



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.**
5. Before you will be allowed to upload / submit your assessment via the portal on the Foundation Certificate web pages, you will be required to confirm / certify that you are the person who completed the assessment and that the work submitted is your own, original work. Please see the part of the Course Handbook that deals with plagiarism and dishonesty in the submission of assessments. **Please note that copying and pasting from the Guidance Text into your answer is prohibited and constitutes plagiarism. You must write the answers to the questions in your own words.**
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. Correct answer is D.

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.
- (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.

Commented [BT3]: Correct. 1 mark.

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

Commented [BT5]: Correct. 1 mark.

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

Commented [BT6]: Correct. 1 mark.

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.
- (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 [BT10]: Correct. 1 mark.

Commented [BT11]: 9/10 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?

There are ownership registers in the Cayman Islands for real estate, ships, aircraft, vehicles and IP all established under various statutory frameworks, including secondary legislation. All of the aforementioned asset classes have their registers centrally maintained and mortgages or charges over these can be registered. However, it is also the case that there is no public security register for other forms of asset (e.g. over shares, although this is common).

Where a purchaser is purchasing one of the asset classes where ownership (and charges) are centrally maintained, the purchaser will be deemed to have notice of the interest and will acquire the asset subject to the secured creditors interest.

For other assets a creditor should review the company's register of mortgages and charges and take steps to ensure control over an asset to prevent a third party from purchasing the asset.

The Companies Act requires that security interests are recorded in the register of mortgages and charges of the debtor company and such registers must be properly maintained at the company's Caymanian registered office (albeit failure to comply with this will not void the security interest itself). Registration does not create a priority, however as the register is open for inspection it provides notice to third parties that there is a security of a certain asset of a company.

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 has not enacted the UNCITRAL MLCBI, albeit given the jurisdiction's place as a leading international financial hub, it does apply many of the MLCBI principles in the interests of comity.

In terms of assistance, as the courts are not subject to the MLCBI there are no thresholds tests for grant of assistance in foreign bankruptcy proceedings, and equally there are no automatic rights based on the COMI of the debtor. Rather the foreign representative must convince the court on an individual, case-by-case basis that it is the appropriate court to exercise its discretion by granting the relief sought in the application.

The Grand Court's discretion is governed by Part XVII of the Companies Act.

Under section 241 of the Companies Act ancillary orders can be sought that reflect, in the main, some of the assistance that would otherwise be provided in the MLCBI. This includes by way of example: staying enforcement of a judgment against a debtor, recognition of the foreign representative, enjoining the commencement or stating the continuation of legal proceedings against a debtor.

Under section 242 of the Companies Act the Grand Court's discretion in granting an ancillary order under section 241 will be guided by matters which will best assure an economic and expeditious administration of the debtor's estate consistent with:

- (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 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;
- (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.

Question 2.3 [maximum 3 marks]

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

The Cayman Islands is not party to any international treaties in respect of reciprocal recognition of foreign judgments, is not a signatory to the Hague Convention on recognition and Enforcement of Foreign Judgments in Civil and Commercial Matters (and equally the UK has not extended its ratification of any such treaties to the Cayman Islands, with the exception to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards).

In Cayman, the recognition (and enforcement) of foreign judgments is dealt with in domestic legislation in the Foreign Judgments Reciprocal Enforcement Act, 1996. This provides a framework for recognition where the country where the judgment originates assures substantial reciprocity in respect of Cayman Judgements. This has only been extended to decisions of the Australian Supreme court to date. In order to be enforceable (and by extension capable of recognition) the foreign judgment must be:

- i. A final judgment
- ii. A money judgment
- iii. Made after the 1996 Act was extended to the foreign country in question.

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

Question 3.1 [maximum 9 marks]

Commented [BT13]: 4 marks

Commented [BT14]: 1.5 marks. Reference to common law, and the mandatory criteria, is essential to answering this question.

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.

Although the Companies Act does not provide for a statutory mechanism prohibiting wrongful trading/trading while insolvent, when in official liquidation the official liquidator can pursue claims for breach of fiduciary duty against the offending director(s) on behalf of the company. By way of case law example, the court in *Prospect Properties v McNeill* held that where a company is insolvent the directors' duty to act in the best interest of the company requires them to have regard to the interests of the creditors. The interests of the creditors naturally includes being paid and therefore it is in the interests of the company to be able to pay its creditors and safeguarded from being put in a position where obligations to a creditor cannot be fulfilled. In such circumstances where there is instances of what would be conventionally considered 'wrongful trading/trading while insolvent' the liquidators have the option to pursue directors via the breach of fiduciary duty route in an attempt to recover losses incurred by the company due to the actions of its directors.

Therefore, directors can be held personally liable to the company for losses incurred by the company where their conduct is in breach of the director(s) fiduciary duty to act in the best interests of the company.

In terms of claw-back provisions, a liquidator can challenge a payment (or transfer of property) where such constitutes a voidable preference. This would occur in the preceding 6 months from the company's liquidation and where the dominant intention of the directors was to prefer one creditor over another. There will be a presumption that a transfer or payment to a related party (*i.e.* one with the ability to exercise significant control or influence over the company) is made with a view to giving preference to that party pursuant to section 145(2) and (3) of the Companies Law Act.

The Appeal Court in *re Weaving Macro Fixed Income Fund (in Liquidation)* set out the test applicable under section 145 of the Companies Law in respect of voidable preferences. The court noted that if the preference is not the dominant purpose of the transaction (e.g. a good faith payment to an essential service provider) then this may not qualify as a voidable transaction under the section 145.

In such circumstances, the liquidator may apply to the Grand Court to order the creditor to return the asset/funds to the company and require the creditor to submit a proof of debt in the liquidation in the ordinary manner *per inter alia* section 87 of the Companies Act.

Similarly, a liquidator can claw back transactions at undervalue under section 146 of the Companies Act where property is transferred for undervalue with the intention of willfully defeating the an obligation owed to a creditor (*i.e.* intent to defraud). Where such a transaction occurs the liquidator can apply to the court to void the transaction. The burden of proof rests with party seeking to unwind the transaction and the limitation period for bringing the claim is 6 years from the date of the transfer of the asset.

Commented [BT15]: 7.5 marks. Don't forget section 147.

Question 3.2 [maximum 6 marks]

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

It is incorrect to say that receivers have no role to play in Cayman Islands insolvency, however there are no provisions on receivers or receivership in the insolvency provisions of the primary legislation or rules n, *i.e.* Companies Act or Company Winding-up Rules. Receivers can be appointed in Cayman, and the Grand Court Rules contemplate their involvement and appointment for the purposes of *e.g.* collecting money or the execution of contracts. Order 45 GCR for example states that a receiver may be appointed to enforce court orders for the payment of monies.

Receivers will also provide, in some cases, an alternative course of action for certain creditors pursuant to rights in a security instrument such as a mortgage or fixed or floating charge where the instrument specifically provides for the appointment or use of a receiver over the charged assets in the event of default. A receiver appointed under the terms of a security will be governed by the terms of that document (as opposed to be under the court's supervision or restricted by the terms of relevant statutory provisions) and derive his or her powers from there, including typically the right of sale. Where the receiver is appointed by a creditor (as it would be pursuant to the enforcement terms of a default under s security instrument), the receiver will owe duties to the creditor (rather than the debtor company or court).

Another potential insolvency scenario where receivers are utilised in Cayman is in Segregated Portfolio Companies. An SPC is a creature of statute and is a single entity with separate portfolios (SPs) holding different assets and liabilities within that portfolio (similar to a protected cell company in other jurisdictions). Each portfolio and its assets/liabilities are ringfenced from the other portfolios within the entity. Once appointed the receiver(s) will relieve the directors of their functions and powers in respect of the SP, although they may still retain this in respect of other SPs and the SPC more generally.

If the SP's assets attributable to a specific portfolio of the SPC is not sufficient to satisfy the creditor obligations/liabilities in connection with that portfolio the Grand Court may make a receivership order in respect of that portfolio pursuant to section 224 of the Companies Act. The court in *JP SPC 1 and JP SPC 4* held that this receivership role is analogous to that of a liquidator. The role of the receiver of an SP is to facilitate the orderly closing down of the business of, or attributable to, the SP and the distribution of the SP's assets attributable to the SP to those entitled to have recourse to those assets.

It should be noted the receivership of an SP will not be made where there is a winding up process of the SPC in progress or will otherwise cease to have effect where the SPC subsequently has winding up proceedings commenced against it. A receivership order will prevent an action being brought against the SP except with leave of the Grand Court.

Although the formalisation of the receivership process in the specific insolvency legislation is absent, the appointment and utilisation of receivers in Cayman is clearly a working function of the tools deployable in certain insolvency scenarios within the jurisdiction.

Commented [BT16]: Good. 5 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?

Sparrow, as a partially secured creditor (and S&C being in default) can enforce its security over the \$80m, irrespective of whether S&C has been put into provisional or official liquidation and without leave of the Court or S&C's liquidator should one be in place. Any stay granted (e.g. pursuant to section 97 of the Companies Act) upon the passing of an order or provisional order will not affect the secured position of Sparrow under section 142 of the Companies Act. The unsecured loan would be subject to the proof of debt process in due course, or where S&C is not yet in liquidation, Sparrow can file a winding up petition in respect of S&C. Sparrow, as the holder of a legal mortgage over four party boats is entitled to take possession of these boats and exercise its power of sale under the mortgage or to appoint a receiver in connection with the realisation of the assets. As the asset is a ship it will be subject to the centralised register under the Maritime Authority Law (if it has not already done so Sparrow should file notice of the security with the register. This will give notice to any third parties of Sparrow's secured position.

Commented [BT17]: Good. 2 marks. Or it could try to participate in a rescue if it thinks it might provide a better return...

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

The Cayman Islands is subject to the NY Convention on the Recognition and Enforcement of Foreign Arbitral Awards (as is the UK where the arbitration was held). From a statutory perspective, only the Australian Courts have been extended reciprocity under the Foreign Judgements Reciprocal Enforcement Act 1996. At Common law however money judgments

can be enforced through the Cayman Courts. The mandatory requirements for Roger Jolly to enforce the awards are that the judgment is final, which it appears to be, the foreign court has jurisdiction over the debtor (which is done by virtue of the contract) the judgment does not appear fraudulent or contrary to public policy, nor is it obtained contrary to the rules of natural justice. In this case Roger Jolly, once the judgment is recognised by the Cayman Court has the full range of domestic options available to him for enforcement of the \$50m judgment debt.

Commented [BT18]: 2 marks

Once a declaration of enforceability is granted Roger Jolly has the option of pursuing a winding up order if the company is not yet in an insolvency process, appoint a receiver or potentially where there is no insolvency process ongoing, seize assets of the company, apply for garnishee orders or charges over assets of the S&C. These steps will assist in protecting Roger Jolly's interests against S&C.

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

Employees unpaid wages are preferential debts under section 141 of the Companies Act. These rank only behind the expenses of the liquidation (and secured creditors which take priority above all). The preferential debt owed to the employee rank equally among other preferential debts (as set out in Schedule 2) and will abate where there are not sufficient sums in the estate to satisfy the obligations owed. The wages claim will apply only to the for months immediately preceding the liquidation of S&C.

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 other creditors.

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

Assuming S&C is carrying on business or is resident, section 91 of the Companies Act provides the Cayman Grand Court with jurisdiction to make winding up orders in respect of the company. This applies if the company is incorporated elsewhere – in which case the Grand Court can sanction e.g. a scheme of arrangement or winding up where the S&C is a registered foreign company with the Cayman Islands Registrar of Companies.

Commented [BT20]: 1 mark.

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

As S&C is in financial distress and will require protection from creditor enforcement, it will require to place itself into provisional liquidation in order for it to pursue and negotiate a scheme of arrangement to have a stay granted over creditors bringing actions against S&C. This will only be available to S&C where they can establish before the Grand Court that the directors believe that the business is viable and can be turned around by a scheme of arrangement. This will put a stop to all debt recovery proceedings unless a creditor obtains leave of the court – this will not affect the rights of secured creditors such as Sparrow as noted above. Provisional liquidation will preserve and protect part of the S&C's assets until an official liquidator is appointed or until a compromise/arrangement can be agreed.

Commented [BT21]: 3 marks.

S&C may apply to the Court for the appointment of provisional liquidators for the purpose of presenting a compromise or arrangement to creditors. The company must be, or be likely to become, unable to pay its debts. This may then allow S&C the opportunity to enter into a scheme of arrangement.

Section 104(3) gives a company standing to apply for the appointment of a provisional liquidator where the company is or is likely to become cash flow insolvent and it intends to present a compromise or arrangement to its creditors.

Section 97(1) provides an automatic moratorium on proceedings against S&C and enforcement of judgments etc. against S&C upon the appointment of the provisional liquidator. It is this moratorium which could give S&C the protection it needs while it seeks to restructure.

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

Where there is a "light touch" provisional liquidation (i.e. where directors retain day-to-day control), existing management can continue to retain control of the business under the supervision of the provisional liquidator and the Grand Court. This would potentially allow the Rackham family to continue to play some part in running S&C during the proposed restructure. This will be fact specific, however given the level of the debts and the position with Roger Jolly

S&C could seek to restructure under a scheme of arrangement, which is a court-approved process which permits the rights of creditors or members to be varied, by forcing the relevant non-consenting creditors and/or members into the compromise or arrangement (also known as "cramming down" the dissenting creditors) (section 86(2)).

and the 8-figure arbitral award, it would appear most likely that the provision liquidators would replace the directors and assume that role in the management of the S&C. The light touch approach is however often employed in foreign insolvency matters, e.g. under Chapter 11 in the US.

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

Where a proposal has the necessary creditor support, the scheme must still be approved by the court before it is able to bind all creditors (or class of creditors), the company and its contributories. There is little room for dissenting creditors to intervene as 50% representing 75% of the value of the creditors in each class will have already voted in favour of the scheme.

The Court's primary focus will be on compliance with the convening orders, whether the majority fairly represent the class, and whether the arrangement is such that an intelligent, honest member of the class convened, acting in its own interest, might reasonably approve it. Overall, the court will be concerned with the fairness of the scheme, must be satisfied the proposal is fair before approving it.

Commented [BT22]: 1 mark. It depends on the terms of the PL order. As per provisions of section 104(1)(4) of the Companies Act, once appointed by the court a provisional liquidator will carry out only such functions as the Court may confer on him/her and will exercise such powers as may be conferred by the order of appointment.

Commented [BT23]: 3

*** End of Assessment ***

43.5 / 50