Restructuring and insolvency in Cayman Islands: overview

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FORMS OF SECURITY

1. What are the most common forms of security granted over immovable and movable property? What formalities must the security documents, the secured creditor or the debtor comply with? What is the effect of non-compliance with these formalities?

Immovable property

Common forms of security and formalities. The most common types of security are:

- **Mortgage.** A mortgage is a transfer of an interest in a property subject to redemption rights. Historically, a mortgage required a transfer of the property that was subject to the mortgage. However, currently a transfer is not always required. Where a property is the subject of a mortgage but is not transferred to the lender, an equitable mortgage is created which can be defeated by a third party buyer with no notice of the lender's interest.
- **Charge.** A charge conveys nothing and merely gives the person entitled to the charge certain rights over the property as security for debt. A charge given by a company over its assets is generally created by debenture. It is also possible to take fixed or floating charges over assets held by a company borrower:
  - **Fixed charges.** These are attached to specified assets which then cannot be disposed of by the borrower;
  - **Floating charges.** These can be used when the borrower holds a number of assets which it needs to be able to deal with freely (for example, shares in a portfolio and trading stock). The borrower can deal with those assets despite the charge. On default, the charge crystallises over the assets that are held by the borrower at the time of default. The charge then becomes a fixed charge, entitling the creditor to sell the assets to recover the amount owed.
- **Lien.** A lien can be used when a creditor has lawful possession of an asset and monies are due to the creditor for services provided. For example, where a repairer has possession of property to repair it, he is automatically entitled to keep possession until the account is paid. A lien arises by operation of law based on lawful possession. If possession is relinquished, so is the lien. No rights in the property are created in the creditor's favour. Therefore, the retained property cannot be sold to obtain funds for payment of the debt.
- **Pledge.** In a contract to pawn or pledge, goods are deposited as security for the debt and the right to the property vests in the creditor to the extent necessary to secure the debt. The creditor can sell the goods if the borrower defaults on its obligations.

Creditors must ensure that the company granting security undertakes appropriate formalities. This generally requires a directors' resolution approving the granting of the security, subject to any special requirements in the company's articles of association (articles). Creditors should obtain legal advice to ensure adequate protection.

There are central ownership registers for land, ships, aircraft and motor vehicles. Creditors' mortgages or charges over the asset can be noted on the relevant register. A third-party buyer is deemed to have notice of any interest that is registered at the time of purchase, and acquires the asset subject to the creditor's interest as the holder of the registered mortgage or charge. In practice, transfers of these assets cannot be registered without the creditor's consent.

There is no central register for other types of immovable property or for charges over company assets (other than the company's internal register of mortgages and charges). Therefore, the creditor must ensure it has sufficient control over the asset to prevent a third party from buying it. A creditor should review the company's register of mortgages and charges before making a loan, and ensure the company updates this register after the loan is made.

Effects of non-compliance. Failure to comply with the requisite formalities does not automatically render the security void. However, there is a risk that both:

- The security will not be binding on the company.
- A third party will acquire the asset free of the creditor's security interest or acquire a higher ranking security interest over the asset.

Movable property

Common forms of security. See above, *Immovable property: Common forms of security.*

Effects of non-compliance. See above, *Immovable property: Effects of non-compliance.*

CREDITOR AND CONTRIBUTORY RANKING

2. Where do creditors and contributories rank on a debtor's insolvency?

The rules for creditor and shareholder rankings are contained in:

- The Companies Law (2013 Revision) (Companies Law).
- The Companies Winding Up Rules 2008 (as amended).
- Case law.

When a company goes into compulsory liquidation, the legal rights of creditors with mortgages or charges over company assets are unaffected. These creditors can enforce their security by, for example, selling the charged asset to repay the debt owed. Secured creditors whose debt is more than the value of their

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security can rank as unsecured creditors in the liquidation for the balance.

Floating charges (*see Question 1*) crystallise when a company is placed in liquidation. Subject to the charge, the creditor can enforce its rights independently of the winding-up and therefore ahead of other creditors.

After considering secured creditors, the order of priority of creditors and shareholders' when a company goes into liquidation is as follows:

- The expenses of the liquidation, including the liquidator's fees and disbursements.
- Preferential debts, which are:
  - certain debts due to employees, including salary, wages and gratuities accrued during the four months before the liquidation commenced, medical health insurance premiums and pension contributions, and severance pay and earned vacation leave when the employment contract was terminated as a consequence of the company's liquidation;
  - certain taxes due to the Cayman Islands Government;
  - for banks incorporated in the Cayman Islands and holding an A licence issued under the Banks and Trust Companies Law (2013 Revision), any sum due to eligible depositors up to CI$20,000 per depositor (*Second Schedule, Companies Law*).
- Ordinary debts which are not otherwise secured, and which are not subject to any agreement between the company and the creditor requiring the debt to be subordinated or otherwise deferred to the claims of other creditors.
- Ordinary debts which are subject to an agreement between the company and the creditor that the debt should be subordinated or otherwise deferred to the claims of other creditors.
- In an official liquidation lasting more than six months, any surplus remaining after payment of debts is applied to pay interest accruing on those debts since the commencement of liquidation at the greater of:
  - the contractual rate of interest;
  - the rate prescribed by the Judgment Debts (Rates of Interest) Rules.
- This interest ranks equally, irrespective of the ranking of the underlying debts.
- Amounts due to preferred shareholders, that is, any shareholders whose shares carry rights relating to capital or income which are preferred (under the company's articles) to the rights of the stakeholders described in the following two bullet points.
- Debts payable by the company in relation to the redemption or purchase of its own shares, provided, among other things, that under the applicable terms the redemption or purchase was to have taken place before the liquidation commenced.
- Any surplus must be distributed between the shareholders of the company in accordance with its articles or any shareholders' agreement.

Debts in each of the above categories are ranked equally within their category and must be paid in full before the next category receives any distribution of assets.

Where there are insufficient assets to meet the debts in any particular category, the debts are reduced in equal proportions, regardless of the date on which the debt became due, and no payments are payable to creditors in any subsequent category.

UNPAID DEBTS AND RECOVERY

3. Can trade creditors use any mechanisms to secure unpaid debts? Are there any legal or practical limits on the operation of these mechanisms?

The most common mechanism used by trade creditors, in addition to security (*see Question 1*), is a retention of title clause incorporated in the terms and conditions of a business or trading contract. This allows trade creditors to retain title in the goods supplied until they have been paid for. However, this is difficult to enforce when the goods supplied are used in manufacturing and lose their identity, or are sold. Consequently, retention of title clauses must be carefully drafted and are not always effective.

4. Can creditors invoke any procedures (other than the formal rescue or insolvency procedures described in *Questions 6* and *7*) to recover their debt? Is there a mandatory set-off of mutual debts on insolvency?

The following procedures are available to creditors:

- **Appointment of receivers.** Secured creditors can appoint a receiver over a charged asset (usually commercial assets) to enforce their security subject to and under the terms of their security document. Receivers are not supervised by the court and usually owe their duties primarily to the secured creditor, not the company.
- **Litigation.** Creditors can use court proceedings to recover debts. A variety of remedies are available to creditors before and after judgment. For example, if it is demonstrated that there is substantial risk that the company may attempt to dissipate its assets to avoid payment of the debt, an application can be made for an injunction freezing the company's assets pending the outcome of the litigation. Once judgment is obtained, the creditor can take steps to enforce the judgment against the company's assets.
- **Set-off.** Liquidators are required to give effect to any contractual rights of set-off or netting of claims between the company and any persons. This is subject to any agreement between the company and any persons to waive or limit these rights. In the absence of any set-off provision, account must be taken of what is due from each party to the other in respect of their mutual dealings, and set-off is applied in relation to those amounts.

For details of cross-border debt recovery, see *Question 13*.

STATE SUPPORT

5. Is state support for distressed businesses available?

There is no state support available for distressed businesses.

RESCUE AND INSOLVENCY PROCEDURES

6. What are the main rescue/reorganisation procedures in your jurisdiction?

Scheme of arrangement

Objective. This allows the company to enter into an agreement with its shareholders and/or creditors (or any class of them) to either:

- Restructure its affairs while solvent so that it can continue to trade and avoid liquidation.

- Reach a compromise or arrangement with creditors or shareholders (or any class of them) after liquidation has commenced.

Initiation. This procedure can be used by any company liable to be wound up under the Companies Law (*see below*). It is initiated by any of the following applying to the court for an order convening a meeting of the creditors, shareholders or class of them in a manner which the court directs:

- The company.
- Any company creditor or shareholders.
- A company liquidator or provisional liquidator.

There is no statutory obligation on a company or its directors to propose a scheme of arrangement.

Substantive tests. The Companies Law does not set out a substantive test that the court must apply. However, before granting an order the court must be satisfied that the interests of all relevant parties, such as creditors and shareholders, have been considered and are not prejudiced.

Consent and approvals. A majority in number constituting at least 75% in value of the creditors, shareholders or each class of them present and voting at the meeting (in person or by proxy) must agree to the compromise or arrangement. An application must then be made for court approval of the scheme.

Supervision and control. The directors remain in control of the company if the scheme is proposed outside of liquidation. If the company is in official or provisional liquidation then its affairs will be controlled by its official or provisional liquidators (who must be qualified insolvency practitioners resident in the Cayman Islands or foreign practitioners appointed jointly with a resident qualified insolvency practitioner), subject to the court's supervision. In all cases the scheme requires the court's approval.

Protection from creditors. No protection from the company's creditors is available if the scheme of arrangement is initiated outside of liquidation. If the scheme is initiated after the commencement of an official or provisional liquidation, then an automatic stay prohibits the commencement or continuance of any suit, action or other proceeding against the company without the court's leave. That stay does not prevent secured creditors from enforcing their security.

There are no statutory implications relating to existing intellectual property licences.

Length of procedure. There is no pre-determined time frame.

Conclusion. Once approved by the court, the scheme is binding on the company and all creditors, shareholders and classes of them (including employees and trading partners to the extent that they are creditors or shareholders of the company). An arrangement can include the reorganisation of the company's share capital by consolidation of shares of different classes or by division of shares into shares of different classes (or both). The court has wide powers to sanction an amalgamation of any two or more companies where the whole or part of the undertaking or the property of the company concerned in the scheme is to be transferred to another company.

There is no formal conclusion to a scheme of arrangement. The scheme comes to an end once all compromise or arrangement terms to which it relates have been complied with. If the company is not in liquidation then it continues to exist. If the company is being wound up then it is dissolved at the conclusion of the liquidation.

7. What are the main insolvency procedures in your jurisdiction?

Provisional liquidation

Objective. The purpose is usually to preserve and protect the company's assets until the hearing of a winding-up petition and the appointment of official liquidators.

However, a company can petition for its own winding-up and apply for the appointment of provisional liquidators to protect itself from creditors and to have time to restructure its business. The purpose of appointing a provisional liquidator in this situation is similar to the UK administration process or US Chapter 11 procedure. The courts have acknowledged the importance of provisional liquidation in assisting the rescue of a solvent company in circumstances where refinancing or sale as a going concern is a real possibility and is likely to be more advantageous to creditors than realising and distributing the assets in a compulsory liquidation.

Initiation. Provisional liquidation is available to companies liable to be wound up under the Companies Law (*see below*). A creditor, shareholder or the company itself can apply for the appointment of provisional liquidators between the presentation and the hearing of the winding-up petition.

There is no statutory obligation on a company or its directors to seek the appointment of a provisional liquidator.

Substantive tests. A creditor or shareholder can make an application (usually *ex parte* or without notice to the company) on the grounds that there is a prima facie case for making a winding-up order and the appointment of a provisional liquidator is necessary to prevent the following:

- The dissipation or misuse of the company's assets.
- The oppression of minority shareholders.
- Mismanagement or misconduct on the part of the company's directors.

The company can make an *ex parte* application to appoint provisional liquidators on the grounds that the company is or is likely to become unable to pay its debts and the company intends to present a compromise or arrangement to its creditors.

An application to appoint provisional liquidators can only be made following the presentation of a winding-up petition. The power of company directors to present a winding-up petition in the company's name has recently been considered by the Grand Court of the Cayman Islands (Grand Court) (*see below, Compulsory liquidation*).

Consent and approvals. Provisional liquidators are appointed by the Court and the consent of stakeholders is not required.

Supervision and control. Provisional liquidators are appointed. They are subject to the court's supervision and only carry out the functions that the court confers on them. Their powers may be limited by the order appointing them and the scope of their powers depends on the reason for their appointment. If a company restructuring is proposed, existing management can be allowed to remain in control of the company subject to the supervision of the court and provisional liquidators.

Protection from creditors. On the appointment of a provisional liquidator, no suit, action or other proceeding can be proceeded with or commenced against the company without the court's leave. This automatic stay does not prohibit secured creditors from enforcing their security.

There are no statutory implications relating to existing intellectual property licences.

Length of procedure. If the purpose of a provisional liquidation is to enable a restructuring of the company's affairs, the hearing of the winding-up petition for a fixed period (which can be extended if necessary) is usually adjourned to provide sufficient time to achieve this. Provisional liquidation can therefore be lengthy. If the purpose is to protect the assets of the company pending the hearing of the winding-up petition, the provisional liquidation is likely to be relatively brief.

Conclusion. Provisional liquidation is brought to an end by court order. This is usually as a result of either:

- The winding-up order being made (in which case the company is dissolved at the conclusion of the liquidation).
- An order dismissing or withdrawing the winding-up petition (in which case the company continues to exist).

The court can also order an earlier termination of the provisional liquidator's appointment either:

- On application by the provisional liquidator, the petitioner, the company, a creditor or a shareholder.
- If an appeal against the provisional liquidator's appointment succeeds.

Compulsory liquidation

Objective. The purpose is to wind up the company and distribute its assets to its creditors and shareholders under the priorities set out in *Question 2*.

Initiation. Compulsory liquidation is available to:

- Companies incorporated and registered under the current Companies Law (or earlier versions).
- Bodies incorporated under any other law.
- Foreign companies which:
  - carry on business or have property located in the Cayman Islands;
  - are the general partner of a limited partnership registered in the Cayman Islands;
  - are registered under Part IX of the Companies Law.

The company, any creditor (including a contingent or prospective creditor) or any shareholder of the company can present a winding-up petition to the court at any time. The Cayman Islands Monetary Authority may also present a winding-up petition to the court at any time in relation to a company which is carrying on a regulated business in the Cayman Islands.

There is no statutory obligation on a company or its directors to commence liquidation proceedings. However directors owe common law and fiduciary duties to creditors if the company becomes insolvent (*see Question 9, Director: Common law or equitable duties*).

Substantive tests. A company may be wound up by the court if any of the following apply:

- The company passes a special resolution requiring it to be wound up by the court.
- The company does not commence business within a year of incorporation.
- The company suspends its business for a whole year.
- The period (if any) fixed by the company's articles for the company's duration expires, or an event occurs which under the articles triggers the company's winding-up.
- The company is unable to pay its debts (*see below*).
- The court decides that it is just and equitable for the company to be wound up.
- The company is carrying on a regulated business in the Cayman Islands and is not duly licensed or registered to do so.
- Certain other grounds specified in regulatory and other laws.

A company is deemed unable to pay its debts where any of the following apply:

- It neglects to pay (or fails to secure the debt, or come to an arrangement, to the creditor's satisfaction) for more than three weeks a sum in excess of CI$100 for which a demand has been made and served on it.
- An execution or other process issued in the form of a judgment, decree or order by the court in favour of any creditor is returned unsatisfied in whole or in part.
- It is proved to the satisfaction of the court that the company is unable to pay its debts.

If the debt claimed in the demand is disputed by the company in good faith and on substantial grounds then it cannot form the basis of a winding-up petition. It is not necessary for the debt claimed to be a judgment debt. However, if it is a judgment debt then the company cannot legitimately dispute it, unless execution of the judgment has been stayed by the court.

The question of whether or not directors are entitled to present a winding-up petition in the company's name was considered by the Grand Court in 2011 (*Re China Milk Products Limited*). The Grand Court held that the scope of the directors' power depends on whether the company was solvent and the date on which it was incorporated. The judge in *China Milk* held that:

- Directors of insolvent companies incorporated before 1 March 2009 have the power to present a winding up petition in the company's name without the authority of a shareholders' resolution and irrespective of any restrictions in the company's articles.
- Directors of insolvent companies incorporated after 1 March 2009 have the power to present a winding up petition in the company's name without the authority of a shareholders' resolution unless the company's articles expressly reserve that power to the shareholders.
- Directors of solvent companies incorporated before 1 March 2009 only have the power to present a winding up petition in the company's name if authorised to do so by a shareholders' resolution, irrespective of any powers granted to the directors in the company's articles.
- Directors of solvent companies incorporated after 1 March 2009 have the power to present a winding up petition in the company's name if authorised to do so by:
  - a shareholders' resolution; or
  - an express power granted to the directors in the company's articles.

It should be noted that the decision in *China Milk* is a decision at first instance and it would not be binding on another Grand Court judge.

A company is placed into compulsory liquidation by court order.

Consent and approvals. Official liquidators are appointed by the Court and the consent of stakeholders is not required.

Supervision and control. Official liquidators are appointed by the court and their authority displaces that of the company's directors. The official liquidators control the company's affairs, subject to the court's supervision. Official liquidators must be qualified insolvency practitioners resident in the Cayman Islands or foreign

practitioners appointed jointly with a resident qualified insolvency practitioner.

Protection from creditors. At any time between the presentation of a winding up petition and the making of a winding up order, the company or any creditor or shareholder can apply for an injunction to restrain further proceedings in any action or proceeding pending against the company in a foreign court. The application can be made to either:

- Any Cayman Islands court in which proceedings are pending against the company.
- The Grand Court.

On the making of a winding-up order, an automatic stay is imposed prohibiting any suit, action or other proceeding from being proceeded with or commenced against the company without the leave of the Grand Court. These stays and injunctions do not prohibit secured creditors from enforcing their security.

There are no statutory implications relating to existing intellectual property licences.

Length of procedure. The length of time needed for compulsory liquidation proceedings depends on the nature and business of the company, and the amount of time required by the official liquidators to wind up the company's affairs. There is no maximum period within which liquidation must be completed.

Conclusion. When the affairs of a company in compulsory liquidation have been fully wound up, the court makes an order, on the liquidators' application, that the company is dissolved from the date of the order.

Voluntary liquidation

Objective. In a voluntary liquidation, the company's affairs are wound up and the assets distributed in accordance with the priorities set out in *Question 2*.

Initiation. Voluntary liquidation can be used by companies incorporated and registered under the Companies Law (or its earlier versions). It is commenced by shareholder resolution or on the expiry of a period or the occurrence of an event (*see below*).

There is no statutory obligation on a company or its directors to commence liquidation proceedings. However, directors owe common law and fiduciary duties to creditors if the company becomes insolvent (*see Question 9, Director: Common law or equitable duties*).

Substantive tests. A company can be wound up voluntarily in the following cases:

- When the fixed period, if any, for the duration of the company in its memorandum or articles expires.
- If an event occurs which the memorandum or articles provide is to trigger the company's winding-up.
- If the company resolves by special resolution that it be wound up voluntarily.
- 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.

A liquidator appointed to conduct a voluntary liquidation does not require the court's authorisation to exercise his powers. However, the liquidator can apply to the court to determine any question that arises during the winding-up process. A voluntary liquidation can be brought under the court's supervision. The voluntary liquidator must apply to the court for an order that the liquidation continues under the court's supervision unless within 28 days of the liquidation commencing, the directors sign a declaration that the company will be able to pay its debts in full (with interest) within a period not exceeding 12 months after the commencement of the liquidation. Even if a declaration is made, the liquidator or any creditor or shareholder can apply to bring the liquidation under the court's supervision on the grounds that either:

- The company is or is likely to become insolvent.
- Court supervision will facilitate a more effective, less expensive or quicker liquidation of the company in the interests of the shareholders and creditors.

Consent and approvals. For the company to resolve by special resolution that it be wound up voluntarily, a majority of at least two-thirds of the company's members is required. For the company to resolve by ordinary resolution that it be wound up voluntarily because it is unable to pay its debts as they fall due, a majority in number of the company's members is required.

Supervision and control. On appointing a voluntary liquidator, the directors' powers cease, except to the extent the company (through a general meeting) or the liquidator sanctions the continuance of those powers. There are no qualification requirements for appointment as a voluntary liquidator. The company must cease business activities except so far as necessary for its beneficial winding-up.

Protection from creditors. No protection from the company's creditors is available during a voluntary liquidation.

There are no statutory implications relating to existing intellectual property licences.

Length of procedure. The length of time depends on how complicated the winding-up process is, but a voluntary liquidation is usually much shorter than a compulsory winding-up or a voluntary liquidation which is brought under the court's supervision.

Conclusion. As soon as the affairs of a company in voluntary liquidation have been fully wound up, the liquidator must call a general meeting of the company to present the liquidator's account of the liquidation. The liquidator must then file a return with the registrar, and the company is deemed to have been dissolved three months after the date of registration of the return.

STAKEHOLDERS' ROLES

8. Which stakeholders have the most significant role in the outcome of a restructuring or insolvency procedure? Can stakeholders or commercial/policy issues influence the outcome of the procedure?

Stakeholders

If the company's business is being restructured through a scheme of arrangement then the members of the scheme (who could be creditors or shareholders, depending on whose rights it is proposed will be compromised) have the most significant role in the restructuring. Voluntary and compulsory liquidations lead to a winding-up and do not involve any restructuring of the company's affairs (*see Question 7*).

In a compulsory liquidation, a liquidation committee must be appointed unless the court orders otherwise. The committee comprises three to five creditors (if the liquidator has determined that the company is insolvent) or shareholders (if the liquidator has determined that the company is solvent). If the liquidator determines that the company is of doubtful solvency then the committee must comprise three to six members of whom a majority must be creditors and at least one of whom must be a shareholder. Members are elected at meetings of creditors and/or shareholders (as appropriate).

Influence on outcome of procedure

Stakeholders will have a practical influence when a company's business is being restructured through a scheme of arrangement. They will also have an influence on the outcome of a compulsory or

court-supervised liquidation through their membership of the liquidation committee.

Debts due to a company's employees, certain sums due to eligible depositors who have money with a Cayman incorporated company holding an "A" license under the Banks and Trusts Companies Law (2009 Revision) and certain taxes, duties and penalties due to the Cayman Islands' Government are classified as preferential debts. In the case of an insolvent company, such debts are paid in priority to all other debts of the company.

LIABILITY

9. Can a director, partner, parent entity(domestic or foreign) or other party be held liable for an insolvent debtor's debts?

Depending on the circumstances, directors, partners, parent entities (domestic or foreign) and other third parties can all be held liable for an insolvent debtor's debts.

Director

Guarantees. Where a director has provided a guarantee to a creditor in relation to the company's debts, that creditor can enforce the guarantee against the guarantor personally.

Fraudulent trading. This can apply where it appears that any business of the company has been carried on with intent to defraud creditors of the company or creditors of any other person, or for any fraudulent purpose. On the liquidator's application, the court can declare any persons who were knowingly parties to the carrying on of the business in that manner to be liable to make such contributions to the company's assets as the court thinks proper.

Common law or equitable duties. A fiduciary obligation arises as a result of the relationship between the company and the director. As a result, a director has a duty to act in the best interests of the company at all times. If a director acts in breach of his fiduciary duties to the company he is liable to the company for damages in relation to that breach. Damages are assessed by reference to the loss that the company has suffered as a result of the breach. When a company becomes insolvent or is on the verge of insolvency, the company's creditors' interests become paramount and directors must act in their best interests by minimising further losses. Directors can be made liable in damages for any failure to fulfil this duty.

Directors can also be liable in damages to the company for negligence if they breach their duty of skill and care to the company.

Misfeasance proceedings. Various offences in connection with the management, operation and liquidation of a company are punishable by a fine and/or imprisonment of up to five years, including:

- Where a director (including a shadow director), in the 12 months before the liquidation (and with the intention of defrauding the company's creditors or shareholders):
  - concealed or removed any part of the company's property worth over CI$10,000;
  - concealed any debt due to or from the company;
  - concealed, destroyed, mutilated, falsified, made any false entry in, parted with, altered or made any omission in any documents affecting or relating to the company's property or affairs;
  - pawned, pledged or disposed of any property of the company which was obtained on credit and was not paid for (unless done in the ordinary course of business).
- Where a company is being wound up and a director, at any time (and with the intention of defrauding the company's creditors or shareholders) either:
  - made or caused to be made any gift of, transfer of, or charge on, or took part in the levying of any execution against, the company's property;
  - concealed or removed any part of the company's property.
- Various other offences for which a director (including a shadow director) is liable if he commits a prescribed act or omission during the course of the winding-up with the intention of defraud the company's creditors or shareholders.

Partner

The liability of a partner for a partnership's debts depends on the type of partnership.

Unregistered partnerships within the meaning of the Partnership Law (2013 Revision) (Partnership Law). Under the Partnership Law, a partnership is defined as the relationship which subsists between persons carrying on a business in common with a view to profit.

Such a relationship will not be considered a partnership within the meaning of the Partnership Law if it is made between members of a company or association which is either:

- Registered as a company under the Companies Law or any other law for the time being in force and relating to the registration of companies.
- Formed or incorporated by or in pursuance of any other law, letter patent or Royal Charter.

Every partner in an unregistered partnership (as defined under the Partnership Law) is liable jointly with the other partners for all debts and obligations of the firm incurred while he is a partner. After his death his estate is also severally liable in the due course of administration for such debts and obligations, so far as they remain unsatisfied, but subject to the prior payment of his separate debts.

Limited partnerships registered under the Partnership Law. Limited partnerships registered under the Partnership Law must consist of both:

- One or more "general partners", who are liable for all debts and obligations of the firm.
- One or more "limited partners" who, when entering into the partnership, contribute a specific cash payment to the limited partnership as capital, and will not be liable for the debts or obligations of the firm beyond the amount that they have contributed.

Partnerships registered under the Exempted Limited Partnership Law (2013 Revision) (ELP). Unlike limited partnerships registered under the Partnership Law, exempted limited partnerships registered under the ELP are designed to cater primarily for overseas investors. Exempted limited partnerships must not undertake business with the public in the Cayman Islands, other than so far as necessary for the carrying on of the business of the partnership outside of the Islands.

Exempted limited partnerships registered under the ELP must consist of both:

- One or more "general partners" (at least one general partner must be a resident of the Cayman Islands or a company registered under the Companies Law).
- One or more "limited partners".

If the assets of the exempted limited partnership are inadequate, the general partners will be liable for all debts and obligations of the exempted limited partnership.

Conversely, limited partners will not be liable for the debts or obligations of the exempted limited partnership, unless the partnership agreement provides that the limited partners will be liable (or partly liable) for the exempted limited partnership's debts.

In addition, where a limited partner takes part in the conduct of the business of an exempted limited partnership in its dealings with persons who are not partners, in the event of the insolvency of the exempted limited partnership, that limited partner will be liable for all debts and obligations of the exempted limited partnership incurred during the period that he participated in the conduct of the business as though he were, for such period, a general partner (*section 7(2), ELP*). However, liability will only arise where the third party has actual knowledge of the limited partner's participation and reasonably believed such limited partner to be a general partner.

The law relating to exempted limited partnerships is due to be amended significantly by the Exempted Limited Partnership Law (2014 Revision), which is due to come into force later this year.

Parent entity (domestic or foreign)

As it is a separate legal entity, a parent company is not usually liable for its subsidiary's debts.

However, it is possible for the courts to lift the corporate veil to make a parent company liable when it can be demonstrated that either:

- Some impropriety has occurred and the incorporation of the subsidiary company is a facade designed to avoid or conceal liability on the part of the parent company.
- The parent company is exercising such a degree of control over the subsidiary that the subsidiary is effectively acting as its agent. In this situation, the creditor would have an action directly against the parent company for any debts of the subsidiary.

Other party

Guarantees. Where a third party has provided a guarantee to a creditor in relation to the company's debts, that creditor can enforce the guarantee against the guarantor personally.

Fraudulent trading. This can apply where it appears that any business of the company has been carried on with intent to defraud creditors of the company or creditors of any other person, or for any fraudulent purpose. On the liquidator's application, the court can declare any persons who were knowingly parties to the carrying on of the business in that manner to be liable to make such contributions to the company's assets as the court thinks proper.

Misfeasance proceedings. Various offences in connection with the management, operation and liquidation of a company are punishable by a fine and/or imprisonment of up to five years, including (*Companies Law*):

- Where any officer (including a shadow director), professional service provider, voluntary liquidator or controller of a company, in the 12 months before the liquidation (and with intent to defraud the company's creditors or shareholders):
  - concealed or removed any part of the company's property worth over CI$10,000;
  - concealed any debt due to or from the company;
  - concealed, destroyed, mutilated, falsified, made any false entry in, parted with, altered or made any omission in any documents affecting or relating to the company's property or affairs;
  - pawned, pledged or disposed of any property of the company which was obtained on credit and was not paid for (unless done in the ordinary course of business).
- Where a company is being wound up and any officer (excluding shadow directors) or professional service provider, at any time (and with intent to defraud the company's creditors or shareholders) either:
  - made or caused to be made any gift of, transfer of, or charge on, or took part in the levying of any execution against, the company's property;
  - concealed or removed any part of the company's property.
- Various other offences for which an officer (including a shadow director), professional service provider or (in certain cases) manager is liable if he commits a prescribed act or omission during the course of the winding-up with intent to defraud the company's creditors or shareholders.

SETTING ASIDE TRANSACTIONS

10. Can an insolvent debtor's pre-insolvency transactions be set aside? If so, who can challenge these transactions, when and in what circumstances? Are third parties' rights affected?

Transactions in which property is disposed of at an undervalue with the intention of wilfully defeating an obligation owed to a creditor, are voidable on application of the official liquidator (*Companies Law*). This is subject to the application being brought within six years of the disposal. The extent to which the court sets aside these transactions depends on whether the transferee acted in bad faith.

Transactions can also be set aside if they constitute voidable preferences. The Companies Law does not specify who can apply for an order setting aside a transaction as a voidable preference, but it is likely that only a liquidator would have standing to do so. A transaction with a creditor constitutes a voidable preference if both:

- The company executes the transaction in the six months before the commencement of the company's liquidation and at a time when it is unable to pay its debts as they fall due.
- The dominant intention of the company's directors in executing the transaction is to give that creditor a preference over other creditors.

A payment is deemed to have been made to give the creditor a preference where the creditor has the ability to either:

- Control the company.
- Exercise significant influence over it in making financial and operating decisions.

If a transaction is set aside as a preference then it is void and the creditor will be required to return the payment or asset and prove (claim) in the liquidation for the amount of its claim.

CARRYING ON BUSINESS DURING INSOLVENCY

11. In what circumstances can a debtor continue to carry on business during rescue or insolvency proceedings? In particular, who has the authority to supervise or carry on the debtor's business during the process and what restrictions apply?

Circumstances

Scheme of arrangement

There are no statutory restrictions on a company subject to a scheme of arrangement carrying on business. If the company is not in liquidation, the business is carried on by the directors. If it is in liquidation, the liquidators can carry on the business, subject to restrictions (*see below*).

Provisional liquidation

Companies can carry on business during provisional liquidation. In practice, they are more likely to do so if the purpose of the appointment is to enable a restructuring of the business, rather than to preserve the company's assets pending the hearing of the winding-up petition. In some circumstances the company's management remain in control of the company, subject to the provisional liquidators' supervision (*see Question 7, Provisional liquidation*). More typically, the provisional liquidators carry on the business (if it is to be carried on).

Compulsory and voluntary liquidation

Liquidators in compulsory and voluntary liquidations can carry on the company's business, but only to the extent necessary for the beneficial winding-up of the company.

ADDITIONAL FINANCE

12. Can a debtor that is subject to insolvency proceedings obtain additional finance both as a legal and as a practical matter (for example, debtor-in-possession financing or equivalent)? Is special priority given to the repayment of this finance?

Liquidators of companies in compulsory liquidation can borrow money and grant security over the company's assets, but that power is only exercisable with the court's approval. The court will approve funding arrangements that provide for the additional funding to be repaid in priority to the company's creditors.

A company in voluntary liquidation can also obtain additional finance, provided that its memorandum and articles include borrowing powers. If the funder requires repayment in priority to other creditors, an application should be made to the court for an order approving the funding arrangement on those terms.

MULTINATIONAL CASES

13. What are the rules that govern a local court's recognition of concurrent foreign restructuring or insolvency procedures for a local debtor? Are there any international treaties or EU legislation governing this situation? What are the procedures for foreign creditors to submit claims in a local restructuring or insolvency process?

Recognition

On application by a foreign representative (defined as a trustee, liquidator or other official appointed for the purposes of a foreign bankruptcy proceeding), the court can make orders ancillary to the foreign bankruptcy proceedings to (*section 253, Companies Law*):

- Recognise the foreign representative's right to act in the Cayman Islands on behalf or in the name of the debtor.
- Grant a stay of proceedings or the enforcement of a judgment against the debtor.
- Require certain persons with information concerning the debtor's business or affairs to be examined by and produce documents to the foreign representative.
- Order the turnover of the debtor's property to the foreign representative.

In determining whether to make these orders, the court must look to assure an economic and expeditious administration of the debtor's estate, consistent with:

- The just treatment of all holders of claims wherever they are domiciled.
- The protection of claims holders in the Cayman Islands against prejudice and inconvenience in the processing of claims in foreign proceedings.
- The prevention of preferential or fraudulent dispositions of property in the debtor's estate.
- The distribution of the estate among creditors substantially in accordance with the order of priority set out in *Question 2*.
- The recognition and enforcement of security interests created by the debtor.
- The non-enforcement of foreign taxes, fines and penalties.
- Comity (mutual recognition and co-operation concerning legal decisions).

Concurrent proceedings

It is common for international bankruptcies and liquidations to involve the Cayman Islands and a number of other jurisdictions. In these cases, the courts adopt a flexible and co-operative approach to ensure the most effective winding-up of the affairs of the company and protection of the interests of its creditors, wherever those creditors are situated.

International treaties

The Cayman Islands are not a signatory to any international treaties relating to bankruptcy or insolvency.

Procedures for foreign creditors

There are no procedures that apply to foreign creditors. All creditors are treated equally regardless of where they are domiciled.

REFORM

14. Are there any proposals for reform?

There are currently no proposals for reform.

Practical Law **Contributor profiles**

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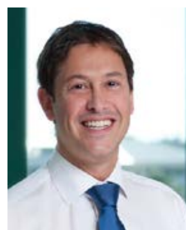
Areas of practice. Dispute resolution; insolvency and restructuring.

- Frequently acts in complex international insolvencies, restructurings and security enforcements and is regularly retained by local and overseas insolvency professionals, directors, fund administrators, auditors, creditors and investors in connection with all aspects of the restructuring and winding-up of companies, investment funds, limited partnerships, SIVs and structured finance entities.
- Specific experience of co-ordinating cross-border appointments and obtaining recognition and assistance for insolvency professionals appointed by foreign courts. Having practised continuously in the Cayman Islands since 1994, Ross is one of the most experienced litigators at the Cayman Islands Bar and has acted in more than 40 reported cases and was admitted in the British Virgin Islands in 2008. He is also regularly engaged to give expert evidence on issues of Cayman Islands law in proceedings before foreign courts.
- Has appeared as lead Counsel in numerous reported cases before the Grand Court, Court of Appeal and Privy Council. In the Chambers Global 2013, he is ranked Band 1 for Dispute Resolution and is described as "extremely incisive and experienced." His recent awards include Lawyer of the Year 2013 (Recovery & Insolvency Specialists' Association Cayman).



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- Completed his training at the Manchester office of international law firm DLA Piper and qualified as a solicitor in DLA Piper's Restructuring group in September 2004. Guy continued to practise at DLA Piper until July 2011 when he joined Campbells and was admitted as an attorney at law in the Cayman Islands.
- Regularly acts for distressed hedge funds, insolvency practitioners, stakeholders and financial institutions in relation to solvent and insolvent liquidations, creditor and/or shareholder disputes, antecedent transactions and enforcement actions. Guy has appeared before the Grand Court and the Cayman Islands' Court of Appeal on numerous occasions and his recently reported cases include *Re SPhinX Group* [2012 (2) CILR 371] and *Re FIA Leveraged Fund* [2012 (1) CILR 248].