

Cayman Islands

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Campbells

1 Issues Arising When a Company is in Financial Difficulties

1.1 How does a creditor take security over assets in the Cayman Islands?

The most common types of security are:

■ Mortgage

A mortgage is a transfer of an interest in a property subject to redemption rights.

■ 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 and becomes a fixed charge.

■ 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. A lien arises by operation of law based on lawful possession. If possession is relinquished, so is the lien.

■ 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.

Formalities: Creditors must ensure that the company granting security undertakes the appropriate formalities. This generally requires a directors' resolution approving the granting of the security, subject to any special requirements in the company's articles.

There are central ownership registers for land, ships, aircraft and motor vehicles. Creditors' mortgages or charges over the asset can be noted on the 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.

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 that it has sufficient control over the asset to prevent a third party from buying it.

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.

1.2 In what circumstances might transactions entered into whilst the company is in financial difficulties be vulnerable to attack and what remedies are available from the court?

In terms of transactions that may be vulnerable to attack, 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. 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. 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; and
- the dominant intention of the company's directors in executing the transaction is to give that creditor a preference over other creditors (in certain circumstances this intention to prefer a creditor is deemed to exist).

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 in the liquidation for the amount of its claim.

In addition, any dispositions of a company's property made after the commencement of the winding-up will be void in the event that a winding-up order is made, unless validated by the court.

1.3 What are the liabilities of directors (in particular civil, criminal or disqualification) for continuing to trade whilst a company is in financial difficulties in the Cayman Islands?

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 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 the intent to defraud the company's creditors or contributories):
 - 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; or
 - 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 the intent to defraud the company's creditors or contributories) 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; or
 - concealed or removed any part of the company's property.

There exist various other offences for which a director, officer (including a shadow director), professional service provider or (in certain cases) manager is liable if he commits a proscribed act or omission during the course of the winding-up with intent to defraud the company's creditors or contributories.

2 Formal Procedures

2.1 What are the main types of formal procedures available for companies in financial difficulties in the Cayman Islands and can any of these procedures be used in a restructuring?

Scheme of arrangement

This allows the company to enter into an agreement with its members 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 members (or any class of them) after liquidation has commenced.

Schemes of arrangement are often used in conjunction with a provisional liquidation to effect a corporate restructuring.

Provisional liquidation

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.

Compulsory liquidation

The purpose is to wind up the company pursuant to an order of the court and distribute its assets to its creditors and shareholders in accordance with the statutory priorities (see below).

Voluntary liquidation

To wind up the company and distribute its assets in accordance with the statutory priorities but without an order from the court.

2.2 What are the tests for insolvency in the Cayman Islands?

A cash flow test of insolvency is used i.e. is the company able to pay its debts as they fall due? The company's balance sheet is not taken into consideration.

2.3 On what grounds can the company be placed into each procedure?

Scheme of arrangement

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 members, have been considered and are not prejudiced.

A majority in number constituting at least 75 per cent in value of the creditors, members 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 sanction of the scheme.

Provisional liquidation

A creditor or contributory 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.

Compulsory liquidation

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 C\$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.

Voluntary liquidation

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.

2.4 Please describe briefly how the company is placed into each procedure.

Scheme of arrangement

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

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

Provisional liquidation

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

Compulsory liquidation

Compulsory liquidation is initiated by a winding-up petition presented to the court and the procedure can be resorted to in respect of:

- 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; and
 - are registered under Part IX of the Companies Law.

The company, any creditor (including a contingent or prospective creditor) or any contributory of the company can present a winding-up petition to the court at any time. In addition, the directors of a company are entitled, in certain circumstances, to present a winding-up petition in the company's name. 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.

Voluntary liquidation

Voluntary liquidation can be used by companies incorporated and registered under the current Companies Law (or its earlier versions). It is commenced by member resolution or on the expiry of a period or the occurrence of a prescribed event.

There is no statutory obligation on a company or its directors to commence voluntary or compulsory liquidation proceedings. Directors do, however, owe common law and fiduciary duties to creditors in the event of the company becoming insolvent.

2.5 What notifications, meetings and publications are required after the company has been placed into each procedure?

Broadly speaking, all insolvency procedures will require:

- notification being provided to the Registrar of Companies, creditors and/or contributories;
- meetings of creditors and/or contributories being called; and
- advertisement of the procedure in the Cayman Islands Gazette, and/or appropriate foreign newspapers.

2.6 Are "pre-packaged" sales possible?

There are no statutory provisions providing an expedited restructuring of the debtor but in appropriate circumstances a pre-packaged sale of the debtor could be achieved.

3 Creditors

3.1 Are unsecured creditors free to enforce their rights in each procedure?

Scheme of Arrangement

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.

Once approved by the court, the scheme is binding on the company and all creditors, members and classes of them (including employees and trading partners to the extent that they are creditors or members of the company).

Provisional liquidation

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.

Compulsory liquidation

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 contributory 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; or
- the Grand Court of the Cayman Islands.

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.

Voluntary liquidation

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

3.2 Can secured creditors enforce their security in each procedure?

There are no prohibitions or restrictions on the rights of secured creditors to enforce their security.

3.3 Can creditors set off sums owed by them to the company against amounts owed by the company to them in each procedure?

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.

4 Continuing the Business

4.1 Who controls the company in each procedure? In particular, please describe briefly the effect of the procedures on directors and shareholders.

Scheme of arrangement

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, subject to the court's supervision. In all cases, the scheme requires the court's approval.

Provisional liquidation

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.

Compulsory liquidation

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.

Voluntary liquidation

On appointing a voluntary liquidator, the directors' powers cease, except to the extent the company (through a general meeting) or the liquidator sanction the continuance of those powers. The company must cease business activities except in so far as is necessary for its beneficial winding-up.

4.2 How does the company finance these procedures?

All formal insolvency procedures are funded from the company's assets, or by way of third party funding.

4.3 What is the effect of each procedure on employees?

Under the common law, a winding-up order serves to immediately terminate all contracts of employment of the company in liquidation.

4.4 What effect does the commencement of any procedure have on contracts with the company and can the company terminate contracts during each procedure?

The commencement of insolvency procedures *per se* has no statutory effect on contracts entered into with the company; however, there may be particular contractual provisions which will apply in the event of a company becoming the subject of such a procedure.

5 Claims

5.1 Broadly, how do creditors claim amounts owed to them in each procedure?

Creditors claim in a liquidation by submitting a "proof of debt", for review by the liquidator. The proof of debt contains details of the amount owed, including the basis for the debt and any interest owed. The liquidator may require further evidence to be submitted by the creditor before accepting (either in full or in part) or rejecting the claim.

5.2 What is the ranking of claims in each procedure? In particular, do any specific types of claim have preferential status?

- Liquidation expenses, including liquidator's fees and disbursements.
- Preferential debts, which are:
 - certain sums due to employees;
 - certain taxes due to the Cayman Islands government; and
 - for certain Cayman Islands banks, certain sums due to depositors.

- Ordinary debts which are not otherwise secured, and not subject to certain subordination or deferral agreements.
- Ordinary debts that are subject to certain subordination or deferral agreements.
- In an official liquidation lasting more than six months, interest accruing on the company's debts since commencement of the liquidation.
- Amounts due to preferred shareholders (under the company's articles of association).
- Debts incurred by the company to redeem or purchase its own shares, provided the redemption or purchase was to take place before liquidation commenced.
- Shareholders of the company in accordance with its articles or any shareholders' agreement.

5.3 Are tax liabilities incurred during each procedure?

There are no tax liabilities incurred in any procedure.

6 Ending the Formal Procedure

6.1 What happens at the end of each procedure?

Scheme of arrangement

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.

Provisional liquidation

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); or
- an order dismissing or withdrawing the winding-up petition (in which case the company continues to exist).

Compulsory liquidation

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

Voluntary liquidation

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.

7 Restructuring

7.1 Is a formal statutory procedure available to achieve a restructuring of the company's debts in the Cayman Islands and, if so, to what extent is it supervised by the court?

Yes – 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 the US Chapter 11 procedure.

The courts have acknowledged the importance of provisional liquidation in assisting the rescue of a company in circumstances where refinancing or a 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.

7.2 If such a procedure is available, is a debt for equity swap possible and how are existing shareholders dealt with?

A debt for equity swap is possible and, to the extent that existing shareholders have an economic interest in the company, their interests can be dealt with by way of, for example, a weighted shareholding or the issuing of different classes of shares.

7.3 Is a moratorium available as part of the restructuring process?

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 may:

- a) where any action or proceeding against the company, including a criminal proceeding, is pending in a summary court, the Grand Court, the Court of Appeal or the Privy Council, apply to the court in which the action or proceeding is pending for a stay of proceedings therein; and
- b) where any action or proceeding is pending against the company in a foreign court, apply to the Grand Court for an injunction to restrain further proceedings therein.

In addition, upon:

- c) the appointment of a provisional liquidator; or
- d) 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 and subject to such terms as the Grand Court may impose (however, these stays and injunctions do not prohibit secured creditors from enforcing their security).

7.4 Can dissenting creditors be crammed down?

Yes, but other than in wholly solvent voluntary liquidations, all insolvency procedures come under the control/supervision of the Grand Court and the court can consider the position of any dissenting creditors/contributories. See also question 7.5 below.

7.5 Is consent needed from other stakeholders for a restructuring?

Generally speaking, a majority in number constituting at least 75 per cent (by value) of each of the classes of a company's creditors or members which will be affected by the proposed restructuring will need to be obtained.

8 International

8.1 What would be the approach in the Cayman Islands to recognising a procedure started in another jurisdiction?

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:

- 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.

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.



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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].

Campbells

Campbells have been at the forefront for over 40 years, advising both international and local clients on Cayman Islands and British Virgin Islands law. We are regularly trusted to advise some of the most prominent names in finance, investment, insolvency and insurance and are frequently involved in the largest and most complex and important transactions in the jurisdiction. Our legal team is internationally recognised for their expertise by leading directories and trade publications. We are actively involved in the development of legislation, sitting on critical government legislative committees.

Campbells' headquarters office is located in the Cayman Islands, within Cayman's premier business community, Cricket Square. We have an office in the British Virgin Islands, and a number of our Cayman-based lawyers are admitted to practise in the BVI. We also offer Asian time-zone corporate advice, through our Australian team, with experienced professionals on the ground.