015) at para 60.
253 *Revenue and Customs Commissioners v Rochdale Drinks Distributors Ltd* [2012] 1 BCLC 748 and *Re Rochdale Drinks* [2013] BCC 419.

In light of this heavy burden, decisions that demonstrate the difficulty establishing that there is necessity are numerous, and include:

- *China Resources and Transportation Group Limited*[254] - the evidence on mismanagement was considered "flimsy" and "little more than mere assertion" and the application did not appear to have the support of other creditors;

- *Grand State Investments Limited*[255] - the evidence did not establish any serious risk of dissipation of assets and / or mismanagement and it was not explained why provisional liquidators were necessary to prevent any dissipation or mismanagement; and

- *Re ICG I*[256] - the evidence did not "paint a satisfactory or clear picture" of alleged conduct giving rise to the application.

The grounds for an application under section 104(3) of the Companies Act

Before the Restructuring Officer regime came into effect on 31 August 2022, the primary restructuring route was to appoint provisional liquidators under section 104(3) of the Companies Act.

Because the law relating such applications still has relevance in the context of the new RO regime,[257] it is worth considering it here. Under the previous section 104(3) regime, to appoint provisional liquidators a company must satisfy the Court that the company –

(a) is or is likely to become unable to pay its debts within the meaning of section 93 of the Companies Act; and

(b) intends to present a compromise or arrangement to its creditors.

It was thought that the rationale behind section 104(3) is to provide companies with some "breathing space" before the actions of creditors might interfere with its attempts to reach a consensual restructuring or, if that is not possible, a scheme of arrangement.[258]

The decision *In the matter of Fruit of Loom Ltd,*[259] provided the following three-stage test (at page 10 of the judgment):

(a) The refinancing and / or sale of the company as a going concern is likely to be more beneficial to the creditors than a liquidation realisation of the company's assets;

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[254] Unreported, 23 April 2021.
[255] Unreported, 28 April 2021.
[256] Unreported, 4 August 2021.
[257] *Oriente Group Limited* – unreported 8 December 2022
[258] *Re Esal (Commodities) Ltd* [1985] BCLC 450 at para 460.
[259] Unreported, 30 October 2000.

(b) There is a real prospect of a refinancing and / or sale as a going concern being affected for the benefit of the general body of the creditors; and

(c) In the circumstances, it is in the best interest of the creditors to try to achieve such a refinancing and / or sale as a going concern.

In other words, the Court's discretion should not be exercised to allow for the appointment of provisional liquidators in circumstances where a company is hopelessly insolvent.[260]

It is important to note that the statutory regime only requires an "intention" to present a compromise or arrangement to its creditors. It is not necessary for the company to have a formulated plan.[261] The Court will be willing to appoint provisional liquidators to explore the viability of a restructuring.[262]

Despite the application being able to be made *ex parte* (something the court ordinarily discouraged), the wishes of creditors should be taken into consideration where possible, including the status of those creditors (that is, whether they are secured or unsecured). But the Court should avoid simply "count[ing] up the claims of supporting and opposing creditors and mak[ing] an order which gives effect to the largest body of creditors".[263] The views of the board may also be relevant.[264] In the recent decision of *In the matter of Midway Resources International*,[265] the proceeding was adjourned to allow the views of the creditors to be ascertained. In doing so, Segal J noted (at paragraph 56):

> "…While it is permissible for an application under section 104(3) of the Act to be made *ex parte*, it is in my view important where possible for the views of creditors to be ascertained and for creditors to have a proper opportunity to file representations and submissions to the Court if they wish to do so. Creditors' views are relevant and important for determining the prospects of the proposed compromise or arrangement (are key creditors supportive or likely to support the proposed compromise or arrangement?) and as the Chief Justice said in *Sun Cheong* the wishes of creditors are one of the matters to be taken into account when the Court is exercising its discretion under section 104(3) and deciding whether to appoint [provisional liquidators]. If there is real urgency and a genuine and substantiated reason why creditors have not been consulted or cannot be given reasonable notice of the hearing, the Court can nonetheless proceed to appoint [provisional liquidators] but on this occasion I was not satisfied that the creditors including the Guarantee Creditors had been given adequate notice of the Hearing or that there was a good reason for the short notice or for appointing [provisional liquidators] immediately rather than

[260] *In the matter of Fruit of the Loom Ltd* (Unreported, 30 October 2000) at p 9.
[261] *Sun Cheong Creative Development Holdings Ltd* (unreported, 20 October 2020).
[262] *ACL Asean Towers Holdco* (unreported, 2 January 2019).
[263] *Grand T G Gold Holdings Limited* (unreported, 22 August 2016) at para 8.
[264] *CW Group Holdings* (unreported, 3 August 2018).
[265] Unreported, 30 March 2021.

> adjourning the hearing for a short period to give the creditors proper notice of the adjourned hearing and an opportunity to appear at the adjourned hearing or file submissions, should they wish to do so…."

Notwithstanding the above, there are instances where the Court has appointed provisional liquidators on the application of the company despite the opposition of creditors.[266]

4.2.4.3 Appointment of provisional liquidators and their powers

Overview

If it is found that the statutory requirements for the appointment of provisional liquidators are met, the Court maintains a general discretion to "grant the provisional liquidators such powers as the Court considers necessary and appropriate to prevent such dissipation, misuse, mismanagement and misconduct and to ensure the Company's assets are properly protected pending the hearing of the winding up petition".[267]

Unlike the automatic statutory powers available to official liquidators following appointment,[268] a provisional liquidator's powers must be expressly granted by the terms of the appointment order.[269] To this end, the powers must be justified and tailored to meet the specific needs of the company. For example, if provisional liquidators are appointed for the purpose of completing a pre-packaged sale of the company's assets, it would make little sense to request that provisional liquidators have the power to borrow money. However, the Court may adjust or extend these powers "so as to respond to particular problems and needs identified by the [provisional liquidators] and changing circumstances".[270]

The usual effect of the appointment of provisional liquidators is that the board of directors becomes *functus officio*, save in relation to certain limited residual powers.[271] However, in accordance with the Court's broad discretionary power, it may be ordered that the directors retain particular or wider powers. Caution should be exercised to ensure that any retained powers are not unhelpful or damaging to the ability of the provisional liquidators to perform their duties.

Independence

As with official liquidators, it is important that provisional liquidators are, and have the appearance of being, independent.[272]

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[266] See *Mongolian Mining Corporation* (unreported, 7 July 2016) and *Abraaj Holdings* (unreported, 4 January 2019).
[267] *Natural Dairy (NZ) Holdings* (unreported, 7 June 2017) at para 5.
[268] Companies Act, s 110(2)(b).
[269] *Idem*, s 104(4).
[270] *Natural Dairy (NZ) Holdings Limited* (unreported, 7 June 2017) at para 5.
[271] See, eg, *Re Union Accident Insurance Co Ltd* [1972] 1 All ER 1105 at para 1113.
[272] *In re Parmalat Capital Fin Ltd* [2004] (5) CILR 22.

Limited investigatory power

There are also some limited investigatory powers that provisional liquidators may deploy to require certain relevant persons to provide information. In short, provisional liquidators may require these persons furnish statements as to the affairs of the company.[273] These statements are to be verified by way of a properly executed affidavit no later than 21 clear days following the request and should include:[274]

(a) particulars of the company's assets and liabilities, including contingent and prospective liabilities;

(b) the names and addresses of any 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) any further or other information that the official liquidator may require.

The provisional liquidators may release an individual from the obligation to furnish a statement and may also extend time for compliance, if required. If the provisional liquidators refuse to extend the time for compliance, the Court may do so.[275]

Court oversight

The Court will maintain oversight over the provisional liquidation to the extent it will hold regular hearings at which the provisional liquidators are required to report to the Court on progress.

4.2.4.4 Completion of the provisional liquidation

At the end of the provisional liquidation, the provisional liquidators can apply to have their appointment discontinued. The original petitioner may then apply to have the winding up petition withdrawn so that the company may continue to trade. Alternatively, the company may be put into liquidation.

[273] Companies Act, s 101.
[274] *Idem*, s 101(2).
[275] *Idem*, s 105(5).

4.2.5 Powers and duties of Official Liquidators (OLs)

4.2.5.1 Introduction

Provided the Court has jurisdiction, a company may be wound up voluntarily by order of the Court or under supervision of the Court.[276] For a detailed discussion on winding up orders see paragraph 4.2.2.

An official liquidator will be appointed to take control of a company from its directors if that company is being wound up by order of the Court, or under the supervision of the Court.[277] This is to be compared to a voluntary liquidator, the appointment of which is provided for separately under the voluntary winding up provisions.[278]

4.2.5.2 Who can be appointed?

An official liquidator must be a "qualified insolvency practitioner", which means a person who meets the various qualifications and requirements set by the Insolvency Rules Committee (pursuant to section 155 of the Companies Act) or possesses such other qualifications as the Court considers appropriate for the winding up of a company.[279]

The Insolvency Rules Committee produced the Insolvency Practitioners' Regulations 2018 (as amended) (the Regulations), which relevantly provide that a person is a qualified insolvency practitioner if they are:[280]

(a) licensed to act as an insolvency practitioner in England and Wales, Scotland, Northern Ireland, The Republic of Ireland, Australia, New Zealand, or Canada; or

(b) qualified as a professional accountant by an approved institute (as determined by the Cayman Islands Society of Professional Accountants), is in good standing with such institute, has a minimum of five years' relevant experience, and is credited with not less than 2,500 chargeable hours of relevant work.

However, in order to be appointed by the Court as an official liquidator, the Regulations provide that a qualified insolvency practitioner must also:

(a) be resident in the Cayman Islands and hold (either personally or through a business entity) a trade and business licence authorising him to carry on business as a professional insolvency practitioner;[281]

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[276] *Idem*, s 90.
[277] *Idem,* s 105(1).
[278] *Idem,* ss 116-130.
[279] *Idem,* s 89.
[280] Insolvency Practitioners' Regulations, reg 4, pt 2.
[281] *Idem*, reg 5, pt 2.

(b) be independent (within the meaning of regulation 6(2), part 2 of the Regulations); and

(c) hold professional indemnity insurance of at least USD 10,000,0000 in respect of each and every claim and at least USD 20,000,000 in the aggregate with a deductible of not more than USD 1,000,000 in respect of the negligent or non-performance of their duties as a liquidator.[282]

A foreign practitioner (that is, a person who is qualified under the law of a foreign country to perform functions equivalent to those performed by official liquidators) may be appointed to act in addition to, but not instead of, a qualified insolvency practitioner if they also satisfy the above-mentioned independence and insurance requirements.[283]

In the event no official liquidator is appointed, all property of the company will be in the custody of the Court.[284]

4.2.5.3 General function

The statutory function of the official liquidator is two-fold:[285]

(a) to collect, realise, and distribute the assets of the company to its creditors and, if there is a surplus, to those entitled to such surplus; and

(b) to report to the company's creditors and contributories upon the affairs of the company and the manner in which it has been wound up.

In order to assist with this dual recovery and reporting function, the Companies Act provides official liquidators with several broad investigatory and dispositive powers. These are discussed below.

4.2.5.4 Investigatory powers

Statement of affairs

The official liquidator should consider requiring relevant individuals to furnish statements as to the affairs of the company.[286] These statements are to be verified by way of a properly executed affidavit no later than 21 clear days following the request and should include the following:[287]

(a) the particulars of the company's assets and liabilities, including contingent and prospective liabilities;

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[282] *Idem*, reg 7, pt 2.
[283] Companies Act, s 108 and the Insolvency Practitioners' Regulations, reg 8, pt 2.
[284] Companies Act, s 105(2).
[285] *Idem*, s 110(1).
[286] *Idem*, s 101.
[287] *Idem*, s 101(2).

(b) the names and addresses of any 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 where respectively given; and

(g) any further or other information that the official liquidator may require.

The official liquidator may release an individual from the obligation to furnish a statement of affairs and may also extend time for compliance, if required. If the official liquidator refuses to extend the time for compliance, the Court may do so.[288]

An individual who fails to comply with a request to furnish a statement of affairs without reasonable excuse commits an offence and is liable on conviction to a fine of KYD 10,000.

Investigations

The official liquidator has broad investigative powers. This includes investigating the cause of the failure of the company (if applicable) and the promotion, business, dealings, and affairs of the company.[289] The results of these investigations may be reported to the Court at the official liquidator's discretion.

The official liquidator may also seek permission from the Court to: (a) assist the Authority or Royal Cayman Islands Police Service to investigate the conduct of certain directors, officers, professional service providers, and recent employees of the company;[290] and (b) institute and conduct a criminal prosecution of those same persons.

Subject to the prior approval of the company's creditors (if insolvent) or contributories (if solvent), the official liquidators may seek the whole or part of the costs of the investigation and prosecution in accordance with section 102(2) of the Companies Act.

Examinations

The official liquidator has the power to seek permission from the Court to examine certain persons and to demand delivery of any property or documents belonging to the company.[291]

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[288] *Idem,* s 105(5).
[289] *Idem,* s 102(1).
[290] *Idem*, s 102(2).
[291] *Idem*, s 103.

The official liquidator must make such an application id requested to do so by one-half (in value) of the company's creditors or contributories agree.[292]

If Court permission is granted, the examination may be ordered to take the form of an affidavit in answer to written interrogatories, and / or an oral examination at a specified time and place.[293]

Meeting of the company's creditors or contributories

The official liquidator must summon a meeting of the company's creditors (if the company is insolvent) or contributories (if the company is solvent) for the purpose of resolving any matters that the liquidator puts before the meeting no later than 28 days from when the winding up order was made.[294]

The requirement to summon this meeting may be disposed of or the time extended within which it must be summoned by court order.[295]

4.2.5.5 Dispositive powers

In addition to the investigatory powers, the official liquidator also possesses certain dispositive powers.[296] These are divided into powers that can only be exercised with the sanction of the Court (Part I Powers), specified in Part I of Schedule 3 of the Companies Act; and powers that can be exercised with or without sanction of the Court (Part II Powers), specified in Part II of Schedule 3 of the Companies Act.[297]

The purpose of this provision (and the powers contained therein) is to subject the OL to the general supervisory jurisdiction of the Court.[298] In respect of Part I Powers, the official liquidator must make what is known as a "sanction application" if they intend to use a power contained therein, irrespective of whether the intended use of that power is controversial. In respect of Part II Powers, the creditors or contributories may make a sanction application if they disapprove of the way in which the official liquidator has exercised or intends to exercise any of the powers contained therein, for which the OL does not necessarily need to seek sanction for in advance.[299]

The Court will generally not grant the OL blanket authority to exercise the Part I Powers, as it would risk usurping the Court's supervisory role and allow the official liquidator to exercise all the powers in any way they saw fit, unless the creditors of contributories made a sanction application of their own.[300]

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[292] *Idem,* s 103(4).
[293] *Idem*, s 103(5).
[294] *Idem,* s 105(3).
[295] *Idem,* s 105(4).
[296] *Idem*, s 110(2).
[297] *Idem*, Sch 3.
[298] *In Re UCF Fund* [2011] (1) CILR 305 at 309.
[299] *Idem*, s 103. Official liquidators will sometimes seek sanction to use Part II powers out of caution and to avoid future disputes in relation to their use.
[300] *In Re UCF Fund* [2011] (1) CILR 305.

The extent of the Court's ability to "control" the OL's use of the dispositive powers is vast and seemingly includes the ability to:

(a) direct the OL whether or not to exercise a power; or

(b) authorise the OL to exercise or refrain from exercising a power; and

(c) direct the OL to exercise a power in a particular way.[301]

But the Court must be careful not to substitute its own commercial judgment for that of the OL.

Part I Powers

The official liquidator may only exercise the powers set out below with the express sanction of the Court.[302] These are the power to:

(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;

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[301] Companies Act, s 110(3) and *Belmont Asset Based Lending Limited* [2011] (2) CILR 484 at para 492.
[302] Companies Act, s 110(2)(a).

(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

The official liquidator may exercise the powers below with or without the sanction of the Court.[303] These are the power to:

(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.

4.2.6 Resignation / removal of OLs

4.2.6.1 Resignation

Resignation of official liquidators is dealt with pursuant to Order 5 the Companies Winding Up Rules.

[303] *Idem,* s 110(2)(b).

If an official liquidator wishes to resign, they must take the following steps in accordance with Order 5, rule 4 of the Companies Winding Up Rules:

(1) Prepare a report and accounts.[304]

(a) The report must provide details and analysis of the steps taken and the further steps intended to be taken in the liquidation generally,[305] along with any other matters specified by the Companies Winding Up Rules, Order 10, rule 2(2). Depending on the timing of the OLs resignation, the report should cover the period since the date of the winding up order or the date of the OLs previous report.[306]

(b) The accounts must be presented in the currency of the liquidation and include:[307]

(i) the nature and estimated realisable value of the company's assets;

(ii) any security over the company's assets;

(iii) the nature and amount of the company's liabilities, including future and contingent liabilities;

(iv) the nature and amount of the company's income;

(v) the expenses of the liquidation;

(vi) the amount of liquidator's remuneration approved by the Court;

(vii) the work done by or on behalf the OL and the amount of remuneration claimed by them;

(viii) the distributions made to creditors and contributories; and

(ix) such other information which is required in order to provide the contributories or creditors with a proper understanding of the company's affairs and financial position.

(2) Give notice of their resignation to the company's liquidation committee.

(3) Apply to the Court for an order that they be released from the performance of any further duties. The application must be served on each member of the liquidation committee,

[304] CWR, O 5, r 4(4) - (5). This step is not required if there are joint official liquidators and one or more is remaining in office, including if a foreign practitioner is resigning.
[305] CWR, O 10, r 2(1)(a).
[306] *Idem*, O 10, r 2(2)(a).
[307] *Idem*, O 10, r 2(4).

counsel to the liquidation committee (if applicable), and any other creditors or contributories as directed by the Court.

The liquidation committee must nominate a qualified insolvency practitioner whom the Court can appoint to succeed the resigning liquidator.[308] Any nominees must swear an affidavit which states that:

(1) they are a qualified insolvency practitioner and meet the residency requirement contained in Regulation 5;

(2) having made due enquiries, they believe that they and their firm meet the independence requirement contained in Regulation 6;

(3) they or their firm are in compliance with the insurance requirement contained in Regulation 7; and

(4) they are willing to act as official liquidator if so appointed by the Court.

4.2.6.2 Removal

Section 107 of the Companies Act provides for the removal of official liquidators and states that "An official liquidator may be removed from office by order of the Court made on the application of a creditor or contributory of the company". Order 5 of the Companies Winding Up Rules is also relevant.

The only parties who may apply to remove an official liquidator are creditors (in the case of an insolvent liquidation) and contributories (in the case of a solvent liquidation) on the basis that they are the only parties with the ultimate interest in the distribution of the company's assets.[309] In particular, in *BTU Power Company*,[310] the Court found that a former director of a company did not have standing to apply for the removal of joint official liquidators and had no legitimate interest in doing so; only the preference shareholders had a legitimate interest as contributories in the solvent liquidation and the former directors' interests were adverse to the preference shareholders' interests.

To remove an official liquidator (and appoint a new one) a creditor or contributory must apply to the Court for the relevant orders by way of a summons (a Removal Summons)[311] supported by an affidavit setting out all of the facts and matters relied upon in relation to the removal application.[312] The Removal Summons must also nominate a qualified insolvency practitioner

[308] This step is not required if there are joint official liquidators and one or more is remaining in office, Companies Winding Up Rules 2018 (as amended), O 5, r 4(4), including if a foreign practitioner is resigning, O 5, r 4(5).
[309] *Johnson and Deloitte & Touche AG* [1997 CILR 120] and *BTU Power Company* 2019 (1) CILR Note 7.
[310] *BTU Power Company* 2019 (1) CILR Note 7.
[311] CWR, O 5 r 6 (1).
[312] *Idem*, O 5 r 6 (3).

who the Court can appoint in succession to the removed liquidator, and every person so nominated must swear an affidavit that complies with the requirements set out above.

The Removal Summons must be served upon the official liquidator, each member of the liquidation committee, counsel for the liquidation committee (if applicable), and any other creditors or contributories as directed by the Court.[313] The official liquidator must be given at least 14 days' notice of a Removal Summons.[314]

If the Court orders that the official liquidator is removed, then the removed official liquidator must:

(1) deliver to their successor the company's books and records and a copy of the liquidation files forthwith. The liquidation files are a complete record of all the work done and the steps taken in connection with the liquidation[315] and must contain:[316]

   (a) a duplicate of the Court file;

   (b) minutes of the meetings of creditors and / or contributories;

   (c) minutes of the meetings of the liquidation committee;

   (d) liquidator's reports;

   (e) liquidator's accounts;

   (f) proofs of debt and records relating to their adjudication;

   (g) records relating to the collection and realisation of the assets;

   (h) records relating to the liquidation bank accounts;

   (i) liquidator's correspondence; and

   (j) notices sent or published by the liquidator.

(2) prepare a report and accounts within 28 days, for which purpose they will be allowed unrestricted access to the company's books and records.[317]

[313] *Idem*, O 5 r 6 (2).
[314] *Idem*, O 5 r 6 (5).
[315] *Idem*, O 26 r 2 (1).
[316] *Idem*, O 26 r 2 (2).
[317] *Idem*, O 5 r 6 (6).

The Court has a broad discretion to remove official liquidators; however, good reason(s) must be demonstrated to remove the official liquidator.[318] For example, the Court may do so if it determines that the official liquidator has a conflict of interest, if the official liquidator pursues litigation against the wishes of a creditor, impropriety or misconduct,[319] and for failing to investigate matters such as misfeasance by former directors. A creditor's preference for an alternative liquidator, or being disgruntled, are generally not sufficient reasons.[320] However, the Court will consider removal if it will be for the general advantage of the majority of the persons interested in the liquidation.[321]

Self-Assessment Questions

Question 1

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

Question 2

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

Question 3

Explain the cash flow test for solvency.

Question 4

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

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.

Question 6

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

[318] *BTU Power Company* 2019 (1) CILR Note 7 and *AMP Enterprises Ltd (t/a Total Home Entertainment) v Hoffinan* [2002] BCC 996.
[319] *BTU Power Company* 2019 (1) CILR Note 7.
[320] *Ibid.*
[321] *Johnson and Deloitte & Touche AG* [1997 CILR 120].

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.

For feedback on these self-assessment questions, see the document "Comment and Feedback on Self-Assessment Questions", which is made available to you as a separate document

4.3 Official liquidation - post appointment actions and case management issues

4.3.1 Statutory post appointments requirements / notices

Notice requirements are contained within the Companies Act and the CWR.

The petitioner must, within two business days after the order is made, serve copies of the winding up order on the company at its registered office, every person who appeared and was heard at the hearing of the petition, the official liquidator, and the CIMA if the company is or was licensed to carry on a regulated business.

The official liquidator must attend to the following within seven business days of being appointed:

- file his order of appointment with the Cayman Islands Registrar of Companies (this is done electronically through the Cayman Island's Government Corporate Administration Platform (CAPs) portal);[322]

- send notice of the order to the Government Information Service (GIS) for publication in the next Cayman Islands Gazette (submission and payment of the notice is now completed online[323] and publication dates are listed on the GIS website).[324] If the petition was advertised in any other newspaper, then notice must also be published in that relevant newspaper;[325]

- send copies of the order to every person who has been a director or professional service provider of the company at the time that the petition was presented.

[322] CAPs can be accessed at https://cap.secure.ky/.
[323] See, eg, https://egazettes.gov.ky.
[324] See, eg, http://www.gazettes.gov.ky.
[325] Companies Act, s 98(b).

It should be noted that there are additional requirements when the winding up order is made in respect of a foreign company.[326]

Either concurrently with the above, but at least within 28 calendar days, the official liquidator is required to:

- give notice of his appointment to all creditors and contributories of the company of whom he is aware;
- publish notice of his appointment in the Cayman Islands Gazette and in whatever newspaper(s) the petition was advertised per the CWR Form Number 9; and
- in accordance with the determination of solvency, convene a first meeting of creditors / contributories, at which a required agenda item is the election of a liquidation committee.

Practically, when an official liquidator gives notice to the creditors of his appointment, the official liquidator should consider the most efficient and economical way to do so.

Whereas when giving notice to the contributories, the official liquidator should first refer to the company's governing documents, although the official liquidator retains the discretion to proceed in whichever manner they deem to be the most efficient and economic.

4.3.2 Stakeholder management

4.3.2.1 Creditors and contributory meetings

The determination of solvency will dictate whether or not an official liquidator is required to convene a meeting of creditors *versus* a meeting of contributories. The official liquidator is required to file a certificate in CWR Form Number 13 within 28 days of the date on which the winding up order was made, outlining the official liquidator's determination about the company's solvency.[327]

The rules are as follows, namely that if the official liquidator is:

- of the opinion that the company is insolvent, then he is required to convene a meeting of creditors only;
- of the opinion that the company is solvent, then he is required to convene a meeting of contributories only; and
- doubtful as to the solvency of the company, then both creditor and contributory meetings are to be held either concurrently or consecutively.

[326] CWR, O 3, r 23(5).
[327] *Idem*, O 8, r 1.

Unless otherwise directed by the court, the official liquidator is required to convene a first meeting within 28 calendar days from the date upon which the winding up order is made.

Thereafter, the official liquidator is statutorily required, at a minimum, to convene a meeting every year or else at a frequency that the official liquidator deems appropriate. An official liquidator can apply to the court to waive or reduce the frequency.

The court can also order the official liquidator to convene additional meetings and a creditor / contributory (as relevant) can also requisition the official liquidator to convene a meeting. The official liquidator must do so when the relevant thresholds noted at Order 8, rule 3 of the CWR have been met (that is, at the request of creditors and / or contributories).

The conduct of the meeting is set out in the CWR in respect of creditors and there are special rules governing a contributories' meeting (including quorum, notice, etcetera) which will be set out per the constitutional documents of the company (namely the articles of association).

The appointed chairperson is usually the official liquidator or else it will be someone appropriately qualified and authorised by the official liquidator to do so. Minutes of the meeting are to be prepared and circulated within 28 days of the meeting.

In order to vote at a creditors' meeting, the official liquidator may require a creditor to lodge a proof of debt.

A person is entitled to vote as a shareholder if he is recorded as a member of the company in its register of members, or if the official liquidator is satisfied that such person is liable to contribute to the assets of the company. The votes attributable to each shareholder will be in accordance with the company's articles of association.

A proxy may be appointed to vote on behalf of the creditor / contributory; however, there are requirements concerning the submission of the proxy. In the absence of a liquidation committee, creditors / contributories may be required to vote on matters including the liquidators' remuneration.

The quorum for a creditors' meeting is at least three creditors or all of the creditors if there are less than three in number. A vote is passed when a majority (in value) of those present and voting, in person or by proxy, have voted in favour of the resolution.

The quorum for a contributories' meeting is whatever number is specified in the company's articles of association as the quorum for a general meeting of the company. A vote is deemed to have been passed when a majority in value of those present and voting, in person or by proxy, have voted in favour of the resolution. The treatment of the votes will depend on whether the votes pertain to a voting shareholder (votes attributable per the company's articles of association) or a non-voting shareholder (based on the par value of the shares).

As discussed above, there are different voting thresholds in respect of voting on schemes of arrangement.[328]

4.3.2.2 Liquidation committee

The liquidation committee must be established unless the court orders otherwise. In practice the court has waived the requirement retrospectively.

The liquidation committee is a body representative of the company's stakeholders, formed to consult with the official liquidator. Whilst the court has inherent jurisdiction to deal with all matters relating to the winding up of the company, the liquidation committee is formed to balance the premise that the court will have regard to wishes of the creditors or contributories.[329]

The liquidation committee acts as a sounding board for the official liquidators and is statutorily required to review the official liquidators' remuneration.[330] In accordance with the Insolvency Practitioners' Regulations, the information to be provided to the liquidation committee is such that it will enable the liquidation committee to consider the reasonableness and appropriateness of the actions taken by the official liquidators and their resulting fees.

In order to discharge its duties, the liquidation committee will be privy to information that might not otherwise be available to the general body of stakeholders. In this regard, a prudent official liquidator may consider requiring the members of the liquidation committee to execute a non-disclosure agreement.

The liquidation committee consists of not less than three and no more than five members (six in circumstances of doubtful solvency)[331] and the eligibly requirements for the nature of the interest of committee members is contingent on the solvency determination made by the official liquidators.

The liquidation committee is to be elected at the first meeting. At a creditors' meeting, a resolution will be passed when a majority (in value) of those present and voting, in person or by proxy, have voted in favour of the resolution. Ordinarily, it will therefore be the largest creditors (by value) of the estate that are elected as liquidation committee members. The voting rules at a contributories' meeting differ per the CWR.[332]

Inherent to their eligibility to be a liquidation committee member, members will have an interest in the estate. It is incumbent on members of the liquidation committee to discharge their function in the best interest of stakeholders and in this regard they owe a fiduciary position to the liquidation estate.

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[328] See para .3.2.1 above in this regard.
[329] Companies Act, s 115.
[330] See para 4.3.2.3 below in this regard.
[331] It may not be possible for a liquidation committee to be established in these circumstances and the Court may retrospectively sanction the waiver of this requirement.
[332] CWR, O 8, r 9(3).

Where a member of the liquidation committee is conflicted, for example in respect of certain litigation being contemplated or pursued by the official liquidator, the member will be recused in dealing with matters arising from the same.

The liquidation committee may resolve to engage an attorney in respect of general or specific matters relating to the liquidation. The reasonable and proper fees and expenses of that attorney are an expense of the liquidation. Also, expenses incurred by the member of the liquidation committee (including travel, etcetera), in attending to matters of the liquidation, will be reimbursed by the official liquidator out of the assets of the company.

4.3.2.3 Liquidators' remuneration

In accordance with section 109(1) of the Companies Act, the expenses properly incurred in the winding up, including the remuneration of the official liquidator, are payable as an expense out of the company's assets in priority to all other claims (noting that there is a statutory order of priority in respect of expenses set out in the CWR Order 20).

The Insolvency Practitioners' Regulations, established by the Insolvency Rules Committee,[333] deals with an official liquidators' remuneration, including the basis of the remuneration and procedure to seek fee approval.

Prior to approval of an official liquidator's fees, an official liquidator may receive payment, out of the assets of the company, on account. This amount may not exceed 80% of the remuneration that will be sought for approval. Ultimately, should the court approve the official liquidator's remuneration at an amount less than what was drawn down by the official liquidator, the difference will need to be reimbursed to the liquidation estate.

As noted above, where a liquidation committee has been formed, it is a primary function of that committee to undertake a review of the remuneration incurred by the official liquidator.

The official liquidator will initially negotiate with the liquidation committee to arrive at the basis of his remuneration. The basis upon which an official liquidator may be remunerated is summarised as:

(a) time spent;

(b) a percentage of distributions;

(c) a percentage of net realisation;

(d) a fixed a fee; or

(e) a combination of the above.

[333] The rates were recently increased in 2022.

The terms of such an agreement will be documented in a remuneration agreement or protocol. Where a liquidation committee has not been formed or is incapable of being formed, the general body of stakeholders will have the same functions as a liquidation committee.

Prior to an official liquidator applying to the court for approval of the remuneration incurred, the official liquidator is required to first seek approval from the liquidation committee, whereafter the official liquidator can apply to the court. Where there is support from the liquidation committee (and the application is unopposed), the court may deal with fee applications administratively, without the need of a hearing.

A liquidation committee, or stakeholder, may apply to the court to oppose the remuneration application. The burden lies with the official liquidator to justify his fees and to meet any challenge. The test that the Court will apply is that of a reasonable person. That is, the Court will consider whether the official liquidator took actions that no reasonable person, acting reasonably, would have taken.[334]

It is important for an official liquidator to have a good working relationship with the liquidation committee.

4.3.3 Liquidator oversight

4.3.3.1 Reports and accounts

One of the functions of an official liquidator is to report to the following parties / groups:

- relevant stakeholders:
    - creditors (where the company is determined to be insolvent / doubtful solvency); or
    - contributories (where the company is regarded as insolvent or as being of doubtful solvency);
- the liquidation committee;
- the Court; and
- CIMA (where the company carried on a regulated business).

The court can direct, or creditors / contributories can request,[335] the official liquidators to prepare and issue a report, but alternatively the reporting timeframes are set out in the CWR (and the minimum period is annually). It should be noted that:

[334] See the decisions *In the Matter of Herald Fund SPC (in official liquidation)* (FSD 27 of 2013 (IKJ)) (Unreported, 1 April 2021) and *In the matter of the Sphinx Group of Companies (in official liquidation)* [2017 (1) CILR 176].

[335] CWR, O 8, r 3 provides that a creditor or contributor can requisition a meeting, and if one is so convened the official liquidator may prepare a report per CWR, O 10, r 1(3).

- a meeting is to be convened within 28 days of the winding up order, and at this meeting a report is to be issued; and

- once a liquidation committee has been established, a written report must be issued and a first meeting must be convened within three months.

The form and minimum content of the reports and accounts are set out in Order 10, rule 2 of the CWR.

4.3.3.2 Sanction applications

Order 11 of the CWR details the service requirements, hearing and evidential requirements that govern sanction applications.

As set out in paragraph 4.2.5 above, certain of an official liquidator's powers are only exercisable with sanction[336] and others can be exercised by the official liquidator without sanction.[337]

Often, where it is appropriate to do so, the Court will grant the official liquidators certain additional powers as part of the initial order of appointment without the need for further sanction applications. However, if this has not been done, the official liquidator will need to apply to the Court for these additional powers.

A creditor or contributory also has the standing to bring a sanction application, directing the official liquidator to exercise or refrain from exercising a power in a particular way.

In approving a sanction application or otherwise, the court will consider the official liquidator's views and also those of other stakeholders with a "real interest". Whilst weight is placed on the views of the official liquidators (as independent office holders they are usually best placed to make an informed view), the set of circumstances involved in the application may result in the Court giving greater weight to other factors.

Costs in liquidation proceedings are governed by the Companies Winding Up Rules, Order 24, rules 7 to 11. The costs specifically related to sanction applications[338] brought or opposed by the liquidator, contributory or creditor, as well as the liquidation committee's costs of participating, are addressed in the Companies Winding Up Rules, Order 24, rule 9.

Ordinarily, the official liquidator's costs relating to the sanction application will be paid out of the assets of the estate, unless the application is opposed and the Court is satisfied that that the application should not have been made by the official liquidator, the directions sought were wholly unreasonable, or the official liquidator misled the Court or acted improperly in connection with the application. This same approach is also applied to any costs incurred by

[336] Companies Act, Sch 3, Part I.
[337] *Idem*, Sch 3, Part II. Also see the discussion in para 4.4 below.
[338] This includes any sanction application under Order 11 of the CWR, including any application for the approval of the official liquidator's remuneration.

liquidation committee, so long as the committee's participation in the application was useful and did not unreasonably duplicate the costs incurred by the official liquidator.

The general rule, where a sanction application has been successfully made or opposed by a creditor or contributory, is that the creditor or contributory should be paid out of the assets of the company with the costs to be taxed on an indemnity basis unless agreed with the official liquidator. However, no order for costs will be made against an unsuccessful creditor or contributory unless the Court determines that the position taken by the creditor or contributory was wholly unreasonable, or misled the Court or they otherwise acted improperly in connection with the application. As for costs of applications made in liquidation proceedings which are not covered by the special costs rules set out in the Companies Winding Up Rules, costs are determined by the general costs rules under Order 62 of the Grand Court Rules.[339] The Cayman Islands legal system's general approach to litigation costs awards under Order 62 is the "loser pays" principle.[340] The loser pays principal at a high level means that the loser pays a portion (to be taxed on a standard basis if not agreed)[341] of the winning party's costs.

4.3.3.3 Legal costs – Order 25

There are statutory requirements governing the official liquidator's engagement of attorneys.

The starting point is that an official liquidator must obtain sanction to engage attorneys (including foreign attorneys), with all engagements having to comply with Order 25 of the CWR.

Legal fees properly and reasonably incurred are an expense of the liquidation. Payment of legal fees does not require sanction of the Court, as compared to the official liquidator's fees; however, there is a process of taxation that can be commenced by the official liquidator if he considers that the fees charged are excessive. Conversely, the attorneys may require their bill of costs to be taxed.

This should be particularly considered in the context of litigation funding agreements.[342]

4.3.4 Assets

4.3.4.1 Collection and distribution of assets – overview

The purpose of an official liquidation is to wind up the company and distribute its assets to its creditors and shareholders.

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[339] See *In the Matter of Performance Insurance Company SPC (in official liquidation)* (FSD 70 of 2021 (RPJ) (Unreported, 29 December 2022) paras. 11 and 12.

[340] See Grand Court Rules, Order 62, r 4(5).

[341] The Court could make an order for indemnity costs if the paying party conducted the proceedings unreasonably, negligently, or improperly. See *In the Matter of Performance Insurance Company SPC (in official liquidation)* (FSD 70 of 2021 (RPJ) (Unreported, 29 December 2022) para. 15.

[342] See the discussion in para 2.4 above.

As set out in paragraph 4.3.4 above, official liquidators may, with sanction of the Court, sell the assets of the company.

> "The primary duty of a liquidator when selling assets of a company is to take reasonable care to obtain the best price available in the circumstances… taking into account the nature of the business to be sold the relevant market, the steps taken to market and sell the assets and the urgency of the sale".[343]

A robust sales process will support the application to the Court, particularly when the application is challenged; however, the Court retains the ultimate discretion concerning the sale of a company's assets.

4.3.5 Distributions

4.3.5.1 Proof of debt process and the quantification of claims

The process for proving debts is set out in Order 16, rules 1 to 8 of the CWR.

It is the duty of the official liquidator to adjudicate putative creditor claims. During the adjudication process the official liquidator acts in a *quasi*-judicial capacity.[344]

The procedure for proving, in part, will depend on the determined solvency of the company.

In circumstances where the company has been determined by the official liquidator to be solvent, the requirement to lodge a proof of debt is at the official liquidator's discretion; however, ordinarily the official liquidator will pay the debts as and when they arise, in the currency of the obligation, without the need of a proof of debt.

In contrast, where a company is insolvent or of doubtful solvency, the official liquidator will ordinarily require a proof of debt to submitted. The form of the proof may take the form of Form Number 24 of the CWR or as otherwise determined by the official liquidator.

Official liquidators and the Court have been seen to take a pragmatic approach to proving process. Upon a successful sanction application, the Court has allowed official liquidators to vary, or to dispense with, the proof of debt process which is contemplated under the CWR.[345]

There are special rules concerning the proving of claims of depositors in the liquidation of a licensed bank.[346]

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[343] *Trident Microsystems (Far East) Limited* [2012 (1) CILR 424].
[344] CWR, O 16, r 1(4).
[345] See, eg, *In the Matter of Premier Assurance Group SPC Ltd (in official liquidation)* (FSD 264 of 2020) (ASCJ) (unreported, 10 September 2021).
[346] CWR, O 16, r 7.

The cost of the official liquidator's fees involved in the adjudication process will be borne by the liquidation estate (and therefore the general body of creditors). The respective putative creditors will bear their own costs.

Upon the official liquidator's adjudication of the creditors' claim, the official liquidator will notify the party that either the proof has been:

- admitted in full (notice is by way of Form Number 25 of the CWR); or
- rejected in full or in part (notice is by way of Form Number 26 of the CWR).

If putative creditor are dissatisfied with the adjudication by the official liquidators, they may appeal to the Court for the decision to be reversed or varied.[347]

The appeal of a proof of debt will be treated as a *de novo* adjudication of the creditor's proof of claim and the creditor may rely upon additional evidence in support of its claim, notwithstanding that it failed to make such evidence available to the official liquidator.[348]

The burden of proof rests on the putative creditor to provide evidence to satisfy the Court that, on the balance of probabilities, its alleged debts are founded on real debts of the company and if so, in what amount.[349]

All claims against the company, whether present or future, certain or contingent, ascertained or sounding only in damages, are admissible to proof against the company.[350]

For contingent claims, the official liquidator must adjudicate and arrive at an estimate, as far as is possible, of the value of such debts or claim. Practically this allows for the appropriate reserves to be made in respect of the claim or for the purposes of voting.

This estimate may be revisited by the official liquidator in light of further information.

Upon adjudication of a contingent claim, the official liquidator will issue a notice by way of Form Number 29 of the CWR. In the usual way, should the creditor be dissatisfied with the estimate it may apply to the Court to have the estimate reversed or varied.

Notwithstanding that a claim has been admitted by an official liquidator, the Court has the jurisdiction to expunge or reduce an admitted claim. The official liquidator may apply to court to vary or expunge the admitted claim on the basis that information has come to the official liquidator's attention which was not available to him at the time of admitting the claim. A

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[347] *Idem*, O 16, rr 17 to 16 cover the applicable procedures.
[348] *Bhatti and Sons Incorporated and Libpak Incorporated v Wigh, Pilling and Mackey (Liquidators of Bank of Credit and Commerce International (Overseas) Ltd) (in liquidation)* [2003] CILR 160.
[349] *In the Matter of Midland Acres Limited* (FSD 88 of 2017 (RPJ)) (unreported, 19 January 2022).
[350] Companies Act, s 139(1).

contributory or an admitted creditor, subject to certain thresholds, may apply to expunge a claim. Such applications may be commenced by summons in Form Number 31 of the CWR.

4.3.5.2 Settling lists of contributories and rectification of the register

Section 112(1) of the Companies Act, together with Order 12 of the CWR, deals with the settlement of the list of contributories. An official liquidator is required to settle the list of the contributories for the purpose of identifying those members:

- liable to contribute to the assets of the company (and their respective contributions);[351] and
- entitled to participate in the distribution of surplus assets (and the amount of their respective entitlements).[352]

In respect of the first point above, it is possible for a company to issue shares that will be paid for at a future date. Accordingly, during a liquidation, a call can be made on contributories for unpaid share capital to ensure that losses suffered by the company and all profits earned by the company are distributed rateably among all the members, in proportion to the amounts subscribed for and not the amounts paid up. Inherent to this process is the power to make calls on contributories, which is vested in the Court.

In order to determine the amount that each contributory is liable to contribute, the register of members should be reviewed or, in the absence of a reliable register of members, the official liquidator should have regard to the subscription / offering memorandum to verify the amounts payable and the financials / bank statements to the amounts actually paid.

Section 112(2) of the Companies Act also provides for the rectification of the register of members. This applies where (i) a company has issued redeemable shares at prices based upon its net asset value from time to time, and (ii) the company is or will become solvent. The CWR limits the power to rectify the register to circumstances where the company has issued or redeemed shares based upon a misstated net asset value which is not binding on the company and its members by reason of fraud[353] or default.

Where an official liquidator has the jurisdiction to rectify the register, he will do so by determining the true net asset value of the company at the relevant dates in accordance with the principles contained in the company's articles of association or, if none is prescribed, then the applicable rectification methodology is to be determined by the official liquidator. The methodology is, however, capable of challenge as the rectification procedural process requires

[351] The official liquidator is only required to do this in circumstances that the company is incorporated on the basis that its members' liability is unlimited or is limited by guarantee, or it appears to him that the company has issued partly paid shares.

[352] Time and costs should only be incurred when the official liquidator is satisfied that the company is, or will be, solvent.

[353] The fraud or default must be as between the company and its members, as opposed to an external fraud, which would have the effect of vitiating the contract between these parties.

that the official liquidator serves a notice[354] on the respective contributories which confirms a contributories' rights of appeal.

Where an investment fund has been impacted by internal fraud, prior to rectifying the register the official liquidator should consider whether it is practical, cost effective and equitable to do so.

4.3.5.3 Order of payment priority from the liquidation estate

The order of payment priority to be observed in an official liquidation is as follows:[355]

- firstly, in satisfaction of the rights of fixed charge creditors;[356]
- secondly, in satisfaction of the claims of preferred creditors;[357]
- thirdly, in satisfaction of the claims of holders of debentures secured by, or holders of any floating charge;[358]
- fourthly, in paying the expenses of the liquidation;[359]
- fifthly, in satisfaction of ordinary unsecured creditors (who are not existing or former shareholders);[360]
- sixthly, in satisfaction of non-provable debts;
- seventhly, in paying statutory interest on the proved debts;[361]
- eighthly, in satisfaction of creditors which are subordinated;[362]
- ninthly, in paying statutory interest on the subordinated debts;[363] and

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354 The notice should be in the prescribed form, being Form No 17 of the CWR.
355 Labour Act (2021 Revision), s 40(2) provides that "[i]n the case of the bankruptcy or winding up of an employer any liability for severance pay shall be paid in priority to all other debts, secured or unsecured, and shall be paid in full unless the property available is insufficient to meet them".
356 Companies Act, s 140(2). This priority is listed in the waterfall for the avoidance of doubt. Strictly speaking the assets, which are the subject of a valid fixed charge, do not form the assets of the liquidation estate and therefore cannot be dealt with by the official liquidator without the express consent of the relevant secured creditor.
357 *Ibid*.
358 *Idem*, s 141(2)(b).
359 *Idem*, s 109(1).
360 *Idem*, s 140(1).
361 *Idem*, s 149(2).
362 *Idem*, ss 37(7) and 49(g). See also *Pearson v Primeo Fund* [2017] UKPC 19.
363 *In the Matter of Herald Fund SPC (in official liquidation)* [2018] (2) CILR 162.

- tenthly, in returning capital to shareholders in respect of their rights and interests in the company as at the commencement of the winding up.[364]

The above priority waterfall is dealt with below in more detail.

4.3.5.4 Secured creditors

A creditor with a valid security interest over whole or part of a company's assets is entitled to enforce its security without reference to the company's liquidator[365] and without the leave of the Grand Court. That is, upon the winding up of the company the automatic stay pursuant to section 97 of the Companies Act does not impact the enforcement rights of a secured creditor. The rights of the secured creditor remain unaffected by the liquidation process and will continue to be subject to the terms of the relevant security agreement.

A secured creditor whose debt is more than the value of its security may claim in the liquidation for the unsecured balance. In such circumstances, the proof of debt submitted by the secured creditor should state the particulars of the security and the value placed on the security.

It is important to differentiate between fixed and floating charges, as this will affect the order of priority where there are insufficient assets to make payment to all preferential debts. In this regard, as noted in the priority waterfall above, preferred creditors rank ahead of secured creditors with a floating charge.

4.3.5.4 Preferential creditors

Per section 141 of the Companies Act, relevant to an insolvent liquidation, there are debts of the liquidation estate that are to be paid in priority to all other debts. These preferential debts rank equally in respect of the order of payment. If available funds are insufficient to satisfy them in full, they abate in equal proportions.

The categories of preferred debts are set out in Schedule 2 of the Companies Act. These categories can be summarised as follows:

- debts due to employees (this encompasses certain employee claims regardless of whether employed in the Cayman Islands or elsewhere);

- debts due to bank depositors (applicable in the liquidation of certain licenced banks incorporated in the Cayman Islands); and

- taxes due to the Government (limited to taxes owed to the Cayman Islands government and its *quasi*-governmental bodies).

[364] Companies Act, s 140(1).
[365] *Idem*, s 142(1).

4.3.5.5 Expenses of the liquidation

The expenses of the liquidation are the costs reasonably and properly incurred when placing the company into liquidation and during the administration of the liquidation.

The expenses of the liquidation are payable out of the assets of the company in priority to all other claims. The priority of such expenses is set out in Order 20 of the CWR.

4.3.5.6 Ordinary unsecured creditors

The basic rule is that property of the company must be applied in satisfaction of its liabilities *pari passu*, with the significant *caveats* providing that effect must first be given to the rights of secured and preferred creditors, subject to any subordination agreement or set-off.

4.3.5.7 Subordinated and deferred debts

Creditors may agree to a subordination or deferment of their claims in a winding up prior to the commencement of the liquidation. Any such agreement is likely to be binding on the company and, as a consequence, will be enforced by the official liquidator.

In addition to contractual arrangements, there are express statutory provisions which defer certain debts and which has the effect of subordinating the right of payment to the other liabilities of the company.

An example of a statutorily deferred debt is a claim by a company's member, or former member, in its capacity as such pursuant to section 49 of the Companies Act.

As confirmed by the Privy Council's decision in *Michael Pearson (as additional liquidator of Herald Fund SPC (in official liquidation)) v Primeo Fund (in official liquidation)*[366] unpaid redemption proceeds are a provable claim[367] in circumstances where a member, prior to the commencement of the winding up, has redeemed his shares in accordance with the company's governing documents (Redemption Creditor). On the basis that the Redemption Creditor's claims originate from the member's shareholding interest in the company, the claim will rank behind the claims of ordinary unsecured creditors.[368]

The important point to highlight here is that in order for a claim for unpaid redemption proceeds to be classified as a provable debt, the redemption must be complete as prescribed by the company's governing documents prior to the commencement of the liquidation. If the redemption process is not complete, the member will have an accrued right to redeem his shares which would need to be considered in the context of section 37(7) of the Companies Act (Shareholder Claims).

[366] [2017] UKPC 19.
[367] *Idem*, s 139.
[368] *Idem*, s 49(g).

The priorities as between Redemption Creditor claims and Shareholder Claims is not settled law. By way of an *obiter dictum*, the Privy Council[369] considered that Redemption Creditor claims would be in priority to, or *pari passu* with, Shareholder Claims. It was however undisputed that both claim types will rank behind the claims of ordinary unsecured creditors.

4.3.5.8 Interest on debts

Section 149 of the Companies Act and Order 16 of the CWR specifically provide that where the company is solvent, creditors of a company in liquidation who have been kept out of their money should be paid interest on their claims before any sums are paid to shareholders.

The Companies Act and the CWR distinguish between pre- and post-liquidation interest. A creditor is entitled to pre-liquidation interest in so far as the creditor had a pre-liquidation contractual right[370] to interest. Comparatively, in respect to post-liquidation interest, a creditor has an automatic entitlement to statutory interest.

All creditors of a company, including Redemption Creditors,[371] are entitled to statutory interest. There is a *pari passu* right to interest irrespective of whether the debts on which it is payable ranked equally[372] (except for such statutory interest amounts which are associated with subordinated debts under sections 37(7) and 49(g) of the Companies Act, which statutory interest amounts are also subordinated).[373]

The rate at which post-liquidation interest is calculated is the greater of the statutory interest rate or the contractual rate of interest that would be applicable to the debt, notwithstanding the winding up.

The statutory interest rates are prescribed in the Judgment Debts (Rates of Interest) Rules (made under section 34 of the Judicature Act (2021 Revision)). The relevant rate will be in the currency of the liquidation[374] as determined by the official liquidator.

4.3.5.9 Existing contracts, netting, set-off and subordination

From a Cayman Islands law perspective, upon the liquidation of a Cayman company, a valid contractual arrangement will not be automatically terminated, unless there is a provision contained within the contract that automatically terminates the contract (or otherwise entitles the contractual counterparty to terminate or modify the contact).

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369 In *Pearson v Primeo Fund* [2017] UKPC 19.

370 The prescribed form of the proof of debt, Form No 24 of the CWR, includes field for creditors to detail their contractual right to interest.

371 *In the Matter of Herald Fund SPC (in official liquidation)* [2018] (2) CILR 162.

372 Companies Act, s149(3).

373 *In the Matter of Herald Fund SPC (in official liquidation)* [2018] (2) CILR 162.

374 The official liquidator's determination is filed with the Court and certified in the prescribed form: Form No 28 of the CWR.

Underpinning this law is the public policy of freedom of contract, so that notwithstanding the liquidation process, there is certainty in contractual[375] dealings.

Further, an official liquidator, of a Cayman domiciled company, does not have the inherent statutory power to disclaim or affirm contracts ("cherry pick"). As a result, practically upon appointment the official liquidator will need to make an assessment of such contracts (that is, perform the obligations in accordance with the contract or else repudiate the contract).

By extension, provisions contained in a contract relating to subordination, deferral or set-off agreed between a company and a creditor prior to liquidation are likely to be binding on the company and therefore enforceable by the official liquidator. Save for subordination, these matters relate to quantification of a claim and are not priority considerations.

In addition to contractual rights, there is a statutory presumption of set-off: "in the absence of any contractual right of set-off or non-set-off, an account shall be taken on what is due from each party to the other… and the sums due from party shall be set-off against sums due from the other".[376]

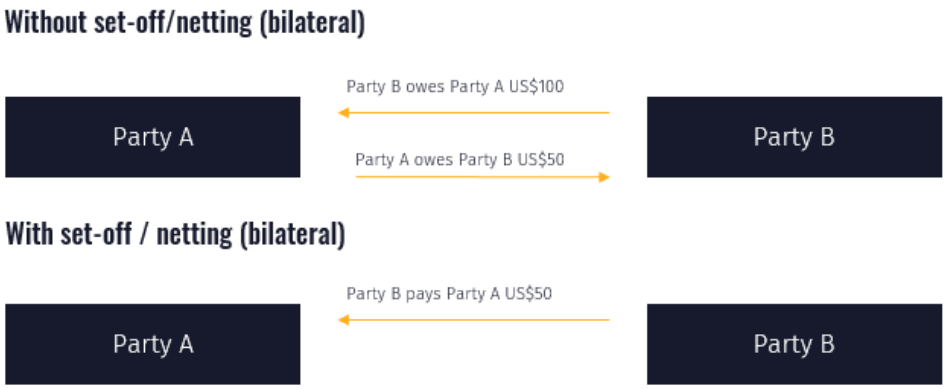
The conditions that must be present for the automatic insolvency set-off are that:

- the claim must be admissible to proof at the relevant time;
- there must have been mutual credits and mutual debits or other mutual dealings between the parties; and
- the mutual dealings must have taken place before the company goes into liquidation (and before the party had notice that a petition and been presented).

Practically, where set-off / netting applies, an account will be taken of what the company owes to the creditor and *vice versa* (calculated at the commencement of the liquidation) and balance after the set-off will be paid to the party to whom it is due.

The following diagram details the effect of the netting / set-off adjustments:

[375] Setting-off provisions are common in respect of banking, derivative, capital markets and structured finance transactions.
[376] Companies Act, s 140(3).



As can be seen in the above diagram where there is no set-off / netting each claim is dealt with separately, whereas set-off / netting provides for the consolidation of the respective liabilities so that only the net difference will be taken into account. The Cayman Islands law also allow for multilateral set-off.

When assessing adjustments, due regard should be given to the provisions of the Companies Act relating to fraudulent preferences and dispositions at an undervalue.

Self-Assessment Questions

Question 1

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

Question 2

What is the statutory function of a liquidation committee?

Question 3

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

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.

For feedback on these self-assessment questions, see the document "Comment and Feedback on Self-Assessment Questions", which is made available to you as a separate document

4.4 Official liquidation – investigations and legal claims

As discussed in the previous section, the purpose of the official liquidation procedure is to wind up a company by collecting in and liquidating its free assets and distributing the proceeds to unsecured creditors (and, if the company is solvent, shareholders). Such assets include any claims that the estate has against the company's officers or third parties.

The liquidators' powers to conduct investigations and bring legal proceedings in the name and on behalf of the company,[377] and their power to make any compromise or settlement with creditors or persons claiming to be creditors, or having or alleging to have any claim against the company,[378] are prescribed by the Companies Act (which are referred to as so-called "Part 1 powers", as distinct from Part II Powers which are exercisable without sanction of the Court and include, for example, the power to convene meetings of creditors and collect in the property of the company).[379] The court will not give "blanket authority" for the exercise of Part I powers and a sanction application ought to be made each time that an official liquidator wishes to exercise a Part 1 power (insofar as the exercise of that power is not authorised by the terms of his appointment order). Any application needs to be based on specific circumstances or transactions in which the exercise of the relevant power(s) is appropriate, and needs to be supported by relevant evidence.[380]

The court has provided guidance as to the distinction between the approach that the court will take when reviewing the appropriateness of a liquidator's exercise of Part I and Part II powers.

Where a court is asked to review the exercise of power by an official liquidator which he is entitled to take without court sanction,[381] the court should only interfere if the official liquidator is not acting *bona fide* or if his decision is one which no reasonable liquidator could take in the circumstances of the case.[382]

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[377] *Idem*, Sch 3, Part 1, para 1.
[378] *Idem*, Sch 3, Part 1, para 5.
[379] *Idem*, Sch 3, Part 1, s 110(2)(a).
[380] *In the matter of UCF Fund Limited* [2011(1) CILR 305] cited recently in *Re Jian Ying Ourgame High Growth Investment Fund (in provisional liquidation)* (FSD 90 of 2021, unreported, Doyle J, 16 September 2021) at para 31, and endorsed in *Re GTI Holdings Limited*, (FSD 102 of 2022, unreported, Doyle J, 15 March 2022) at para 78, clarifying that (i) the liquidators must be able to demonstrate that the Part 1 powers for which sanction is sought must be specific powers that are necessary in the particular circumstances of the case, and (ii) it is inappropriate and wrong in principles for the Court to authorise a liquidator to exercise all Part 1 powers as the liquidator sees fit without further reference to the Court, simply on the basis that it might become appropriate to exercise such powers.
[381] Companies Act, Sch 3, Part II, s 110(2)(b).
[382] *Re ICP Strategic Credit Income Fund Limited and ICP Strategic Credit Income Mater Fund Limited* [2014 (1) CILR 314], where Jones J cited the English Court of Appeal in *Re Greenhaven Motors Ltd* [1999] 1 BCLC 635.

Where a court is asked to authorise the exercise of a power by an official liquidator which requires the sanction of the court,[383] the court must consider all the relevant evidence.[384] In order for the court to sanction the exercise of the proposed Part 1 power, it must be satisfied that the transaction is in the commercial best interests of the company – reflected *prima facie* by the commercial judgment of the liquidator.[385] The court will give the liquidators' views considerable weight unless the evidence reveals substantial reasons for not doing so,[386] as the court recognises that the liquidators are usually in the best position to take an informed and objective view.[387]

The procedure and relevant legal tests specific to applications sanctioning the commencement of litigation and / or entering into settlements, are dealt with in further detail below at paragraph 4.4.3.5.

4.4.1 Investigations

Section 102 of the Companies Act bestows upon the official liquidator certain investigative powers. A liquidator is an officer of the court and is required to "make himself thoroughly acquainted with the affairs of the company; and to suppress nothing, and to conceal nothing, which has come to his knowledge in the course of his investigation, which is material to ascertain the exact truth in every case before the Court".[388]

Section 102(1) empowers the liquidator to investigate:

(a) if the company has failed, the causes of the failure; and

(b) generally, the promotion, business, dealings and affairs of the company,

and to make such report, if any, to the court as the liquidator thinks fit.

In addition, subject to obtaining directions of the court, the liquidator has the power to assist the CIMA and the Royal Cayman Islands Police Service to investigate the conduct of persons, and institute and conduct a criminal prosecution of persons referred to in section 101(3) of the Companies Act (these persons are listed and discussed in the section below).[389]

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[383] Companies Act, Sch 3, Part I, s 110(2)(b).
[384] *Re DD Growth Premium 2X Fund* [2013 (2) CILR 361 at 371] at para 30 citing *Universal & Surety Co Ltd* [1992-93 CILR at 152]. In this regard, also see the discussion in para 4.3.3.2 above.
[385] *Idem*, citing *Re Edennote Ltd* (No 2) [1997] 2 BCLC at 89.
[386] *Idem*, citing *Re Edennote Ltd* (No 2) [1997] 2 BCLC at 92. See also *In the matter of Pacific Harbor Asia Fund I Ltd (in Official Liquidation)* (FSD 139 of 2017, unreported, McMillan J, 6 May 2020) where the Court declined to sanction a sale which had been recommended by the liquidators, due to deficiencies in the sale process.
[387] *Idem,* citing *Re Greenhaven Motors Ltd* [1999] I BCLC at 643.
[388] *Gooch's Case* 1872, 7 Ch App 207, applied in Cayman Islands in *In the Matter of Citrico International Limited* [2004-05 CILR 435].
[389] Companies Act, s 102(2).

Section 102(3) of the Companies Act states that:

> "Subject to obtaining the prior approval of the company's creditors, if it is insolvent, or its contributories, if it is solvent, the directions given under s 102(2) may include a direction that the whole or part of the costs of investigation and prosecution be paid out of the assets of the company."

4.4.1.1 Statement of affairs, practical issues regarding service of a section 101 notice

Pursuant to section 101(1) of the Companies Act, where a winding up order has been made, a liquidator can require some or all of the persons identified in section 101(3) of the Act to prepare and submit a statement in the prescribed form as to the affairs of the company.

The persons listed in section 101(3) of the Companies Act from whom a statement of affairs can be required are existing or former:

(a) directors or officers of the company;

(b) professional service providers to the company; and

(c) employees of the company, during the period of one year immediately preceding the relevant date.

In relation to category (b), professional service providers have been found not to include auditors as they are independent and unable to provide general administrative services. The statutory power has been held to have been intended "to apply only to those who were involved in the company's promotion / management".[390]

For the purposes of section 101 of the Companies Act in the context of an official liquidation (noting that this section also applies to provisional liquidators), the "relevant date" (mentioned in category (c) above) means the commencement of the winding up. In many cases, this is the presentation of the winding up petition. However, subject to section 100(1) this may be an earlier date if, before the presentation of a petition for the winding up of a company by the court, (i) a resolution was passed by the company for voluntary winding up, (ii) any period fixed for the duration of the company by the articles of association has expired, (iii) an event giving rise to a requirement to wind up the company in the articles of association has occurred, or (iv) a restructuring officer has been appointed, then the winding up is deemed to have commenced at the time of the relevant aforementioned event.[391]

[390] *In the Matter of ICP Strategic Credit Income Fund Limited* [2012 (1) CILR 383].
[391] Companies Act, s 7.

A liquidator who requires a person to provide a statement of affairs must give notice and a recipient of the relevant notice is required by section 101(4) of the Companies Act to comply within 21 days of the said notice being served on such person.[392]

The rules of service prescribed by the Grand Court Rules[393] apply to service of documents required to be served under the CWR.[394] Thus whilst the default position is that a section 101-notice should be served personally on the intended recipient, an order for substituted service may be granted if there is a practical impossibility of personal service.[395]

There is a duty to comply with a liquidator's request for a statement of affairs, and a person who, without reasonable cause, fails to comply commits an offence and is liable on conviction to a fine of KYD 10,000.

In relation to the form and content of a statement of affairs, it must be verified by an affidavit sworn by the persons required to submit it and show:

(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.[396]

4.4.1.2 Order for examination of relevant persons

Section 103(3) of the Companies Act 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:

(a) for the examination of any relevant person; or

[392] *Idem*, s 101(5) provides that a liquidator may release a person from the s 101(1) obligation or may extend the time for compliance. The Court may also extend the time for compliance in the event that a liquidator refuses to do so.
[393] Grand Court Rules, O 10 and O 65.
[394] CWR, O 1, r 4(1).
[395] Grand Court Rules, O 65, r 4(1) and see *Saad* v *AHAB* [2010 (2) CILR 422].
[396] Companies Act, s 101(2).

(b) that a relevant person transfer or deliver up to the liquidator any property or documents belonging to the company.

Section 103(2) of the Companies Act imposes a duty on every relevant person to co-operate with the official liquidator.

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; or

(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.[397]

In relation to professional service providers, as set out in relation to section 101(3) of the Companies Act above, section 103(1)(c) does not encompass auditors who are considered independent and unable to provide general administrative services.[398] Moreover, the Cayman Islands Court of Appeal has confirmed that this provision must be used for the purposes of the liquidation and the fulfilment of a liquidator's statutory duties only. It should not be used by a liquidator to obtain documents in order to comply with a company's discovery obligations in litigation against a third party.[399]

In addition to an application made by the official liquidator of his own volition, where requested to do so by one-half, in value, of the company's creditors or contributories, the official liquidator must make an application in accordance with section 103(3), unless the Court orders otherwise.

On an application for an examination made in accordance with section 103(3)(a), the court may order that a relevant person swear an affidavit in answer to written interrogatories and / or attend for oral examination by the official liquidator at a specified time and place.[400] The court may also direct that any creditor or contributory of the company be permitted by the official liquidator to participate in an oral examination.[401]

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[397] *Idem*, s 103(1).
[398] *ICP Strategic Credit Income Fund Limited* [2012 (1) CILR 383] and *In the matter of Primeo Fund (in official liquidation)* [2016 (2) CILR 402].
[399] *In the matter of Primeo Fund (in liquidation)* [2016 (2) CILR 386].
[400] Companies Act, s 103(5).
[401] *Idem,* subs (6).

The court's jurisdiction to make an order under section 103 of the Companies Act extends to relevant persons resident outside of the Cayman Islands and the court may issue a letter of request for the purpose of seeking assistance of a foreign court in obtaining the evidence of a relevant person resident outside the jurisdiction.[402]

4.4.1.3 Books and records of the company / liquidator, inspection by third parties

The company's property comprises its books and records. It is the duty of the official liquidator to take possession or control of all the company's books and records, including those maintained in electronic form.[403]

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.[404] This provision is to be used solely for the purpose of the liquidation and for the discharge of the official liquidator's statutory functions.[405] It cannot be used by an official liquidator to gain any special advantage in ordinary litigation to which he is a party.[406]

Where the official liquidator seizes or disposes of any property which he reasonably believed belonged to the company, he will not be personally liable for any loss or damage caused to its true owner, except in so far as such loss or damage is caused by the official liquidator's own negligence.[407]

The court may, at any time after making a winding up order, make such orders as it thinks fit for the inspection of the company's documents by creditors and contributories,[408] and the preparation of reports by the official liquidator and the provision of such reports to the company's creditors and contributories.[409] Any application by a contributory will not be dismissed by reason of the fact that the company is or may be insolvent.[410]

Notwithstanding section 114 of the Companies Act, Order 24, rule 6(1) of the CWR provides that the court may direct that the whole or part of any report, order, affidavit or other document (except the petition, winding up order or supervision order) which has been filed or is required to be filed, must be sealed and kept confidential or a specific period of time or until the happening of a specified event on the grounds that:

(a) the information in question is of a confidential nature and will not come into the public domain unless and until the document containing such information is filed in court; and

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402 *Idem*, subs (7).
403 *Idem*, Sch 3, Part II, para 1 and CWR, O 26, r 3.
404 *Idem*, s 138(1).
405 This provision is identical to s 127 of the Insolvency Act 1986 (UK) and decisions of the courts of England and Wales will be persuasive authority in the Cayman Islands.
406 Companies Act, s 99.
407 *Idem*, s 138(2).
408 *Idem*, s 114 (1)(a).
409 *Idem*, s 114(1)(b).
410 *Idem*, subs (2).

(b) the publication or immediate publication of the information contained in the document will harm the economic interests of the creditors or contributories of the company.

The sealing of documents departs from the principle of open justice and will only be made if the court is satisfied that (i) the information is confidential, and (ii) sealing is necessary to protect the economic interests of the company's stakeholders.[411]

However, Order 24, rule 6(2) of the CWR provides that a liquidator and any creditor or contributory may apply to the court for a direction that a sealed document be unsealed on the grounds that:

(a) the information contained in it is no longer confidential;

(b) the reasons for sealing the document no longer exist or have expired; or

(c) publication of the information is not or is no longer harmful to the economic interests of creditors or contributories.

Moreover, where material such as a liquidator's report has already been disclosed to one stakeholder, it is considered to have entered the public domain. A recipient of an official liquidator's report is not subject to any implied duty of confidentiality and in the absence of any express confidentiality agreement having been entered into, the court has held that it not have jurisdiction to give directions about the way in which the recipient could use the material received.[412] Accordingly, any application to place under seal a liquidator's report which has already been provided to a creditor, will fail.

4.4.2 Determination of claims and distributions

4.4.2.1 Adjudication of provable debts

In order to be eligible to share in the proceeds of realisation of a company's assets, a debt must be provable.

Section 139(1) of the Companies Act defines "provable debts" as follows:

> "All debts payable on a contingency and all claims against the company whether present or future, certain or contingent, ascertained or sounding only in damages, shall be admissible to proof against the company and the official liquidator shall make a just estimate so far as is possible of the value of all such debts or claims as may be subject to any contingency or sound only in damages or which for some other reason do not bear a certain value."

[411] *In the matter of the Sphinx Group of Companies (in official liquidation)* [2017 (1) CILR 176].
[412] *Re Harley International (Cayman) Limited* [2012 (1) CILR 178].

However, section 139(2) of the Act limits the ability to admit to proof against the company, foreign taxes, fines and penalties only if and to the extent that a judgment in respect of the same would be enforceable against the company pursuant to the Foreign Judgments Reciprocal Enforcement Act (1996 Revision), or any laws permitting the enforcement of foreign taxes, fines and penalties. Although this Act only applies to Australian judgments as there is reciprocal treatment of Cayman Islands judgments under Australian legislation, section 3(2)(b) of the Act excludes from its scope the enforceability of judgments in respect of taxes, fines and penalties.

The procedure for proving in an official liquidation is contained in Order 16, Part 1 of the CWR and (as explained above in paragraph 4.3.5.1) is commenced by the submission of a proof of debt. Order 16, Part II of the CWR addresses the procedure for the official liquidator's quantification of claims.

4.4.2.2 Appeal against rejection of proof

Order 16, Part III of the CWR deals with the procedure for appealing an official liquidator's adjudication of a claim.

If a creditor is dissatisfied with the official liquidator's decision with respect to his proof (including any decision on the question of priority), it may appeal to the court for the decision to be reversed or varied.[413]
Order 16, rule 18 of the CWR prescribes the procedure for an appeal. An appeal is made by way of application to the court within 21 days of the date upon which the creditor received the official liquidator's notification under Order 16, rule 6 of the CWR,[414] and should be made by summons in the prescribed form,[415] which should be served on the official liquidator.[416]

The application should be supported by an affidavit and the CWR[417] will apply.[418] The CWR[419] will apply to the hearing of every appeal.[420]

Order 16, rule 18(5) of the CWR states that an appeal must be treated as a *de novo* adjudication of the creditor's proof and the creditor may rely upon additional evidence in support of its claim, notwithstanding that it failed to make such evidence available to the official liquidator.

[413] CWR, O 16, r 17.
[414] *Idem*, r 18(1).
[415] *Idem*, Form No 30.
[416] *Idem*, r 18(2).
[417] *Idem*, O 11, r 4(2) prescribes various evidential requirements which apply to sanction applications made by the liquidation committee or any creditor or contributory (see para 4.3.5.1 above).
[418] *Idem*, O 16, r 18(3).
[419] *Idem*, O 11, r 3 governs hearings of sanction applications (see para 4.3.5.1 above).
[420] *Idem*, O 16, r 18(4).

The principles to be applied by the court in proof of debt appeals, pursuant to Order 16, rules 17 to 19 of the CWR are addressed in a series of Cayman Islands cases.[421] In *Midland Acres Limited*[422] Parker J summarised the applicable principles stating (at paragraph 37, pages 9 to 10) that:

> "…
>
> b. The burden of proof rests on the Appellants as the putative creditors to provide evidence to satisfy the court that, on the balance of probabilities, their alleged debts are founded on real debts of the Company and if so, in what amount. It follows that a claim based on tenuous or inadequate proof will not succeed. There is no requirement for the official liquidator to justify his decision to reject the proof of doubt.
>
> c. Unsurprisingly, the starting point for any contractual analysis is the written legal agreements entered into by the parties."

4.4.2.3 Expunging claims

Order 16, Part IV of the CWR deals with expunging admitted claims, and rule 20 provides that the court may expunge admitted claims, or reduce the amount in respect of which it has been admitted. Such an order may be made on an application by the official liquidator, contributories and creditors.

An official liquidator may apply to expunge a proof on the ground that it appears, on the basis of information that was not available to the official liquidator at the time of his adjudication of the proof, that it ought not to have been admitted or ought to have been admitted for a lesser amount.[423]

A contributory or creditor who is dissatisfied with the official liquidator's decision to admit the whole or part of a creditor's proof for an amount exceeding KYD 100,000 (or its equivalent in the currency of the liquidation), or 5% of the company's total liabilities (whichever is less), may apply to expunge the proof on the ground that it should not have been admitted.[424]

Order 16, rule 21 of the CWR prescribes the procedure and evidential requirements for an application to expunge an admitted claim.

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[421] *Re China Branding Group Limited (in official liquidation)* (FSD 52 of 2016, unreported, McMillan J, 23 January 2019); *Re Ardon Maroon Asian Master Fund (in official liquidation)* [2018 (2) CILR Note 1] and judgment of 17 July 2018 (with respect to which the Cayman Islands Court of Appeal dismissed an appeal by its judgment of 20 May 2020).

[422] (FSD 88 of 2017, unreported, Parker J), 19 January 2022).

[423] CWR, O 16, r 20(2).

[424] *Idem*, O 16, r 20(3).

An application must be made by summons in the prescribed form,[425] and if made by the official liquidator it must be served on the creditor. If the application is made by a creditor, it must be served on the official liquidator.[426]

An application to expunge an admitted claim must be made promptly and, in any event, not later than the date upon which a dividend has been paid in respect thereof.[427]

Every application under this rule 21 must be supported by an affidavit and Order 11, rule 4(2) of the CWR will apply.[428]

4.4.3 Anti-avoidance

4.4.3.1 Avoidance of property dispositions

Section 99 of the Companies Act 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 void, unless the Court orders otherwise.[429]

The determination of the commencement date of the winding up is therefore important in the context of section 99 as it determines the relevant back-stop date for dispositions of property. The date on which the winding up commenced is prescribed by section 100(2) of the Companies Act, which provides that the winding up of a company under the official liquidation procedure is deemed to commence at the time of the presentation of a petition. The law does not, however, provide a definition of "presentation"[430] and as such, there is some ambiguity as to whether presentation takes place upon the filing of the petition with the court, or the issue of the petition by the Registry with a seal and hearing date endorsed.

If a disposition is avoided pursuant to section 99, the official liquidator is entitled to apply for appropriate relief which will usually require repayment of the funds or the return of the asset.

However, the company may seek, and the court has the power to make, a validation order approving post-petition transactions, including but not limited to a grant of security for new consideration (retrospectively or prospectively).

Where a company is insolvent, the court is less likely to validate a disposition, unless it can be shown that it has corresponding benefit to the company and enhances value for creditors as a

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[425] *Idem*, Form No 31.
[426] *Idem*, O16, r 21(1).
[427] *Idem*, O16, r 21(2).
[428] *Idem*, O16, r 21(3).
[429] Note this provision is in the same terms as s 127 of the UK's Insolvency Act 1986, and therefore decisions of the courts of England and Wales are treated as persuasive authority.
[430] *Re China Shanshui Cement Group Limited* (FSD 161 of 2018, unreported, Mangatal J, 12 September 2019), para 5.

whole.[431] The court will more readily validate such transactions if the company is clearly solvent and if satisfied that an intelligent and honest director acting reasonably would come to that decision.[432] These requirements form part of a five-fold test which for many years was accepted as that which needed to be surmounted in order for a validation order to be granted.

Speaking to this test in *Re Fortuna Development Corporation,* [433] the Grand Court held:

> "…First the proposed disposition must appear to be within the power of the directors…Secondly the evidence must show that the directors believed the disposition is necessary or expedient in the interests of the company…Thirdly, it must appear that in reaching the decision the directors have acted in good faith. The burden of establishing bad faith is on the party opposing the application. Fourthly, the reasons for the disposition must be shown to be in ones which an intelligent and honest director could reasonably hold."

In *Evenstar v Tianquan and Fang*[434] it was stated that:

> "…in the context of an application to validate a specific payment that was not in the ordinary course of business and where irregularities in the conduct of the affairs could be shown… even if the company was clearly solvent, payment may not be validated where irregularities in the conduct of the affairs of the company can be shown."

Both Fortuna and Cybervest Fund were solvent companies and were subject to winding up on just and equitable grounds. More recently, these two cases were considered by the Cayman Islands Court of Appeal in the case of *Tianrui v China Shanshui.*[435] This case also concerned a solvent company, but unlike the two earlier cases, did not concern a proposed transaction which formed part of the company's ordinary course of business.

The previous formulations of the applicable test were considered and Moses JA said:

> "The real danger I detect in the approach in Burton and Fortuna is that it focuses on the burden of proof and creates a presumption in favour of the belief of directors as to the proprietary of their proposals. Cases will rarely turn on the burden of proof; there is no presumption. In every case, those seeking a validation order must be able to satisfy the court that what is proposed will not undermine the avoidance function of s.99, that it will not impede or frustrate the unwinding of transactions after the presentation of the petition but will maintain the status quo. That is so whether the company is solvent or insolvent, and

[431] *In the Matter of Torchlight Fund LP* [2018 (1) CILR 290].
[432] *In the matter of Fortuna Development Corporation* [2004-05] CILR 533 and *Re Cybervest Fund* [2006 CILR 80].
[433] *Re Fortuna Development Corporation* [2010] (2) CILR 336, relying on the English case of *In re Burton & Deakin Ltd* [1977] 1 WLR 390.
[434] (FSD 278 of 2020, unreported, Smellie CJ, 13 September 2021).
[435] [2020 (1) CILR 417].

> whether the proposal is made in the ordinary course of business or not. Where the proposal is made for the purposes of the ordinary course of business the court will more readily take the view that there is no unacceptable risk to the maintenance of the status quo. In such a case the views of directors as to whether the proposals are for the benefit of the company will plainly be relevant even though not dispositive."[436]

However, Moses JA also confirmed that:

> "Careful scrutiny is needed not just to protect creditors in an insolvency petition but also contributories at a stage when no-one can say whether the petition in respect of a solvent company will succeed or not. Validation orders should only be made if they are consistent with the purposes of section 99 and of the power to make such orders."[437]

The Court of Appeal's clarification of the applicable test has been followed in *Jian Ying Ourgame High Growth Investment Fund v International Holdings Limited*[438] and recently summarised in *Adenium Energy Capital Ltd*.[439] This means that the court will no longer, without scrutiny, grant validation orders for company transactions in the context of just and equitable winding up petitions, merely because the company is solvent. A company will need to demonstrate not only solvency, but also that the transaction is in the ordinary course of business and / or will not materially alter the *status quo* pending resolution of the petition.

No transaction or disposition made prior to the presentation of a winding up petition is capable of being caught by section 99 of the Companies Act, but it may however be subject to other claw-back mechanisms available to office holders, which are discussed below.

4.4.3.2 Applications to dispose of company property

The official liquidator's power to dispose of company property with the sanction of the court is provided for in section 110 and Schedule 3, Part I of the Companies Act.

The power to dispose of property now includes any dispositions to a "related person", following the amendment to section 110(5) of the Companies Act by section 10 of the Companies (Amendment) Act 2021. The revised section 110(5) of the Companies Act now states:

> "For the purposes of exercising the powers specified under para 3 of Part I of Sch 3, a person shall be treated as related to a company if the person –
>
> (a) has acted for the company as a professional service provider;

[436] *Idem*, para 45.
[437] *Idem*, para 47.
[438] (FSD 218 of 2021, unreported, Segal J, 11 August 2021).
[439] (FSD 54 of 2020, unreported, Richards J, 26 April 2022).

(b) is or was a shareholder or director of the company or of any other company in the same group as the company;

(c) has a direct or indirect beneficial interest in the shares of the company; or

(d) is a creditor or debtor of the company."

The procedure for making a sanction application and the relevant tests that apply have been addressed above at paragraph 4.3.3.2. In summary, the test that applies to seeking sanction of a disposition is the best interests test, and in essence an official liquidator must demonstrate that there is no better deal on the table.

4.4.3.3 Offences and antecedent transaction remedies (statutory remedies)

As noted above, there are certain remedies that are only available to officeholders. These are the statutory claw-back remedies provided in the Companies Act.[440] Each of these claims are dealt with in turn below.

Voidable Preferences – section 145

Any payment or disposal of property constitutes a voidable preference if:

(a) 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

(b) the dominant intention of the company's directors was to give the applicable creditor a preference over other creditors.

In *Re Weavering Macro Fixed Income Fund Ltd (in Liquidation)*, the Cayman Islands Court of Appeal[441] and the Privy Council[442] considered each stage of the test to be applied in identifying voidable preference under section 145(1) of the Companies Act. The Privy Council clarified that giving a preference over other creditors means putting that creditor in a better position than it otherwise would have been.[443] Thus, if the company's dominant intention in making the payment or 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 as a voidable transaction even if the collateral effect is to prefer the creditor in question.

A dominant intention to prefer may be inferred by the court from the available evidence and a disposition made to a "related party" of the company (such as a person who had the ability to

[440] Companies Act, ss 145-147.
[441] [2016 (2) CILR 514].
[442] *Re Weavering Macro Fixed Income Fund Ltd (in Liquidation)* [2019 (2) CILR 245].
[443] *Re Weavering Macro Fixed Income Fund Ltd (in Liquidation)* 2019 UKPC 36.

control the company or exercise significant influence) will be deemed to have been made with a view to giving a preference.[444]

Prior to the enactment of the Companies (Amendment) Act on 31 August 2022, a voidable preference was said to be "invalid". The Privy Council in *Weavering* noted that the effect of this language in the previous section 145 of the Companies Act was such that there was no statutory right to recover the property or payment which were the subject of the preference, but the section merely rendered the relevant transfer or payment or payment voidable.[445] Therefore, it was not previously clear what remedy a liquidator was able to avail themselves of in these circumstances. In the amended section 145, the word "invalid" was substituted by "voidable upon the application of the company's liquidator".[446] The effect of this amendment is that there now appears to be a remedy stated within the statute.

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 and as confirmed by the Privy Council in *Weavering*, as a liquidator's right to repayment arose under statute and not at common law, common law defences such as "change of position" are not available to a claim under section 145.[447]

Avoidance of dispositions at an undervalue – section 146

Section 146(2) 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."

Section 146(1)[448] provides the following definitions:

- "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 wilfully defeat an obligation owed to a creditor.

Therefore, an official liquidator must establish the following:

(a) that property has been disposed of at an undervalue; and

(b) with the intention of wilfully defeating an obligation owed to a creditor.

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[444] Companies Act, s 145(2) and (3).
[445] *Re Weavering Macro Fixed Income Fund Ltd (in Liquidation)* 2019 UKPC 36, para 74.
[446] Companies Act, s 145(1) as amended by the Companies (Amendment) Act 2021, s 16.
[447] *Re Weavering Macro Fixed Income Fund Ltd (in Liquidation)* 2019 UKPC 36, para 59.
[448] Note that any terms that also apply to s 147, are given the same definitions as provided in s 146.

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.

Practical issues may arise in relation to the valuation of an asset which is alleged to have been disposed of at an undervalue.

Fraudulent trading – section 147

This section provides that if the business of the company 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.

This claw-back provision operates as a "catch all" provision as, unlike sections 145 and 146 of the Companies Act which have a particular focus on certain types of transactions, this applies to any conduct that was carried out with the intent of defrauding creditors. Its broader scope also applies to any persons who were knowingly parties to such conduct, such that it even applies to persons who did not hold a position of power but had the requisite knowledge of the fraudulent conduct. The court has a wide discretion to order any amount of contribution to the company's assets as it thinks fit in all the circumstances.

Although this provision provides a remedy for liquidators in circumstances where sections 145 and 146 are not engaged, it is yet to be tested and there is presently no judicial authority arising from a claim pursued under section 147 of the Companies Act in the Cayman Islands. However, the court has commented upon the extraterritorial effect of section 147 in the context of a claim that liquidators wished to pursue in the United States. In *Re ICP*[449] the court held that reading section 147 together with section 146 (which were statutory remedies "aimed at different aspects of the same kind of mischief") and noting that section 146 is expressly stated to be actionable in foreign courts, the legislators clearly intended that section 147 was also actionable in foreign courts. Accordingly, the statutory remedy provided by section 147 is not limited to claims pursued in the Cayman Islands and can also be pursued in other jurisdictions.

4.4.3.4 Other litigation

Fraudulent Dispositions Act (1996 Revision)

The Fraudulent Dispositions Act (1996 Revision) (FDA) provides for a solely creditor action.

[449] *Re ICP Feeder Fund & ICP Master Fund* (FSD 82 of 2010 and FSD 269 of 2010, unreported judgment, Jones J, 15 May 2014).

Section 4 provides that:

> "(a) Subject to this Law, every disposition of property made with an intent to defraud and at an undervalue shall be voidable at the instance of a creditor thereby prejudiced.
>
> (b) The burden of establishing an intend to defraud for the purposes of this Law shall be upon the creditor seeking to set aside the disposition.
>
> (c) No action or proceedings shall be commenced under this Law unless commenced within six years of the date of the relevant disposition."

"Undervalue" is defined in the FDA in relation to a disposition of property, as:

(a) the provision of no consideration for the disposition, or

(b) a consideration for the disposition the value of which in money or money's worth is significantly less that the value of the property the subject of the disposition.

"Intent to defraud" means an intention of a transferor wilfully to defeat an obligation owed to a creditor.

Section 5 of the FDA provides for the saving of rights of transferees and beneficiaries of a trust where the Court is satisfied that the transferee / beneficiary has not acted in bad faith. In the case of a transferee, it must have a first and paramount charge over the property (the subject of the disposition) of an equal amount to the entire costs properly incurred by the transferee in the defence of the action of proceedings to set aside, and the relevant disposition must be set aside subject to fees, costs and pre-existing rights, claims and interests of the transferee (and of any predecessor transferee who has not acted in bad faith).[450] In the case of a beneficiary, the disposition will only be set aside subject to the right to retain any distribution made consequent upon the prior exercise of trust, power or discretion vested in the trustee of such trust, or any other person, and otherwise properly exercised.

Section 6 provides that:

> "A disposition shall be set aside under this Act only to the extent necessary to satisfy the obligation to a creditor at whose instance the disposition has been set aside together with such costs as the Court may allow."

In *Raiffeisen International Bank AG v Scully Royalty & 7 Others*[451] the Grand Court clarified that both immediate transferees or subsequent transferees (by successor in title) were each transferees for the purposes of the FDA and therefore the Court has the power to set aside

[450] FDA, s 5(a) and (b).
[451] (FSD 162 of 2019, unreported, Parker J, 12 March 2021).

subsequent transactions following the initial disposition.[452] This decision also confirmed that transferees outside of the jurisdiction did not fall outside of the scope of the FDA – the statute being of extraterritorial effect.[453]

In considering an appeal of the Grand Court's decision (albeit not on the interpretation and application of the FDA) the Cayman Islands Court of Appeal[454] expressed the view that in the context of an insolvent company, section 6 of the FDA must mean that the disposition must be set aside to the extent necessary to put back into the transferor company sufficient funds to enable the creditor to be paid in full. Otherwise, "the creditor would only receive a proportionate part of its claim depending upon the level of insolvency and the percentage of the claims of all creditors which could be met".

Breach of duty – officers and directors

There is no statutory or other obligation imposed on directors or companies to file for insolvency under the law of the Cayman Islands, and the Companies Act does not contain a prohibition on wrongful trading (that is, continuing to trade whilst insolvent) like other jurisdictions, such as the UK. Directors can be found personally liable to the company for losses which they cause the company by breaching their fiduciary duty to act *bona fide* in what they consider to be the best interests of the company, prior to the commencement of any winding up. When a company is in official liquidation, the liquidator can pursue claims against the directors on behalf of the company (in the company's name) for breach of the directors' fiduciary duties.

In *Prospect Properties v McNeill*[455] the Court held that where a company is insolvent,[456] the directors' duty to act in the best interests of the company requires them to have regard to the interests of other creditors. It is in the interest of the creditors to be paid and it is in the interest of the company to be safeguarded against being put in a position where it is unable to pay.

Directors also have a common law duty to exercise care, skill and diligence, and to exercise independent judgment.

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[452] *Idem*, para 55.
[453] *Idem*, para 57.
[454] *Scully Royalty Ltd and MFC 2017 II Ltd v Raiffeisen Bank International AG* (CICA) (CICA (Civil) Appeal No 21 of 2020, unreported, Morrison JA, Moses JA and Birt JA, 30 December 2021).
[455] [1990-91 CILR 171].
[456] In the recent UK Supreme Court decision of *BTI v Sequana* [2022] UKSC 25, the Supreme Court held that the duty to have regard to the interests of creditors arises when a company is actually insolvent or bordering on insolvency or insolvent liquidation, or administration is probable. While the case has not yet been applied in the Cayman Islands, UK Supreme Court decisions are of persuasive authority in the Cayman Islands and it is expected that this clarification of the trigger point at which directors need to begin to weigh the interests of creditors, will be followed in the Cayman Islands.

Claims against third parties – breach of contract / duty

Such claims may include claims the company has against third-party service providers such as lawyers, auditors and administrators, and may be founded upon a breach of a contractual and / or tortious duty.

4.4.3.5 Court applications for sanction to commence litigation

As mentioned above, in order to commence litigation, sanction of the Court is required.

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.[457]

Following or during the pursuit of proceedings, if a settlement is reached in principle, the liquidator will need to apply for sanction of the proposed compromise.[458] In *Re Income Collecting 1-3 Months T-Bills Mutual Fund*[459] the Court summarised the legal principles drawing on earlier decisions of the English[460] and Cayman Islands Courts.[461] The Court in *Income Collecting* referred to the well-known English case of *Re Edennote*[462] which is authority for the proposition that where a liquidator takes the view that a compromise is in the best interests of the company's creditors, where there is no suggestion of lack of good faith by the liquidator or that he is partisan, the Court will attach considerable weight to the liquidator's views unless the evidence reveals substantial reasons why it should not do so or that for some other reason, his view is flawed. The Court also noted that in the Cayman Islands' case of *Universal and Surety*,[463] the judge agreed that it was not for him to exercise the official liquidator's discretion but to consider the correctness or otherwise of the official liquidator's discretion having regard to the criteria set out in *Edennote* and, before that, in the judgment of Plowman J in *Leon v York-o-Matic Ltd*:[464]

> "Here, as I have said, there is no question of fraud and having considered all the evidence I am not satisfied that the liquidator did not exercise his discretion bona fide; nor am I satisfied that he acted in a way in which no reasonable liquidator could have acted."

However, it is important to bear in mind that, as can be seen from the decision in *Universal and Surety*, the liquidator is not automatically entitled to the Court's sanction of a proposal for final

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457 *Re Greenhaven Motors Ltd* [1999] 1 BCLC 635; *In the Matter of ICP Strategic Credit Income Fund Limited and ICP Strategic Credit Income Mater Fund Limited* [2014 (1) CILR 314].
458 Companies Act, Sch 3, Part I, paras 5 and 7.
459 (FSD 188 of 2021, unreported, Doyle J, 4 February 2022).
460 *Re Edennote Ltd (No 2)* [1997] BCLC 89.
461 *In the Matter of Universal and Surety Company Limited* [1992-93 CILR 149].
462 *Re Edennote Ltd (No 2)* [1997] BCLC 89.
463 *In the Matter of Universal and Surety Company Limited* [1992-93 CILR 149].
464 [1966] 2 All ER 277, paras 280-281.

settlement of the proceedings against the wishes of the creditors. The Court should take account of the evidence in relation to:

(i) the chances of success;

(ii) any reasonable assessment of the financial consequences to the liquidator and the creditors; and

(iii) the wishes of creditors and how far these had been taken into account by the liquidator.[465]

In addition, prospective sanction applications are likely to be looked upon more favourably than applications which seek retrospective sanction. If seeking retrospective sanction, it will be necessary to justify or explain why sanction is being sought after the event. In *Re ICP*[466] the Court sanctioned the liquidators' inclusion of a claim under section 147 of the Companies Act in proceedings that the liquidators had already commenced for causes of action that had been previously sanctioned. In that case it was explained that factual evidence gave rise to grounds for the additional cause of action.

Sanction applications to commence litigation are often coupled with or follow applications seeking sanction to enter into funding agreements with third-party funders. This has been made easier by the enactment of the PFLSA.[467]

Procedure, costs and section 97-leave

The CWR provides the procedure for applications seeking sanction.[468] The evidence submitted in support of the application will need to set out why the liquidator considers the pursuit of the proposed litigation is in the best interests of the company's stakeholders. In order to establish this, the evidence will need to address the prospects of success of the litigation and in so far as is possible, the prospects of and likely amount of recovery. Prospects of success is often dealt with by a qualified and experienced lawyer practicing in the jurisdiction in which it is intended that the claim will be pursued. Such an opinion or advice should be referred to in the liquidator's affidavit and / or exhibited to the application. Care must be taken to ensure that the claim to privilege over the legal advice is maintained and not waived. In this regard, a liquidator may also apply for the evidence to be sealed (which is addressed above at paragraph 4.4.1.3) so as not to risk its disclosure harming the economic interests of stakeholders.

The CWR addresses costs of sanction applications.[469] The general rule is that the official liquidator's costs of making a sanction application must be paid out of the assets of the company unless the Court is satisfied that the directions sought by the official liquidator were unnecessary and served no useful purpose, were wholly unreasonable or the official liquidator misled the

[465] [1992-93 CILR 149] at [150]
[466] *Re ICP Feeder Fund & ICP Master Fund* (FSD 82 of 2010 and FSD 269 of 2010, unreported, Jones J, 15 May 2014).
[467] Also see the discussion in para 2.4.1 above in this regard.
[468] CWR, O 24, rr 1 and 2. See the discussion in para 4.3.3.2 above.
[469] *Idem*, O 24, r 9.

Court or otherwise acted improperly in connection with the application.[470] This approach also applies with respect to the liquidation committee's costs of participating in a sanction application.[471] However, the position is different with regard to a creditor or contributory who makes or opposes an application. Whereas a creditor or contributory should be awarded their costs to be paid out of the assets of the company and taxed on the indemnity basis in the event they successfully made or opposed a sanction application, if an application or opposition by a creditor or contributory is unsuccessful, no order for costs should be made against that party unless the Court is satisfied that his position was wholly unreasonable, or if guilty of misleading the Court or otherwise acting improperly.[472]

Where a liquidator wishes to resist an action being pursued against a company in liquidation or pursue a claim against another company in liquidation, section 97(1) of the Companies Act is relevant. This section provides that no action may be proceed with or commenced against the company once a winding up petition has been presented (and before winding up order has been made) without leave of the Court.

Drawing on the *dicta* of previous cases, in *BDO Cayman Ltd and BDO Trinity Ltd v Ardent Harmony Fund Inc*[473] the Court summarised the principles governing section 97 and the correct approach to the Court's exercise of its discretion as follows:

> "(1) The applicant for leave must first establish an arguable case to be litigated;
> (2) If it establishes an arguable case, the Court then has to consider whether it would be fair, in the context of the liquidation as a whole, for the JOLs to have to deal with the burden of that litigation. The Court's discretion is wide and unfettered – there is no presumption in favour of or against giving leave – each case turns on its own facts;
> (3) In deciding what would be fair, the Court can give s.97 leave subject to conditions subject to a consideration of what would be fair, in the context of the liquidation as a whole."

This approach has been followed in the recent case of *Re Adenium Energy Capital, Ltd.*[474]

[470] *Idem*, O 24, r 9(2).
[471] *Idem*, O 24, r 9(3).
[472] *Idem*, O 24, r 9(4).
[473] [2020 (2) CILR Note 22] and (FSD 74 of 2020, unreported (full judgment), Ramsay-Hale J, 19 November 2020), para 24.
[474] (FSD 54 of 2020, unreported, Richards J, 26 April 2022).

4.4.4 Ending liquidations

4.4.4.1 Resolution of estate, unclaimed dividends, dissolution, discharge, and books and records

As soon as the affairs of the company have been completely wound up, the official liquidator must publish his final report and accounts in accordance with the CWR[475] and apply to the Court for an order under section 152 of the Companies Act that the company be dissolved.[476]

The official liquidator's final report and accounts must contain:[477]

(a) notice of the date upon which his application for an order for dissolution will be heard by the Court; and

(b) a statement of the fact that any creditor (in the case of an insolvent company) or member (in the case of a solvent company) may appear and be heard on the application.

The official liquidator must publish a notice of the hearing of the application in one or more newspapers circulating in a country or countries in which the company appears most likely to have creditors, and any such notice must be published at least 14 days prior to the date of the hearing.[478]

In relation to an order for dissolution, Order 22, rule 2 of the CWR states that:

(1) an order for dissolution must be in the form of the prescribed form, Form 36;

(2) an order for dissolution will take effect upon the date upon which it is made or such later date specified in the order;

(3) the official liquidator must file the order for dissolution with the Registrar of Companies within 14 days from the date upon which the order is perfected; and

(4) an order for dissolution must include supplementary directions relating to:

  (a) the retention of the whole or part of the liquidation files for longer than the minimum period of three years as specified in Order 25, rule 1;

  (b) the retention, storage and destruction of the company's books and records pursuant to Order 25, rule 2;

[475] CWR, O 10, r 3.
[476] *Idem*, O 22, r 1(1).
[477] *Idem*, O 22, r 1(2).
[478] *Idem*, O 22, r 1(3).

(c) the terms upon which the official liquidator will be remunerated for acting as trustee of any unclaimed dividends or undistributed assets under section 153 of the Companies Act; and

(d) such other consequential matters as the Court thinks fit.

As a matter of procedure, this means that a liquidator needs to file its application for dissolution and secure a hearing date before finalising the final report to creditors to ensure that all relevant information can be included in the report.

Unclaimed dividends and undistributed assets are to be dealt with in accordance with section 153 of the Companies Act and Order 23 of the CWR, which makes provision for the:

- establishment of a trust account for the receipt of any unclaimed dividends or uncleared dividend cheques;[479]
- transfer of title to the liquidator of any undistributed assets which ought to have been distributed *in specie* but remain in the possession or control of the liquidator, to be held on trust and administered by the official liquidator for the benefit of the creditors / contributories who are entitled to receive such assets;[480]
- payment out of the trust account and transfer of any undistributed assets once beneficiaries are located and believed to be entitled to the funds / assets;[481]
- former liquidator's trustee fees and expenses;[482] and
- transfer to the Financial Secretary any money or assets remaining in the hands of the former liquidator as trustee at the end of one year from the date upon which the company was dissolved.[483]

Following the dissolution of a company, the liquidator must retain the liquidation files in safe custody for at least three years.[484]

Upon making an order for dissolution, the Court must give directions in respect of the preservation, storage and destruction of the company's remaining books and records pursuant to Order 26, rule 3(4) of the CWR and, in accordance with rule 3(6), the cost of post-dissolution storage and destruction of a company's books and records will be an expense of the liquidation for which provision must be made in the official liquidator's final accounts. Upon the making of an order dissolving a company, the official liquidator's duties as officeholder cease save for any

[479] *Idem*, O 23, r 2.
[480] *Idem*, O 23, r 3.
[481] *Idem*, O 23, r 4.
[482] *Idem*, O 23, r 5.
[483] *Idem*, O 23, r 6.
[484] *Idem*, O 26, r 2(3) and see r 2(2) for what the liquidation files are to comprise of.

residual duties preserved by the order for dissolution, including for the preservation, storage and destruction of the company's remaining books and records, and dealings with unclaimed dividends. An order for discharge of the liquidators is often included in the order for dissolution.

Self-assessment questions

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.

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.

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 which 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.

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.

For feedback on these self-assessment questions, see the document "Comment and Feedback on Self-Assessment Questions", which is made available to you as a separate document

4.5 Controllerships

4.5.1 Introduction to controllerships

The CIMA has power under the regulatory laws[485] of the Cayman Islands to appoint a person to assume control of the affairs of a regulated entity. The appointment of a controller is used by the CIMA to fulfil its regulatory objectives, protect stakeholders and reduce financial crime by enabling it to stop licensees, registrants and unauthorised persons carrying on insolvent or unlawful business and protect the assets of the licensee or registrant.[486]

4.5.2 Appointment of controllers

A controller may be appointed by the CIMA where it identifies serious concerns regarding the solvency or lawfulness of a licensee or registrant's business.[487] While the CIMA will consider the particular circumstances of each company, general factors that it will consider are set out in paragraph 15.6 of its Enforcement Manual, and include:

(a) the seriousness of any suspected breach of the regulatory laws;

(b) the extent of any loss, risk of loss or other adverse effect on the stakeholders;

(c) management's present and historical attitude to resolving problems;

(d) contagion risk (could the breach have adverse implications for other financial system participants or the financial system);

(e) the entity's financial position, specifically its solvency; and

(f) the availability of alternative solutions.

While the appointment of controllers in the Cayman Islands is not a frequent occurrence, examples of circumstances in which the CIMA has resolved to appoint a controller to a licensee or registrant (and the regulatory laws pursuant to which they were appointed) include:

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[485] Pursuant to s 4 of the CIMA Enforcement Manual (hereinafter referred to as the Enforcement Manual), regulatory laws means the Banks and Trust Companies Act (2021 Revision), Building Societies Act (2020 Revision), Companies Management Act (2021 Revision), Cooperative Societies Act (2020 Revision), Development Bank Act (2018 Revision), Directors Registration and Licensing Act 2014, Insurance Act 2010, Banks and `trust Companies Act (2021 Revision) Money Services Act (2020 Revision), Mutual Funds Act (2021 Revision), Securities Investment Business Act (2020 Revision) and any other laws prescribed by the Governor by regulations under the Monetary Authority Act (2020 Revision), including any rules, statement of principle or guidance issued in accordance with the Monetary Authority Act and regulations made thereunder.

[486] Enforcement Manual at 15.2.

[487] The full procedure for appointing a controller is set out in the CIMA's document: *Procedure for Appointing Controllers and Advisers*; and *Auditors for Anti-Money Laundering Audits and Assessing Costs (Procedure for Appointing Controllers).*

(a) a bank which was headquartered in the Cayman Islands and subject to an investigation and allegations of fraudulent trading by the United States Securities Exchange Commission, pursuant to section 18 of the Banks and Trust Companies Act;[488]

(b) a broker dealer which offered online discount trading services and had committed serious and ongoing regulatory breaches, pursuant to section 17(2A)(h) of the Securities Investment Business Law (2019 Revision) (as amended by the Securities Investment Business Amendment Law, 2019);[489] and

(c) a segregated portfolio company which provided insurance products, in respect of which the CIMA found that two directors were not fit and proper to hold the position of director of a licensee, pursuant to sections 24(1)(g) and 24(2)(h) of the Insurance Act (2020 Revision).[490]

Once the CIMA resolves to appoint a controller to an entity under the relevant regulatory law, it will provide the terms and conditions of the appointment to the controller by letter of appointment[491] and, where applicable, advise the controller of the requirement to apply to the Grand Court to obtain directions under section 18 of the Bankruptcy Act (1997 Revision).[492]

4.5.3 Powers and responsibilities of controllers

Upon appointment, a controller is vested with immediate control of the affairs of the entity to which they have been appointed.[493] This means that management of any entity to which controllers have been appointed must cede operation of its business immediately and hand over the books and records of the entity upon request.

The effect of a controller appointment by the CIMA on the operations of a company or licensee was considered in the matter of *Caledonian Bank Limited (in voluntary liquidation)*[494] where the sole shareholder of the bank resolved to place it into voluntary liquidation after having been notified of the appointment of controllers by CIMA. The voluntary liquidators subsequently sought confirmation of their appointment by the Grand Court in place of the CIMA-appointed controllers. Smellie CJ dismissed the application, concluding that the sole shareholder did not have the power to vest control of the affairs of the bank in its nominated voluntary liquidators once the controllers had been appointed. From the moment of their appointment, Smellie CJ considered that "the controllers have effectively assumed control of the licensee's affairs to the

[488] *In the matter of Caledonian Bank* (no citation as controllership appointments do not have judgments to refer to).
[489] *In the matter of OneTradex Limited* (no citation – see previous footnote).
[490] *In the matter of Premier Assurance Group SPC Ltd* (no citation – see previous footnote).
[491] Procedure for Appointing Controllers, Sch 1.
[492] This section provides for the appointment of receivers but may be applied mutatis mutandis with appropriate modifications to controllers (see section 18(h) of the Bank and Trust Companies Act).
[493] *In the matter of Caledonian Bank* [2015] (1) CILR 143. It had been argued that following their appointment the controllers were only vested with conditional power, unless and until they were confirmed by the Court (at para 13). This argument was rejected.
[494] *Ibid*.

exclusion of the JVLs, the directors and the shareholder, and anyone else who may claim any aspect of control" (at paragraph 16 of the judgment).

While controllers may be vested with immediate exclusive authority over the internal management of an entity following their appointment, they do not necessarily have unrestricted powers "against the world at large" unless and until such powers are conferred by the Court. An application for declaratory relief may be made pursuant to section 18 of the Bankruptcy Act (1997 Revision) insofar as the relevant regulatory law makes provision for such an application (as occurred in *Caledonian Bank*),[495] or pursuant to the inherent jurisdiction of the Court where it is necessary to fill the "practical gap" left by the relevant regulatory law (as occurred in *Premier Assurance Group SPC Ltd (in controllership)*).[496] This declaratory relief is particularly important where, for example, the controllers may need to seek recognition in foreign proceedings.

A controller is ordinarily required by the relevant regulatory laws[497] to provide a report to the CIMA on the affairs of the entity and the controller's recommendations within 90 days of the date of his appointment. This deadline may be extended by the CIMA, or the CIMA may request the provision of an interim report, depending upon, amongst other things, the extent of the concerns regarding the insolvency or unlawfulness of the business, the risk of dissipation and other public interest considerations.[498]

4.5.4 Conclusion of controllership

Upon receipt of any report prepared by the controller, the CIMA may apply to the Grand Court to wind up the company (or, in the case of a segregated portfolio company, apply for the appointment of a receiver over one or more of the segregated portfolios)[499] where it considers it appropriate to do so in order to prevent improper persons from carrying on insolvent or unlawful business and / or to ensure the orderly realisation and distribution of the company's assets.[500]

The CIMA has jurisdiction to present a winding up petition in respect of a regulated entity pursuant to section 94(1)(d) and (4) of the Companies Act. Following presentation of a petition, it may also seek the appointment of provisional liquidators pursuant to sections 104(2) and (6) of the Companies Act.

In determining whether it is appropriate to take steps to wind up an entity in controllership, the CIMA will consider the recommendations of the controller, the interests of the creditors, and the public interest. The CIMA will also consider the particular facts of the case, including:

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[495] *Ibid*.
[496] [2020] (2) CILR 864.
[497] See, eg, the Bank and Trust Companies Act (2021 Revision), s 18A(3) of the Insurance Act 2010, s 24(4).
[498] *Procedure for Appointing Controllers* at 3.4.
[499] *Idem*, at 17.3.
[500] *Idem*, at 17.4.

(a) whether the licensee or registrant has taken or is taking steps to deal with its insolvency, and the effectiveness of these steps;

(b) whether any stakeholder or other creditor has taken steps to petition to wind up the licensee;

(c) the effect on the licensee or registrant and on the creditors if the licensee or registrant is wound up, dissolved, or a receiver is appointed over a segregated portfolio;

(d) whether the use of other powers available to the CIMA will achieve the same or a more advantageous result in terms of protection of consumers, and of market confidence and the restraint and remedy of unlawful activity;

(e) the nature and extent of the licensee's or registrant's assets and liabilities, and in particular whether the licensee or registrant holds stakeholders' assets and whether its secured and preferred liabilities are likely to exceed available assets;

(f) whether there is a significant cross border or international element to the business of the licensee or registrant and the effect on foreign assets or on the continuation of the business abroad of making an order for winding up, dissolution, or the appointment of a receiver over a segregated portfolio;

(g) whether the licensee or registrant appears to have been or has been involved in financial crime or appears to be or has been used as a vehicle for financial crime; and

(h) the complexity of the licensee or registrant (as this may have a bearing on the effectiveness of winding up, dissolution, or the appointment of a receiver over a segregated portfolio, or any alternative action).

The rules governing the presentation of a winding up petition by the CIMA are set out in Order 3, Part IV (rules 14 to 16) of the CWR. Unlike petitions presented by creditors or contributories, the only parties who may appear at the hearing of the petition (without leave of the Court) are members, directors or professional service providers of the subject company, who have provided the requisite three days' notice.

Self-assessment questions

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.

Question 2

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

Question 3

What are a controller's reporting obligations?

For feedback on these self-assessment questions, see the document "Comment and Feedback on Self-Assessment Questions", which is made available to you as a separate document

4.6 Inspectors

4.6.1 Introduction to inspectorships

Members of a Cayman Islands company may apply to the Court, or a company may by special resolution resolve, to appoint inspectors to examine the affairs of the company and provide a report. These inspectors have broad powers to, among other things, examine the books and records of the company and examine the officers and agents of the company upon oath.

4.6.2 Procedure for the appointment of inspectors

Pursuant to section 64 of the Companies Act, the Court may appoint one or more inspectors:

(a) in the case of a banking company having a capital divided into shares, upon the application of members holding not less than one-third of the shares of the company for the time being issued;

(b) in the case of any other company having a capital divided into shares, upon application of members holding not less than one-fifth of the shares of the company for the time being issued; and

(c) in the case of a company not having a capital divided into shares, upon the application of members being in number not less than one-fifth of the total number of persons for the time being entered on the register of the company as members.

An application for the appointment of inspectors must be made by originating motion.[501] The Clerk of the Court will assign a day and time for hearing of the motion at the time of issue and

[501] Grand Court Rules, O 102, r 3(a).

unless there are grounds justifying determination of the motion *ex parte*,[502] the motion must be made on notice of at least four clear days to the parties affected.[503]

Inspectors may, alternatively, be appointed by special resolution of the company pursuant to section 67 of the Companies Act.

4.6.3 Consequences of appointment of inspectors

Following the appointment of inspectors by the Court:[504]

(a) all officers and agents of the company are subject to a duty to produce for examination all books and documents in their custody or power;

(b) all officers and agents of the company may be examined on oath in relation to the business of the company; and

(c) any officer or agent who fails or refuses to comply with the inspector will incur a penalty not exceeding KYD 40 in respect of each such offence.

Subject to the duty to cooperate outlined above, the powers of the board remain unaffected by the appointment of the inspectors and no statutory moratorium is engaged by the appointment of inspectors under section 64 of the Companies Act.

At the conclusion of their examination of the company, the inspectors must report their findings to the Court. Any report prepared by an inspector is thereafter admissible in subsequent legal proceedings as evidence of the opinion of the inspector pursuant to the Companies Act[505] (and subject to approval of the Court and the usual rules of evidence (see *Re Fortuna Development Corporation*[506]). As proceedings for the appointment of inspectors are investigative rather than adversarial, an applicant is not estopped from bringing further proceedings following the conclusion of the inspectorship, in reliance on the same allegations that underpinned the application for appointment of inspectors.[507]

Inspectors appointed by special resolution have the same powers and perform the same duties as those appointed by the Court, except that any report must be made to the representatives of the company identified in the resolution pursuant to which they were appointed.[508]

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[502] That the delay caused by proceedings in the ordinary way would or might entail irreparable or serious mischief.
[503] Grand Court Rules, O 8, r 2(2) and (3).
[504] Companies Act, s 65.
[505] *Idem*, s 68: "The report of any inspectors appointed under this Act, or any copy thereof certified and signed by the inspectors, shall be admissible in any legal proceeding as evidence of the opinion of the inspectors in relation to any matter contained in such report".
[506] [2010] (2) CILR 336.
[507] See, eg, *In the matter of China CVS (Cayman Islands) Holding Co Ltd* [2019] (1) CILR 266 at 39 to 48, where a winding up petition was presented based on the same allegations raised in an earlier inspectorship application.
[508] Companies Act, s 67.

Self-assessment questions

Question 1

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

Question 2

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

Question 3

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

For feedback on these self-assessment questions, see the document "Comment and Feedback on Self-Assessment Questions", which is made available to you as a separate document

4.7 Exempted limited partnerships

4.7.1 Introduction to exempted limited partnerships

Exempted limited partnerships (ELPs) are an important feature of the Cayman Islands financial services industry, and remain one of the most widely used vehicles selected by fund sponsors setting up private equity and real estate structures, tax transparent master funds and single investor vehicles.[509]

An ELP is a partnership[510] consisting of at least one general partner with responsibility for the management of the business of the partnership, and any number of limited partners who are the passive investors with limited liability.[511] An ELP is effectively a contract between partners that has no separate legal personality, and its general partner holds the ELP's assets on statutory trust and conducts all of its business and affairs (to the exclusion of the limited partners) on behalf of the partnership.[512] This balance of power facilitates passive investment and limits the liability of the investors.

[509] Cayman Islands General Registry, available at www.ciregistry.ky/partnerships-register/.
[510] Partnership Act (2013 Revision), s 3(1) defines a partnership as "the relation which subsists between persons carrying on business in common with a view to profit".
[511] ELP Act, ss 4(2) and 20.
[512] *Idem*, ss 14(2), 16 and 33(1).

4.7.2 Statutory framework of exempted limited partnerships

The principal statutes governing the formation and operation of the Cayman Islands' ELPs are the Partnership Act (2013 Revision) and the Exempted Limited Partnership Act (2021 Revision) (the ELP Act). Unlike most Cayman Islands statutes, the ELP Act has no English equivalent, and was originally drafted based on the Delaware limited partnership legislation.[513]

The ELP Act expressly provides that the principles of common law and equity applicable to partnerships will apply to an ELP.[514]

The operations of an ELP are also governed by the terms of a limited partnership agreement (LPA) agreed between the general partner and limited partners. which sets out the respective rights and obligations of the general partner and limited partners. The ELP Act provides that certain statutory powers or prohibitions are subject to the express provisions of the LPA.

4.7.3 Duties and liabilities of partners

A general partner of an ELP has a statutory duty to act in good faith at all times and, subject to any express provisions of the partnership agreement to the contrary, in the best interests of the ELP.[515] The effect of the language in section 19(1) of the ELP Act is that whereas the duty to act in the best interests of the ELP (and other fiduciary duties) can be modified or varied by express provision of the LPA, the duty of good faith cannot be waived or modified.

In *Kuwait Ports Authority*[516] the Grand Court considered the nature and extent of the duties owed by a general partner to a limited partner and the latter's ability to pursue direct claims for breach of those duties. Parker J held: [517]

> "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 duties, these claims are vested in the limited partners themselves and may be brought directly."

In addition to the powers vested in the limited partners to bring direct claims against the general partner, under section 33(3) of the ELP Act, limited partners also have a statutory right to bring derivative claims against third parties on behalf of the ELP where a general partner has, without cause, failed or refused to institute proceedings. In *Kuwait Ports Authority* the Court confirmed that this "straightforward test"[518] imposes no requirement to obtain leave of the Court to bring

[513] Uniform Limited Partnership Act as then in force in Delaware.
[514] ELP Act, s 3.
[515] *Idem*, s 19(1).
[516] (FSD 236 of 2020, unreported, Parker J, 25 November 2021).
[517] *Idem*, para 83.
[518] *Idem*, para 91.

or continue proceedings on behalf of the ELP, nor is it necessary for the limited partner to plead any special circumstances.[519]

In the event of insolvency, where the assets of the ELP are inadequate to meet the partnership's obligations, the general partner has unlimited liability and will be liable for all debts and obligations of the ELP.[520]

A limited partner has limited liability, meaning that it does not owe any fiduciary duties to the ELP or other partners in exercising rights or performing obligations under the partnership agreement, unless the partnership agreement provides otherwise[521] or the limited partner engages in the conduct of the business of the ELP.[522] The exclusion of the limited partner from the management of the ELP is the "*quid pro quo*" for the benefit of limited liability.[523]

For this reason a limited partner should not take part in the business of an ELP and all letters, contracts, deeds, instruments or documents must be entered into by the general partner on behalf of the ELP. If a limited partner takes part in the conduct of the business of an ELP and in the event of the insolvency of the ELP, that limited partner maybe liable to any person who transacted business with the exempted limited partnership during the period with actual knowledge of that limited partner's participation and who then reasonably believed the limited partner to be a general partner, for all debts and obligations of that exempted limited partnership incurred during the period that the limited partner participated in the conduct of the business, as though that limited partner were, for that period, a general partner.

The ELP Act provides a specific list of activities (known as "safe harbour" provisions) which may be undertaken by a limited partner without constituting "participation" in the conduct of the business of the ELP. These include, but are not limited to, the presentation of a winding up petition, approval of an amendment to the partnership agreement, acting as surety or guarantor for the ELP, and calling, requesting, attending or participating in any meeting of the partners.[524]

4.7.4 Liquidation and dissolution of exempted limited partnerships

Part V of the Companies Act and the CWR apply, with modifications, to the court-ordered winding up and dissolution of ELPs, and to a limited extent to a voluntary winding up.[525] Where there are inconsistencies, the ELP Act will take priority over the Companies Act.

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[519] This decision was subsequently upheld on appeal by the Cayman Islands Court of Appeal (CICA (Civil) Appeal Nos 002 & 003 of 2022, unreported, Field JA, Birt JA, Beatson JA, 20 January 2023).

[520] ELP Act, s 4(2).

[521] *Idem*, s 19(2). Also see *Kuwait Ports Authority* (FSD 236 of 2020, unreported, Parker J, 25 November 2021), para 84.

[522] ELP Act, ss 4(2) and 20(1).

[523] *Kuwait Ports Authority* FSD 236 of 2020, Unreported, 25 November 2021, para 49.

[524] ELP Act, s 20(2).

[525] *Idem*, s 36(3). See also *In the Matter of Duet Real Estate Partners* (FSD 22 of 2020, unreported Kawaley J, 9 June 2020), para 15 citing *Re XIO Diamond LP* (FSD 256 of 2019, unreported, Kawaley J, 30 April 2020).

The liquidation of an ELP consists of two distinct steps: its winding up and its subsequent dissolution.

An ELP may be wound up, and the winding up will be deemed to commence upon the earlier occurrence of any of the following circumstances:[526]

(a) the passing of a resolution for winding up (of all the general partners and a two-thirds majority of partners, unless otherwise specified in the partnership agreement);[527]

(b) the automatic wind up date (if a new qualifying general partner is not elected within ninety days after service of notice of withdrawal of the former general partner, the ELP);

(c) the expiry of the period fixed for the duration of the exempted limited partnership by the partnership agreement;

(d) the occurrence of an event providing by the partnership agreement upon which the ELP is to be wound up; or

(e) by order of the Court upon the presentation of the petition for winding up.[528]

Consistent with the principles applicable to the winding up of companies under Part V of the Companies Act, where the LPA includes a non-petition clause which expressly prohibits the presentation of a petition, this will be binding and will prevent a winding up petition being presented by the parties so bound.[529] In the case of *Re Rhone Holdings LP*,[530] Mangatal J struck out a winding up petition as an abuse of court process where the petitioner was contractually bound not to present such a petition pursuant to a non-petition clause contained in the LPA.

The presentation of a winding up petition may also be stayed pending the resolution of a dispute over debt where the terms of the LPA expressly provide that any such dispute should be determined by arbitration.[531] In referring to earlier authorities, the Court in *Grand State Investments Limited*[532] re-confirmed that once it is established that a debt is *bona fide* disputed on substantial grounds, in circumstances where the dispute falls within the scope of an arbitration agreement, the Court will normally exercise its discretion to stay a winding up petition.[533]

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[526] ELP Act, s 36(10).
[527] *Idem*, s 36(1)(b).
[528] *Idem*, ss 36(3)(g) and 36(10)(e). *In the Matter of Kuwait LBO Fund LP (In Voluntary Liquidation)* (FSD 273 of 2021, Unreported, 9 November 2021, Doyle J).
[529] See *Re Rhone Holdings LP* [(FSD 119 of 2015, unreported, Mangatal J, 29 September 2015), paras 53 to 57 and Companies Act, s 95(2).
[530] *Ibid*.
[531] *Re Grand State Investments Limited* (FSD 11 of 2021, unreported, Parker J, 28 April 2021).
[532] *Ibid*.
[533] *Idem*, para 75.

In the event of the death, commencement of liquidation or bankruptcy proceedings, or the withdrawal, removal or making of a winding up or dissolution order in relation to the sole or last remaining qualifying general partner, the ELP will (subject to any express or implied term in the partnership agreement) be wound up on the date falling 90 days after the date of the service of a notice on all the limited partners informing them of that event (the automatic wind up date).[534] However, the business of the ELP may be resumed and continued if, before the automatic winding up date, the requisite majority of the partners elect a new eligible general partner.[535] The necessary majority is such majority specified in the partnership agreement as being entitled to vote to elect a new general partner, or if no such majority is specified in the partnership agreement, a simple majority of the partners (determined by reference to capital contributions).

The ELP Act incorporates express provisions from Part V of the Companies Act to the application and distribution of property on winding up[536] – including clawback provisions for the recovery of assets which have been disposed of in circumstances of undue preferences or dispositions at an undervalue. Any surplus remaining after the satisfaction in full of all the ELP liabilities is distributed to the partners in accordance with their rights under the partnership agreement.

On completion of the winding up, the general partner or other liquidator must sign and file a notice of dissolution with the Registrar, following which the ELP is dissolved.[537]

There has been some debate in the Courts of the Cayman Islands recently over the appropriate procedure for presentation of a winding up petition in respect of an ELP, in particular as to whether the petition may be presented directly against an ELP or may only be presented against the general partner (in its capacity as general partner of the ELP).

In the decision of *Padma Fund LP*[538] Parker J held that the Grand Court has no jurisdiction to wind up an ELP on a petition presented by a creditor as this is inconsistent and contrary to the provisions of the ELP Act. He considered that the appropriate route for an aggrieved creditor is to commence proceedings against the general partner of the ELP on the basis that:

(a) an ELP does not have a separate legal personality;

(b) section 33(1) of the ELP Act provides legal proceedings (which necessarily include winding up petitions) are to be brought against the general partner only;[539]

(c) section 36(3) of the ELP Act (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);[540]

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534 ELP Act, s 36(7) and (11).
535 *Idem*, s 36(12).
536 *Idem*, s 36(3).
537 *Idem*, s 36(2).
538 (FSD 201 of 2021, unreported, Parker J, 8 October 2021).
539 *Idem*, para 65.
540 *Idem*, paras 47-53.

(d) as section 36(3) of the ELP Act provides in the event of any inconsistency with the Companies Act, the ELP Act will prevail;[541] and

(e) the entities over which the Court has jurisdiction to grant a winding up order are set out in section 91 of the Companies Act and such entities do not include an ELP, but rather include a foreign company which "is the general partner of a limited partnership".[542]

However, subsequently Kawaley J in *Formation Group (Cayman) Fund I LP*[543] held that a winding up petition may be presented directly against an ELP, and not just against its general partner for the following reasons:

(a) section 33(1) of the ELP Act does not provide that legal proceedings cannot be brought against an ELP. Rather, it creates a general rule immunising 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;[544]

(b) section 36(3) of the ELP Act 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;[545]

(c) the available evidence of the legislative history preceding section 36(3) of the ELP Act 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. This legislative history was not before Parker J in *Padma Fund LP*[546] and was not considered by him;[547]

(d) section 36(3) of the ELP Act 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;[548]

(e) 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;[549] and

(f) 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 Order 81, rule 1 of the Grand Court Rules.[550]

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[541] *Idem*, para 50.
[542] *Idem*, para 90.
[543] (FSD 366 of 2021, unreported, Kawaley J, 21 April 2022).
[544] *Idem*, para 14.
[545] *Idem*, para 21.
[546] (FSD 201 of 2021, unreported, Parker J. 8 October 2021).
[547] *Formation Group (Cayman) Fund I LP* (FSD 366 of 2021, unreported, Kawaley J, 21 April 2022), para 35.
[548] *Idem*, para 37.
[549] *Idem*, para 38.
[550] *Idem*, paras 40-42 and 45.

Both of these cases are first instance decisions and this specific issue is yet to be considered by the Court of Appeal. However, as *Formation Group* is the latest decision on the question it should be taken to represent the current law of the Cayman Islands – that a petition to wind up an ELP may be presented against the ELP.

4.7.5 Strike Off

Where an ELP is not carrying on business, or is not in operation, the general partner may request that it be struck off the register by the Registrar and be dissolved.

A partner or creditor who objects to an ELP being struck off the register may, within the period of up to 10 years following the date the ELP was struck off, apply to Court for the ELP to be reinstated. The striking off the register of an ELP does not affect the liability, if any, of any general partner or limited partner of the ELP, and the liability continues and may be enforced as if the ELP had at all times continued to be in existence.

The strike-off provisions therefore provide a convenient, simpler alternative to formal dissolution which will be suitable for some ELPs; but the reinstatement provisions mean that strike-off is a less final method of terminating an ELP.

Self-assessment questions

Question 1

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

Question 2

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

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?

For feedback on these self-assessment questions, see the document "Comment and Feedback on Self-Assessment Questions", which is made available to you as a separate document

CHAPTER 5

CORPORATE RESCUE AND OTHER PROTECTIVE MEASURES / MECHANISMS

5.1 Introduction

Until the introduction of the restructuring officer regime through the amendment of Part V of the Companies Act on 31 August 2022, the Cayman Islands had no equivalent to Chapter 11 of the United States' Bankruptcy Code or the UK's Administration procedure (in other words, there was no formal corporate rescue mechanism available). Despite the absence of such legislative apparatus, Cayman Islands lawyers and the judiciary found innovative means of facilitating the rescue and rehabilitation of insolvent Cayman Islands companies. Such innovations can be traced back to the *Fruit of the Loom*[551] case in which the Grand Court appointed joint provisional liquidators (JPLs) to an insolvent company, not because there was a risk of dissipation of assets, but rather because there was a prospect of the company's enterprise being saved if the directors were given sufficient breathing space to pursue that outcome. This was a remarkable development at the time because the companies legislation then in force only contemplated JPLs being appointed in a "risk of dissipation" scenario.

In 2009, the companies legislation was amended to allow a company to apply for the appointment of JPLs on the basis that the company was insolvent and it intended to present an arrangement to its creditors.[552] That application could only be made within winding up proceedings. This methodology for restructuring Cayman Islands companies (within a statutory moratorium) prevailed until August 2022 when the Cayman Islands' corporate rescue apparatus was completely overhauled.

Insolvent Cayman Islands companies can now petition for the appointment of a restructuring officer. The petition for the appointment of a restructuring officer is made without need for winding up proceedings. The moratorium on creditor action arises immediately upon filing of this petition (rather than upon appointment, as was the case for JPLs under section 104(3) of the Companies Act). The restructuring officer regime includes a provision (section 91I) which allows a Scheme to be proposed to creditors within a restructuring officer appointment (RO Scheme).[553] Section 91I mirrors section 86 (the longstanding scheme of arrangement provision, which is also the subject of this chapter) and was included in the restructuring officer regime with hopes of a RO Scheme being recognised in the UK and overcoming the "Rule in Gibbs";[554] that is, that a UK debt can only be compromised pursuant to a UK restructuring.

In cases where there is perceived to be a low risk of creditor enforcement (and so a moratorium is not essential), or where the liabilities of the company do not include significant English law governed debt (and so the Rule in Gibbs does not have to be overcome), it will be open to financially distressed Cayman Islands companies to use the traditional scheme of arrangement

[551] *In the Matter of Fruit of the Loom* [2000] CILR, Note 78.
[552] Companies Law, s 104(3) (as it then was) was inserted.
[553] The RO Scheme process is only referenced here and is covered in detail in para 5.4 below.
[554] *Antony Gibbs & Sons v La Société Industrielle et Commerciale des Métaux* (1890) 25 QBD 399.

provision (section 86 of the Companies Act) to promote an arrangement with creditors, rather than to take the route of appointment of a restructuring officer and a RO Scheme.

The above commentary pertains to arrangements between a company and its creditors and the alternatives of a moratorium-bound RO Scheme, or a "free-standing" creditors' scheme of arrangement pursuant to section 86 of the Companies Act. These alternatives do not exist for arrangements between Cayman Islands companies and their shareholders. Cayman Islands schemes between a company and its members are, as they have always been, advanced pursuant to section 86 of the Companies Act.

5.2 Informal creditor workouts

Before seeking to invoke a formal restructuring or insolvency process, a company may seek to refinance or restructure is financial obligations informally, or out of court. In the right circumstances this can be a more cost-efficient process which also allows the debtor to avoid adverse publicity frequently associated with the commencement of formal process. Ultimately where value can be preserved and liquidations of viable companies avoided this will be to the advantage of the company and its stakeholders as whole.

An informal workout between a company and its creditors would usually be between a distinct class of the company's creditors rather than the creditor body as a whole. A significant risk to the debtor company in seeking an informal or out of court approach is that the company remains exposed to unilateral creditor enforcement action. In the absence of a moratorium coming into effect it is advisable to put in place standstill agreements.

Standards of best practice for informal workouts have developed overtime and the most influential source of those principals is INSOL International's International Statement of Principles for a Global Approach to Multi-Creditor Workouts[555] (INSOL Principles). These principles have in turn been developed from the approach that was adopted by the Bank of England in the 1970s, which was referred to as the "London Approach". The INSOL Principles have been endorsed by both the World Bank and the Bank of England, and provide that:

(a) The interests of all creditors are best served by coordinating their response to a debtor in financial difficulty.

(b) All creditors should agree to a standstill period on enforcement so they can properly evaluate the debtor's financial position and investigate the potential for a workout.

(c) Conflicts of interest in the creditor group should be identified early and dealt with appropriately.

(d) One or more creditor committees ought to be established, with the benefit of professional workout advisors, as the potential for a workout is investigated and progressed. It is usual

[555] https://www.insol.org/_files/Publications/StatementOfPrinciples/Statement of Principles II 18 April 2017 BML.pdf.

practice for creditors' committees to appoint legal counsel and for the company to meet the reasonable costs of the committees' attorneys.

(e) The debtor should provide, and allow relevant creditors and professional advisors reasonable and timely access to, all relevant information relating to its assets, liabilities, business and prospects, to enable proper evaluation to be made of its financial position and any proposals to be made to relevant creditors.

(f) Any new financing provided should be accorded super-priority status.

These principles are a voluntary code and in the absence of a statutory moratorium the debtor remains exposed to the risk of unilateral creditor enforcement action. In the Cayman Islands a moratorium may now be put in place by the filing of a petition seeking the appointment of a restructuring officer (as discussed in paragraph 5.4.4). While commencement of the restructuring moratorium occurs at an earlier stage to the moratorium which applies on the appointment of provisional liquidations (discussed in paragraph 5.3.3.4 below), the moratorium remains part of a formal process as opposed to being a standalone stay on enforcement action where a restructuring is negotiated.

Notwithstanding the absence of a formal process it is common and in many instances of great value for a financial advisor to be retained to assist in the development and negotiation of an informal workout. A suitable professional would be one who could otherwise act as a restructuring officer or liquidator. While the debtor will incur an inevitable cost for the services of that professional, the neutrality of a third party with expertise in brokering resolutions can be hugely beneficial to the company and creditors alike.

5.3 Formal corporate rescue mechanism – provisional liquidation

5.3.1 Purpose of provisional liquidation and standing to apply

5.3.1.1 What is provisional liquidation?

Provisional liquidation is one of three types of corporate liquidation processes available under the Cayman Islands Companies Act, Part V.[556] As in the case of voluntary and official liquidation, provisional liquidators may be appointed to any company, partnership or corporate entity which is liable to be wound up under the jurisdiction of the Grand Court.

In contrast to the appointment of official liquidators, which is commenced by filing a winding up petition, an application for the appointment of provision liquidators is made by way of summons after a winding up petition has been filed, but before a winding up order has been made.[557]

[556] See Ch 4 (Corporate Liquidation).
[557] Companies Act, s 104(1).

The circumstances in which an application for provisional liquidation may be available, and who may apply for the appointment of provisional liquidators, are set out in section 104 of the Companies Act, 2021 (as revised).

Prior to the changes brought into effect by the Companies (Amendment) Act on 31 August 2022,[558] the appointment of provisional liquidators could be sought as either:

(a) a powerful means of protecting the assets and affairs of the company from abuse, dissipation or misappropriation by management and / or majority members of the company; or

(b) a mechanism which enabled the company to develop and propose a restructuring of its financial obligations with its stakeholder, or any class of thereof.

With the recent introduction of the restructuring moratorium and role of restructuring officers,[559] and amendments of the Companies (Amendment) Act, a company may make an application for the appointment of provisional liquidators under section 104(1) of the Companies Act and "on such application the Grand Court may appoint a provisional liquidator if it considers it appropriate to do so".[560]

Notably, the amended terms of section 104(3) of the Companies Act are broad and do not preclude a company from seeking to appoint provisional liquidators for the purposes of proposing a restructuring. For whichever purpose a company seeks to have provisional liquidators appointed, the Grand Court must be persuaded that the appointment must be appropriate. The Grand Court has not yet had the opportunity to consider when it would be appropriate to appoint provisional liquidators on the company's application, and the potential breadth of this new statutory provision remains to be determined.

Outside of applications which may be made for provisional liquidators by the company, creditors and contributories of the company may in specified circumstances seek the appointment of provisional liquidators. These applications most commonly arise where a dispute has arisen between the management and / or shareholders of the company, and a winding up petition is presented pursuant to section 92(e) of the Companies Act on just and equitable grounds.

[558] See para 5.1 above.
[559] Companies Act, s 91B.
[560] *Idem*, s 104(3).

5.3.1.2 Standing

Standing of creditors and contributories

An application may be made by creditors or contributories of the company, or (in certain circumstances by the CIMA.[561]

Where an application is made by contributories of the company it is generally in circumstances where there is a dispute between the contributories or between contributories and management, resulting in a loss of trust and confidence and the presentation of a petition that the company be wound up on a just and equitable basis.

The standing of a creditor or contributory to bring the application may be a point in dispute, and the Court may proceed to determine this point through at the interlocutory stage, which may require considerable court time to evaluate a heavily contested fact pattern. Alternatively, it is open to the Court to take a pragmatic view and assume that the applicant has standing for the purposes of considering the merits of the provisional liquidation application.[562] The latter approach defers the consideration of standing of the applicant where in dispute until such time as it is decisive in the appointment of provisional liquidators enables the provisional liquidation application to be managed by the Court in line with the overriding objective , as set out in the Preamble to the Grand Court Rules. The overriding objective provides that litigation and proceedings before the Court must be conducted and managed in a way that is "just, expeditious and economical.[563]

Standing of the company

Between a winding up petition being filed and a winding up order being made, it is open to the company to seek the appointment of provisional liquidators, pursuant to section 104(3) of the Companies Act.

Section 104(3) of the Companies Act does not stipulate the circumstances in which a company may seek the appointment of provisional liquidators and provides only that "the Court may appoint a provisional liquidator if the Court considers it appropriate to do so". This is in contrast to the very specific grounds on which creditors and contributories are entitled to seek the appointment of provisional liquidators (discussed immediately below). It will ultimately be for the discretion of the Court whether it is appropriate to appoint provisional liquidators in any one case, and the terms of section 104(3) indicate that this discretion is broad.

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[561] *Idem*, s 102(2). CIMA is able to seek the appointment of provisional liquidators where the debtor company is carrying on a regulated business within the Islands without being duly licensed or registered to do so. The instances of these applications are rare and are not considered further in these materials, which focuses on the applications which may be made by a creditor, contributories or the debtor company.

[562] *In the Matter of ICG I,* FSD 192 of 2021 (DDJ) (unreported, judgment dated 4 August 2021), para 10.

[563] Grand Court Rules, Preamble.

5.3.1.3 Grounds for seeking appointment of provisional liquidators

(a) Creditors and contributories

Section 104(2) of the Companies Act provides the grounds on which provisional liquidators may be appointed on the application of a company's creditors or contributories, namely where:

(a) there is a *prima facie* case for making a winding up order (*Prima Facie* Hurdle); and

(b) the appointment of a provisional liquidator is necessary in order to:

(i) prevent the dissipation or misuse of the company's assets;[564]

(ii) prevent the oppression of minority shareholders;[565] or

(iii) prevent mismanagement or misconduct on the part of the company's directors.[566] (collectively, the Necessity Hurdle).

In *Orchid Development Group Limited*[567] Jones J emphasised that the Court only has jurisdiction to appoint provisional liquidators in the very specific circumstances set out in the Companies Act, and it is in that context that the terms of section 104(2)(b)(i)-(iii) should be considered.

Further, as noted by Parker J in *In the Matter of Al Najah Education Limited*,[568] an order to appoint provisional liquidators as an interim remedy during winding up proceedings against a company "must always be viewed by the Court as a serious step. The potential adverse consequences for the company are in most cases likely to be considerable, both in relation to its commercial operations and its business reputation more generally." The seriousness of the application was echoed by the Doyle J in *In the Matter of ICG I*[569] who stated with reference to a trading company in particular "[i]t is not an order to be made lightly and its making required the giving by the Court of the most anxious consideration".[570]

The requirements that must be satisfied by a creditor or contributory making an application for provisional liquidators have recently been considered in *ICG I*.[571] In that case, the purported majority shareholder of the company sought the appointment of provisional liquidators on the basis that there was a need to undertake an investigation and to preserve the books and records of a related company, ICGi, where the dealings between the two companies had become confused.

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[564] Companies Act, s 104(2)(b)(i).
[565] *Idem*, s 104(2)(b)(ii).
[566] *Idem*, s 104(2)(b)(iii).
[567] (2012 (2) CILR Note 14), para 5.
[568] FSD Cause No 119 of 2021 (unreported, 9 August 2021), para 33.
[569] FSD Cause No 192 of 2021 (DDJ) (unreported, 4 August 2021).
[570] *Idem,* para 21.
[571] *Ibid.*

The application was ultimately denied on the basis that the while the petitioner may have had genuine and serious concerns as to how the affairs of the company were being managed by the directors, the petitioner had failed to satisfy the heavy and onerous burden of satisfying the Necessity Hurdle.[572]

In addition to the *Prima Facie* Hurdle and Necessity Hurdle, Doyle J identified that the petitioner must also satisfy the Court that a winding up petition has been presented and that the applicant has standing in order to seek the appointment of provisional liquidators. While the question of the petitioner's standing was an issue in *ICG I,* for the purposes of hearing the application Doyle J was prepared to assume this criteria was satisfied. In the event that the Court had been satisfied that the Necessity Hurdle was satisfied, the issue of standing would then need to have been resolved.

In practice the requirements under section 104 of the Companies Act that are most frequently contested are the *Prima Facie* Hurdle and the Necessity Hurdle, in the context of winding up petitions presented on the just and equitable basis.

Prima facie hurdle

The applicant must demonstrate to the satisfaction of the Court that it is more likely than not that a winding up order would be made on the hearing of the winding up petition.

Where the petition is brought by a creditor, it will be sufficient to demonstrate to the civil evidential standard that the petition debt is due and payable and is not the subject of a genuine or *bona fide* dispute, and that the company is unable to pay its debts within the meaning of section 93 of the Companies Act.

The *Prima Facie* Hurdle is more difficult to assess where the petition is presented on just and equitable grounds, but requires the applicant to demonstrate an objectively justifiable loss of confidence in the company's management by the petitioner.[573]

In *Asia Strategic Capital Fund LP*[574] Segal J held that:

> "It is not necessary to demonstrate that a winding up order will be granted. A prima facie case is established if the allegations made in the petition for the appointment of provisional liquidators are supported by the evidence and have not been disproved, with any conflicts of evidence to be resolved at a substantive hearing."

This *dicta* was cited with approval by Parker J in *Grand State Investments Limited*,[575] and more recently endorsed by Kawaley J when appointing provisional liquidators on the application of

[572] See the discussion below in this regard.
[573] *In the Matter of Seahawk Dynamic Fund* Cause No. FSD 23 of 2022 (Unreported, 16 February 2022), para 38.
[574] [2015] (1) CILR Note 4.
[575] (Unreported, 28 April 2021).

majority contributory and exposed to a disputed dilution in *In the Matter of Global Cord Blood Corporation*.[576]

In *Global Cord Blood Corporation* a majority shareholder issued a just and equitable petition on the basis that all trust and confidence that the assets and affairs of the company were being managed properly had been lost. It was alleged, *inter alia*, that the chief financial officer of the company, which was a listed company, had put in evidence in proceedings before the Court a forged bank statement with the purpose of persuading the Court that the company had paid amounts in respect of a significant transaction when in fact those amounts had not been paid and the company did not have sufficient funds to pay the amount due.

While it was not necessary for the Court to make a positive finding that the bank statement in question had been forged, the chief financial officer had been given the opportunity to explain the discrepancies in the forged bank statement, and merely denied the allegation of forgery without offering any further explanation in respect of the discrepancies that had been identified. The unanswered allegation of forgery was particularly compelling in the Court's decision to appoint provisional liquidators and Kawaley J opined that "it was difficult to imagine a stronger case for appointing provisional liquidators than the present situation",[577] which indicated a serious risk of mismanagement and misconduct by the company's directors.

In *In the Matter of Seahawk Dynamic Fund*[578] Doyle J found that the *Prima Facie* Hurdle was satisfied where the serious allegations of misconduct in respect of the company had resulted in an objectively justifiable loss of confidence by the petitioner. The petitioner alleged that the director who held 100% of the management shares of the company had acted dishonestly by, *inter alia*:

(i) attempting to divert significant assets from the company for his own benefit;

(ii) purporting to make amendments to the company's constitutional documents and investment management agreement so that the performance fee payable to the manager would have been paid to him as director; and

(iii) wrongly taking steps to dilute and amend the constitutional documents of the company so as to exclude from the petitioner from management of the company.

The Court will not be likely to find that the *Prima Facie* Hurdle has been satisfied where there is no evidence of ongoing mismanagement at the company or risk of future mismanagement. It was on this basis that the Court refused to appoint provisional liquidators in *Re Al Najah Education Limited*[579] and noted that the former directors – who had been found to have engaged in very serious dishonesty offences directly concerning the company – were no longer directors of the company. On the evidence before the Court, it appeared that the company was "well run

[576] Cause No FSD 108 of 2022 (Unreported, 28 September 2022).
[577] *Idem*, para 27.
[578] Cause No FSD 23 of 2022 (Unreported, 16 February 2022).
[579] *FSD Cause No 119 od 2021 (unreported, 9 August 2021),* para 52.

and profitable in all the prevailing circumstances … and enjoys the support of its employees and customers".

Necessity hurdle

The evidential threshold for satisfying the Necessity Hurdle is a "heavy burden"[580] and the Court requires clear and strong evidence that the appointment of provisional liquidators is necessary in order to prevent the dissipation or misuse of the company's assets, and / or the oppression of minority shareholders, and /or mismanagement or misconduct on the part of the company's directors.[581]

In respect of the need to prevent a risk of dissipation, the evidential threshold is not the same standard which applies to the risk of dissipation where a freezing injunction is sought. It is sufficient for the applicant to show that the assets are being or are likely to be dissipated to the detriment of the petitioners.[582]

Where provisional liquidators are sought for the purposes of preventing mismanagement or misconduct on the part of the company's directors, it is necessary to demonstrate that the directors are culpable of behaviour involving a breach of duty or improper behaviour that involves a breach of the company's governing documents or governance regime.[583]

In *Pacific Fertility Institutes Holding Company Limited*[584] Kawaley J appointed provisional liquidators having been satisfied that their appointment was necessary because there was a clear risk of dissipation of assets from the company where the principal of the company was directly or indirectly engaged with misconduct in connection with the company's affairs. In this case the principal director of Pacific Fertility had been convicted and questioned by police in connection with the suspected misappropriation of funds from the company.

In contrast, in *ICG I*[585] Doyle J did not consider the applicant to have discharged the heavy burden of demonstrating that the appointment of provisional liquidators was necessary. The application had been premised on there being inter-mingling of assets between ICG I and its affiliate company ICGi. His Lordship denied the application for provisional liquidators for the reasons that, *inter alia*:

(a) provisional liquidators were not necessary to prevent dissipation or misuse of ICGi's assets. The assets comprised two assets in Japan. Those assets were subject to seizure orders which made it difficult for the properties to be disposed of while those orders remained in place.

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[580] *In the Matter of Re CW Holdings Limited* (unreported, 3 August 2018), para 62; and *In the Matter of ICG I,* Cause No FSD 192 of 2021 (DDJ) (unreported, judgment dated 4 August 2021), paras 23 and 36.
[581] *Ibid*.
[582] *In the Matter of Asia Strategic Capital Fund LP* (Unreported, 30 April 2015), [2015 (1) CILR Note 4].
[583] *Idem*, para 60.
[584] (Unreported, 17 July 2019).
[585] FSD Cause No 192 of 2021 (DDJ) (Unreported, 4 August 2021).

Furthermore, an independent director had been appointed who could take control of the assets; and

(b) the misconduct by management alleged to have taken place occurred in the past and the appointment of receivers and independent directors to the company appeared to have brought any misconduct under control. Between the hearing of the application for provisional liquidation and the hearing of the principal petition for winding up, the management of the company would be in the hands of Deloitte & Touché against whom no complaint had been raised.

Where the appointment of provisional liquidators is based on the apparent mismanagement and misconduct by the company's board of directors, there is likely to be an immediate need for the affairs of the company to be investigated.[586] It remains open whether the need to investigate a company's affairs is a free-standing basis on which to make a winding up order on just and equitable grounds.[587] However, the Court has determined that the need for an investigation is not sufficient by itself to justify the appointment of provisional liquidators, as stated by Parker J:

> "I should add that the need for an investigation is not enough by itself to satisfy the statutory test under s104(2). The court only has jurisdiction to appoint JPLs if it is necessary to prevent one or more of the risks set out. There needs to be strong evidence to show that an order is necessary for that purpose."[588]

Where the Court is not satisfied that the Necessity Hurdle has been satisfied, but there remains a need to investigate the company's affairs, it may be appropriate for an alternative order to be made by the Court to regulate the company's affairs which could include the appointment of Inspectors or an independent director.[589]

(b) Application by company for appointment of provisional liquidators

Between a winding up petition being filed and a winding up order being made, it is open to the company to seek the appointment of provisional liquidators.[590]

Previously a company was expressly permitted to seek the appointment of provisional liquidators where it intended to propose a compromise or arrangement to its creditors and / or contributories (or a class thereof). However, as of 31 August 2022, the express right of a company to apply for the appointment of provisional liquidators for the purposes of proposing a compromise or arrangement has been removed from the Companies Act. In its place, the

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[586] *In the Matter of Seahawk China Dynamic Fund* Cause No, FSD 23 of 2022 (Unreported, 16 February 2022).
[587] *In the Matter of Paradigm Holdings Limited* 2004-05 CILR 542, para 35; *In the Matter of GFN Corporation Limited* 2009 CILR 135, para 42; and *In the Matter of Fortune Nest Corporation* (Unreported, 5 February 2013), paras 30-33.
[588] *In the Matter of Al Najah Education Limited* Cause No FSD 119 of 2021 (Unreported, 9 August 2021), para 51.
[589] Companies Act, s 95(3).
[590] *Idem*, s 104(3).

revised language of section 104(3) does not stipulate the grounds on which a company may seek the appointment of provisional liquidators, and provides only that the Court may appoint provisional liquidators where the Court considers it appropriate to do so.

This is in contrast to the specific grounds on which creditors and contributories are entitled to seek the appointment of provisional liquidators. The evidential requirements imposed on a company making an application for provisional liquidators are simply that the board of directors of the company must consider the appointment of provisional liquidators to be in the best interests of the company.[591]

Notably, the amended terms of section 104(3) do not preclude a company from seeking the appointment of provisional liquidators where it intends to present a restructuring proposal to its creditors or members (or a class thereof). For example, where there is uncertainty as to whether a compromise or arrangement presented by a restructuring officer or the authority of the restructuring officer would be recognised in a foreign jurisdiction it may be appropriate for the company to seek the appointment of provisional liquidators for the purposes of presenting and implementing a restructuring of its financial obligations, which is likely to be in the best interests of the company.

5.3.2 Procedural requirements

The procedural requirements which set out how an application for provisional liquidators should be made, are set out in the CWR.

Whether the application is made by the company, a creditor or contributory it must be made by way of ordinary summons[592] which is filed as an application in the proceedings commenced by the winding up petition.

The evidential requirements set out in the CWR for applications made by stakeholders (creditors or contributories) differ from the requirements of applications made by the company itself.

5.3.2.1 Documents required

Applications by creditors and contributories

The documents required for applications by a creditor or contributory seeking the appointment of provisional liquidators are an:

(i) ordinary summons on notice to the company;[593]

[591] CWR, O 4, r 6(2).
[592] *Idem*, O 4, r 1.1(1) (Creditors of Contributories); and O 4, r 6(1) (Company).
[593] *Ibid*, O 4, r 1(1).

(ii) affidavit (or affidavits) in support of the summons addressing the grounds justifying the appointment of provisional liquidators;[594] and

(iii) affidavit from each of the nominated provisional liquidators giving their formal consent to act as provisional liquidators, should the Court grant the application.[595]

When preparing an application to appoint provisional liquidators it is also prudent to prepare a draft order to be provided to the Court at the time the application is filed. The terms of an appointment order for provisional liquidators are discussed in paragraph 5..3.2.3 below.

As provided for in Order 4, rule 2(1) of the CWR:

> "The application shall be supported by an affidavit or affidavits containing all the relevant evidence upon which the applicant relies, to which all the documents intended to be relied upon must be exhibited."

The relevant evidence in this case would be the matters required to satisfy the Court that it has jurisdiction to appoint provisional liquidators, and that the *Prima Facie* and Necessity Hurdles (discussed above in paragraph 5.3.1.3) have been fulfilled.

It may be the case that the creditor or contributory applying for provisional liquidators is not the party who has presented the winding up petition against the company. If that is the case the creditor or contributory make seek to have persons other than the person nominated to act as liquidator in the petition to be appointed as provisional liquidators.

In these circumstances and in accordance with Order 4, rule 2(2) of the CWR, the creditor or contributory must also provide a Consent to Act in the form of an affidavit containing the information stipulated in Order 3, rules 4 and 5 of the CWR, depending on whether a nominee resident within the jurisdiction is nominated alongside a foreign practitioner. At least one of the nominated provisional liquidators must be resident within the jurisdiction, and a foreign IP may also be appointed where necessary, such as where the operations and assets of the company which need to be managed by the provisional liquidators are located in a foreign jurisdiction. The content of the Consent to Act is addressed in paragraph 5.3.3.3 below.

In contrast to an application made by the company, creditors and contributories are required to provide an undertaking the Court that any damage suffered by the company by reason of the appointment of the provisional liquidators and the remuneration and expenses of the provisional liquidators.[596] While the Court may dispense with the need for applicants to provide an undertaking, the requirement reflects the seriousness of an application for provisional liquidators and the potential adverse consequences an application may have on a company "both in relation to its commercial operations and its business reputation more generally".[597]

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[594] *Ibid*, O 4, r 2(1).
[595] *Ibid*, O 4, r 2(2).
[596] *Ibid*, O 4, r 3.
[597] *In the Matter of Al Nahaj Education Limited* Cause No FSD 119 of 2021 (Unreported, 9 August 2021), para 33.

Applications by the company

Where the company seeks the appointment of provisional liquidators it will be necessary for the company to prepare and file an:

(i) ordinary summons seeking the appointment of provisional liquidators;[598]

(ii) affidavit in support of the summons sworn on the authority of the company's board of directors containing a statement of the reasons why the company's board of directors believes that the appointment of provisional liquidators would be in the best interests of the company; [599] and

(iii) affidavit from each of the nominated provisional liquidators giving their formal consent to act as provisional liquidators, should the Court grant the application.[600]

As in the case of an application made by creditors or contributories, it would be usual for a draft appointment order to be submitted along with the summons and supporting evidence. In contrast to applications made by creditors or contributories, under the CWR a company may make an application for provisional liquidators on an *ex parte* basis, without needing to establish exception circumstances.

5.3.2.2 Process

Whether the application is brought by the company or by creditors of contributories of the company the application documents and evidence will first be filed with the FSD of the Court.

The application for the appointment of provisional liquidators is generally heard on the first return date of the winding up petition. If the application for provisional liquidators is successful, the winding up petition will be adjourned for a period of time sufficient for the provisional liquidators to take office, establish the status of the company's affairs and make a report to the Court.

It is possible for an application to be expedited for reasons of urgency. That urgency may arise from the same reasons which give rise to the application of provisional liquidators (that is, risk of dissipation or assets or mismanagement causing prejudice to the interests of the company and its stakeholders). Equally, the company may seek to have its application for provisional liquidators expedited, such as where it was subject to competing insolvency applications in foreign jurisdictions, but where it was considered far more appropriate for provisional liquidators under the supervision of the Court to be appointed.[601]

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[598] CWR, O 4, r 6(1).
[599] *Ibid*, O 4, r 6(2).
[600] *Ibid*, O 4, r 6(4).
[601] *In the Matter of Sun Cheong Creative Development Holdings Limited* [2020 (2) CILR 942] (Smellie CJ).

Creditors and contributory application

Order 4, rule 1(3) of the CWR provides that an application for the appointment of provisional liquidators made by a creditor or contributory may be heard in chambers. It would be usual practice for such an application being made in the FSD to be heard in the chambers of the judge assigned to hear the winding up petition.

Applications for the appointment of provisional liquidators brought by creditors or contributories of the company are governed by the Order 4, Part 1 of the CRW. Unless there are "exceptional circumstances" the company must be given as least four clear days' notice of the hearing of the application.[602]

It is only in exception circumstances[603] where an application brought by a creditor or contributory may proceed without giving notice or only giving short notice to the company, reflects the general principle that an order should not normally be made against a party without giving such party an opportunity to be heard. There are exceptions to this rule including:

(i) firstly, where the genuine and exceptional urgency of the situation requires the matter to proceed immediately and without notice. However, these are very rare cases; and

(ii) secondly, notice may be shortened or dispensed with entirely where it appears likely that if notice is given the defendant or others would take action which would defeat the purpose of the application before any order could be made and any damage, which may be compensated under the cross undertaking, or the risk of uncompensatable loss is outweighed by the risk of injustice to the plaintiff if the order is not made without notice.[604]

In any case where the application is made *ex parte* (whether or not on notice to the company) the applicant will owe a duty to make full and frank disclosure. Further the evidence filed in support of the application must state the reasons for proceeding without notice or with only short notice.[605]

Circumstances which have been found by the Court to justify proceeding with an *ex parte* application for the appointment of provisional liquidators without the company having notice or only being given short notice where the evidence disclosed an immediate risk of dissipation of assets from the company and a risk of concealment of the company's records that the very purpose of the application would be defeated.[606] In *Seahawk China* serious allegations of dishonesty and concealment were made against the director who held 100% of the company's management shares. The Court was persuaded by the point that once the director had knowledge that his dishonesty had been discovered, there was a further risk that the director

[602] CWR, O 4, r 1(2).
[603] *Ibid*.
[604] *Cathay Capital Holdings III LP* (Unreported, 24 August 2021), para. 15. This is further reflected in the Financial Services Division Guide, B1.2(b).
[605] *Idem*, para 24.
[606] *In the Matter of Seahawk China Dynamic Fund,* Cause No. FSD 23 of 2022 (Unreported, 16 February 2022).

would take further steps to conceal the extent of his dishonesty, and that in the circumstances the interests of justice the Court should proceed on an *ex parte* short notice basis.[607]

In *In the Matter of Principal Investing Fund 1 Limited*[608] Doyle J permitted an application for the appointment of provisional liquidators to proceed without notice being given to the company, because giving notice would enable the alleged wrongdoers in control of the funds to defeat the object of the applications either entirely or to some significant extent by further dissipating or misusing the company's assets, and increase the risk that necessary documents and records where not held by service providers would be destroyed or fabricated.

5.3.2.3 Orders

Irrespective of whether the provisional liquidators have been appointed on the application of the company or creditors of contributories of the company the appoint order must be in the prescribed form,[609] detailing:

(i) the full names and contact details of the provisional liquidators;[610]

(ii) the powers and authority of the provisional liquidators;[611]

(iii) the powers and authority of the company's board of directors which the directors remain authorised to exercise, and any limitations thereon;[612]

(iv) unless the requirement to advertise the appointment is dispensed with, details of where and by which date the order appointing the provisional liquidators must be advertised; and

(v) an order that the remuneration and expenses of the provisional liquidators must be paid out of the assets of the company in any event.

The Companies Act does not prescribe the scope of authority and powers which will be granted to provisional liquidators. The ability to draft the terms and scope of the provisional liquidators' appointment makes the provisional liquidation process inherently flexible and, when used appropriately, of significant value to the company and its stakeholders alike.

The powers and duties of provisional liquidators, including any reporting obligations which the provisional liquidators are to assume, are granted by the Court. The powers which are conferred on provisional liquidators will be determined by the grounds on which the application for their appointment has been made.

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[607] *Idem,* paras 22-27.
[608] Cause No FSD 268, 269 and 270 of 2021, (Unreported 17 September 2021).
[609] CWR, Form 7 (on the application of creditors of contributories); and Form 7A (on the application of the company).
[610] *Idem*, O 4, r 4(2).
[611] *Idem*, O 4, r 4(3).
[612] *Ibid*.

The Court will need to be persuaded that the terms of the order in any case are appropriate. It is important to anticipate the powers which the provisional liquidators may require during the course of their appointment. Doing so will avoid or limit the need for the provisional liquidators to seek further or additional powers from the Court during the course of their appointment.

Factors which should be considered in preparing an appointment order for approval by the Court, include:

(a) *International recognition*: many companies liable to be wound up in the Cayman Islands are holding companies of groups with operations and assets in other jurisdictions. As such it may be necessary for the provisional liquidators to obtain recognition of their appointment and powers from foreign courts. Provisional liquidators appointed by the Court frequently seek recognition under Chapter 15 of the United States' Bankruptcy Code and from the courts of the Special Administrative Region of Hong Kong.

(b) *Payment approval and oversight*: in circumstances where provisional liquidators have been appointed to prevent the misuse, misappropriation and /or dissipation of the company's assets, it is usual for the provisional liquidators to have supervisory control of the bank accounts of the company, and have authority to approve pending transactions from the company's bank accounts. It would be usually for the provisional liquidators to be given authority to open a bank account for the purpose of payment the costs and expenses of the provisional liquidation.

(c) *Engagement of attorneys and professional advisers*: the terms of the order should usually confer on the provisional liquidators the power to retain advisers included attorneys in all jurisdictions where it is anticipated the provisional liquidators will need to carry out their functions.

(d) *Entitlement to information and assistance*: with a view to preserving the assets of the company the provisional liquidators would require access to the books, records and documents of the company. Where the company is also a regulated entity the provisional liquidators should also be given authority to engage with and obtain information from regulatory bodies who have supervisory responsibility for the company.

(e) *Obligations of the board of directors*: the appointment of provisional liquidators does not automatically displace the board of directors. The terms of the order would usually include the right of the provisional liquidators to oversee the board and to attending any board meetings. The efficacy of the provisional liquidation process will depend in part on the cooperation received from the incumbent board of directors, and it is prudent for the terms of the order to include disclosure and cooperation obligations of management in respect of the provisional liquidators.

(f) *Reporting obligations*: the provisional liquidators are officers of the Court, and provisional liquidation is a court-supervised process. To that end the provisional liquidators will have obligations to keep the Court appraised of the conduct of the provisional liquidation and to

file a report at regular intervals, and in any event in advance of the next hearing of the winding up petition.

In contrast to official liquidators, provisional liquidators are not appointed with the statutory function of gathering in and realising the assets of the company in satisfaction of its liabilities. As such there is no adjudication or formal proving process provided for in a provisional liquidation.

While the terms of an order appointing provisional liquidators are likely to empower the appointed IPs to conduct investigations and commence proceedings in the name of or on behalf of the company, provisional liquidators do not have standing under the Companies Act to bring actions in respect of antecedent transactions, which are confined to actions brought by official liquidators during the winding up of a company.[613]

5.3.3 Appointment

5.3.3.1 Formalities of orders obtained by creditors or contributories

Immediately after the hearing, the applicant is required to draw up and file the order appointing the provisional liquidators with the Court.

Thereafter, the filing and service obligations that apply to winding up orders pursuant to Order 3, rule 23 of the CWR apply equally to orders appointing provisional liquidators following the application of creditors of contributories.

Within two business days of the order being made, the applicant is obliged to serve copies of the order appointing the provisional liquidators on:

(i) the company at its registered office;

(ii) every person who appeared and was heard at the hearing;

(iii) the provisional liquidators; and

(iv) where the company is licensed to carry on a regulated business, the CIMA.

Within seven business days of the order being made, the provisional liquidators are required to:

(i) file the appointment order with the Registrar of Companies;

(ii) send notice of the appointment order to the Government Information Service for publication in the next edition of the Cayman Islands Gazette; and

[613] Companies Act, ss 146 and 147.

(iii) send copies of the order to every person who appears to him to have been a director or professional service provider of the company at the time the winding up petition against the company was presented.

5.3.3.2 Formalities of orders obtained by the company

Where the company has secured the appointment of provisional liquidators, those provisional liquidators are required within seven days to:

(i) register the order of appointment with the Registrar of Companies;[614] and

(ii) send notice of the order to the Government Information Services for publication in the next edition of the Cayman Islands Gazette.[615]

Further, the provisional liquidators are required to give notice of their appointment to the company's creditors and contributories as directed by the Court, or in whatever manner appears to the provisional liquidators to be most expedient.

5.3.3.3 Qualifications of provisional liquidators

As set out in paragraphs 5.3.3.1 and 5.3.3.2 above, an application for the appointment of provisional liquidators must include from each proposed provisional liquidator an affidavit providing that nominee's "Consent to Act" as provisional liquidator, should the Court grant the application.

The content of a "Consent to Act" for provisional liquidators is set out in Order 3, r 4 (1) of the CWR (in respect of IPs residing within the jurisdiction) and Order 3, rule 4(2) of the CWR in respect of foreign IPs.

Included below is a summary table setting out the requirements for prospective provisional liquidators who reside within the jurisdiction, and foreign IPs who are proposed to act jointly with a resident IP.

	The provisional liquidator's supporting affidavit must contain the following information:	
	Local IP[616]	**Foreign IP**[617]
Qualification	A statement that he is a qualified IP within the meaning of the Insolvency Practitioners' Regulations	His professional qualifications and experience

[614] CWR, O 4, r 8(1).
[615] *Idem*, O 4, r 8(2).
[616] *Idem*, O 3, r 4(1).
[617] *Idem*, O 3, r 4(2).

Residency	A statement that he complies with the residency requirement in the Insolvency Practitioners' Regulations, Regulation 5.	Details of the country in which he is qualified to perform functions equivalent to those performed by an official liquidator appointed under the Companies Act.
Independence	Confirmation that, having made due enquiry, he believes that he and his firm meet the independence requirement in the Insolvency Practitioners' Regulations, Regulation 6.	Confirmation that, having made due enquiry, he and his firm meet the independence requirement in the Insolvency Practitioners' Regulations, Regulation 6.
Insurance	Confirmation that he and / or his firm are in compliance with the insurance requirement contained in the Insolvency Practitioners' Regulations, Regulation 7.	Confirmation that he will have the benefit of professional indemnity insurance meeting the requirements of the Insolvency Practitioners' Regulations.
Appointments	Confirmation that he is willing to act as official liquidator if so appointed	Full particulars of any foreign appointments as liquidator, trustee, receiver or administrator of the Company or a related party

5.3.3.4 Stay of proceedings

Once an order is made for the appointment of provisional liquidators the property and assets of the company are subject to a moratorium pursuant to section 97 of the Companies Act which provides that:

> "**Avoidance of attachments and stay of proceedings**
> 97. (1) When a winding up order is made or a provisional liquidator is appointed, no suit, action or other proceedings, including criminal proceedings, shall be proceeded with or commenced against the company except with the leave of the Court and subject to such terms as the Court may impose."

The statutory moratorium under section 97(1) of the Companies Act is treated by the Court as having extra-territorial effect, so as to maximise the ability of the stay to preserve value for the collective body of the company's stakeholders. It is a matter for the relevant foreign court whether, and to what extent, the statutory moratorium is upheld in a foreign jurisdiction.

The stay applies to actions and proceedings that are commenced or proceeded with by unsecured creditors and creditors holding security remain at liberty to enforce against the assets of the company.

5.3.3.5 Impact on operations of the company

The board of directors

The authority of the company's board of directors is not automatically displaced by the appointment of provisional liquidators. However, where the grounds giving rise to the need for provisional liquidators are premised on the misconduct and mismanagement of some or all of the board of directors, the terms of the appointment order are likely to severely curtail the powers and authority of the board, such that the authority of the board (or specific members) is effectively suspended for the duration of the provisional liquidation, subject to further direction of the Court.

Stakeholders and counter-parties

Right to appear

Creditors and contributories who have filed a notice of appearance in connection with the winding up petition will be entitled to appear at the hearing of the petition.

For the most part, the summons seeking the appointment of provisional liquidators will be listed for hearing at the same time as the petition, although it is possible for the application for provisional liquidators to be expedited in urgent situations.

While the notice of appearance relates to the winding up petition, the Court will hear and take into account the views of creditors and contributories in respect of the appointment of provisional liquidators at that hearing. In the absence of those creditors or contributories filing a competing summons for the appointment of provisional liquidators, those views can be placed before the Court by way of an affidavit.

Consultation

Provisional liquidators are officers of the Court and are required to discharge their duties in the best interests of the company's stakeholders. As in the case of an official winding up, the proper stakeholders of the company depend on whether the company is solvent, insolvent or of doubtful solvency.

There is no requirement to form a liquidation committee for the purposes of the provisional liquidators consulting with the company's creditors / stakeholders. Although the appointing party or the provisional liquidators may take the view that it would be beneficial to establish such a committee, and seek to include the power to establish a liquidation committee in the order of appointment.

Enforcement

Unsecured creditors of the company are precluded by the terms of the stay (see above, paragraph 5.3.3.4) from commencing or proceeding with any action or suit against the company or its assets. However, this does not preclude creditors from terminating contracts with the company if the terms of the relevant contract permit them to do so.

While unsecured creditors may be prevented from taking enforcement action, the provisional liquidators are not able to disclaim onerous contracts or property to the prejudice of the company's unsecured creditors.

5.3.4 Termination

The appointment of provisional liquidators is brought to an end by an order of the Court, discharging them from office where:

(i) the winding up petition is dismissed by the Court or withdrawn by the petitioner; or

(ii) a winding up order is made in respect of the company.

Where the discharge of the provisional liquidators is as a result of a winding up order being made in respect of the company, there is no need for an application discharging the provisional liquidators to be made, and the terms of the winding up order displace the order appointing provisional liquidators. In most instances it is the provisional liquidators who are subsequently appointed as official liquidators, in any event.

Where the winding up petition is to be withdrawn an application for discharge may be made by:[618]

(i) the person on whose application the order appointing provisional liquidators was made;

(ii) the petitioner, if he is not the party on whose application the provisional liquidators were appointed;

(iii) in respect of a creditor's petition, any other creditor;

(iv) in respect of a contributory's petition, any other contributory;

(v) in respect of the company's petition, CIMA; or

(vi) the company, acting by its directors.

[618] *Idem*, O 4, rr 5 and 9.

In each case the application must be made by summons, supported by an affidavit and must be served by the applicant seeking the discharge of the provisional liquidators on the provisional liquidators and every person who was entitled to be served with the order appointing the provisional liquidators.[619]

Self-Assessment Questions

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?

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?

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?

Question 4

Where are the powers of provisional liquidators prescribed?

Question 5

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

Question 6

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

[619] *Idem*, O 4, rr 5(3) and 9(3).

For feedback on these self-assessment questions, see the document "Comment and Feedback on Self-Assessment Questions", which is made available to you as a separate document

5.4 Formal corporate rescue mechanisms - restructuring officers

5.4.1 Introduction

On 31 August 2022, amendments to Part V of the Companies Act became effective which were intended to facilitate the efficient restructuring of distressed companies. Pursuant to the Companies (Amendment) Act and the Companies Winding Up (Amendment) Rules, 2022 (Amendment Rules), a company may now petition the Court for the appointment of a restructuring officer under the supervision of the Grand Court.

The Companies (Amendment) Act introduces the first restructuring regime in the Cayman Islands where the presentation of a winding up petition will not be required and under which an automatic stay takes effect as soon as a petition is presented, to prevent the continuation or commencement of any proceedings against the company without leave of the Grand Court.

Section 4 of the Companies (Amendment) Act imports new sections 91A to 91J into the Companies Act which give effect to the new restructuring regime. The Amendment Rules incorporate a new section 1A which prescribes the requisite procedures in order to invoke the new restructuring regime.

5.4.2 Test / who can apply?

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 (Restructuring Petition). A Restructuring Petition may be presented without a resolution of the company's members or an express power in its articles of association.[620]

The requirements for the appointment of restructuring officers are the same as the former requirements for the appointment of a provisional liquidator under section 104 (3) of the Companies Act, which has been repealed and replaced by the Companies (Amendment) Act.[621] That is, the satisfaction of a two-limb test: that (i) a company is or is likely to become unable to pay its debts as they fall due, and (ii) the company intends to present a compromise or

[620] Companies Act, s 91B(2).

[621] Following the enactment of the Companies (Amendment) Act, s 104(3) now provides that "An application for the appointment of a provisional liquidator may be made under subs (1) by the company and on such an application the Court may appoint a provisional liquidator if it considers it appropriate to do so".

arrangement to its creditors. In *Re Oriente Group Limite*,[622] the Grand Court confirmed that the well-established authorities on the interpretation of this test apply with equal force to the restructuring officer regime. These authorities (followed by *Re Oriente*) address how the interests of stakeholders are to be balanced and how advanced a restructuring proposal must be for a company to present a Restructuring Petition.[623]

5.4.3 Procedure

5.4.3.1 Documents / evidence

Every Restructuring Petition is required to be in Form Number 2A of the CWR. In addition to the inclusion of information regarding the incorporation and business of the company the petition is required to contain:

(i) a concise statement of the grounds upon which the appointment of the restructuring officer is sought;

(ii) the name and address of the person or persons whom the petitioner nominates for the appointment as a restructuring officer; and

(iii) a statement that the company either acting by the directors or the restructuring officer intends to present a compromise or arrangement to its creditors either pursuant to the Companies Act, the law of a foreign country, or by way of a consensual restructuring.[624]

A Restructuring Petition is "presented" when it is filed with the Grand Court. The company will be required to pay the filing fee prescribed in the First Schedule of the Court Fee Rules, which is currently KYD 5,000.

The Restructuring Petition is required to be supported by:

(a) an affidavit sworn by or on the authority of the company's board of directors containing, amongst other things:

  (i) a statement that, having made due enquiry and taken appropriate advice, the board believes that the company is or is likely to become unable to pay its debts (and the reason for the stated belief);

  (ii) a statement of the company's financial position specifying details regarding the company's assets and liabilities (including contingent and prospective liabilities) and an explanation of how the company will be funded in the event and during the restructuring period; and

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[622] (FSD 231 of 2022, unreported, Kawaley J, 8 December 2022).
[623] See, eg, *In the Matter of Sun Cheong Creative Development Holdings Limited* (FSD 169 of 2020, unreported, Smellie CJ, 20 October 2020).
[624] CWR, O 1A, r 1.

(iii) a statement of why the directors believe that the appointment of a restructuring officer and the mortarium will be in the bests interest of the company and if relevant, its creditors;[625]

(b) an affidavit sworn by the person or persons nominated for the appointment as restructuring officer containing matters which are specified in Order 3, rule 4 of the CWR, which relates to an official liquidator's consent to act.[626]

5.4.3.2 Process

Unless the Grand Court otherwise orders, once the Restructuring Petition is presented it is required to be advertised in accordance with Form Number 3A of the CWR:

(i) once in a newspaper having circulation in the Cayman Islands;[627] and

(ii) in a newspaper having circulation in a country (or countries) in which the petition is most likely to come to the attention of the company's creditors and contributories.[628]

The advertisements are required to appear no more than seven business days after the filing of a Restructuring Petition and not less than seven business days before the hearing date.[629]

This means that the default position is that a Restructuring Petition will be heard on notice to stakeholders. While the prior statutory framework provided that applications for appointment of provisional liquidators were to be made *ex parte*, recent authorities have emphasised the importance of notifying stakeholders in all but exceptional circumstances, so the new regime brings the application process in line with this practice.[630] A petition for the appointment of a restructuring officer on an *interim* basis pending the hearing of the Restructuring Petition may nevertheless still be made *ex parte* in appropriate circumstances.[631]

5.4.3.3 Hearing

Unless the Grand Court otherwise directs, all Restructuring Petitions should be heard within 21 days of presentation.[632] This provision enables companies to seek relief quickly and efficiently while also protecting creditors from debtor companies who may seek to use the statutory moratorium without progressing the substantive application or without a *bona fide* intention to restructure the company.

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[625] *Idem*, O 1A, r 2(2).
[626] *Idem*, O 1A, r 2(3).
[627] *Idem*, O 1A, r 1(3).
[628] *Idem*, O 1A, r 1(4).
[629] *Idem*, O 1A, r 1(6).
[630] See, eg, *In the Matter of Midway Resources International* (FSD 51 of 2021, unreported, Segal J, 30 March 2021).
[631] Companies Act, s 91C(1).
[632] CWR, O 1A, r 1.

Every Restructuring Petition must be heard in open court unless the Grand Court directs, for some special reason, that it should be heard in chambers.

Upon the hearing of a Restructuring Petition the Grand Court may:

(i) make an order appointing a restructuring officer;

(ii) adjourn the hearing conditionally or unconditionally;

(iii) dismiss the petition; or

(iv) make any other order as the Grand Court thinks fit except an order placing the company into official liquidation.[633] That is, the Grand Court will have no power to wind up a company on the basis of a Restructuring Petition.

5.4.4 Appointment of restructuring officers

5.4.4.1 Qualifications

Restructuring officers are officers of the Court and are required to be qualified IPs, save that the Court retains a discretion to appoint a foreign practitioner in appropriate cases[634] (on the condition that a foreign practitioner must not be appointed as the sole restructuring officer of the company). The Court may appoint two or more persons as restructuring officers and they must be authorised to act jointly and severally, unless otherwise ordered by the Court.

The Amendment Rules provide that the Insolvency Practitioners' Regulations which regulate the identity of an official liquidator and their remuneration will apply *mutatis mutandis* (with the necessary modifications) to restructuring officers, save that certain regulations do not apply to restructuring officers.[635]

A qualified IP must also be properly regarded as independent as regards the company before they may be appointed as a restructuring officer.[636] The Amendment Rules clarify that a qualified IP may be regarded as independent notwithstanding that he (or the firm or company of which he is a partner / director or employee) has previously provided advice to the company as a financial advisor or otherwise. This enshrines in statute the approach adopted by the Court to historical applications under section 104(3) of the Companies Act.[637] Consistent with the provisions of the Insolvency Practitioners' Regulations, an IP is not regarded as independent if he has acted in relation to the company as auditor within a period of three years immediately preceding the filing of the Restructuring Petition.[638] The Amendment Rules also clarify that if the

[633] Companies Act, s 91B(3).
[634] *Idem*, s 91D.
[635] The Independence Requirement under Reg 6 will not apply and Regs 12 and 13 will not apply.
[636] CWR, O 1A, r 10.
[637] See, eg, *In the Matter of Sun Cheong Creative Development Holdings Limited* (FSD 169 of 2020, unreported, Smellie CJ, 20 October 2020).
[638] CWR, O 1A, r 10(6).

company is wound up after the presentation of a Restructuring Petition, a qualified IP may still be regarded as independent even if he had previously been nominated or appointed as its restructuring officer.

5.4.4.2 Appointment order and effect of appointment

The order appointing restructuring officers is required to be in Form Number 8A of the CWR. The powers of the restructuring officers, including the manner and extent to which such powers will modify the function of the board of directors, are flexible and will be defined by the terms of the appointment order.[639] The rules do however provide that the Court may make orders in respect of certain matters including but not limited to:

(a) entry into an international protocol with a foreign officeholder, which the restructuring officers are under a duty to consider for the purpose of promoting an orderly restructuring of the company and to avoid duplication of work and conflict between the restructuring officer and the foreign office holder;[640]

(b) convening meetings of creditors and members;

(c) validation of dispositions; and

(d) the provision of reports about the financial condition of the company.[641]

The appointment order is required to be:

(a) registered with the Registrar of Companies within seven business days after the order is made;

(b) sent to the Government Information Service for publication in the Cayman Islands Gazette within seven business days after the order is made; and

(c) sent, upon request to every creditor (including a prospective and contingent creditor) or contributory or a person claiming to be a creditor, provided that they can produce reasonable evidence to demonstrate their creditor status.[642]

Restructuring officers must otherwise give notice of their appointment in the manner that the Court directs. The notice requirements under the Amendment Rules highlight the importance of giving stakeholders transparency regarding the company's restructuring efforts, which in turn allows stakeholders to intervene in the proceedings both before or after the appointment order is made should they choose to do so (paragraph 5.4.5 below addresses stakeholder rights in the context of Restructuring Petitions in further detail).

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[639] Companies Act, s 91B(4) and (5).
[640] CWR, O 1A, r 15.
[641] *Idem*, O 1A, r 6(3).
[642] *Idem*, O 1A, r 7.

5.4.4.3 Reporting requirements

Once appointed, the restructuring officers must report to the Court within 28 days of their appointment, reflecting the close supervision that is intended to be provided by the Court over a Restructuring Petition, with a view to monitoring its progress and protecting stakeholders from potentially prolonged, expensive, and ultimately unsuccessful restructuring efforts. Amongst other things, the report must include details of the:

(a) steps taken in the restructuring and the further steps intended to be taken in the restructuring generally;

(b) financial position of the company at the latest practicable date; and

(c) work done by the restructuring officers and the amount of remuneration claimed by them.[643]

5.4.5 Creditor / shareholder rights

5.4.5.1 Standing to appear

Every person who intends to appear and be heard on the hearing of a Restructuring Petition must give three days' notice of their intention to do so. The notice should be prepared in accordance with Form Number 4A of the CWR and needs to specify the details of the person giving notice and whether they are a creditor or contributory (and the amount of debt or shares), whether they intend to oppose or support the appointment of a restructuring officer and in the event an appointment order is made, whether they intend to support or oppose the persons nominated by the company. If a stakeholder opposes the appointment of the company's nominee they must nominate an alternative IP and file the appropriate consents to act pursuant to Order 3, rule 4 of the CWR.

5.4.5.2 Creditor protection

The Companies (Amendment) Act and the Amendment Rules ensure that there are adequate protections in place to preserve and protect the rights of both creditors and contributories. The key protections are summarised as follows:

(a) a contributory or creditor may apply to the Court for a variation or a discharge of an order appointing the restructuring officers by way of summons in Form Number 16B of the CWR. The company, restructuring officer or the CIMA may also bring such an application under section 91E of the Companies Act;

(b) a contributory or creditor may also apply to the Court for the removal and replacement of a restructuring officer by way of summons in Form Number 16C of the CWR. With respect to grounds for removal, we anticipate that the Court will continue to follow the existing

[643] *Idem,* O 1A, r 8.

authorities on this question which were recently set out by Doyle J In the *Matter of Global Fidelity Bank, Ltd*.[644] A removal and replacement summons is required to be served on the company, the restructuring officers and on any other creditors and contributories as the Court may direct. If a restructuring officer is removed, they will be required to report to the stakeholders of the company and to deliver all files relating to the company's restructuring to their successor; and

(c) creditors with security over the whole or part of the assets of the company will remain entitled to enforce that security without the leave of the Court and without reference to the restructuring officer.[645]

5.4.5.3 Concurrent petitions

Creditors may nevertheless present a winding up petition in respect of the company following presentation of a Restructuring Petition, with leave of the Court. An application for leave is required to be made by summons and will be heard by the judge assigned to the Restructuring Petition (the winding -up petition will also be assigned to the same judge if leave is subsequently granted). Depending on the progression of the Restructuring Petition proceedings, the Court may hear the winding up petition and the Restructuring Petition at the same time.[646]

5.4.6 Termination

5.4.6.1 Successful

If the restructuring of a company is successful, through for example a private agreement entered into between the company and its stakeholders, or where a Scheme has been approved by the Court, an application may be made for a discharge of the appointment order under section 91E of the Companies Act. The procedure that is required to be followed for obtaining such an order is set out in Order 1A, rule 9 of the CWR. As in the case of restructuring under the previous section 104(3) of the Companies Act, the Court is likely to make an order for the discharge of the appointment order where the restructuring has been achieved and the appointment of restructuring officers has served its purpose.[647] The company will then continue as a going concern.

5.4.6.2 Unsuccessful

The Court may on the other hand also discharge an appointment order under section 91E of the Companies Act, if the restructuring of the company proves to be unsuccessful or if there is little to no viability that a restructuring plan will be successfully implemented. It is expected that such applications will either be made by the restructuring officers themselves or by creditors or contributories who may wish to present a winding up petition. On such applications, the Court

[644] (FSD 168 of 2021, unreported, Doyle J, 20 August 2021).
[645] Companies Act, s 91H.
[646] CWR, O 1A, r 5.
[647] *In the Matter of Star International Drilling Ltd* (FSD 88 of 2021, unreported, Smellie CJ, 24 August 2022).

is also likely to take into account the views of the restructuring officers with respect to the viability of the proposed restructuring. Except in the case of concurrent petitions (that is, where the Court has granted leave for the presentation of a winding up petition notwithstanding an *extant* Restructuring Petition), the Court will have no power to wind up a company on the basis of a Restructuring Petition.

If the restructuring of a company fails and the company is subsequently wound up (pursuant to a concurrent petition or a winding up petition presented after the discharge of an appointment order), the winding up will be deemed to have commenced on the date of the presentation of the Restructuring Petition, such that official liquidators will be in a position to claw-back any preference payments made to creditors within the six months immediately preceding the presentation of the Restructuring Petition. Any invalidated transactions in the twilight period between presentation of the Restructuring Petition and the winding up order will also be void under section 99 of the Companies Act.

Self-Assessment Questions

Question 1

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

Question 2

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

Question 3

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

For feedback on these self-assessment questions, see the document "Comment and Feedback on Self-Assessment Questions", which is made available to you as a separate document

5.5 Corporate Rescue plan (schemes of arrangement)

A Scheme of Arrangement (Scheme) is a court-approved compromise or arrangement entered into between a company and its creditors or members, or any classes of them, in accordance with section 86 of the Companies Act. An "arrangement" is construed widely and extends to almost any kind of internal arrangement in the company, but an element of accommodation on both sides (company and stakeholder) is required in order for the proposal to be considered

and approved as a Scheme. The Grand Court would not, therefore, permit a proposed arrangement to go forward as a Scheme if all creditors or members effected by the Scheme are known to be in unanimous agreement[648] or (in the case of a member Scheme) there is only one shareholder of the company.[649] The purpose and function of a Scheme is to sanction an arrangement which is binding on all applicable creditors or shareholders, notwithstanding that not all of the relevant constituents are in favour of the arrangement. Thus, there must always be an element of "cram-down" (that is, the effect of binding a dissenting minority) in order to invoke the statutory power of a Scheme.

The commercial uses of member Schemes are widely varied, reflecting the versatility of the Scheme process. Examples of member Schemes include reorganisations of share capital through mergers and demergers; privatisations and friendly takeovers (the target company advances the Scheme, not the bidding company); share exchanges and purchases; top-hattings (parent company replaced with a new holding company); and demutualisations. The uses to which creditor Schemes have been put are similarly diverse, including debt and contingent liability restructurings through debt-for-debt, debt-for-equity and debt-for-assets swaps, distribution of assets and payment of debts without liquidation, simplification of entitlements in liquidations, giving effect to contractual debt moratoriums, insurance run-offs, and compromise of class actions or group litigation.

Although Schemes are customised to the particular needs of the company concerned, all Schemes serve one of two broad purposes, either:

(a) preserving the life of the company at a time of financial distress through some form of debt restructuring; or

(b) adjusting the company's ownership structure in order to rationalise, redirect or revitalise the company's enterprise.

5.5.1 Some or all creditors or members

A Scheme can be an arrangement with the whole, or only a subset, of a company's creditors or shareholders. Examples of Schemes that pertain to only a subset of a company's stakeholders are:

- a creditors' Scheme which restructures senior bondholder debt but leaves all other creditors (secured, trade and intercompany) unaffected; and

- a members' Scheme which alters the rights of holders of only a particular series of a company's shares.

In both of these examples, all other, unaffected stakeholders, take no part in the Scheme.

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[648] *In re Universal Tours Ltd* (Grand Court: Harre, CJ), 29 December 1994.
[649] *In re Interamerican Bank Corp* (Grand Court: Collett, CJ), 23 May 1988.

Irrespective of whether the Scheme affects the whole or only a subset of the company's creditors / members, an assessment must be made by the company whether it is appropriate that the Scheme creditors / members vote as one group or whether the affected parties need to be split into different classes. This question, the justifiability of the company's answer to it and the voting within each class (if there is more than one), are all highly significant as to whether the Scheme comes into effect and class composition is a common battlefield in contested Schemes. If one or a group of dissenting stakeholders can make the case for being in a class of their own, this effectively hands them a veto because all classes are required to return an affirmative vote in order for the Scheme to be considered for sanction by the Court.

Cayman Islands law regarding class composition[650] is derived from the law as stated by Chadwick LJ in the English case *Re Hawk Insurance Company Limited*.[651] Cayman Islands law requires, therefore, that a class must be confined to those persons whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest, having regard to what is surrendered and obtained pursuant to the Scheme, when measured against liquidation (being the "appropriate comparator").

Once class composition has been determined by a company, the usual practice (in creditor Schemes, particularly) is for the company to seek to enter into lock-up agreements with the stakeholders in each class. This allows a company to amass dependable support for the Scheme which can be used as negotiation leverage with dissenters and brings some commercial certainty to whether the Scheme will come into effect (subject to overcoming objections raised with the Court and obtaining the Court's sanction of the Scheme).

5.5.2 Who may commence the Scheme?

A Scheme will most commonly be proposed by the company concerned. The company does so by filing a petition pursuant to section 86 of the Companies Act (Petition) which seeks sanction of the arrangement that constitutes the Scheme. The Petition is supported by an affidavit which provides the commercial context for and details of the Scheme, outlines the proposed composition of classes of stakeholders and exhibits the Scheme documentation which it is proposed be sent to the Scheme stakeholders in advance of the court-permitted extraordinary general meeting at which the Scheme is put to the vote.

It is not possible for a Scheme to be involuntarily imposed upon a company. This is because the company (through its board, its restructuring officer or its official liquidator) must either be the proponent of the Scheme or have consented to the Scheme being proposed by a creditor or shareholder of the company.[652]

[650] *In re Euro Bank Corp*, 2003 CILR 205.
[651] [2001] EWCA Civ 241 (citing *Sovereign Life Assurance Co (In Liquidation) v Dodd* [1892] 2 QB 573).
[652] Companies Act, s 86.

5.5.3 The moratorium on creditor action

The risk of enforcement by the company's creditors may deprive the company of the breathing space it needs to promote a Scheme with its creditors. In such a scenario, the board of an insolvent company may (prior to filing its Petition for sanction of a Scheme) file a petition for the appointment of a restructuring officer.[653] That filing immediately activates the statutory stay on any proceedings (including creditor action) against the company and thereby ringfences the company's assets pending the resolution of the Scheme process.[654]

Once a restructuring officer is appointed, it is not mandatory for a section 86 Scheme or a RO Scheme to be used to restructure the company. The need for a Scheme will be a function of the level of opposition to the proposed arrangement, and the need for a RO Scheme will be driven by whether there is a significant amount of UK debt that the company seeks to restructure.

5.5.4 Company management

A Scheme does not (either by operation of section 86 or the general law) remove or restrict the power of a company's board of directors. The only scenario in which there can be any restrictions upon the board's powers is if the company concerned is in some form of insolvency process; that is, there is either a restructuring officer or an official liquidator appointed to the company. If that is the case, it is not the Scheme provisions of the Companies Act which modify the board's powers. Rather, the board's powers are impacted by the provisions pertaining to the insolvency process to which the company is subject, if any.

If a restructuring officer has been appointed to the company, the Grand Court will have determined (in the appointing order) which powers are retained by the directors and which will be vested in the restructuring officer. Most commonly, the restructuring officer's powers will be "light touch" (essentially supervision and oversight of the board) and the directors will continue to manage the company's affairs while the Scheme proceeds.

If an official liquidator seeks sanction of a Scheme, then all of the board's powers will be vested in the liquidator, save for any express delegations of responsibility which the liquidator has made to the board.

5.5.5 Approval procedure

The procedure for commencing a process seeking orders sanctioning a Scheme are set out in Order 102, rule 20 of the Grand Court Rules and Practice Direction 2/2010.

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[653] *Idem*, s 91C.

[654] Prior to 31 August 2022, an insolvent company could file a summons for appointment of restructuring JPLs pursuant to s 104(3) of the Companies Act. Upon the appointment of JPLs, a statutory moratorium automatically came into effect pursuant to s 95(3) of the Companies Act. In contrast, under the restructuring officer regime, a moratorium comes into effect at the time of the filing of the petition (Companies Act, s 91G).

In summary:

(a) Order 102, rule 20 of the Grand Court Rules provides that:

- Schemes are commenced by Petition which is filed with a summons for directions and supporting affidavit;
- the supporting affidavit should describe the purpose and effect of the Scheme, allowing the Court to determine whether an extraordinary general meeting (Scheme Meeting) should be convened and the appropriate class composition;
- the affidavit should exhibit the Scheme document, an explanatory statement and other prescribed documents;
- if the Scheme pertains to listed shares or debt instruments, a further affidavit should be filed which sets out the relevant listing rules and practice;
- the Court must make directions regarding satisfaction of the statutory majorities at the Scheme Meeting;
- the explanatory statement must contain a timetable of principal events;
- within seven days of the Scheme Meeting, an affidavit must be filed from the Chairman which verifies that the meeting was convened and held in accordance with the Court's directions and sets out the results of the vote;
- the directions summons is heard in chambers, and the Petition in open court; and
- any person who voted at the Scheme Meeting or gave instructions to a custodian / clearing house to do so, is entitled to appear at the hearing of the Petition.

(b) Practice Direction 2/2010 tracks the terms of Order 102, rule 20 of the Grand Court Rules, but relevantly adds that the Court may be prepared to hear any other person (other than "person who voted at the Scheme Meeting or gave instructions to a custodian/clearing house to do so") whom it is satisfied has a substantial economic interest in the shares or debt instruments to which the Scheme relates.

5.5.6 Convening hearing

The first hearing in a cause for sanction of a Scheme is a summons for directions which seeks permission to dispatch the court-approved Scheme documentation to the relevant stakeholders (known as the "Convening Hearing").

Before the Court will make the orders sought in the company's summons, it has to be persuaded that the composition of classes proposed by the company is appropriate and that the Scheme

documents provide shareholders / creditors with all of the information that they reasonably require in order to make an informed decision on whether to support or oppose the Scheme.

Accordingly, the orders sought by the company at the Convening Hearing are that the:

(a) relevant class or class of shareholders or creditors affected by the proposed Scheme is as constituted by the company (or as the Court otherwise orders);

(b) company is permitted to convene a meeting of the Scheme shareholders / creditors at which the proposed Scheme (as described by the company, subject to any modifications by the Court) be put to the vote of those parties;

(c) the method of convening and conducting the meeting for the vote on the Scheme be as ordered; and

(d) the identity of the Chairman of the meeting and that the Chairman report the result of the vote to the Court.

Any creditor or shareholder affected by the proposed Scheme has standing to appear at the Convening Hearing and object to the making of the orders sought by the company. Most commonly, the grounds for objection center on class composition and the objecting party contends that they, and others, should be in a class of their own. Where an objector persuades the Court that classes should be split, that separate objecting class may effectively veto the Scheme. However, if the Court resolves any class composition issues and is satisfied that the Scheme documents are in order and the timeframe for the vote on the Scheme is appropriate, the directions are made and the company expeditiously produces all of the Scheme documentation, which is usually dispatched to the stakeholders within a day or two of the Court's directions. Great care is required to be taken in the handling and dispatch of the Scheme documents, because the company must evidence that meticulous processes have been followed to ensure that each of the relevant shareholders or creditors was sent copies of those documents within sufficient time[655] to consider them before the Scheme Meeting at which the vote on the Scheme occurs.

Affected creditors / shareholders remain entitled to object to the Scheme at the final hearing of the company's petition for sanction of the Scheme, notwithstanding that the Scheme is approved by all classes at the Scheme Meeting. Objectors have this entitlement irrespective of whether or not they made, appeared and raised no objections at the Convening Hearing. The Court expects, however, that any party who has objections to the company's proposed composition of classes will raise those objections at the Convening Hearing. If a creditor / shareholder seeks to challenge the company's class composition at the sanction hearing[656] (after

[655] The current practice is for the Court to allow 21 to 28 days of dispatch of the Scheme documents and the Scheme Meeting.

[656] See para 5.5.9 below for a discussion on the sanction hearing.

the votes have been cast in accordance with the orders made at the Convening Hearing) they will need compelling reasons why the objections were not raised at the Convening Hearing.[657]

5.5.7 Scheme meetings

A vote is taken on whether to approve the Scheme at the Scheme Meeting. There may be a number of consecutive meetings comprising the Scheme Meeting if there are multiple classes or if the votes of both creditors and shareholders are required for the particular Scheme.

In order for a member's Scheme to be approved, an affirmative vote is required from 75% of the members present and entitled to vote in each class. Prior to the 31 August 2022 amendments to the Companies Act, a "majority in number" of members was also required, however the headcount test has now been abolished for members' Schemes.[658]

Creditor Schemes, however, retain the double majority thresholds – for a creditor Scheme to be approved at the Scheme meeting, an affirmative vote is required from 75% of the creditors present and entitled to vote in each class and those creditors approving the Scheme must also be a simple majority of the creditors who voted at the Scheme Meeting, in each class.

5.5.8 Cross- / intra-class cram-down

As previously noted, the purpose and functional effect of a Scheme is that the decision of a requisite majority of a class of stakeholders binds a dissenting minority. That "cram-down" effect only happens within a properly constituted class or classes (each class being made up of parties whose rights are sufficiently similar they can vote together), where all relevant documents have been made available within time that the Court considers sufficient to consider the terms of the proposed Scheme (see above).

Where there is more than one class of shareholders or creditors voting on whether to approve or reject the Scheme, in order for the Scheme to proceed to the next stage, every class must return an affirmative vote with the required majority. It is not possible for one class to cram down another, unlike the cross-class cram-down in a Chapter 11 proceeding in the United States.

5.5.9 Court sanction

Following the approval of the Scheme by the requisite majority in all classes and the filing of the Chairman's affidavit detailing the Scheme document dispatch process and the result of the Scheme Meeting, the company's Petition (for sanction of the Scheme) is heard (the "Sanction Hearing"). Dissentient members / creditors are entitled to appear and be heard. At the Sanction Hearing, the Court considers (in light of any opposition) whether:

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[657] This has become the modern practice in the Cayman Islands, being consistent with the commentary of Chadwick LJ in *Re Hawk Insurance Company Limited* [2001] EWCA Civ 241.

[658] Companies Act, s 91G.

(a) approval of the Scheme was reasonable (whether an intelligent, honest member of the class convened, acting in his own interest, might reasonably have approved the Scheme);

(b) each class was fairly represented at the Scheme Meeting;

(c) the majority acted *bona fide*;

(d) all notice periods were met; and

(e) the resolutions were carried by the requisite majority.

At the Sanction Hearing, the Court may:

(i) refuse to sanction the Scheme;

(ii) sanction the Scheme without variation; or

(iii) sanction the Scheme with certain variations to take account of justified objections to the Scheme (although variations to the stakeholder-approved Scheme at the Sanction Hearing are uncommon).

5.5.10 Timeframe

In most cases, the time required to complete the court process, from the time of filing the Petition and the supporting evidence to the approval of the Scheme at the Sanction Hearing, is between 10 to 12 weeks.

It can often be the case, however, that many months of preparation are required before the Petition is filed, both formulating and documenting the Scheme proposal (including all related advices and commercial negotiations) and canvassing key stakeholders for support of the proposed Scheme.

It is common for restructuring agreements (or lock-up agreements) to be entered into between the company and key stakeholders, pursuant to which those stakeholders commit to support the Scheme. Having these agreements in hand from key stakeholders provides the company with leverage in their discussions with other stakeholders and it is not unusual for a company to be assured, or close to assured, of an affirmative vote at the Scheme Meeting by reason of such agreements.

5.5.11 Trading claims

In the creditor Scheme context, there is no statutory prohibition on trading of creditor claims. In order for a legal assignment of debt to be effective, however, the company would need to be given notice of the assignment.

5.5.12 Groups

It is feasible to implement a Scheme across a number of group companies. The *Ocean Rig*[659] case was a landmark case that used interlocking Schemes in respect of three group companies. Complex questions can arise in relation to Schemes of multiple group companies.

In *Ocean Rig*, a creditor with the benefit of security from the parent company argued that it should be put in a class of its own because its rights were divergent from unsecured creditors. That argument failed, however, because the creditor had security over the shares in the subsidiary companies, which were insolvent, and therefore the creditor's security had no value and there was no practical difference between the rights of the secured and unsecured creditors.

5.5.13 Disposal of assets

The only restrictions on disposals of assets in a Scheme are the terms of the Scheme itself and, if the company is in liquidation or subject to the appointment of a restructuring officer, the requirement to obtain Court approval for the disposal.

5.5.14 Funding a Scheme

Funding for a Scheme will be a matter negotiated by the company, the providers of new money and, as appropriate, the company's key stakeholders.

5.5.15 Conclusion of Scheme

In summary, the following needs to occur in order for a Scheme to become effective:

(a) the company (or an IP, creditor or shareholder authorised to do so) must file a Petition, summons for directions and supporting evidence at the Grand Court;

(b) the evidence must contain the Scheme documentation which should have all information that a party being asked to vote on the Scheme could reasonably need to decide whether to vote in favour of the Scheme;

(c) the company must group together all of those stakeholders whose rights are sufficiently similar for the purpose of the vote on the Scheme, and must separate into their own class any stakeholder(s) whose rights differ such that they could not reasonably vote in the same class;

(d) the Court must approve the Scheme documents, classes and proposed meeting time, place and procedure at the Convening Hearing, taking account of any objections raised;

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[659] *In the Matter of Ocean Rig UDW Inc and Others*, 2017 (2) CILR 495.

(e) the company must carry out the procedure in strict adherence to the orders made at the Convening Hearing;

(f) at the Scheme Meeting, all classes must approve the Scheme, in line with the requisite majority;

(g) the Chairman must give a fulsome account of the Scheme Meeting in evidence to be considered at the Sanction Hearing;

(h) the Court must make orders sanctioning the Scheme (with or without modifications) at the Sanction Hearting, taking account of any objections;

(i) the company must fulfil all conditions to the Scheme; and

(j) the Scheme will become effective when each of the above has occurred and the company files the Order sanctioning the Scheme at the Registrar of Companies.

Self-Assessment Questions

Question 1

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

Question 2

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

Question 3

Does a Scheme automatically impose a moratorium on creditor action?

Question 4

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

Question 5

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

Question 6

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

Question 7

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

Question 8

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

Question 9

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

Questions 10

What are some common scenarios in which Schemes are used?

For feedback on these self-assessment questions, see the document "Comment and Feedback on Self-Assessment Questions", which is made available to you as a separate document

5.6 Case studies demonstrating how the corporate rescue procedure works

Lego House Limited is an exempted limited company incorporated in the Cayman Islands (Lego House). The shares of Lego House are listed for trading on the Stock Exchange of Hong Kong. Lego House is a holding company of a corporate group (the Group) which engages in the manufacturing and retail of children's toys and operates primarily out of Hong Kong and the People's Republic of China (PRC).

In order to meet the Group's capital and operating expenditure, Lego House offered notes of differing values, interest rates and maturity dates to investors on the Stock Exchange of Hong Kong. Interest rates were payable on the notes on 1 January and 1 June of each year up until the date of maturity. From about mid to late 2020, the Group began to suffer steep declines in toy sales leading it to experience serious cash flow problems. Lego House fell behind on the interest payments due under the notes and while it continued to make payments to the note-holders, the payments were becoming increasingly late.

Lego House is continuously chased by the note-holders, some of whom are becoming impatient and concerned that the late payments will eventually stop. Lego House engaged an independent financial adviser (IP Experts) to provide advice with respect to how to deal with its cash flow problems. IP Experts advised Lego House to either attempt to find an investor to inject cash into the Group or to consider the possibility of shutting down one of its manufacturing facilities to reduce the Group's operating expenditure and to use some of the sale proceeds to pay note-holders and other creditors. Lego House is currently considering these options but is concerned that it will take some time to find investors or to sell a large manufacturing facility and wants to prevent any creditor actions in the meantime.

In light of its concerns, Lego House sought advice from its Cayman Islands attorneys and was advised that in circumstances where Lego House (i) is unable to pay its debts (or, to the extent it is able to do so now, is unlikely to be able to do so imminently), and (ii) intends to present a compromise or arrangement to its creditors, it could apply for the appointment of restructuring officers under section 91B of the Companies (Amendment) Act. Lego House subsequently presented a petition (together with the supporting documents referred to above) seeking the appointment of Raymond Holt and Madeline Wench of IP Experts as its restructuring officers, both of whom had provided the independent financial advice summarised above and therefore had an understanding of its business. A statutory moratorium on creditor actions (including the presentation of a winding up petition against Lego House by its creditors or the commencement of any proceedings in Hong Kong or the PRC without leave) took effect as soon as the petition was filed.

The petition was advertised in Hong Kong, the PRC and in the Cayman Islands. The Grand Court of the Cayman Islands heard that application in 21 days (at which no objecting creditors were present) and approved the appointment of Raymond Holt and Madeline Wench of IP Experts as restructuring officers. The order appointing the restructuring officers set out the scope of their powers and in particular, that the board of Lego House would continue to be involved in the day-to-day operations of the company while the restructuring officers took the role of liaising and negotiating with note-holders and assessing whether the sale of company assets was a viable means of securing some much needed cash flow. The appointment order also gave the restructuring officers oversight over Lego House's operating subsidiaries in the PRC.

After completing its necessary filings under the Companies (Amendment) Act, the restructuring officers took possession of the company's books and records, particularly its financial statements to allow them to assess the financial position of the company. Given the time-consuming nature of the sale of the company's non-current assets, the restructuring officers took the view that seeking outside investment was the best way of securing the future of Lego House and began to assist the board of the company in negotiating with potential investors. These negotiations took a number of months during which time the restructuring officers were required to provide the Court with periodic updates with respect to the steps they were taking and the financial position of Lego House, and to call and attend creditor meetings to provide stakeholders with updates on progress. An external investment was subsequently secured and the restructuring officers negotiated with the note-holders to reach a compromise with respect to their debts.

Most but not all of the note-holders agreed to the proposal presented by Lego House and the restructuring officers.

The restructuring officers subsequently sought and were granted approval of the proposed arrangement under section 86 of the Companies Act on the basis that the arrangement was approved by a majority of creditors representing 75% in value. Following approval of the arrangement, the restructuring officers made an application and were granted relief under section 91E of the Companies (Amendment) Act for the discharge of the appointment order.

CHAPTER 6

CROSS-BORDER INSOLVENCY

6.1 Introduction

The Cayman Islands is a major offshore financial center. As at 31 December 2022, there were approximately 100,000 exempted companies and 35,000 ELPs registered in the Cayman Islands.[660] An "exempted" company or ELP is required to declare that it does not conduct business within the Cayman Islands. As a result, it is inevitable that cross-border issues form a significant aspect of Cayman Islands insolvency, because the place where the vehicle conducted business or held assets or contracted with third parties will generally not be the Cayman Islands.

This is a complex and developing area. The overview of the principles that follows is intended to be introductory in nature.

6.2 Universalist or territorialist approach?

The Cayman Islands common law adopts the key principles of English common law in respect of cross-border insolvency. Two are of particular significance, namely the:

- principle of universalism: insolvency proceedings commenced in one jurisdiction are regarded as having a universal effect across other jurisdictions; and

- principle of assistance: courts in one country should actively assist insolvency proceedings commenced in another country.

However, the obligation to assist has certain limits; that is, it is subject to local law and public policy and to the limits of the Cayman Islands Court's own statutory and common law powers. In that regard, a Cayman Islands Court would not be able to give a foreign liquidator greater powers than that which the foreign liquidator would enjoy before his home Court.[661]

Moreover, the Cayman Islands is a creditor-friendly jurisdiction insolvency regime that treats local and foreign creditors equally. The key exceptions are that: (i) the Cayman Islands will not allow the enforcement of foreign taxes, fines and penalties, and (ii) certain types of creditor claims (most notably for certain claims of employees and the Cayman Islands government) are given preferential treatment up to a certain level.[662]

6.3 Statutory provisions dealing with cross-border issues

The Cayman Islands Court's powers to make orders in support of foreign insolvency proceedings are provided for in Part XVII of the Companies Act.

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[660] See https://www.ciregistry.ky.
[661] *Singularis Holdings Ltd v PriceWaterhouseCoopers* [2014] UKPC 36, para 29.
[662] The preferential claims are set out in the Companies Act, Sch 2.

The Cayman Islands has not implemented the UNCITRAL Model Law on Cross-Border Insolvency (the Model Law). As such, there are no threshold tests for the grant of assistance, nor are there automatic rights based on the centre of main interests (COMI) of the debtor.

Instead, foreign representatives must satisfy the Cayman Islands Court that it is appropriate for the Court to exercise its discretion by granting the relief sought in the foreign representative's application.

Under section 241 of the Companies Act, the foreign representative may apply for the following orders:

(a) recognising the right of a foreign representative to act in the Cayman Islands on behalf of or in the name of a debtor;

(b) enjoining the commencement or staying the continuation of legal proceedings against a debtor;

(c) staying the enforcement of any judgment against a debtor;

(d) requiring a person in possession of information relating to the business or affairs of a debtor to be examined by and produce documents to its foreign representative; and

(e) ordering the turnover to a foreign representative of any property belonging to a debtor.

Section 242 of the Companies Act provides that the Court must take into account the following factors in the exercise of its discretion:

(a) the just treatment of all holders of claims against or interests in a debtor's estate wherever they may be domiciled;

(b) the protection of claim holders in the Cayman Islands against prejudice and inconvenience in the processing of claims in the foreign bankruptcy proceeding;

(c) the prevention of preferential or fraudulent dispositions of property comprised in the debtor's estate;

(d) the distribution of the debtor's estate amongst creditors substantially in accordance with the order prescribed by Part V of the Companies Act;

(e) the recognition and enforcement of security interests created by the debtor;

(f) the non-enforcement of foreign taxes, fines and penalties; and

(g) comity.

There are no statutory provisions expressly dealing with the circumstances in which a liquidator of a Cayman Islands company or exempted limited partnership that has been appointed by the Cayman Islands Court may apply for recognition of their appointment in foreign jurisdictions or for assistance from foreign courts.

However, it will generally be the case that a sanction application is required to do so in order to obtain the requisite permission from the Cayman Islands Courts.[663]

6.4 Common law rules for dealing with cross-border issues

As noted above, the key common law principles applied in the Cayman Islands in relation to cross-border issues are universalism and assistance. The Cayman Islands will likely follow the modified universalism expounded in *Singularis Holdings Ltd v PriceWaterhouseCoopers*.[664] Modified universalism has been the "golden thread" running through cross-border insolvency law since the 18th century. The doctrine and its rationale were described by Lord Sumption in *Singularis* in the following terms:[665]

> "It is founded on the public interest in the ability of foreign courts exercising insolvency jurisdiction in the place of the company's incorporation to conduct an orderly winding up of its affairs on a world-wide basis, notwithstanding the territorial limits of their jurisdiction. The basis of that public interest is not only comity, but a recognition that in a world of global business it is in the interests of every country that companies with transnational assets and operations should be capable of being wound up in an orderly fashion under the law of the place of their incorporation and on a basis that will be recognised and effective internationally."

Recent authorities from the Cayman Islands Court highlight the importance of the principles of modified universalism to cross-border co-operation and the risks of conflict that can arise. For example:

- In *Altair Asia Investments Limited,*[666] the Cayman Islands Court declined to make an immediate winding up order in respect of a Cayman Islands-incorporated company pending delivery of a judgment by the Hong Kong Court, noting: "[c]omity and cooperation is particularly important in the field of cross-border insolvency and it would not be appropriate for this court to proceed to a judgment on the disputed debt by determining the Petitioner before Mr Justice Harris has handed down judgment"; and

- In *Sun Cheong Creative Development Holdings Limited,*[667] the Cayman Islands Court considered the impact that his appointment of provisional liquidators may have on winding

[663] See the discussion in para 4.3.3.2 above.
[664] [2014] UKPC 36.
[665] *Idem*, para 23.
[666] (Unreported, Parker J, 16 March 2020) at para 67.
[667] (Unreported, Smellie CJ, 20 October 2020) at para 46.

up petitions already filed in Hong Kong, noting that "[t]he rights of the [Hong Kong] Petitioners are of course to be determined by the Hong Kong court in accordance with Hong Kong law in relation to the HK Petitions. However, the foregoing principles reflect how their rights would be viewed had they petitioned in the Cayman Islands".

6.5 Concurrent proceedings

A recent illustration of the approach of the Cayman Islands Court to concurrent proceedings is provided by the case of *Silver Base*.[668]

Silver Base is the Cayman Islands-incorporated holding company for a large group specialising in liquor distribution. Most of Silver Base's revenue is generated in the PRC. The profitability of the Silver Base group had been severely impacted by the global Covid-19 pandemic.

Several creditors based in Hong Kong and the PRC had made demands against Silver Base. At the time of filing in the Cayman Islands, there were existing winding up proceedings in Hong Kong. As a result, the Grand Court raised concerns regarding issues of comity and the scope of recognition of the nominated Cayman Islands officeholders.

Those concerns were dealt with, in part, by modifying the order appointing the provisional liquidators to allow the Hong Kong court to determine the existing proceedings. Through its ruling, the Cayman Islands Court indicated to the Hong Kong Court that, at least from the Cayman Islands' perspective, it would be "sensible and appropriate" for the Hong Kong Court to recognise and give assistance to the Cayman Islands provisional liquidators to promote a restructuring of Silver Base's debt.[669]

6.6 Liquidation of foreign companies in the Cayman Islands

Under section 91(d) of the Companies Act, the Cayman Islands Court has jurisdiction to wind up a foreign company that –

- has property located in the Cayman Islands;
- is carrying on business in the Cayman Islands;
- is the general partner of an ordinary limited partnership or an ELP; or
- is registered under Part IX of the Companies Act.

Part XI of the Companies Act requires a foreign company to register in the Cayman Islands where it establishes a place of business, or commences carrying on business within the Cayman Islands.

[668] (Unreported, Doyle J, 8 December 2021).
[669] *Idem*, at para 21.

6.7 Foreign creditors

As noted in paragraph 6.2 above, foreign creditors are treated equally with domestic creditors in a Cayman Islands insolvency.

6.8 Protocols

The Cayman Islands recognises the desirability that an insolvency proceeding involving multiple jurisdictions should, if possible, be dealt with on a universal basis within a single "main proceeding".

In that regard, Cayman Islands legislation make provision for Cayman Islands official liquidators to enter into international protocols with foreign officeholders to promote the:

(a) orderly administration of an estate of a company in official liquidation;

(b) avoidance of duplication of work; and

(c) avoidance of conflict between the official liquidator and the foreign officeholder.[670]

Such protocols may allocate responsibilities between the Cayman Islands liquidator and foreign officeholder in relation to, *inter alia* the:

(a) preservation and realisation of assets;

(b) pursuit of causes of action;

(c) exchange of information;

(d) procedures for the administration of the estate and reporting;

(e) adjudication of claims; and

(f) distribution of assets.

Relevant provisions include:

- Part XVII (International Co-Operation) of the Companies Act;
- Order 21 (International Protocols) of the CWR;
- section 11A (Interim relief in the absence of substantive proceedings in the Cayman Islands) of the Grand Court Act; and

[670] CWR, Order 21, r 2(2).

- Practice Direction 1 of 2018 entitled "Court-to-Court Communications and Co-Operation in Cross Border Insolvency"[671] and Practice Direction 2 of 2019 entitled "Adoption of Judicial Insolvency Network Modalities for Court-To-Court communications".[672]

International protocols agreed between a Cayman Islands liquidator and a foreign officeholder must be approved by both the Grand Court and the appropriate foreign court or authority.

In *Re LATAM Finance Limited*,[673] the Cayman Islands Court approved a cross-border court-to-court communication protocol between the Cayman Islands, United States, Colombian and Chilean Courts in order to facilitate the restructuring of the LATAM Airlines group. The main principles are as follows:

- the Court has a positive duty to assist the foreign main insolvency or restructuring proceeding, unless there are good reasons not to;

- there is a starting assumption that a clear framework for communication between the respective courts will improve the efficiency of the relevant cross-border case; and

- there is a starting assumption that the ALI / III Guidelines and / or the JIN Guidelines[674] are suitable to adopt.

6.9 The approach of overseas courts to Cayman Islands companies

The key jurisdictions in which liquidators of Cayman Islands companies tend to seek recognition and assistance are the United States, the UK and Hong Kong. Generally speaking, Cayman Islands liquidators who have been appointed by the Cayman Islands Court will generally enjoy a favourable reception in these jurisdictions upon the requisite applications being made.

There may, however, be tensions between the Cayman Islands Court and foreign courts where applications have been made in multiple jurisdictions for the appointment of an officeholder or the commencement of insolvency proceedings. The way in which those tensions are managed will depend on the particular country concerned, the company in question, and the stakeholders and assets that are impacted.

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[671] https://judicial.ky/wp-content/uploads/practice-directions/12684483-GazettePublicationPD1of2018-7Aug18.pdf.

[672] https://www.judicial.ky/wp-content/uploads/practice-directions/PracticeDirection2of2019-AdoptionofJudicialInsolvencyNetworkModalities.pdf.

[673] *In the Matter of LATAM Finance Limited et al*, FSD 105, 106 and 154 of 2020 (IKJ), Judgment dated 24 August 2020 (unreported).

[674] American Law Institute / International Insolvency Institute Guidelines and / or the Judicial Insolvency Network Guidelines.

6.10 Proceedings in more than one jurisdiction at the same time, relating to the same company

While the Cayman Islands Court does not purport to exercise exclusive jurisdiction over the liquidation of Cayman Islands companies, in general the Cayman Islands Court considers that the Cayman Islands, as the jurisdiction of incorporation, should be the main Court dealing with the insolvency of a Cayman Islands company. In *Re GTI Holdings Limited*[675] the Court stated:

> "It is a very serious step for a foreign court to make a winding-up order against a company incorporated under the laws of another jurisdiction. … Usually the best and most appropriate way forward is to leave it to the courts of the place of incorporation of the company to deal with applications for winding up orders and to be treated as the courts with primary jurisdiction. As Chief Justice Smellie stated at paragraph 6 of his oft-cited judgment in *Sun Cheong Creative Development Holdings Limited* (FSD; unreported 20 October 2020) in considering which jurisdiction is the more appropriate to assume the role of primary insolvency proceeding all things being equal 'this will generally be assumed to be the place of incorporation of the company.'"

This is in contrast to countries which have adopted the Model Law which gives primacy to the country in which the company had its COMI (centre of main interest). This can lead to situations where the courts of two or more jurisdictions are seized of matters, which may well lead to conflicting results.

6.11 Case studies demonstrating the principles of cross-border insolvency

6.11.1 Scenario 1: Foreign representative of a foreign company seeks assistance in the Cayman Islands

FBS LLC is a hedge fund incorporated in Delaware, United States. Max Stone is the founder and CEO of FBS LLC.

It has raised over USD 10 billion to be invested in exotic cryptocurrency products and other investments. Some of those investments are made via Cayman Islands companies and ELPs.

A front-page exposé reveals that FBS LLC has likely diverted a large proportion of the USD 10 billion into Max Stone's personal companies, many of which are incorporated in offshore jurisdictions, including the Cayman Islands. Large sums of money have been transferred to Cayman Islands banks.

Max Stone dismisses the rumours that any funds have been improperly used. However, on the advice of his US attorneys and to placate the market, he signs papers to seek Chapter 11 relief for FBS LLC in the United States. Ultimately, an experienced insolvency professional, Jay Reynolds, is appointed as the bankruptcy trustee of FBS LLC.

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[675] (Unreported, 15 February 2022) at para 38.

Jay Reynolds' investigations have confirmed that a number of companies incorporated in the Cayman Islands have received funds from FBS LLC and those funds are being held in bank accounts in the Cayman Islands. There does not appear to be any legitimate explanation for the transfers.

In order to gain assistance from the Cayman Islands courts to secure those funds, Jay Reynolds can make an application under section 241 of the Companies Act for an order recognising his right to act in the Cayman Islands on behalf of or in the name of FBS LLC. This is the first step in the Cayman Islands for Jay Reynolds to make other applications, or bring other proceedings, to secure the return of the funds diverted to Max Stone's personal companies. Jay Reynolds can now apply for injunctions to freeze the funds and to bring proceedings to ultimately order the Cayman Islands companies to return the funds to FBS LLC.

6.11.2 Scenario 2: Winding up petitions filed in both the Cayman Islands and a foreign jurisdiction in respect of a Cayman Islands company

Cement China Co Limited (Cement China) is incorporated in the Cayman Islands and listed on the Hong Kong Stock Exchange. It has substantial operations in the People's Republic of China (PRC) in the cement industry.

Cement China has a USD 100 million bank facility from the Bank of Hong Kong. The bank facility is governed by Hong Kong law and provides for the exclusive jurisdiction of the Hong Kong courts to resolve any disputes. The shares in Cement China's subsidiaries have been pledged as security for the bank facility.

Cement China has also raised funds from the international bond markets. There is over USD 500 million outstanding. The bonds are governed by New York law and provide for the exclusive jurisdiction of the New York courts to resolve any disputes.

None of Cement China's board of directors reside in the Cayman Islands. In fact, the majority of the directors are executives who live in the PRC.

As a result of the Covid-19 restrictions and the decline in the real estate market, Cement China has faced hugely diminished demand and serious disruptions to its supply chain. This has led to serious financial difficulties. Its revenue has dried up, it is struggling to pay its day-to-day expenses and its cash reserves are nearly depleted. There is a significant interest payment of USD 10 million due under the bank facility at the end of the quarter and, without any infusion of cash from outside sources, Cement China will be unable to pay it. Early next year, one of the bond series, amounting to USD 200 million, falls due.

News of this situation is front page news in the Wall Street Journal, the Financial Times, and the South China Morning post. That same day:

(a) the Hong Kong Bank enforces its security and appoints receivers over the shares of Cement China's subsidiaries;

(b) a shareholder of Cement China files a just and equitable winding up petition in the Hong Kong courts. The shareholder considers the real reason for Cement China's financial difficulties is that there has been mismanagement and the shareholder is fearful that the board will issue more shares at a deep discount and dilute the shareholder's stake in the company;

(c) the bond trustee receives an instruction from the requisite majority of bondholders and files a winding up petition in the Grand Court of the Cayman Islands.

The above is a simplified example of common scenarios that face a Cayman Islands company in distress. How the matter is actually resolved is challenging to predict and, in practice, matters will move quickly and rapid decisions will need to be made in real time. It is, however, a useful illustration of some of the following cross-border insolvency principles:

(a) Competing winding up petitions: the Cayman Islands court's starting point is that the Cayman Islands courts should be the main liquidation proceeding. However, it will need to conduct a careful review of the particular facts of China Cement's situation in order to decide whether it should exercise its discretion to make orders in respect of China Cement.

(b) Modified universalism: both the Cayman Islands and Hong Kong adhere to the principle of modified universalism and will therefore be keen to ensure that the liquidations are operating in the best interests of the company's stakeholders, and in a fair and efficient manner.

(c) Priority of secured creditors: the Cayman Islands gives priority to secured creditors. This is considered a sacrosanct principle of Cayman Islands insolvency law, and is one of the chief attractions of the jurisdiction to international capital markets. The filing of a winding up petition in the Cayman Islands does not amount to a stay on the enforcement by secured creditors. The Bank of Hong Kong is therefore free to enforce its security and appoint receivers over the shares. In practice, however, the Bank of Hong Kong may not be so quick to pull the trigger and its actions will be guided by a careful assessment of what is most likely to result in the maximum possible recovery of its loan. (By contrast, in some jurisdictions, such as the United States, the institution of bankruptcy proceedings can give rise to a stay on enforcement by secured creditors. Therefore, one option the bond holders should consider is whether they make a bankruptcy filing in the United States in order to restrain the enforcement by the Bank of Hong Kong. Whether or not that stay has practical effect will depend on whether the Bank of Hong Kong has a presence or assets in the United States (or is otherwise concerned to ensure that it does not commit a contempt of court in the United States).)

Self-Assessment Questions

Question 1

Explain the principle of modified universalism.

Question 2

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

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?

For feedback on these self-assessment questions, see the document "Comment and Feedback on Self-Assessment Questions", which is made available to you as a separate document

6.12 Recognition of foreign judgments

6.12.1 Introduction

A judgment or order of a foreign court has no direct legal effect in the Cayman Islands. A foreign judgment is not enforceable in the Cayman Islands in and of itself. Steps have to be taken to have a foreign judgment legally enforced in the Cayman Islands.[676]

6.12.2 Treaties

The Cayman Islands has not entered into any international treaties for the reciprocal recognition or enforcement of foreign judgments. The UK has not extended its ratification of any such treaties to the Cayman Islands by Order in Council (save for the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958, and the International Convention on Civil Liability for Oil Pollution Damage 1992).

[676] However, note Kawaley J's first-instance judgment in *In the matter of Guoan International Limited* (unreported, 29 October 2021) which confirms that a creditor may rely upon a foreign judgment as the basis for seeking a winding up order without first obtaining recognition and / or enforcement orders in respect of such foreign judgment from the Cayman Islands Court.

The Cayman Islands is not a signatory or party to the Hague Convention of 2 July 2019 on the Recognition and Enforcement of Foreign Judgments in Civil and Commercial Matters.

6.12.3 Statute(s)

The Foreign Judgments Reciprocal Enforcement Act (1996 Revision) provides that foreign judgments given in specified foreign courts may be registered in the Cayman Islands and enforced within the Cayman Islands in the same manner as a domestic judgment of the Cayman Islands Court.

However, the Act only applies to certain courts of Australia (and its external territories) as set out in the Foreign Judgments Reciprocal Enforcement (Australia and its External Territories Order) 1993.

In circumstances where the Act applies, Order 71 of the Grand Court Rules sets out the relevant procedural rules.

A foreign judgment registered under the Foreign Judgments Reciprocal Enforcement Act (1996 Revision) can be set aside on an application of any party against whom a registered judgment may be enforced. The registration of a foreign judgment must be set aside if the Supreme Court is satisfied that the:

(a) judgment is not covered by the Foreign Judgments Reciprocal Enforcement Act (1996 Revision) or was registered in contravention of the Act;

(b) foreign court had no jurisdiction in the circumstances of the case;

(c) defendant did not receive notice of the proceedings in the foreign jurisdiction in sufficient time to enable him to defend the proceedings and did not appear;

(d) judgment was obtained by fraud; or

(e) rights under the judgment are not vested in the person by whom the application for registration was made.

The registration of a foreign judgment may be set aside if the Cayman Islands Court is satisfied that the matter in dispute in the proceedings giving rise to the registered judgment had, previous to the date of such judgment, been the subject of a final and conclusive judgment by a court having jurisdiction in the matter.

The enforcement of foreign judgments given by courts in a country that is party to the International Convention on Civil Liability for Oil Pollution Damage 1992 in respect of certain marine shipping and oil pollution liabilities, may be subject to the provisions of the Merchant Shipping Act (2021 Revision).

The enforcement of foreign judgments and court orders for maintenance in a private family law context may be subject to the provisions of the Maintenance Act (1997 Revision), although this currently only applies to the courts of England and Wales, Ireland, Jamaica, Belize, and two Canadian jurisdictions (the Yukon Territory and Province of Ontario).

The recognition and enforcement of foreign judgments and court orders for divorces and legal separation may be subject to the provisions of the Matrimonial Causes Act (2005 Revision) and the Civil Partnership Act 2020.

There is an extensive body of statutory provisions and case law relating to the recognition and enforcement of foreign judgments and court orders made in the bankruptcy and insolvency context, see for example paragraph 6.3 above. The statutory provisions include the Bankruptcy Act (1997 Revision) and the Companies Act, and secondary legislation made thereunder.

The enforcement of foreign judgments against states or governments may be subject to the provisions of the UK's State Immunity Act 1978, as applied to the Cayman Islands by the State Immunity (Overseas Territories) Order 1979, or, in the case of judgments against the Cayman Islands Government, the Crown Proceedings Act (1997 Revision).

Foreign arbitration awards are capable of recognition and enforcement in the Cayman Islands pursuant to the provisions of the Foreign Arbitral Awards Enforcement Act (1997 Revision), the Arbitration Act, 2012, and Order 73 of the Grand Court Rules.

6.12.4 Common law

Foreign judgments from other jurisdictions which are not registrable under the Foreign Judgments Reciprocal Enforcement Act (1996 Revision) must be enforced by way of commencing a new action in the Cayman Islands, on the basis that the foreign judgment is treated as evidence of a debt (or other obligation).

Money judgments and non-money judgments (including declaratory judgments)[677] are enforceable at common law in the Cayman Islands, subject to any further developments of the common law and, in the case of non-money judgments, at an appellate level.

The basic common law rule is generally stated to be that a foreign money judgment will be recognised and enforced as a debt against the judgment debtor where:

(a) such judgment is final and conclusive in the foreign court;

(b) the judgment was obtained in a court of law which had jurisdiction over the judgment debtor;

[677] See *Miller v Gianne* [2007 CILR 18] (applied in *Bandone v Sol Properties* [2008 CILR 301] and referred to in *Masri v Consolidated Contractors* 2010 (1) CILR 265), in which Jones J confirms that "a foreign *in personam* judgment which created a non-monetary obligation could be recognized and enforced if specific performance of it could be ordered".

(c) the judgment was not obtained by fraud;

(d) the judgment was not in respect of taxes, fines or penalties;

(e) the enforcement of the judgment would not contravene the public policy of the Cayman Islands; and

(f) the rules of natural justice were observed in the foreign proceedings.

In general, the Cayman Islands Court will follow the principles of the common law of England in recognising and enforcing foreign judgments which fall within the aforementioned rule.

Under the "firewall" provisions of the Cayman Islands' Trusts Act (2021 Revision), a foreign judgment will not be enforced if it holds that Cayman Islands trusts or dispositions in respect of them are void or liable to be set aside either because the foreign law does not recognise the trust concept, or because of heirship, matrimonial or certain other rights that will not be enforced by the foreign court.

Once a local judgment has been obtained, the full range of domestic enforcement remedies will be available.[678]

6.12.5 Procedure

Order 72 of the Grand Court Rules provides that any action for the enforcement of a foreign judgment, whether at common law or pursuant to statute, is a financial services proceeding which must be commenced in the FSD of the Court.

For enforcement pursuant to the Foreign Judgments Reciprocal Enforcement Act (1996 Revision), commencement must be by originating summons. For enforcement pursuant to the common law, commencement must be by writ of summons, setting out the cause of action and details of the claim. Personal service of the writ is required.

Once service is effected, the defendant must file an acknowledgment of service and a defence within the requisite time period. In the absence of such, the claimant may apply for default judgment. If the defendant does file an acknowledgment of service and defence, the claimant may apply for summary judgment in appropriate circumstances on the ground that there is no real triable defence.

6.12.6 Limitations

Section 4(1) of the Foreign Judgments Reciprocal Enforcement Act (1996 Revision) requires that any application for registration of the foreign judgment must occur within six years of the date

[678] Grand Court Rules, O 45 provides for the practice and procedures for enforcement of judgments generally.

of the judgment, or where there have been proceedings by way of appeal against the judgment, after the date of the last judgment given in those proceedings.

Further, section 30(1) of the Limitation Act (1996 Revision) provides that an action will not be brought upon any judgment after the expiration of six years from the date on which the judgment became enforceable.

6.12.7 Recognition

A foreign judgment given by a court of a foreign country with jurisdiction to give that judgment, which is final and conclusive on the merits and not impeachable on any of the grounds referred to above, is also entitled to recognition at common law and may be relied on in proceedings in the Cayman Islands (that is, recognition alone, rather than positive enforcement).

For example, no proceedings may be brought by a person on a cause of action in respect of a judgment which has been given in his favour in proceedings between the same parties or their privies in a foreign court, unless that judgment is not enforceable or not entitled to recognition.

6.12.8 Estoppel

In dealing with estoppel, the case of *House of Spring Garden and Ors v Waite and Ors*[679] is instructive in this context. In this case, an Irish judgment was sought to be enforced in England by a common law action for summary judgment and a defendant who had not been party to the Irish action (but could have been if he chose), sought to say he was not bound by the decision. The Court of Appeal held that the defendant was bound by estoppel because of the privity of interest between himself and the other defendants.

The requisite privy is said to be a privity of either blood, title or interest.[680] The principle is said to be founded on "justice and common sense". The Court of Appeal also relied on the doctrine of abuse of process – that it would be such an abuse to require the plaintiffs to re-litigate the matter. However, *House of Spring Garden* is an exceptional case as it was based on a fraud perpetrated on the plaintiffs and the Court of Appeal took a robust view.

In *Desert Sun Loan Corp v Hill*,[681] the English Court of Appeal in principle accepted that estoppel could potentially arise from an interlocutory judgment of a foreign court on a procedural, non-substantive issue where there was express submission of the issue in question to the foreign court and the specific issue of fact was raised before and decided, finally and not just provisionally, by the Court. A judgment in default or by consent may be a judgment on the merits, but caution needs to be exercised.[682]

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[679] [1990] 2 All ER 990. Referred to in passing in *Torchlight GP Ltd v Millinium Asset Services Pty Limited and Others* (unreported, 27 October 2020) and *Arnage Holdings Ltd and Ors v Walkers (a firm)* (unreported, 24 July 2019).

[680] See *Carl Zeiss Stiftung v Rayner and Keeler (No 2)* [1967] 1 AC 853. See also *The Sennar (No 2)* [1985] 1 WLR 490, HL.

[681] [1996] 2 All ER 847, CA.

[682] See *Carl Zeiss Stiftung v Rayner and Keeler (No 2)* [1967] 1 AC 853 at 916-917, 926, and 946.

Self-Assessment Question

Question 1

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

For feedback on these self-assessment questions, see the document "Comment and Feedback on Self-Assessment Questions", which is made available to you as a separate document

CHAPTER 7

PERSONAL / CONSUMER BANKRUPTCY

7.1 Introduction

The Cayman Islands has a fragmented insolvency system in the sense that different primary and secondary legislation must be consulted depending on whether one is dealing with a personal or a corporate debtor.

Personal Insolvency is governed by:

- The Bankruptcy Act (Cap 7) (1997 Revision); and
- The Grand Court (Bankruptcy) Rules (2021 Revision).

The Cayman Islands is regarded as a creditor-friendly jurisdiction. Creditors are not treated differently based on whether they are based in the Cayman Islands or elsewhere. The Cayman Islands has taken a conscious decision to remain creditor-friendly to attract international business.

Personal bankruptcy is rare in the Cayman Islands, which probably accounts for the failure of the legislature to update the antiquated language and unrealistically low monetary figures in the legislation.[683]

7.2 Court

The Grand Court is the Chief Court of Bankruptcy, which hears all applications for personal bankruptcy.[684]

7.3 Who qualifies as a "debtor"

Section 2 of the Bankruptcy Act defines a "debtor" to include any person who, at the time when any act of bankruptcy was done or suffered by him, –

- was personally present in the Islands;
- ordinarily resided in, or had a place of residence in, the Islands;
- was carrying on business in the Islands, personally or by means of an agent or manager; or
- was a member of a firm or partnership which carried on business in the Islands.

[683] For a recent example, see *In the Matter of Pelletier (a debtor)* [2020 (1) CILR 570].
[684] Bankruptcy Act, s 3(1).

7.4 Commencement of proceedings

Proceedings may be commenced by filing a petition with the Grand Court.[685] A debtor may present a bankruptcy petition against himself. Alternatively, a single creditor, or two or more creditors, may present a bankruptcy petition to the Court against a debtor, provided the aggregate amounts of debt owing are not less than KYD 40.

7.4.1 Grounds for petition (Acts of Bankruptcy)

A debtor may present a bankruptcy petition against himself without alleging any grounds.[686] However, the petition must be accompanied by a statement setting out details of the debtor's financial affairs.[687]

Creditors applying for the bankruptcy of a debtor must allege at least one "act of bankruptcy" from the following list:[688]

(a) that the debtor has, in the Islands or elsewhere, made a conveyance or assignment of their property to a trustee or trustees for the benefit of their creditors;

(b) that the debtor has, in the Islands or elsewhere, made a fraudulent conveyance, gift, delivery or transfer of their property or any part thereof;

(c) that the debtor has, with intent to defeat or delay their creditors, departed out of the Islands, departed from their dwelling-house, otherwise absented themself, begun to keep house or begun to sell their stock-in-trade at an under-value;

(d) that the debtor has, by any act, declared themself unable to meet their engagements;

(e) that the debtor has presented a bankruptcy petition against themself;

(f) that execution issued in the Islands against the debtor on any legal process for the obtaining of payment of any sum of money has been levied by seizure and sale of their goods, or enforced by delivery of their goods;

(g) that the creditor has served on the debtor a summons in an action in the Grand Court wherein the creditor claims payment of a liquidated sum of not less than KYD 40;

(h) that the creditor presenting the petition has obtained final judgment against the debtor for not less than KYD 40 and has served on the debtor in the Islands a bankruptcy notice in writing and the debtor has not, within seven days after the service of notice, paid such amount;

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[685] *Idem*, s 4.
[686] *Idem*, s 15; see, eg, *Northern Mariana Islands Government v Millard and Millard* [2014 (1) CILR 342.
[687] *Idem*, s 17.
[688] *Idem*, s 14.

(i) that the debtor has not paid an obligation of not less than KYD 40 upon a negotiable security within 14 days;

(j) that the debtor has, in the Islands or elsewhere, made any conveyance or transfer of their property which would be void as a fraudulent preference if they were adjudged bankrupt;

(k) that the debtor has, in the Gazette and in a newspaper circulated in the Islands, given notice of their intention to convey, assign or transfer their stock-in-trade, debts or things in action relating to their business to any other person; and that the creditor, having a demand against the debtor of not less than KYD 40, has served on the debtor in the Islands a bankruptcy notice in writing, and that the debtor has not, within seven days after the service of such notice, paid such amount.

(l) that the debtor has paid money to or given or delivered any satisfaction or security for the debt of a petitioning creditor, or any part thereof, after such creditor has presented a bankruptcy petition against the debtor.

In addition to establishing one of the above acts of bankruptcy:

- the alleged act of bankruptcy must have occurred within six months before the presentation of the petition; and

- the debt of the petitioning creditor must be a liquidated sum due, or growing due at law or in equity, and must not be a secured debt.

7.4.2 Provisional order

After the presentation of a petition, if the Court is satisfied of the evidence of the creditor's debt, the Court will make a provisional order that the affairs of the debtor must be wound up and their property administered under the Act.[689]

7.4.3 Service and notice to show cause

The provisional order is served on the debtor, together with a notice that within a specified number of days the debtor may show cause why the provisional order should be revoked.[690]

7.4.4 Revocation of provisional order

If the debtor, within the time appointed, shows to the satisfaction of the Court that either the proof of the petitioning creditors debt, or of the act of bankruptcy, is insufficient, the Court must

[689] *Idem*, s 29; see, eg, *In the Matter of Joe Otu, Margaret Mendes, Josephine Otu and Fernando Mendes* [2011 (1) CILR 26].
[690] *Idem*, s 30.

revoke the provisional order and, unless it sees good cause to the contrary, will order costs to be paid to the debtor.[691]

7.4.5 Statement of affairs

If the debtor does not show cause why the provisional order must be revoked, an order is served on the debtor requiring them to file, within the specified number of days, a statement of their affairs.[692]

7.4.6 Absolute order

If the debtor fails to comply with the order to file their statement of affairs, or to show a sufficient excuse for not having complied with it, the Court may, on the application of any creditor, make an absolute order for bankruptcy against the debtor.[693]

7.5 Stay

All proceedings to recover debts are stayed upon the making of a provisional or absolute order[694] unless leave of the Court is obtained.[695]

The effect of the provisional order is retroactive (to the date of the proven "act of bankruptcy").[696]

Secured creditors: This stay does not affect the power of any secured creditor to realise or otherwise deal with their security in the same manner as they could have done prior to the making of the provisional or absolute order.[697] Secured creditors may appoint receivers to enforce security rights (see below).

7.6 Property vests in Trustee in Bankruptcy

Upon a provisional or absolute order being made, the property of the debtor immediately passes to, and vests in, the Trustee in Bankruptcy (Trustee).[698]

The Trustee is attached to the Court. It administers the estates of debtors in bankruptcy subject to the Bankruptcy Act.

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[691] *Idem*, s 31.
[692] *Idem*, s 32.
[693] *Idem*, s 33.
[694] *Idem*, s 34(1).
[695] *Idem*, s 35(2).
[696] *Idem*, s 35.
[697] *Idem*, s 34(3).
[698] *Idem*, s 37.

7.7 Powers and duties of Trustee

Until the provisional order is made absolute, it is the duty of the Trustee to preserve the property such that it may be returned to the debtor in the event the provisional order is revoked.[699]

The Trustee may carry on the trade of the debtor so far as may be necessary or expedient for the beneficial winding up or sale of the business.[700]

The Trustee may bring or defend any legal proceedings relating to the property of the debtor.[701]

The Trustee must receive and adjudicate the proof of debts.[702] The way proof of debts must be filed is set out in the Grand Court (Bankruptcy) Rules 2021.

Once an absolute order has been made, the Trustee must proceed to administer the debtor's estate for the benefit of the creditors.[703]

7.8 Allowances to debtor for support

The Trustee may, from time to time, make such allowances to the debtor as the Trustee thinks just (out of the debtor's property) for the support of the debtor and their family, or in consideration of the debtor's services if the debtor is engaged in the winding up of their own estate.[704]

7.9 Onerous and unprofitable property

The Trustee may disclaim onerous and unprofitable property in certain prescribed circumstances. These circumstances, and the effects of such disclaimer, are set out in section 105 of the Bankruptcy Act.

7.10 Duty to aid Trustee

The debtor has a duty to aid the Trustee in the realisation of their property and the distribution of the property among their creditors.[705] Failure to do so amounts to contempt.[706]

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[699] *Idem*, s 38.
[700] *Idem*, s 79.
[701] *Idem*, s 80.
[702] *Idem*, s 87.
[703] *Idem*, s 65.
[704] *Idem*, s 137.
[705] *Idem*, s 39.
[706] *Idem*, s 40.

7.11 Meetings of creditors

The Court must, as soon as practicable after the provisional order, summon a general meeting of the creditors of the debtor. Such a meeting will not take place if an absolute order has been made.[707]

Various rules, which are beyond the scope of this module, govern such meetings. These rules include:

- A person is not entitled to vote at such a meeting unless they have, in the prescribed manner, proved a debt that is due to them; and
- A secured creditor will only be deemed to be a creditor for the purposes of voting in respect of any balance due to the debtor.

At the meeting the creditors may, by the votes of a majority in value of the creditors present, personally or by proxy,[708] resolve that:

- the petition be stayed, the affairs of the debtor wound up and their property administered under a "deed of arrangement"; or
- that an adjudication of bankruptcy be made.

7.12 Deed of arrangement

A deed of arrangement may be entered into between a debtor and their creditors,[709] provided the deed is assented to by a majority in number (more than 50%) representing 75% in value of the creditors of the debtor who have proved their debt.

The deed of arrangement must be taken into consideration by the Court but, before the deed is considered by the Court, the debtor must submit themself to the public examination of the Court and the Trustee must make a report to the Court under section 67 of the Bankruptcy Act.[710]

The Court will confirm the deed if it appears to be in the interest of the creditors generally that it should be so confirmed. Only then will the deed become binding on all creditors and the debtor.

If a deed is so approved, the terms of the deed will provide for the date and circumstances in which the debtor will ultimately be discharged.[711]

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[707] *Idem*, s 41.
[708] *Idem*, s 44.
[709] *Idem*, s 48.
[710] *Idem*, s 50.
[711] *Idem*, s 55.

7.13 Absolute orders

When an absolute order for bankruptcy has been made against a debtor, a public examination of the affairs of the debtor must take place. The debtor must attend and submit to examination.[712]

If it appears to the Court that the debtor has failed to keep proper books of account or that they have incurred debt by breach of trust or without having had any reasonable expectation of being able to repay such debt, the Court has the discretion to imprison them.[713]

7.14 Trustees report

It is the duty of the Trustee, as soon as possible after the close of the public examination of the debtor, to make a report as to the state of the debtor's affairs and as to the conduct of the debtor before and during the bankruptcy.[714]

In particular, the Trustee is required to note in its report any matters which might constitute offences under the Bankruptcy Act and / or which would justify the Court refusing, suspending or qualifying an order for the debtor's discharge.

7.15 Divisible property

When a provisional order has been made against a debtor, their property becomes divisible between their creditors in proportion to the debts owed.

The property of the debtor divisible amongst their creditors and vesting in the Trustee will be comprised of:[715]

(a) all such property as may belong to, or be vested in, the debtor at the commencement of the bankruptcy or which may be acquired by, or devolve on, them at any time previous to their discharge;

(b) the capacity to exercise, and to take proceedings for exercising, all such powers in, or over, or in respect of, property as might have been exercised by the debtor;

(c) all goods and chattels being at the commencement of the bankruptcy in the possession of the debtor.

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[712] *Idem*, s 62.
[713] *Idem*, s 64.
[714] *Idem*, s 67.
[715] *Idem*, s 100.

7.16 Non-divisible property

The following property of the debtor is not available to satisfy claims:[716]

(a) property held by the debtor on trust for any other person; or

(b) the tools, if any, of their trade, the clothes and bedding of the debtor, their spouse and children to a value not exceeding KYD 60 in the whole.

In addition, marital property may be exempt depending on the date and circumstances of its settlement.

7.17 Secured creditors

A secured creditor may on giving security prove for their whole debt, or they may prove for any balance due to them after realising or giving credit for the value of their security.

7.18 Priority creditors

The following debts are paid in priority to all other debts:[717]

(a) all public taxes imposed by law due from the debtor at the date of the provisional order not exceeding in the whole one year's taxes;

(b) all wages or salary of any clerk or servant in respect of services rendered to the debtor for four months preceding the date of the provisional order, not exceeding KYD 100; and

(c) all wages of any labourer or workman in respect of services rendered to the debtor for four months preceding the date of the provisional order.

These debts rank equally and must be paid in full unless the property of the bankrupt is insufficient to meet them.

7.19 Preferences and void payments

Such payments are governed by Part XVII of the Bankruptcy Act.

Any conveyance, transfer, charge or payment made by a debtor in favour of any creditor, with a view to giving such creditor a preference over the other creditors, must, if a provisional order takes effect within six months, be deemed fraudulent and void as against the Trustee.

Any disposition, made by any trader unable to pay their debts, of their stock-in-trade or things in action relating to their business, otherwise than in the ordinary course of business, must, if a

[716] *Idem*, s 100(i-ii).
[717] *Idem*, s 135.

provisional order or an absolute order takes effect within six months, be deemed fraudulent and void as against the Trustee, except in the following circumstances:

(a) if the dispositions were made and executed with the assent of 75% in number and value of the creditors;

(b) the same were made and executed after not less than 21 days' notice in the Gazette and in a newspaper circulated in the Islands of the intention of the trader to make such disposition.

7.20 Bailiff[718]

When the goods of a debtor have been taken in execution in respect of a judgment and sold, the bailiff must, if it has notice of a petition filed against the debtor, hold the balance of the proceeds of the sale, after deducting expenses, upon trust to pay the same to the Trustee.

When the goods of a debtor have been taken in execution in respect of a judgment and not sold before the bailiff or officer executing the process receives notice of the appointment of a receiver or Trustee under a bankruptcy petition, the bailiff after receipt of the notice, must deliver up such goods to the receiver or Trustee.

7.21 Creditor that has executed on property

A creditor who has levied execution on the property of a debtor, or has made an attachment thereof, is not entitled to retain the benefit of such execution or attachment unless and except insofar as they have, before the filing of a petition against or by such debtor, enforced such execution by sale of the property seized, or enforced such attachment by actual possession of the moneys attached or, as the case may be, by sale of the property attached.[719]

7.22 Landlord

A landlord to whom any rent is due from the debtor may, at any time, either before or after the commencement of the bankruptcy, distrain upon the goods or effects of the debtor for the rent due to them.[720]
If such distress for rent is levied after the commencement of the bankruptcy, it will be available only for one year's rent accrued due prior to the date of the provisional order.

After notice received by the person making the distress of the appointment of the Trustee or receiver, no sale may be made of the goods distrained, unless the Court otherwise orders, except by the Trustee or receiver.

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[718] *Idem*, s 114-115.
[719] *Idem*, s 116.
[720] *Idem*, s 117.

7.23 Netting-off

Where there have been mutual credits, mutual debts, or other mutual dealings, between the debtor and any person having a debt provable under the bankruptcy petition, netting-off is allowed.[721]

7.24 Debtor's discharge

The debtor may, at any time after the filing of such report, apply for an order of discharge.[722]

The Trustee or any creditor may oppose the discharge and may show cause why it should be refused, postponed, or made subject to conditions.[723]

The Court may grant the discharge unconditionally or conditionally or it may suspend or refuse the discharge.[724]

The discharge, if made, releases the debtor from their debts (subject to any conditions set out by the Court and subject to the *caveat* that it must not release a bankrupt from any liability incurred by means of fraud).[725]

Self-Assessment Exercise 3

Question 1

Which law governs personal bankruptcy in the Cayman Islands?

Question 2

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

Question 3

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

Question 4

Is all the debtor's property available to creditors?

[721] *Idem*, s 127.
[722] *Idem*, s 68(1); see, eg, *In the Matter of Foster (A Debtor)* [2016 (2) CILR 69].
[723] *Idem*, s 68(2).
[724] *Idem*, ss 68 and 70.
[725] *Idem*, s 71.

For feedback on these self-assessment questions, see the document "Comment and Feedback on Self-Assessment Questions", which is made available to you as a separate document

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