



SUMMATIVE (FORMAL) ASSESSMENT: MODULE 5C

CAYMAN ISLANDS

This is the **summative (formal) assessment** for **Module 5C** of this course and must be submitted by all candidates who **selected this module as one of their elective modules**.

The mark awarded for this assessment will determine your final mark for Module 5C. In order to pass this module, you need to obtain a mark of 50% or more for this assessment.

INSTRUCTIONS FOR COMPLETION AND SUBMISSION OF ASSESSMENT

Please read the following instructions very carefully before submitting / uploading your assessment on the Foundation Certificate web pages.

1. You must use this document for the answering of the assessment for this module. The answers to each question must be completed using this document with the answers populated under each question.
2. All assessments must be submitted electronically in **Microsoft Word format**, using a standard A4 size page and an 11-point Arial font. This document has been set up with these parameters – **please do not change the document settings in any way. DO NOT** submit your assessment in PDF format as it will be returned to you unmarked.
3. No limit has been set for the length of your answers to the questions. However, please be guided by the mark allocation for each question. More often than not, one fact / statement will earn one mark (unless it is obvious from the question that this is not the case).
4. You must save this document using the following format: **[studentID.assessment5C]**. An example would be something along the following lines: 202122-336.assessment5C. **Please also include the filename as a footer to each page of the assessment** (this has been pre-populated for you, merely replace the words "studentID" with the student number allocated to you). Do not include your name or any other identifying words in your file name. **Assessments that do not comply with this instruction will be returned to candidates unmarked.**
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6. The final submission date for this assessment is **31 July 2022**. The assessment submission portal will close at **23:00 (11 pm) BST (GMT +1) on 31 July 2022**. No submissions can be made after the portal has closed and no further uploading of documents will be allowed, no matter the circumstances.
7. Prior to being populated with your answers, this assessment consists of **8 pages**.

ANSWER ALL THE QUESTIONS

QUESTION 1 (multiple-choice questions) [10 marks in total]

Questions 1.1. – 1.10. are multiple-choice questions designed to assess your ability to think critically about the subject. Please read each question carefully before reading the answer options. Be aware that some questions may seem to have more than one right answer, but you are to look for the one that makes the most sense and is the most correct. When you have a clear idea of the question, find your answer and **mark your selection on the answer sheet by highlighting the relevant paragraph in yellow**. Select only **ONE** answer. Candidates who select more than one answer will receive no mark for that specific question.

Question 1.1

Select the **correct answer**.

Once a provisional liquidator is appointed:

- (a) No action may be commenced against the company without leave of the court.
- (b) No existing action may be continued against the company without permission of the provisional liquidator.
- (c) Legal proceedings may be commenced or continued against the company without leave of the court.
- (d) No action may be commenced against the company.

Commented [BT1]: Correct. 1 mark.

Question 1.2

Which of the following is **not** available in the Cayman Islands?

- (a) Appointment of a receiver.*
- (b) Court-supervised liquidation.
- (c) Official liquidation.
- (d) Deed of Company Arrangement.

Commented [BT2]: Incorrect. Answer is D.

**the appointment of a receiver is actually available in the Cayman Islands, albeit it is not explicitly mentioned in the Cayman Islands statutory provisions regarding insolvency. It should be noted that such appointments are provided for in the Grand Court Rules. The other three are available and codified in the Cayman Islands' law. As such, all four are technically available tools in the Cayman Islands.*

Question 1.3

Select the **correct answer**.

In a voluntary liquidation:

- (a) The company may cease trading where it is necessary and beneficial to the liquidation.
- (b) The company must cease trading except where it is necessary and beneficial to the liquidation.

Commented [BT3]: Correct. 1 mark.

- (c) The company must cease trading if it is necessary and beneficial to the liquidation.
- (d) The company may cease trading unless it is necessary and beneficial to the liquidation.

Question 1.4

Select the **correct answer**.

The Grand Court of the Cayman Islands has jurisdiction to make winding up orders in respect of:

- (a) A company incorporated in the Cayman Islands.
- (b) A company with property located in the Cayman Islands.
- (c) A company carrying on business in the Cayman Islands.

(d) Any of the above.

Commented [BT4]: Correct. 1 mark.

Question 1.5

Select the **correct answer**.

In a provisional liquidation, the existing management:

- (a) Continues to be in control of the company.
- (b) Continues to be in control of the company subject to supervision by the court and the provisional liquidator.

(c) May continue to be in control of the company subject to supervision by the provisional liquidator and the court.

Commented [BT5]: Correct. 1 mark.

(d) Is not permitted to remain in control of the company.

Question 1.6

Select the **correct answer**.

When a winding up order has been made, a secured creditor:

- (a) May enforce their security with leave of the court.
- (b) May enforce their security with leave of the court provided the liquidator is on notice of the application.

(c) May enforce their security without leave of the court.

Commented [BT6]: Correct. 1 mark.

(d) May not enforce their security until the liquidator has adjudicated on the proofs of debt.

Question 1.7

Select the **correct answer**.

Any payment or disposal of property to a creditor constitutes a voidable preference if:

- (a) It occurs in the six months before the deemed commencement of the company's liquidation, or at a time when it is unable to pay its debts and the dominant intention of the company's directors was to give the applicable creditor a preference over other creditors.
- (b) It occurs in the six months before the deemed commencement of the company's liquidation and at a time when it is unable to pay its debts and the dominant intention of the company's directors was to give the applicable creditor a preference over other creditors.
- (c) 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, or the dominant intention of the company's directors was to give the applicable creditor a preference over other creditors.
- (d) It occurs in the six months before the deemed commencement of the company's liquidation, or at a time when it is unable to pay its debts, or the dominant intention of the company's directors was to give the applicable creditor a preference over other creditors.

Commented [BT7]: Correct. 1 mark.

Question 1.8

Which of the following **is not** a preferential debt ranking equally with the other four?

- (a) Sums due to company employees.
- (b) Taxes due to the Cayman Islands government.
- (c) Amounts due to preferred shareholders.
- (d) Sums due to depositors (if the company is a bank).
- (e) Unsecured debts which are not subject to subordination agreements.

Commented [BT8]: Correct. 1 mark.

Question 1.9

Select the **incorrect statement**.

A company may be wound up by the Grand Court if:

- (a) The company passes a special resolution requiring it to be wound up.
- (b) The company does not commence business within a year of incorporation.
- (c) The company is unable to pay its debts.
- (d) The board of directors decides it is "just and equitable" for the company to be wound up.
- (e) The company is carrying on regulated business in the Cayman Islands without a license.

Commented [BT9]: Correct. 1 mark.

Question 1.10

Select the **correct answer**.

In order for a proposed scheme of arrangement to be approved:

(a) 50% or more representing 75% or more in value of the creditors must agree.

Commented [BT10]: Incorrect. D.

(b) 50% or more representing more than 75% of the creditors must agree.

(c) More than 50% representing more than 75% of the creditors must agree.

(d) More than 50% representing 75% or more in value of the creditors must agree.

Commented [BT11]: 8/10 for this section

QUESTION 2 (direct questions) [10 marks]

Question 2.1 [maximum 3 marks]

Is it possible for a creditor to register its security over an asset in the Cayman Islands? If so, how, and what is the effect of it doing so, if any?

In the Cayman Islands, there are several **ownership registers** which are centrally held. These include registers for real estate, ships, aircrafts, motor vehicles, and intellectual properties. Mortgages and charges can be registered in these registers **by filing a notice** of the security. Once a registration is complete, lenders can ensure that other people will have notice of the secured position as they are **deemed to have notice**.

Other assets cannot be registered as such as these are not included in the public security registration regime. Security interests should be entered in the **register of mortgages** and charges of the debtor company itself, within its registered office. If the debtor does not register or update the information in its register, this does not render the security interests invalid. The register is open for inspection and **puts third parties on notice** of the existence of a security. As such, a potential creditor can review the registers prior to making a loan.

Commented [BT12]: 3 marks

Question 2.2 [maximum 4 marks]

Does the Cayman Islands Grand Court have the power to assist foreign bankruptcy proceedings? If so, what is the source of that power and in what circumstances may it exercise it?

The Cayman Islands Grand Court does have the **power to assist foreign bankruptcy proceedings**, as provided for under **Part XVII of the Companies Act**.

These powers, within the scope of Part XVII of the Companies Act, are exercised by the Court's **discretion** if the foreign representatives satisfy the Court that granting the relief that is being sought in the foreign representative's application is appropriate.

However, the Court should be guided by **certain factors** in determining whether it should grant **ancillary orders** (ie assist the foreign bankruptcy proceedings). These factors ensure the relatively cost and time efficient options for administration of the debtor's estate. These include: the just treatment of all holders of claims and the protection of claim holders in the Cayman Islands, prevention of fraudulent actions, distribution of the proceeds according to the statutory priority, recognition and enforcement of security interests, non-enforcement of foreign taxes, and comity.

Commented [BT13]: 3 marks. Good but the examiner was looking for explicit reference to section 242 and the statutory test therein ('best assure an economic and expeditious administration of the debtor's estate')

Question 2.3 [maximum 3 marks]

Outline the legal framework for the recognition of foreign judgements in the Cayman Islands.

Firstly, it should be noted that the Cayman Islands has not entered into international agreements regarding reciprocal recognition, and is not signatory to international convention regarding recognition and enforcement of civil and commercial judgements such as the Hague

Commented [BT14]: 3 marks

Convention on the Recognition and Enforcement of Foreign Judgements in Civil and Commercial Matters.

The **Foreign Judgments Reciprocal Enforcement Act (1996 Revision)** provides a statutory scheme for such foreign judgments to be recognized and enforced in situations where the judgement originates from a country which assures substantial reciprocity of treatment regarding the enforcement of judgments originating from the Cayman Islands courts. The applicability of the Act is rather limited. The criteria for enforcing a foreign judgement are that it should be a money judgment that is final and made after the 1996 Act was extended to the subject foreign country.

Enforcing a foreign judgment is often done in practice by **commencing a new action under common law** in the Cayman Islands based on the foreign judgement under the regular procedural regime of the **Cayman Islands Grand Court Rules**. This would include money, non-money, and declaratory judgments which are enforceable if they are final, if the foreign court had jurisdiction, if foreign judgement was not obtained by fraud, and not contrary to the Cayman Islands public policy, nor contrary to the rules of natural justice.

Both common law and 1996 Act enforcements of foreign judgements have a 6-year time constraint which runs from the date of the judgement.

QUESTION 3 (essay-type questions) [15 marks in total]

Question 3.1 [maximum 9 marks]

In the absence of a statutory prohibition on insolvent trading, is it possible for court appointed liquidators of an insolvent company, or creditors of such a company, to hold its former directors accountable by either seeking financial damages against those directors and / or by seeking to "claw back" any payments that those directors should not have made? If so, please explain the possible options.

There are several claw-back and/or directors' liability options the creditors or the liquidators may resort to.

Firstly, under section 99 of the Companies Act, any **dispositions made by the debtor company after the commencement of the winding-up will be void**. The liquidator may apply for relief to court in order to require the repayment of the funds or return of assets, unless the Court validates a post-petition grant of security upon the debtor's petition for a validation order.

Secondly, another claw-back mechanism is the **voidable preference** under section 145 of the Companies Act, which stipulates that any payment or disposal of property to a creditor constitutes a voidable preference if it takes place six months before the commencement of the liquidation, during which the debtor company was unable to pay its debts, and its dominant intention was to give preference to the creditor above other creditors, see also *In re Weaving Macro Fixed Income Fund Ltd (in Liquidation)* [2016 (2) CILR 514].

Similarly, any transactions of assets or dispositions made at an **undervalue** and with the intention of wilfully defeating an obligation to a creditor (defrauding) is voidable by court order upon application by the liquidator within six years of the disposal. See section 146 of the Companies Act.

Furthermore, per section 147 of the Companies Act, if the business was carried out with fraudulent intentions, ie **fraudulent trading**, the liquidator may apply for an order to impose the obligation on involved parties to make contributions to the insolvent estate.

Lastly, although there is no statutory obligation to file for insolvency nor a prohibition against wrongful trading during insolvency in the Companies Act, directors may be made **personally liable** to the company for any losses incurred during the period in which they acted in breach of their fiduciary duty to act in the best interests of the company (which means to not continue trading during insolvency). The criteria of the "best interests of the company" during a state of insolvency requires the debtors to assess and have due regard to the interests

Commented [BT15]: 8 marks

of the creditors and safeguarding the company from entering a state in which it is unable to pay its debts, see also *Prospects Properties v McNeil* [1990-1991 CILR 1711].

Question 3.2 [maximum 6 marks]

Receivers have no role to play in a Cayman Islands insolvency scenario. Discuss.

The receivership is not codified and explicitly mentioned in the statutory provisions regarding insolvency. However, this statement is hardly true as receivership does play a role in an insolvency context, more specifically, it can provide creditors with an alternative.

To begin with, receivership should be defined. A receiver is a person who may be appointed by the Court for collecting money such as rent, or to carry out other acts such as the execution of a contract or a document of title.

Receivership can have drastic effects on third parties. For example, after an application for receivership has been made and during the receivership process, no suit, action, or other proceeding may be instituted against a segregated portfolio company, except by leave of the court. Receivers play an important role in dealing with such entities and have far-reaching powers, such as relieving the directors and taking over their powers regarding the business.

In the context of insolvency, receivership may offer an alternative option for creditors. Particularly, when no court-involvement or supervision is desired, receivers may be appointed by the rights attached in a security if the security holder, eg a fixed/floating charge holder, owns a charging document which provides for the right to appoint a receiver over the debtor company's charged assets in case the debtor defaults.

The duties and responsibilities, as well as the powers of the receiver are outlined in the charging document. It is common that the receiver has the right to sell the charged assets in order to pay the outstanding debts of the debtor to the creditor.

As such, in specific circumstances as mentioned above, receivership does play a role in an insolvency context, despite the fact that it is not explicitly mentioned in the statutory insolvency provisions.

Commented [BT16]: Ok but what about SPCs? 4 marks.

QUESTION 4 (fact-based application-type question) [maximum 15 marks in total]

Skull & Crossbones Inc (S & C) is a company registered in the Cayman Islands. It operates a fleet of pirate-themed party ships across central America and the Caribbean. It was founded by the wealthy Rackham family over 50 years ago. The family continues to own and manage the business.

Between 2015 and 2019, S & C had been rapidly expanding its operations. However, the unexpected slump in worldwide tourism at the start of 2020 due to COVID-19 adversely affected S & C's revenues.

S & C has only managed to stay afloat for the past 2 years with the assistance of a very large loan from Sparrow's Treasure Bank (Sparrow). Sparrow has lent S & C USD 200 million (USD 80 million of which is secured by a mortgage over four of S & C's largest party boats). The loan facility has now been exhausted. S & C has also fallen behind on the monthly repayments to Sparrow.

There are early signs that the tourism market is starting to pick up again; however, S & C cannot afford to pay the ongoing costs associated with maintaining its fleet of ships (which include electricity and water costs for its huge dry dock facility, ongoing engineering and mechanical costs and also wages, pension and health insurance for its reduced team of employees) let alone find enough money to buy the vast quantities of top-shelf rum it will need for its forthcoming booze cruises.

To make matters worse, S & C commissioned Roger Jolly to build 10 more oversized party boats only a few months before the pandemic struck. S & C attempted to wriggle out of the contract but, by virtue of an arbitration clause, the dispute was referred to the ICC sitting in London. Earlier this month, the ICC ruled that S & C must pay damages of USD 50 million to Roger Jolly by mid-February 2022. S & C has no prospect of being able to satisfy that award.

You are a Cayman Islands-based insolvency professional and have been approached to provide advice on the following:

- (a) What action can Sparrow take to protect its interests?
- (b) What action can Roger Jolly take to protect its interests?
- (c) What action can the unpaid employees take against S & C?
- (d) Does the Cayman Islands Court have jurisdiction over S & C?
- (e) Is there a legal route via which S & C can protect itself and seek to restructure?
- (f) Following on from (e) above, can the Rackham family continue play a part in running S & C during any restructuring process?
- (g) What factors will the Cayman Islands court take into consideration before approving any proposed restructuring?

Each question will be addressed individually below by outlining the issue, presenting the relevant rules, and applying to the case.

(A) What action can Sparrow take to protect its interests?

Sparrow's Treasure Bank has lent out a total of 200 million USD to Skulls & Crossbones Inc ("S&C"). 80 million USD is secured under a mortgage agreement.

Under Cayman Islands' law, mortgages are commonly vested on moveable property such as on ships. The mortgages need to be registered in the centrally maintained vessel ownership register, see also Maritime Authority Law. The ratio behind the prerequisite to register is that third parties are aware of the "burdened" asset ie the existence of a security.

Sparrow should therefore ensure that the mortgage is registered in the said register. In the event of a default, Sparrow can enforce its security. Regardless of whether the debtor enters into a provisional or official liquidation, a secured creditor is entitled to enforce its security, without the need for leave of the court or reference of the company's liquidator.

One should note that Sparrow also has 120 million USD unsecured loans. The bank could serve S&C a summons in action in the Grand Court, claiming payment of a liquidated sum of approximately 100 million KYD in execution [on 2022, July 27th 1 KYD equals 1,20 USD]. Sparrow could then present a bankruptcy petition of S&C to the Grand Court, alleging its act of bankruptcy on the grounds of eg that Sparrow served on the debtor a summons in action in court wherein Sparrow claims payment of a liquidated sum of not less than KYD 40, and that within six months prior to the presentation of the bankruptcy petition. This could be a potential action to take as the 100 million KYD is unsecured and a liquidated sum due. If all goes according to plan, Sparrow will have to file a claim with the liquidator and will most likely be ranked as preferential debt as it is an unsecured debt which is not subject to subordination agreements, as per Section 141 of the Companies Act.

Alternatively, if the Bank prefers non-involvement of the court, it may consider appointing a receiver for its mortgaged loan, if the mortgage document provides such right.

Commented [BT17]: Good. 2 marks. Examiner was looking for candidate to reference ability of secured creditor to enforce its security (which should be centrally registered given it concerns vessels) outside of liquidation proceedings and without leave of the court (s.142). Also, that S&C cannot pay its debts (s.92 and 93) such that Sparrow has standing as an unsecured creditor to petition to wind up S&C. It may therefore choose to help S&C restructure via a work out or alternatively as part of a court supervised process depending on its view of the likely recovery in each scenario.

(B) What action can Roger Jolly take to protect its interests?

Roger Jolly has a final award from the ICC in London. This matter concerns the recognition and enforcement of foreign judgments (or awards).

The Cayman Islands is not part of international treaties for reciprocal recognition or enforcement of foreign judgments, nor has the UK extended the ratification of the treaties to the Cayman Islands, as the country is a British Overseas Territory, by Order in Council. The New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards is an exception.

Under Article III of the Convention, it is stipulated that each contracting state shall “recognize arbitral awards as binding and enforce them in accordance with the rules of procedure of the territory where the award is relied upon”.

Roger Jolly is fortunate that this is not a foreign court judgement (as the rules were more complicated should that have been the case, eg recognition by way of the Foreign Judgement Reciprocal Enforcement Act (in limited cases) or common law (commonly used in practice)). As such, he should apply for recognition and enforcement in the Cayman Islands Grand Court and should per Article IV of the Convention, supply the court with a duly authenticated original award and the original arbitration agreement or their duly certified copies.

Commented [BT18]: Good. 1.5 marks. RJ can apply for recognition and enforcement of the arbitral award since the New York Convention has been extended to the Cayman Islands. The key point is that RJ has to apply to have the judgment recognised in the Cayman Islands. Once it does so, a range of enforcement remedies become available to it, including a charging order, writ of execution, examination of judgment debtor, attachment of earnings, garnishee proceedings and the ability to petition to wind up S&C (since RJ will be an unsecured creditor). If winding up petition has already been filed, there may be a moratorium preventing JR from taking any of the enforcement actions mentioned above in which case it will be left to file a proof of debt for its US\$50m as part of the official liquidation.

(C) What action can the unpaid employees take against S & C?

In the event of an insolvency, employees fall under the category of preferential debts per Section 141 of the Companies Act. These are debts which are paid before all other debts with absolute priority unless the availability of funds are insufficient to do so. In such cases, they are distributed in equal portions. Under these rules, all wages of any labourer in respect of services rendered to the debtor for four months prior to the (provisional) order should be paid in priority.

As such, the employees should file their claims with the liquidator/administrator to secure their preferential position.

Commented [BT19]: 1.5 marks. The unpaid employees can sue S&C for the unpaid debts (provided a winding up petition has not yet been filed). Alternatively, they can apply to wind up under section 92 - 94 Companies Act or apply to apply to appoint provisional liquidators under 104 (if they are concerned about mismanagement or wish to support a court-supervised restructuring). If an order is made that S&C be liquidated, the sums due to the employees rank as preferential debts (section 141) ahead of certain (not all) other creditors.

(D) Does the Cayman Islands Court have jurisdiction over S & C?

Under Section 91 of the Bankruptcy Act, the Grand Court of the Cayman Islands has jurisdiction over a company if it is incorporated in the Cayman Islands, is incorporated elsewhere but subsequently registered within the Cayman Islands, is a foreign company with property located or carrying on business in the Cayman Islands, is a foreign company and a general partner of a limited partnership, or an overseas company as stipulated under Part IX.

In this case, S&C carries out business across central America and the Caribbean (which would include the Cayman Islands) but is in any case registered in the Cayman Islands. As such, the Grand Court does have jurisdiction.

Commented [BT20]: 1 mark.

(E) Is there a legal route via which S & C can protect itself and seek to restructure?

S&C can opt for informal workouts. However, although it is commonly used in practice, these workouts could prove to be somewhat challenging as they need the cooperation of the (major) creditors. *In casu*, S&C seems to have many creditors, who it is seriously indebted to. As such, this option may not be ideal in this case especially as it does not provide for any form of protection.

However, for the S&C to protect itself, it can apply for a moratorium against any proceedings that are in continuation or are being commenced against it by entering into a provisional liquidation. This could provide a necessary breathing space for the negotiations to run smoothly and to achieve an agreement.

Commented [BT21]: 2.5 marks. The Court may, at any time after the presentation of a winding up petition but before making a winding up order, appoint provisional liquidators (PLs). An application may be made *ex parte* by the company (S&C) on the grounds that it is, or is likely to become, unable to pay its debts and intends to present a compromise or arrangement to its creditors in accordance with section 104(3) of the CICA. In the event that a winding up petition is presented by a creditor, S&C could respond by seeking to appoint provisional liquidators. The appointment of PLs would ensure that no action or proceedings may be commenced or continued against the S&C without the leave of the Court as per Section 97 of the CICA (statutory moratorium). Under the supervision of the Court and the JPLs, S&C could then explore a restructuring.

As such, if the S&C seeks to restructure, the provisional liquidation can be used in conjunction with a scheme of arrangement. This scheme is an agreement between S&C and the creditors which is court approved and concerns *inter alia* the restructuring of liabilities, reorganization of share capital, and changes the distribution rights of shareholders and creditors, and which could include debt-for-equity swaps and pre-packaged sales.

(F) Following on from (e) above, can the Rackham family continue play a part in running S & C during any restructuring process?

The answer to this question depends on the facts and details of the case, and on the route S&C decides to take. If it does not enter in provisional liquidation, the Rackham family, being the managing body of the S&C company, will continue to manage the business. If the provisional liquidator is appointed, the Grand Court determines the separation of powers between the Rackham family and the liquidator. Depending on the facts of the case, the liquidator may take over completely, or conversely, the Rackham family may retain most of their powers. The latter option is often referred to as "light touch" proceedings.

Commented [BT22]: 1 mark

(G) What factors will the Cayman Islands court take into consideration before approving any proposed restructuring?

The approval for a scheme is codified in Order 102 (rule 20) of the Grand Court Rules and Practice Direction 2/2010.

In the convening hearing, the Court will consider the issues surrounding its jurisdiction, the class composition and its possible rearrangement, administrative and formal issues such as scheme documentation, explanatory statements, and notices.

After the scheme meeting with the creditors, the acceptance of the restructuring (which occurs by majority of creditors (over 50%) representing at least 75% in value of the creditors), the proposed and accepted restructuring is presented to Court. In turn, the Court should scrutinize whether the voting took place according to the law and has sufficient creditor support. It will also consider whether the convening orders were complied with, whether the majority fairly represents the class, considering the alternatives whether a reasonable intelligent and honest member of the class which is acting in its own interests might reasonably approve such a scheme. If the Court is satisfied it may sanction the arrangement to make it binding on all stakeholders.

Commented [BT23]: 3 marks

*** End of Assessment ***

41.5 / 50