Chambers

GLOBAL PRACTICE GUIDE

Definitive global law guides offering comparative analysis from top ranked lawyers

Insolvency

Cayman Islands
Campbells

chambers.com

2019

CAYMAN ISLANDS

The 'Law & Practice' sections provide easily accessible information on navigating the legal system when conducting business in the jurisdiction. Leading lawyers explain local law and practice at key transactional stages and for crucial aspects of doing business.

Law and Practice

Contributed by Campbells

Contents

Campbells advises on Cayman Islands and British Virgin Islands Law, and has offices in Cayman (head office), the BVI and HK. The group acts for local and overseas insolvency professionals, creditors, investors, directors and other professional service providers in connection with all aspects of the restructuring and winding-up of companies, investment funds, limited partnerships and structured finance entities. Lawyers have specific experience of co-ordinating cross-border appointments, obtaining injunctions, assisting with gathering evidence and obtaining recognition and assistance from overseas courts. The team is involved in many of the jurisdiction's most high-profile disputes, liquidations and restructurings.

Authors

Guy Manning is head of Campbells' Litigation, Insolvency & Restructuring Group and acts on behalf of creditors, shareholders, provisional and official liquidators, directors, managers and other professional service providers in relation to the restructuring and liquidation of Cayman companies and other entities. He also has an active general litigation practice involving widely varying commercial contexts and structures, but with a particular emphasis on shareholder and investment fund disputes.

Guy Cowan's primary area of practice and expertise is solvent and insolvent liquidations, often with significant cross-border aspects. He acts for distressed hedge funds, insolvency practitioners, stakeholders and financial institutions, and regularly advises in relation to creditor and/or shareholder disputes and remedies, antecedent transactions, contentious restructuring matters, schemes of arrangement and enforcement actions. He has significant experience of all insolvency procedures under Cayman law, and has appeared before the Grand Court's specialist Financial Services Division and the Cayman Islands' Court of Appeal on numerous occasions. He is a fellow of INSOL International.

Mark Goodman is a partner in the Litigation, Insolvency & Restructuring Group and specialises in insolvency, restructuring and investment fund litigation. He advises and appears in the Cayman Islands Courts on behalf of provisional and official liquidators, creditors, shareholders, directors, managers and other professional service providers in relation to a broad range of pre- and post-liquidation disputes. He has acted in litigation involving widely varying commercial contexts and structures, but his practice principally involves distressed and failed investment funds.

1. Market Trends and Developments

1.1 The State of the Restructuring Market

In 2017, a total of 17 restructuring petitions were filed in the Grand Court of the Cayman Islands. Of these, nine related to share capital reductions and eight related to schemes of arrangement. This compares to a total of 24 restructuring petitions filed in 2016.

In addition, 40 insolvency petitions were also filed in 2017, of which 22 sought winding-up orders and the other 18 sought orders bringing voluntary liquidations under the supervision of the court. This compares to a total of 46 insolvency petitions filed in 2016.

Ten of the insolvency petitions filed in 2017 did not proceed, whilst winding-up/supervision orders were made on 30 of the 40 petitions filed.

Full data is not yet available for 2018, but so far, no distinct trends are discernible in terms of specific industry sectors or economic cycles.

Legislative reforms have been proposed with a view to making it easier for directors of distressed Cayman companies to commence restructuring proceedings, under the protection of a statutory moratorium, without first having to obtain shareholder approval. If and when those changes are enacted, it is generally anticipated that there will be an uptick in the number of court restructurings in Cayman, particularly in respect of groups with operating subsidiaries in China (the PRC).

1.2 Changes to the Restructuring and Insolvency Market

There have been no notable changes or new trends in this market over the last 12 months.

2. Statutory Regimes Governing Restructurings, Reorganisations, Insolvencies and Liquidations

2.1 Overview of the Laws and Statutory Regimes

Corporate insolvency in the Cayman Islands is governed by Part V of the Companies Law (2018 Revision – the Companies Law) and the Companies Winding-up Rules 2018 (the CWR). Those provisions apply both to the winding-up of companies – including certain foreign companies – as defined by the Companies Law and, pursuant to Section 36 of the Exempted Limited Partnership Law (2018 Revision), to the winding-up of exempted limited partnerships in the Cayman Islands.

The Cayman Islands insolvency regime is based on many of the same underlying principles as the corresponding regime in England and Wales (and other Commonwealth countries), although there are some fundamental differences. These include the test for insolvency, which is assessed, on a winding-up petition, solely by reference to cash flow insolvency.

The principal tool used for financial restructurings is the scheme of arrangement under Part IV of the Companies Law. Schemes procedure is governed by Grand Court Practice Direction No 2 of 2010.

The doctrine of judicial precedent applies in the Cayman Islands, so case law is also relevant and important. Cayman Islands case law is developing but remains comparatively small in scope, however. Where there is no applicable Cayman Islands case law, the Cayman courts will look to English authorities. The latter's decisions are not binding, but as a general rule they will be followed to the extent that they are not inconsistent with either Cayman statutory provisions or authorities, and to the extent that they do not relate to English statutory provisions which have no equivalent in Cayman. Decisions from courts in other Commonwealth jurisdictions are similarly of persuasive, but not binding, authority.

2.2 Types of Voluntary and Involuntary Financial Restructuring, Reorganisation, Insolvency and Receivership

The key insolvency and restructuring procedures available in respect of corporate entities in the Cayman Islands are:

- voluntary liquidation;
- provisional liquidation;
- official liquidation; and
- schemes of arrangement.

It is also possible for receivers to be appointed over Cayman Islands companies (either by the Grand Court or by a creditor of the company with suitable security).

2.3 Obligation to Commence Formal Insolvency Proceedings

Directors of a company have fiduciary duties in relation to the interests of the company's creditors if the company is insolvent or of doubtful solvency. In such circumstances they must, therefore, have regard to whether it is appropriate for insolvency proceedings to be instigated.

Furthermore, if a company goes into voluntary liquidation then, unless all the directors have sworn declarations to the company's solvency within 28 days, the voluntary liquidators are required to petition the Grand Court within 35 days of the commencement of the voluntary liquidation to bring the liquidation under the court's supervision.

2.4 Procedural Options

As noted in **2.3 Obligation to Commence Formal Insolvency Proceedings** above, the only statutory obligation to commence insolvency proceedings arises when voluntary liquidators are required to petition the Grand Court to bring the voluntary liquidation under the court's supervision. The effect of a supervision order is to place the company into official liquidation with retrospective effect from the commencement of its voluntary liquidation.

If the directors' fiduciary duties require them to instigate insolvency proceedings, the appropriate type of process will depend on all the facts and circumstances, including whether they believe that the company should be restructured or wound up.

In restructuring cases, the principal option open to directors is a scheme of arrangement. This can be coupled with provisional liquidation proceedings if a moratorium on creditor claims is needed during the restructuring process, although as noted below there may be issues regarding the power of the directors to commence the provisional liquidation process.

In winding-up cases, directors do not have the power to petition for a winding-up order in their own names. They may be able to do so in the name of the company, but only if authorised to do so by a shareholders' resolution or (in certain cases) by the articles of association. The same problem can arise when provisional liquidation proceedings are required in connection with a restructuring. This can create difficulties in practice, and legislative reform has been proposed to resolve this issue.

Other procedural options may include inviting the shareholders to resolve to wind up the company voluntarily, or inviting a "friendly" creditor to present a winding-up petition.

2.5 Liabilities, Penalties or Other Implications for Failing to Commence Proceedings

No statutory penalties are imposed on a company or its management or owners for trading while insolvent, but if the directors' failure to commence insolvency proceedings amounts to a breach of their fiduciary duties to the company, then they may be liable at common law for damages caused by the breach.

Nor are there any statutory penalties imposed on voluntary liquidators for failing to apply to bring a voluntary liquidation under the court's supervision within the prescribed period. However, if their failure to do so causes the company loss, then the voluntary liquidators could also be liable to the company in damages at common law. As noted in **2.3 Obligation to Commence Formal Insolvency Proceedings** above, voluntary liquidators must file a supervision application unless all of the directors swear a declaration of solvency within 28 days of the commencement of a voluntary liquidation, and the Companies Law does impose statutory penalties on directors for knowingly swearing a false solvency declaration, namely, imprisonment for two years and a fine of KYD10,000 (approximately USD12,000) on conviction. Furthermore, voluntary liquidators (or, in their absence, directors) are liable to a fine of KYD10,000 if they fail to file various prescribed documents with the Registrar of Companies and comply with various notice requirements, following the commencement of a voluntary liquidation.

2.6 Ability of Creditors to Commence Insolvency Proceedings

Provisional Liquidation

Initiation – provisional liquidation is available to companies liable to be wound up under the Companies Law, following the presentation of a winding-up petition. Winding-up petitions and provisional liquidation applications may be presented against:

- companies incorporated and registered under the Companies Law (or which existed prior to the enactment of the Companies Law);
- bodies incorporated under any other law; and
- foreign companies which, firstly, carry on business or have property located in the Cayman Islands; secondly, are the general partner of a limited partnership registered in the Cayman Islands; or, thirdly, are registered as foreign companies under Part IX of the Companies Law.

A creditor, shareholder, the company itself or (in respect of regulated businesses) the Cayman Islands Monetary Authority (CIMA) can apply for the appointment of provisional liquidators between the presentation and the hearing of the winding-up petition.

Substantive Test – a creditor, shareholder or (in respect of a regulated business) CIMA may apply (usually ex parte) 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 dissipation or misuse of the company's assets;
- the oppression of minority shareholders; or
- mismanagement or misconduct on the part of the company's directors.

Furthermore, the company may, if properly authorised, apply for the appointment of provisional liquidators on the grounds that the company is, or is likely to become, unable to pay its debts and intends to present a compromise or arrangement to its creditors.

Official Liquidation

Initiation – official liquidation is available in respect of all the types of company identified above. The company (if properly authorised), any creditor (including a contingent or prospective creditor), any shareholder or (in respect of a regulated business) CIMA may present a winding-up petition to the Grand Court at any time.

The right of creditors and shareholders to present a winding-up petition is, however, subject to any contractually binding non-petition clauses. In addition, shareholders must be registered as such in the company's register of members and have either inherited or been allotted the shares, or been registered as their holder for at least six months.

Substantive Test – a company may be wound up by the Grand Court if:

- 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 **2.7 Requirement for Insolvency to Commence Proceedings** below):
- the Grand Court decides that it is just and equitable for the company to be wound up; or
- the company is carrying on a regulated business in the Cayman Islands and it is not duly licensed or registered to do so, or for any other reason provided under the regulatory or other laws.

2.7 Requirement for Insolvency to Commence Proceedings

Insolvency is not required to commence voluntary/involuntary proceedings. A voluntary liquidation is commenced simply by the passing of a shareholders' resolution. A winding-up order can be made on any of the (non-insolvency)

grounds set out in **2.6 Ability of Creditors to Commence Insolvency Proceedings** above.

If a winding-up petition is presented on the grounds of insolvency, the petitioner must demonstrate that the company is unable to pay its debts.

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

- a creditor serves a valid statutory demand and the company fails to pay the debt or settle with the creditor within 21 days;
- the execution of any judgment or order by the court, made in favour of a creditor against the company, is unsatisfied in whole or in part; or
- the creditor proves to the court that the company is unable to pay its debts. This is a cash-flow test of insolvency.

In Conway and Walker (as joint official liquidators of Weavering Macro Fixed Income Fund Limited) v SEB (2016 (2) CILR 514), the Court of Appeal stated that *"the cash flow test in the Cayman Islands is not confined to consideration of debts that are immediately due and payable. It permits consideration also of debts that will become due in the reasonably near future."* Although the Court of Appeal's comments were technically obiter, they are very likely to be followed by the Grand Court, such that a company may be liable to be wound up if it is unable to pay its debts which are immediately due and payable or its debts which will become due and payable in the *"reasonably near future"*. What constitutes the *"reasonably near future"* will be fact-specific in each case. If a creditor's claim is disputed by the company in good faith and on substantial grounds, however, then it cannot be relied on to demonstrate insolvency. A winding-up petition based on non-payment of such a claim is liable to be struck out as an abuse of process.

2.8 Specific Statutory Restructuring and Insolvency Regimes

Although there are no specific statutory restructuring and insolvency regimes applicable to banks and other credit institutions, or insurance undertakings, CIMA does have the power to appoint controllers over banks, trust companies, regulated mutual funds and licensed fund administrators. Controllers are granted wide powers, including the power to terminate the business, and CIMA can exercise various powers on receipt of a controller's report, including the power to apply for the entity to be wound up, or the power to require the entity to reorganise its affairs.

Furthermore, in a liquidation of a bank, eligible depositors enjoy a (limited) priority over other unsecured creditors.

3. Out-of-court Restructurings and Consensual Workouts

3.1 Consensual and Other Out-of-court Workouts and Restructurings

Due to the nature of the Cayman Islands as an offshore jurisdiction, restructuring market participants, company management and lenders are almost invariably based onshore. As such, their views and preferences on consensual workouts and restructurings tend to reflect the prevailing market views and preferences in the onshore jurisdiction(s) where they are based. These vary from case to case, but the most common jurisdictions (in no particular order) are London, New York and Hong Kong.

Cayman insolvency and creditors' rights laws do not really interact to a significant extent with the viability, desirability or choice of informal/consensual out-of-court restructuring and workout strategies. In particular, Cayman legislation is silent on consensual restructuring negotiations and therefore does not require that they take place before the commencement of a formal statutory process. That said, if a company requires a stay while it negotiates a scheme of arrangement or other form of compromise, it will need to apply for the appointment of provisional liquidators. The Financial Services Division Guide states that, on such an application, the Grand Court will expect to see evidence from the CEO or chairman which includes reasons why the directors believe that the company's affairs can be restructured in such a way that it can continue as a going concern. Although conducting consensual restructuring negotiations is not necessarily a prerequisite to the directors forming any such view, positive restructuring negotiations can obviously help to underpin their belief (particularly if these negotiations have led to substantial creditors signing restructuring support agreements), whereas the absence of any such negotiations (or unsuccessful negotiations) might undermine the directors' evidence.

As noted in **2.3 Obligation to Commence Formal Insolvency Proceedings** above, if a company is insolvent then its directors have a fiduciary duty to act with regard to the interests of its creditors. Whether that duty can be discharged by commencing/attempting an informal/consensual restructuring process rather than a statutory insolvency process will depend on all the facts and circumstances of the particular case.

3.2 Typical Consensual Restructuring and Workout Processes

As noted in **3.1 Consensual and Other Out-of-Court Workouts and Restructurings** above, due to the nature of the Cayman Islands as an offshore jurisdiction, restructuring market participants, company management and lenders are almost invariably based onshore. As such, there is not really a standard "Cayman" approach to consensual restructuring

and workout processes; rather the processes adopted in a consensual restructuring in the Cayman Islands will tend to vary based on the prevailing processes in the onshore jurisdiction(s) where the majority of the participants are based.

3.3 Injection of New Money

For information on the injection of new money, see above **3.2 Typical Consensual Restructuring and Workout Processes**.

3.4 Duties of Creditors to Each Other, or of the Company or Third Parties

Consensual/out of court restructurings in Cayman require the agreement of 100% of creditors, so in most circumstances the provision of a creditor's consent would preclude it from subsequently challenging the restructuring. Remedies may, however, exist at common law and/or in equity if a creditor gave consent based on some form of misinformation.

Without a separate contractual agreement between creditors, or one creditor voluntarily assuming a duty to another, there is no basis on which creditors would owe duties to each other in a consensual restructuring governed by Cayman Islands law.

3.5 Consensual, Agreed Out-of-court Financial Restructuring or Workout

Creditors cannot be crammed down in a consensual, out-of-court restructuring under Cayman Islands law. This can only be done through the use of a scheme of arrangement, which involves a court process. Shareholders' rights can be crammed down in certain circumstances without court proceedings, most commonly through a merger or consolidation under Part XVI of the Companies Law. Under that procedure a shareholder's shares can be acquired for "fair value" if the merger or consolidation is approved by a special resolution of the shareholders (requiring a two-thirds majority unless the articles impose a higher threshold). However, although a dissenting minority shareholder does not have the ability to block the merger/consolidation, it is entitled to be paid fair value for its shares, and the question of what fair value is will have to be resolved in court proceedings if the company and the shareholder disagree.

See also **3.2 Typical Consensual Restructuring and Workout Processes** above.

4. Secured Creditor Rights and Remedies

4.1 Type of Liens/Security Taken by Secured Creditors

Subject to the nature of the asset, the most common forms of security are mortgages, fixed and floating charges, liens and pledges.

There are central ownership registers for land, ships, aircraft and motor vehicles on which mortgages and charges can be recorded. 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 that it has sufficient control over the asset to prevent a third party from buying or otherwise dealing with 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.

4.2 Rights and Remedies for Secured Creditors

Section 142 of the Companies Law and CWR Order 17 specifically provide that a creditor with security over the whole or part of the assets of a company is entitled to enforce its security without the leave of the Grand Court and without reference to the company's liquidator.

There is therefore no stay of any kind, although the secured creditor's exercise of its rights would be subject to the applicable terms of any intercreditor agreement entered into by the secured creditor.

The remedies available to a secured creditor will depend principally on the terms of its security document, but this might typically include the right to appoint a receiver over a charged asset.

4.3 The Typical Timelines for Enforcing a Secured Claim and Lien/Security

The timeline will depend on the terms of the security to be enforced and, for example, whether there is any resistance to the enforcement. No timelines are proscribed by statute and there are no special procedures for enforcing cash collateral, share security or any other type of collateral.

4.4 Special Procedures or Impediments That Apply to Foreign Secured Creditors
There is no distinction between foreign and local creditors under Cayman Islands law.

4.5 Special Procedural Protections and Rights for Secured Creditors
See **4.2 Rights and Remedies for Secured Creditors** above.

5. Unsecured Creditor Rights, Remedies and Priorities

5.1 Differing Rights and Priorities Among Classes of Secured and Unsecured Creditors
See **5.2 Unsecured Trade Creditors** below.

5.2 Unsecured Trade Creditors
Given the nature of the Cayman Islands as an offshore jurisdiction, trade creditors will typically have claims against the group's onshore operating subsidiaries, rather than its Cayman holding companies. Whether trade creditors are kept whole during the restructuring will therefore depend upon any prevailing practice in the applicable onshore jurisdiction.

5.3 Rights and Remedies of Unsecured Creditors
A moratorium on unsecured creditors' claims will only arise if provisional liquidators are appointed.

Without such a moratorium, unsecured creditors may therefore be able to disrupt a restructuring by obtaining and enforcing judgment on their claims. The Grand Court does, however, have jurisdiction to stay a writ action brought by a creditor in the Cayman Islands, pending the outcome of the restructuring.

In the absence of a moratorium, unsecured creditors would, alternatively, be able to disrupt a restructuring by filing a winding-up petition against the company. Although an unpaid creditor of an insolvent company is entitled to a winding-up order ex debito justitiae, the making of a winding-up order remains a matter for the Grand Court's discretion, and it might adjourn or dismiss the creditor's petition if other creditors are opposed to the winding-up because of the proposed restructuring.

If a company is placed into official liquidation, then the Grand Court does have the power, on the application of the liquidator or any creditor or shareholder, to stay the liquidation either altogether or for a limited time. This power is rarely exercised in practice, but a stay might be granted if the court was satisfied that it would result in a successful restructuring.

5.4 Pre-judgment Attachments
Although pre-judgment attachments are not strictly available in the Cayman Islands, Mareva (or freezing) injunctions are available as an interim remedy to a plaintiff who can show a good, arguable case and a real risk that, if the injunction is not granted, the defendant will remove the relevant assets from the jurisdiction or otherwise dissipate them.

The commencement of the Grand Court (Amendment) Rules 2014 – and the corresponding changes implemented to the Grand Court Rules – has seen the jurisdiction of the court expanded so that an unsecured creditor is now able to apply for an interlocutory injunction against a defendant in relation to proceedings which, firstly, either have been or are about to be commenced in a court outside the Cayman Islands; and secondly, could give rise to a judgment which may be enforced in the Cayman Islands under any Cayman Islands statute or at common law.

5.5 Typical Timeline for Enforcing an Unsecured Claim
The time taken to obtain and enforce a judgment outside liquidation will depend on the extent to (and the manner in) which the proceedings are contested, but six to 12 months would be typical.

If a creditor seeks to enforce its rights by filing a winding-up petition, then the petition will normally be heard within four to six weeks of the filing. If a winding-up order is made, the timeline for payment of the creditors varies widely from liquidation to liquidation.

5.6 Bespoke Rights or Remedies for Landlords
Landlords may have the right to distrain the goods or effects of a company, but if they do so within the three months preceding its winding-up, then the preferential debts in the liquidation will constitute a first charge on the goods or effects so distrained, or the proceeds of sale thereof.

5.7 Special Procedures or Impediments or Protections That Apply to Foreign Creditors
There are no special procedures/impediments that apply to foreign creditors – all creditors are treated equally, regardless of where they are domiciled.

5.8 The Statutory Waterfall of Claims
There is no administration procedure in the Cayman Islands. The basic statutory order of priorities in a liquidation is as follows:

- liquidation expenses;
- preferential debts, comprising: certain sums due to or payable on behalf of employees; certain taxes due to the Cayman Islands government; for certain Cayman Islands banks, certain sums due to depositors;

- unsecured debts which are not subject to subordination or deferral agreements (with contractually subordinated/deferred debts being paid in accordance with the subordination agreement);
- amounts due to preferred shareholders under the company's articles of association, provided that the rights of those shares are preferred to the rights of the shares referred to below;
- debts incurred by the company in respect of the redemption or purchase of its own shares (although it remains an open question whether such claims arising where the redemption or purchase took place before the liquidation commenced, rank ahead of or pari passu with such claims where the shares were due to be redeemed before the liquidation commenced but were not redeemed due to the company's default); and
- any surplus remaining after payment of the above amounts is returned to the shareholders of the company in accordance with its articles or any shareholders' agreement.

Note also that pursuant to Section 140 of the Companies Law, the collection and distribution of the company's assets is without prejudice to, and after taking into account and giving effect to, the rights of preferred and secured creditors and to any agreement between the company and any creditors that the claims of such creditors shall be subordinated or otherwise deferred to the claims of any other creditors and to any contractual rights of set-off or netting of claims between the company and any person or persons (including without limitation any bilateral or any multilateral set-off or netting arrangements between the company and any person or persons) and subject to any agreement between the company and any person or persons to waive or limit the same. In the absence of any contractual right of set-off or non set-off, an account is taken of what is due from each party to the other in respect of their mutual dealings, and the sums due from one party shall be set off against the sums due from the other.

5.9 Priority Claims

See **5.8 The Statutory Waterfall of Claims** above.

5.10 Priority Over Secured Creditor Claims

Such claims do not have priority over secured creditor claims. Pursuant to Section 142 of the Companies Law and CWR Order 17, a secured creditor can enforce its security without reference to a liquidator and without the need to obtain leave from the Grand Court.

6. Statutory Restructurings, Rehabilitations and Reorganisations

6.1 The Statutory Process for Reaching and Effectuating a Financial Restructuring/Reorganisation

The principal restructuring tool in the Cayman Islands is the scheme of arrangement under Section 86 of the Companies Law. Cayman schemes are substantively very similar to schemes in the UK, although there are certain procedural differences.

A scheme is a statutory form of compromise or arrangement between a company and its creditors (or any class of them) or its shareholders (or any class of them). There is no statutory definition of the terms "compromise" or "arrangement". The Grand Court will construe them broadly but they must involve some element of accommodation or "give and take" between the company and the scheme creditors or shareholders.

The principal uses of Cayman schemes are to reorganise the company's share capital, to enable a company to restructure its liabilities and avoid an insolvent liquidation, or to alter the distribution rights of creditors and/or shareholders in the company's liquidation.

Scheme proceedings can be commenced by the company, by any creditor or shareholder of the company or (where the company is being wound up) by a liquidator. Scheme proceedings commenced by a creditor or shareholder would, however, require the company's support.

If a moratorium is required during the scheme process, then the company will present a winding-up petition and apply for an order appointing provisional liquidators prior to filing the scheme petition.

If the scheme is supported by more than 50% by number and 75% by value of those attending and voting in each scheme class, and is subsequently approved by the Grand Court, it will bind all scheme creditors/shareholders (including those who did not vote or who voted against the scheme) in accordance with its terms.

Generally speaking, a Cayman scheme will usually take between ten and 12 weeks from the date when the scheme petition and summons for directions are filed, to the date when an order approving the scheme is made. The Grand Court requires that the entire timetable be established at the outset, which ensures a swift resolution of the scheme process.

However, prior to the filing of the scheme petition there may and likely will be a lengthy period in which the scheme terms are negotiated with key creditors, funding is raised, and the

scheme document, detailed explanatory memorandum, evidence and other documentation are all prepared.

Order 102, rule 20 of the Grand Court Rules (GCR) and Practice Direction 2/2010 govern the procedure for obtaining approval of a scheme of arrangement. After the filing of a scheme petition, there is a three-stage process for schemes. In broad terms:

- first, there must be an application to the Grand Court for an order that a meeting or meetings be convened of creditors (or a class of creditors) or members (or a class of members) for the purpose of approving the scheme – this is known as the convening hearing;
- second, the scheme proposals are put to the meeting or meetings held in accordance with the order that has been made, and are approved (or not) by the requisite majority in number and value of those present and voting in person or by proxy – these are known as the scheme meetings;
- third, if approved at the meeting or meetings, there must be a further application to the court to obtain sanction to the compromise or arrangement – this is known as the sanction hearing.

Each of the three stages serves a distinct purpose:

- At the first stage, the Grand Court directs how the meeting or meetings are to be convened. It is concerned primarily with class composition, the adequacy of the scheme documentation, and ensuring that those who will be affected by the proposed compromise or arrangement have a proper opportunity to be present (in person or by proxy) at the scheme meetings.
- The second stage ensures that the proposals are acceptable to at least 50% in number, representing 75% in value, of those who take the opportunity to be present (in person or by proxy) at the meeting or meetings.
- At the third stage, the court is concerned to ensure that the meeting or meetings have been convened and held in accordance with the previous order, the proposals have been approved by the requisite majorities, and the scheme is fair.

The scheme process is not confidential. Detailed scheme documentation will be sent to all scheme participants and may also be advertised depending on the circumstances. All scheme participants have the right to appear by counsel at the scheme sanction hearing, which is held in open court. They may also appear at the convening hearing, although the convening application will typically be made on an ex parte basis unless there are contentious issues of class composition or jurisdiction.

If there is any uncertainty over creditors' claims, then this will principally be relevant for the purposes of voting at the scheme meetings and distributions to be made under the scheme. As regards the former, the Grand Court might give directions at the convening hearing regarding the valuation of claims for voting purposes, or it may leave that issue to be addressed by the chairperson of the scheme meetings. As regards the latter, the scheme document will typically contain a mechanism for determining claims, post-sanction of the scheme, for distribution purposes.

There is no formal conclusion to a scheme. The scheme comes to an end once all compromise or arrangement terms to which it relates have been complied with.

6.2 Position of the Company During Procedures

No moratorium is available if the scheme is initiated when the company is not in liquidation. If the scheme is initiated during a provisional liquidation, then an automatic stay prohibits the commencement or continuance of any suit, action or other proceeding against the company without the Grand Court's leave.

The company can and will continue to operate its business during the restructuring process. If the company is not in provisional liquidation, then incumbent management will continue to manage the company. If the company is in provisional liquidation, then the appointment order will specify whether incumbent management or the provisional liquidators will manage the business during the restructuring.

The company can borrow money during the process, but this will require Grand Court approval if the company is in provisional liquidation.

6.3 The Roles of Creditors During Procedures

The Grand Court considers the class composition of creditors at the scheme convening hearing. The basic test is whether the members in each class have rights which are not so dissimilar as to make it impossible for them to consult together with a view to their common interest.

If the company is not in liquidation, then there are no statutory provisions regarding creditor committees, although in practice ad hoc committees may be formed. If the company is in provisional liquidation, then the Grand Court will decide whether a committee should be established and, if so, how that should be done. If a committee is established, its role will be to act as a sounding board for the provisional liquidators and to review their fees. The committee may be authorised to retain counsel at the company's expense.

At the scheme convening hearing the Grand Court will need to be satisfied that the scheme document and supporting explanatory statement contain all the information reasonably necessary to enable the scheme creditors (and/or shareholders as applicable) to make an informed decision about the merits of the proposed scheme. If the company is in provisional liquidation, then it is likely that the Grand Court will

also require the provisional liquidators to report to the court and the creditors periodically.

6.4 Modification of Claims
Dissenting creditors' rights will be crammed down in accordance with the terms of the scheme if the statutory majorities are obtained in each class and the scheme is sanctioned by the Grand Court.

6.5 Trading of Claims
There is no statutory prohibition on the trading of creditor claims, but notice of the assignment would need to be given to the company.

6.6 Using a Restructuring Procedure to Reorganise a Corporate Group
A restructuring procedure may be utilised to reorganise a corporate group on a combined basis for administrative efficiency. A separate scheme would be required for each scheme company, but the procedure can be co-ordinated and streamlined by the Grand Court to minimise inefficiencies.

6.7 Restrictions on the Company's Use of or Sale of Its Assets During a Formal Restructuring Process
If a scheme is implemented when a company is not in provisional liquidation, no restrictions or conditions will be applied to the use or sale of the company's assets, other than any applicable contractual restrictions. If a scheme is implemented when a company is in provisional liquidation, then any disposition of assets would be subject to the approval of the Grand Court, either through its sanction of the scheme, or otherwise. Contractual consents would be enforceable unless the applicable right was itself compromised by the scheme.

6.8 Asset Disposition and Related Procedures
If a scheme is implemented when a company is not in provisional liquidation, the sale of assets will be executed by the duly authorised representatives of the company – that is, typically, its directors. If a scheme is implemented when a company is in provisional liquidation, the terms of the appointment order (or subsequent orders) will determine whether and to what extent the sale is executed by the directors or by the provisional liquidators. In either case, the company would only transfer such right, title and interest as it had in the assets. In particular, any security over the assets would remain in place unless it was compromised by the scheme.

Creditors may bid for assets and act as a stalking horse in a sale process. No specific rules apply to bids by creditors, but if the restructuring is happening in a provisional liquidation, the Grand Court will need to approve the sale, and in so doing, it will consider the sales process as part of its assessment of whether the creditor's bid represents the best deal available in the circumstances.

In appropriate circumstances, the pre-packaged sale of assets could be arranged. Grand Court approval would be required if the company is in provisional liquidation.

6.9 Release of Secured Creditor Liens and Security Arrangements
Secured creditor liens and security arrangements may be released pursuant to such a procedure.

6.10 Availability of Priority New Money
New money can be given priority by the company granting security to the lender or by subordinating the claims of scheme creditors through the scheme itself. Pre-existing security over an asset would take priority over any new security granted to the lender.

6.11 Statutory Process for Determining the Value of Claims
The process is not prescribed by statute, but if there are disputed, contingent or unliquidated claims, then the scheme document will include an adjudication mechanism.

6.12 Restructuring or Reorganisation Plan or Agreement Among Creditors
The Grand Court must approve the terms of the scheme before it becomes effective and will not do so unless satisfied that it is fair.

6.13 The Ability to Reject or Disclaim Contracts
The company – or a statutory office holder – cannot reject or disclaim contracts in such a procedure.

6.14 The Release of Non-debtor Parties
In certain circumstances, a statutory procedure can release non-debtor parties from liabilities provided that there is a sufficiently close connection between the subject matter of the scheme and the relationship between the company and its creditors/members: see the SPhinX Group of Companies [2010 (1) CILR 452].

6.15 Creditors' Rights of Set-off, Off-set or Netting
The question of whether creditors can exercise rights of set-off or netting in a proceeding would need to be addressed in the scheme documentation.

6.16 Failure to Observe the Terms of an Agreed Restructuring Plan
The implications of a company/creditor failing to observe the terms of an agreed restructuring plan would depend on the particular circumstances.

6.17 Receive or Retain Any Ownership or Other Property
Existing equity owners can receive/retain any ownership or other property on account of their ownership interests.

7. Statutory Insolvency and Liquidation Proceedings

7.1 Types of Statutory Voluntary and Involuntary Insolvency and Liquidation Proceedings

There are three types of insolvency/liquidation proceedings in the Cayman Islands: voluntary, provisional and official liquidations.

Voluntary Liquidation

Objective – voluntary liquidation can be used by any company incorporated and registered under the Companies Law (or predecessor laws). The company must cease its business activities, except so far as continuing them is necessary for its beneficial winding-up: its affairs are wound up, its creditors are paid in full, and its remaining assets or the proceeds of their realisation are distributed to its shareholders.

Initiation – a company may 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 a trigger to the company's winding-up;
- if the company resolves by special resolution that it be wound up voluntarily; or
- 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.

Supervision and control – the directors are displaced by a voluntary liquidator on the commencement of a voluntary liquidation, except to the extent (if any) that the company (through a general meeting) or the voluntary liquidator sanctions the continuance of the directors' powers. The directors may also be appointed as voluntary liquidators, as there are no qualification requirements for the role.

A voluntary liquidator does not require the Grand Court's authorisation to exercise his or her powers, but he or she may apply to the court under Section 129 of the Companies Law to determine any question that arises during the winding-up process.

A voluntary liquidator must apply to the Grand Court for an order that the liquidation continues under the court's supervision unless, within 28 days of the commencement of the voluntary liquidation, 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 voluntary liquidation. Even if such a declaration is made, the liquidator or any creditor or shareholder can apply to bring the liquidation under the Grand Court's supervision on the grounds that either:

- the company is, or is likely to become, insolvent; or
- court supervision will facilitate a more effective, economic or expeditious liquidation of the company in the interests of the shareholders and creditors.

If a voluntary liquidation is brought under the supervision of the Grand Court then it continues as an official liquidation which is deemed to have commenced on the commencement of the voluntary liquidation.

Moratorium – no protection from the company's creditors is available during a voluntary liquidation. Voluntary liquidators are required to pay debts owed to creditors as they fall due. If they fail to do so there is nothing to stop a secured creditor from enforcing its security, or to prevent any creditor from commencing ordinary litigation or winding-up proceedings against the company.

Claims – there is no statutory set off or netting off which applies during a voluntary liquidation, nor is there any procedure for adjudicating creditors' actual or contingent claims. The voluntary liquidator is required to pay claims in full and, as noted above, there is no moratorium preventing a creditor from commencing ordinary litigation or winding-up proceedings in respect of its claim. In the event of a dispute in respect of an actual or contingent claim, this would need to be determined by whichever court or arbitral tribunal has jurisdiction over the claim. Claims may be traded during a voluntary liquidation, subject to any contractual restrictions.

Onerous contracts – voluntary liquidators have no statutory power to disclaim onerous contracts.

Information rights – voluntary liquidators are required to provide reports and accounts to the company's shareholders and (on request) any creditors who have not been paid in full, whenever the voluntary liquidator thinks appropriate and, in any event, in connection with each annual general meeting and the final meeting in the voluntary liquidation. Shareholders and creditors have no other statutory information rights during a voluntary liquidation.

Length of procedure – the duration of a voluntary liquidation depends on how complicated the winding-up process is, but it would typically be substantially shorter than an official liquidation. The statute contemplates that all creditors in a voluntary liquidation will be paid in full within 12 months by imposing an obligation to apply to bring the liquidation under the Grand Court's supervision unless all the directors swear a statutory declaration of their belief that the company will be able to do so.

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 his or her account of the voluntary liquidation. The liquidator must file

a return with the registrar and the company is then deemed to have been dissolved three months after the return's registration date. Once it is deemed to have been dissolved, the company cannot be restored to the register.

Provisional Liquidation

Objective – provisional liquidation is available to any company liable to be wound up under the Companies Law, following the presentation of a winding-up petition.

Applications by creditors, shareholders or CIMA to appoint provisional liquidators are made for the purpose of preserving and protecting the company's assets until the hearing of a winding-up petition and the appointment of official liquidators.

A company can also petition for its own winding-up and apply for the appointment of provisional liquidators in order to present a compromise or arrangement to creditors with the protection of an automatic stay. The purpose of appointing a provisional liquidator in this situation is similar to the UK administration process or US Chapter 11 procedure, albeit there are significant legal and procedural differences. If the restructuring is successful then, typically, the company will emerge from provisional liquidation and the winding-up petition will be dismissed.

Initiation – creditors, shareholders or (in respect of regulated businesses) CIMA may 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 dissipation or misuse of the company's assets;
- the oppression of minority shareholders; or
- mismanagement or misconduct on the part of the company's directors.

As mentioned above, the company may, if properly authorised, apply to appoint provisional liquidators on the grounds that the company is, or is likely to become, unable to pay its debts and intends to present a compromise or arrangement to its creditors.

Supervision and control – provisional liquidators are appointed and supervised by the Grand Court. The consent of stakeholders is not required, but their views on whether an appointment should be made, and who should be appointed, will or may (depending on the circumstances) be given weight by the Grand Court in the exercise of its discretion.

Provisional liquidators only have the powers given to them in the appointment order. The scope of those powers will depend on the reason for their appointment. If a restructuring is proposed, then in some cases existing management will be allowed to remain in control of the company (subject to the supervision of the provisional liquidators and the Grand Court) in what are known as "light touch" provisional liquidations. In other restructuring cases, the directors' powers may be displaced entirely by the powers given to the provisional liquidators for the duration of the provisional liquidation.

The Grand Court may (or may not) direct that a provisional liquidation committee be established. The principal functions of a committee are to act as a sounding board for the provisional liquidators and to review their fees.

Moratorium – on the appointment of provisional liquidators, a statutory stay automatically takes effect pursuant to Section 97 of the Companies Law. No suit, action or other proceeding against the company may proceed or commence without the leave of the Grand Court. The stay does not prohibit secured creditors from enforcing their security, however.

Claims – there is no statutory mechanism for dealing with the submission and/or adjudication of creditors' claims during a provisional liquidation, or for setting or netting off claims. If the provisional liquidation is being used to preserve assets pending a winding-up, then claims will be submitted and adjudicated in the official liquidation (see below). If the provisional liquidation has been commenced for the purpose of a restructuring, then the scheme of arrangement (or other form of compromise or arrangement) will address the process for submitting and adjudicating claims. In either case, claims may be traded during the provisional liquidation, subject to any contractual restrictions.

Onerous contracts – provisional liquidators have no statutory power to disclaim onerous contracts.

Information rights – the frequency and scope of voluntary liquidators' reporting obligations are matters to be addressed in the appointment order (and/or subsequent orders) made by the Grand Court.

Length of procedure – if the purpose of the provisional liquidation is to protect the assets pending the hearing of a winding-up petition, then the provisional liquidation is likely to be brief. The Grand Court aims to hear creditors' winding-up petitions within four to six weeks of the petition being filed.

If the purpose is to enable a restructuring, it is typical for the winding-up petition to be listed for hearing within one to three months, so as to allow time for an initial assessment of whether a restructuring is viable. If it does not appear to be viable, then the company will typically be wound up at that first hearing. If it appears that a restructuring may be viable, then the Grand Court will typically adjourn the petition

for one or more fixed periods to allow the restructuring to proceed. The length of the provisional liquidation will vary in these circumstances, but it could last for up to a year (or longer) in more complex cases.

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), or 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; or if an appeal against the provisional liquidator's appointment succeeds.

Official Liquidation

Objective – official liquidation is available to:

- companies incorporated and registered under the Companies Law (or predecessor laws);
- bodies incorporated under any other law; and
- foreign companies which carry on business or have property located in the Cayman Islands, or foreign companies which are the general partner of a limited partnership registered in the Cayman Islands, or foreign companies which are registered under Part IX of the Companies Law.

The functions of official liquidators are to:

- collect, realise and distribute the assets of the company to its creditors and, if there is a surplus, to the persons entitled to it; and
- report to the company's creditors and contributories on the affairs of the company and the manner in which it has been wound up.

Initiation – the company (if properly authorised), any creditor (including a contingent or prospective creditor), or any shareholder of the company, may present a winding-up petition to the Grand Court at any time.

The right of creditors and contributories to present a winding-up petition is, however, subject to any contractually binding non-petition clauses and, in the case of a contributory, to the contributory having either inherited or been allotted its shares, or having been registered as their holder for at least six months.

CIMA may also present a winding-up petition to the Grand Court at any time in relation to a company which is carrying on a regulated business in the Cayman Islands.

A company may be wound up by the Grand 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 Grand 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; or
- certain other grounds specified in regulatory and other laws.

The test of inability to pay debts for this purpose is a cash-flow test (see **2.7 Requirement for Insolvency to Commence Proceedings** above).

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, the company is unlikely to be able to assert that there is a legitimate dispute in relation to the debt unless an appeal against the judgment is pending and/or execution of the judgment has been stayed by the court.

A company is placed into official liquidation by order of the Grand Court. The consent of stakeholders is not required, but their views on whether a winding-up order should be made and who should be appointed may, and usually will, be taken into account in the exercise of the court's discretion.

Supervision and control – official liquidators must be qualified insolvency practitioners resident in the Cayman Islands or foreign practitioners appointed jointly with a resident qualified insolvency practitioner. They displace the company's directors and control the company's affairs, subject to the Grand Court's supervision. Some of their powers can be exercised without the sanction of the court, whereas others require court sanction. A liquidation committee is required to be established in every official liquidation, unless the Grand Court orders otherwise. The principal functions of a committee are to act as a sounding board for the official liquidators and to review their fees.

Moratorium – 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 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 foreign court.

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

Claims – creditors (including contingent creditors) claim in an official 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. A creditor has a right of appeal regarding any decision taken by a liquidator in relation to its proof of debt (including in relation to questions of priority). In addition, other creditors (or the liquidator himself or herself) may, in certain circumstances, apply to expunge a proof which has been admitted by the liquidator.

All debts payable on a contingency, and all claims against the company whether present or future, certain or contingent, ascertained or sounding only in damages, are admissible as proof against the company. Official liquidators are required to make a just estimate, so far as is possible, of the value of all such debts or claims as may be subject to any contingency or sound only in damages or which for some other reason do not bear a certain value.

The collection in and application of the property of the company is without prejudice to, and after taking into account and giving effect to, the rights of preferred and secured creditors and to any agreement between the company and any creditors that the claims of such creditors shall be subordinated or otherwise deferred to the claims of any other creditors and to any contractual rights of set-off or netting of claims between the company and any person or persons (including without limitation any bilateral or any multilateral set-off or netting arrangements between the company and any person or persons) and subject to any agreement between the company and any person or persons to waive or limit the same.

There is no prohibition on the trading or assignment of creditor claims within an official liquidation, subject to any contractual restrictions. Shareholders, however, require the leave of the court and the consent of the liquidator before they can transfer their shares to third parties.

Onerous contracts – official liquidators have no statutory power to disclaim onerous contracts.

Information rights – official liquidators are subject to various reporting obligations to the liquidation committee, creditors, shareholders and the Grand Court. Creditors, shareholders and certain other interested parties also have rights to inspect the court's liquidation file. On the application of an official liquidator, the Grand Court has the power to seal various documents on its files, so as to prevent their inspection, where they contain confidential information which, if disclosed, could harm the economic interests of the stakeholders.

Length of procedure – the duration of official liquidation proceedings depends on the nature of the assets and the complexity of the issues. There is no maximum period within which liquidation must be completed.

Conclusion – when the affairs of a company in official liquidation have been fully wound up, the Grand Court makes an order, on the liquidators' application, that the company be dissolved from the date specified in the order. Once the company is dissolved following an official liquidation, it cannot be reinstated.

7.2 Distressed Disposals as Part of Insolvency/ Liquidation Proceedings

Within a liquidation, the sale of a company's assets (or the business itself) is effected by the liquidator. All contractual agreements relating to the sale will need to be executed by the company acting for its liquidator (without personal liability). In a provisional or official liquidation, the power to sell the company's property may only be exercised with the sanction of the Grand Court.

A purchaser would only obtain such right, title and interest in any assets sold as the company itself holds, and the liquidators would be unlikely to give any representations or warranties as to the title of such assets, so that any existing proprietary claims by third parties would continue to be enforceable.

Creditors of the company are not restricted from bidding for the assets of the company and may also act as a stalking horse in such sale procedures, although court approval of the obligation to pay a stalking-horse bidder would be required.

It is possible to effectuate pre-negotiated sales transactions following the commencement of a statutory procedure, but Grand Court approval would be required in a provisional or official liquidation.

7.3 Implications of Failure to Observe the Terms of an Agreed or Statutory Plan

The implications of a company/creditor failing to observe the terms of an agreed/statutory plan would depend on the particular circumstances.

7.4 Investment or Loan of Priority New Money

Priority new money can be invested or loaned during the statutory process, subject to Grand Court approval in a provisional or official liquidation.

7.5 Insolvency Proceedings to Liquidate a Corporate Group on a Combined Basis

Concurrent liquidation proceedings in respect of several group companies can be co-ordinated by the Grand Court to avoid duplication and improve efficiency and costeffectiveness. In certain circumstances, the Grand Court may order the pooling of assets and liabilities of group companies, but this is rare in practice.

7.6 Organisation of Creditors

There are no (formal) liquidation committees in voluntary liquidations. In provisional liquidations, the Grand Court has the power to give directions with regard to the establishment of a provisional liquidation committee. In an official liquidation, a liquidation committee must be appointed unless the Grand Court orders otherwise. The committee must comprise three to five creditors (if the official liquidator has determined that the company is insolvent) or shareholders (if the official liquidator has determined that the company is solvent). If the official liquidator determines that the company is of doubtful solvency, then the committee must comprise three to six members, the majority of whom 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).

The committee's role is to act as a sounding board for the liquidators and to review their remuneration. The committee does not have powers as such, but it may make sanction applications to the Grand Court with regard to the exercise or proposed exercise of the liquidators' powers.

The committee may retain counsel at the expense of the estate. Committee members are also entitled to be reimbursed for reasonable travel expenses and/or telephone charges properly incurred in attending meetings of the committee. No other committee expenses may be reimbursed, unless such expenses have been approved by the committee and the liquidator before being incurred.

7.7 Conditions Applied to the Use of or Sale of Assets

No conditions apply in a voluntary liquidation. In a provisional or official liquidation, the liquidators' power to sell assets is only exercisable with the sanction of the Grand Court. Liquidators have a duty to obtain the best price they can for the assets of the company; see, for example, Trident Microsystems (Far East) Limited (2012 (1) CILR 424), where it was held that *"the primary duty of a liquidator when selling the assets of a company is to take reasonable care to obtain the best price available in the circumstances... taking into account the nature of the business to be sold, the relevant market, the steps taken to market and to sell the assets and the urgency of the sale."*

8. International/Cross-border Issues and Processes

8.1 Recognition or Other Relief in Connection with Foreign Restructuring or Insolvency Proceedings

On application by a foreign representative (defined as a trustee, liquidator or other official appointed for the purposes of a foreign bankruptcy proceeding), the Grand 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 for, the foreign representative; and
- order that the debtor's property be turned over to the foreign representative.

In determining whether to make these orders, the Grand Court must aim to assure the economic and expeditious administration of the debtor's estate, consistent with:

- the just treatment of all holders of claims wherever they are domiciled, in accordance with established principles of natural justice;
- the protection of claim 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 statutory order of priority;
- 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).

It is common for international bankruptcies and liquidations to involve the Cayman Islands.

8.2 Protocols or Other Arrangements with Foreign Courts

The Cayman Islands are not a signatory to any international treaties relating to bankruptcy or insolvency. However, Cayman official liquidators are required to consider whether or not it is appropriate to enter into an international protocol with any foreign officeholder. The purpose of an international protocol is to promote the orderly administration of the estate of a company in official liquidation and avoid duplication of work and conflict between the official liquidator and the foreign officeholder. Any international protocol agreed between a Cayman liquidator and a foreign officeholder will not take effect and become binding until it has been approved by both the Grand Court and the appropriate foreign court or authority.

Protocols between the Grand Court and foreign courts (as opposed to their respective officers) are very rare in practice and are not expressly provided for in Cayman Islands legislation.

8.3 Rules, Standards and Guidelines to Determine the Paramountcy of Law

In cross-border cases, the Grand Court adopts 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.

8.4 Foreign Creditors

There are no alternative procedures in the Cayman Islands that apply to foreign creditors. All creditors are treated equally, regardless of where they are domiciled.

9. Trustees/Receivers/Statutory Officers

9.1 Types of Statutory Officers Appointed in Proceedings

There are no restrictions on who may be appointed as a voluntary liquidator of a company under Cayman Islands law. Provisional and official liquidators must be qualified insolvency practitioners resident in the Cayman Islands or foreign practitioners appointed jointly with a resident qualified insolvency practitioner.

9.2 Statutory Roles, Rights and Responsibilities of Officers

Voluntary liquidators are officers of the company over which they are appointed and owe statutory and fiduciary duties to the company and its stakeholders.

Provisional and official liquidators are officers of the Grand Court and act as agents of the company over which they are appointed. They stand in a fiduciary position towards the company and must act in the interests of the general body of the company's stakeholders. An official liquidator is required to make *"himself thoroughly acquainted with the affairs of the company; and to suppress nothing, and to conceal nothing, which has come to his knowledge in the course of his investigation, which is material to ascertain the exact truth in every case before the Court"* (see Gooch's Case 1872, 7 Ch App 207). Official liquidators have various statutory duties, including the duty to ensure that the assets of the company are secured, realised and distributed to the company's creditors and, if there is a surplus, to the persons entitled to it.

9.3 Selection of Statutory Officers

Voluntary liquidators are appointed by a resolution of the company's shareholders. Provisional and official liquidators are nominated by the petitioner and appointed by the Grand Court (which may have regard, and give consideration, to any alternative nominations put forward by other stakeholders).

9.4 Interaction of Statutory Officers with Company Management

See **7.1 Types of Statutory Voluntary and Involuntary Insolvency and Liquidation Proceedings** above for a description of how statutory officers interact with company management and directors.

9.5 Restrictions on Serving as a Statutory Officer

As to who can and cannot serve as a statutory officer, see **9.1 Types of Statutory Officers Appointed in Proceedings** above.

10. Advisers and Their Roles

10.1 Types of Professional Advisers

Voluntary liquidators often do not retain attorneys or other professionally qualified persons but they may do so if they deem it necessary.

The power of provisional and official liquidators to retain lawyers and other professionally qualified persons is only exercisable with the sanction of the Grand Court. Cayman Islands attorneys will always be retained by provisional and official liquidators to assist them with various aspects of the liquidation process. Foreign counsel may also be retained as necessary. Financial advisers are commonly retained by provisional liquidators who have been appointed for the purpose of a restructuring. They are less commonly retained by official liquidators, although this is possible with Grand Court approval.

Professionals are retained by the liquidators at the expense of the liquidation estate. As noted above, Grand Court approval is required before professionals can be appointed by provisional or official liquidators. In many cases, the Grand Court will leave the terms of the professionals' remuneration to be negotiated by the liquidators, but a liquidator would be

unlikely in practice to agree to any professional being remunerated on a basis other than time spent, without seeking the express approval of the alternative fee basis from the Grand Court. The reasonableness of the fees charged by Cayman and foreign counsel to the liquidators can be taxed (assessed) by the Grand Court.

10.2 Authorisations Required for Professional Advisers

See **10.1 Types of Professional Advisers** above.

Professional advisers owe duties/responsibilities to the liquidation estate, on whose behalf they have been retained by the liquidators.

10.3 Roles Typically Played by the Various Professional Advisers

See **10.1 Types of Professional Advisers** above.

11. Mediations/Arbitrations

11.1 Use of Arbitration/Mediation in Restructuring/Insolvency Matters

It is very rare for arbitration or mediation to be used in the context of restructuring/insolvency matters in the Caymans. In general, the Grand Court regards formal insolvency processes (such as the granting of winding-up orders) as "non-arbitral" because they amount to "class remedies" rather than a resolution of private rights. Recently, however, the Cayman Islands Court of Appeal has given effect to an arbitration clause between liquidators and a third party in the context of an application to release a reserve which had been made for disputed claims (including attorneys' fees) prior to making an interim distribution to creditors. In Deutsche Bank v Krys, as official liquidator of the SPhinX Group (2016 CICA J0202-1), the Court of Appeal stayed a summons which had been issued by creditors of the company in liquidation seeking the release of part of a reserve made by the liquidator, in order that an arbitration could take place between the liquidator and his former attorneys concerning the remuneration of those attorneys, pursuant to an arbitration clause in the engagement letter. Since the application to release the reserve depended on the answer to a question that had been agreed to be referred to arbitration, the Court of Appeal upheld the judge's decision to stay the application. In so doing, the Court of Appeal followed the English line of authority, commencing with Fulham Football Club v Richards (2012 CH 333).

11.2 Parties' Attitude to Arbitration/Mediation

At present, arbitration and mediation are not commonly-adopted dispute resolution processes in the Cayman Islands, although they do occur and their use is growing.

11.3 Mandatory Arbitration or Mediation

The Grand Court does not have power to mandate arbitration or mediation in any proceedings.

11.4 Pre-insolvency Agreements to Arbitrate

As noted above in **11.1 Use of Arbitration/Mediation in Restructuring/Insolvency Matters**, arbitration clauses contained in contracts which pre-existed the insolvency proceedings should be upheld, unless they infringe on a "class remedy". This principle was recently endorsed by the decision of the Grand Court in BDO Cayman v Argyle Funds SPC Inc, in official liquidation (unrep 13 February 2018), in which the Grand Court issued an anti-suit injunction to stay proceedings in New York which had been brought by the fund against its auditors in breach of an arbitration clause in the original engagement letters.

A party seeking arbitration would be required to apply to the Grand Court under Section 97 of the Companies Law for permission to commence or continue those proceedings, which are subject to an automatic stay once the company is wound up or placed into provisional liquidation.

11.5 Statutes That Govern Arbitrations and Mediations

There are a number of statutes governing arbitration, and the enforcement of arbitration awards. The Arbitration Law 2012 is in force and largely based on the UNCITRAL Model rules. Enforcement proceedings are based on the New York Convention, provisions of which have been incorporated into the Arbitration Law and the Foreign Arbitral Awards Enforcement Law (1997 Revision).

There is currently no legislation governing mediation; court rules have recently been introduced to support mediation in family law proceedings, and it is expected that these will slowly be extended.

11.6 Appointment of Arbitrators/Mediators

Parties to an arbitration clause are free to choose the method adopted for selection of an arbitral tribunal. The Arbitration Law 2012 provides a default mechanism in the absence of agreement which can lead to the Grand Court (as appointing authority) selecting the tribunal.

As mediation is still essentially an ad hoc process in the Cayman Islands, the parties must agree to the appointment of a mediator or mediators between themselves.

There are no restrictions as to who may serve as arbitrator/mediator. However, the Cayman Islands Association of Mediators and Arbitrators has been established in order to provide a locally-based hub for qualified mediators and arbitrators, and an informal chapter of the Chartered Institute of Arbitrators is also available.

12. Duties and Personal Liability of Directors and Officers of Financially Troubled Companies

12.1 Duties of Officers and Directors of a Financially Distressed or Insolvent Company

As a general principle of Cayman Islands law, directors' duties are owed to the company, rather than directly to shareholders or creditors. A number of duties might be engaged in circumstances of financial difficulty, but the fiduciary duty to act in the best interests of the company will always be relevant. What is meant by the best interests of the company in times of financial difficulty was considered in Prospect Properties v McNeill (1990-91 CILR 171). In Prospect Properties the Grand Court, following the well-known line of English authorities, held that where a company is insolvent or of doubtful solvency, the directors' duty to act in the best interests of the company requires them to have regard for the interests of its creditors. It is in the interest of the creditors to be paid, and it is in the interest of the company to be safeguarded against being put in a position where it is unable to pay. Although there is no point prescribed by statute at which a company must enter a restructuring or insolvency process, directors can be made personally liable to the company for any losses which they cause to the company if they act in breach of that duty; an example of this might be incurring additional liabilities when they knew, or should have known, that there was no reasonable prospect of the company avoiding insolvent liquidation.

12.2 Direct Fiduciary Breach Claims

A creditor could only bring a claim directly against the directors if the directors had voluntarily assumed a direct duty to the creditor. Once the company has entered into official liquidation, claims against a company's directors for breach of their fiduciary duty to the company would be pursued by the liquidator in the name of the company. Note that it is common for the articles of association of Cayman Islands companies to indemnify and hold directors harmless in respect of liability for non-intentional wrongdoing.

12.3 Chief Restructuring Officers

The appointment of a Chief Restructuring Officer is not something that typically occurs in the Cayman Islands.

12.4 Shadow Directorship

A shadow director is defined under the Companies Law as being *"any person in accordance with whose directions or instructions the directors of the company are accustomed to act, but the person is not deemed to be a shadow director by reason only that the directors act on advice given by that person in a professional capacity"*. Certain provisions of the Companies Law are expressly stated to apply to shadow directors, including those sections which deal with fraud committed prior to the commencement of a company's liquidation, misconduct in the course of the winding-up, and the production of the company's statement of affairs.

12.5 Owner/Shareholder Liability

A Cayman company is a legal entity that is separate from, and distinct from, the individual members of the company. The court will only lift the "corporate veil" in exceptional circumstances where it is shown that it is a mere facade concealing the true facts. The doctrine of piercing the corporate veil will generally only be invoked where a person is under an existing legal obligation or liability, or subject to an existing legal restriction which he or she deliberately evades or the enforcement of which he or she deliberately frustrates by interposing a company under his or her control, eg, see Prest v Petrodel Resources Ltd, 2013, UKSC 34 at (35).

13. Transfers/Transactions That May Be Set Aside

13.1 Grounds to Set Aside/Annul Transactions

The principal applicable statutory provisions are sections 99 (avoidance of property dispositions), 145 (voidable preference), 146 (avoidance of dispositions at an undervalue) and 147 (fraudulent trading) of the Companies Law.

Section 99 (avoidance of property dispositions) provides that any dispositions of a company's property (or transfers of its shares) made after the deemed commencement of the winding-up will be void in the event that a winding-up order is subsequently made, unless validated by the Grand Court. The liquidator is entitled to apply for appropriate relief to require the repayment of the funds or the return of the asset.

Pursuant to Section 145 (voidable preference), any payment or disposal of property to a creditor constitutes a voidable preference if:

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

A payment or disposition is deemed to have been made to give the creditor preference where the creditor has the ability to control the company or exercise significant influence over it in making financial and operating decisions.

If a payment or disposition is set aside as a preference then it is void and the creditor will be required, on application by the liquidator, to return the payment or asset and prove (claim) the amount of its claim in the liquidation.

Section 146 (avoidance of dispositions at an undervalue) provides that 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 the application of the liquidator. This is subject to the application being brought within six years of the disposal. If a transferee has not acted in bad faith then, although the disposition will be set aside, the transferee's pre-existing rights and claims will be preserved, and it will be entitled to a charge over the property securing the amount of costs which it properly incurs defending the proceedings.

If the business of a company was carried on with intent to defraud creditors or for any fraudulent purpose then, pursuant to Section 147 (fraudulent trading), a liquidator may apply for an order requiring any persons who were knowingly parties to such conduct to make such contributions to the company's assets as the court thinks proper.

Lastly, transactions made by a company in financial difficulty and in breach of the directors' fiduciary duties may also be vulnerable to claims based on dishonest assistance or knowing receipt.

13.2 Look-back Period

An application to set aside a transaction at an undervalue must be brought within six years of the relevant disposal.

To constitute a voidable preference, a payment or disposal of property to a creditor must have occurred in the six months before the deemed commencement of the company's liquidation.

13.3 Claims to Set Aside or Annul Transactions

The proper plaintiff in proceedings to recover property or obtain reimbursement for the benefit of a company in liquidation is the company itself, acting through its liquidators - see for eg, In the Matter of Freerider Limited (2010 (2) CILR N10), applying dicta of Chadwick J in Ayala Holdings Ltd (1993 BCLC 256).

The claims referred to above (which arise pursuant to provisions of the Companies Law) can only be brought by an official liquidator.

However, outside a formal liquidation, any creditor of a company may apply, pursuant to the Fraudulent Dispositions Law (1996 Revision), for a declaration that a disposition is void if it was made at an undervalue with the intention to defraud the company's creditors.

14. Intercompany Issues

14.1 Intercompany Claims and Obligations

Intercompany claims are treated in the same way that any third party claims would be.

14.2 Off-set, Set-off or Reduction

See **7.1 Types of Statutory Voluntary and Involuntary Insolvency and Liquidation Proceedings** and **14.1 Intercompany Claims and Obligations** above.

14.3 Priority Accorded Unsecured Intercompany Claims and Liabilities

See **14.1 Intercompany Claims and Obligations** above.

14.4 Subordination to the Rights of Third-party Creditors

See **14.1 Intercompany Claims and Obligations** above.

14.5 Liability of Parent Entities

In the absence of any valid contractual agreements (such as a guarantee), parent entities are not liable for the liabilities and obligations of their direct or indirect subsidiaries.

14.6 Precedents or Legal Doctrines That Allow Creditors to Ignore Legal Entity Decisions

It is a fundamental principle of Cayman Islands law that each company in a group is a separate legal entity possessed of separate legal rights and liabilities. See **14.5 Liability of Parent Entities** above.

14.7 Duties of Parent Companies

Unless a parent company has entered into a valid contractual agreement (such as a guarantee) with its subsidiaries or its subsidiaries' creditors, no such duties arise as a matter of Cayman Islands law.

14.8 Ability of Parent Company to Retain Ownership/Control of Subsidiaries

The parent company will retain ownership of its insolvent subsidiary during the subsidiary's restructuring or insolvency process, but the subsidiary will be controlled during the process by the liquidators and the Grand Court. As noted in **7.1 Types of Statutory Voluntary and Involuntary Insolvency and Liquidation Proceedings** above, the directors of the subsidiary may also retain some control in a "light touch" provisional liquidation restructuring process.

15. Trading Debt and Debt Securities

15.1 Limitations on Non-banks or Foreign Institutions

There are no provisions under Cayman Islands law which operate to restrict non-banks or other foreign institutions from holding loans, bonds or other debt securities in the Cayman Islands. However, with respect to the issuer of the debt securities, it is worth noting that:

- under Section 175 of the Companies Law, if the debt issuer is a Cayman Islands-exempted company, it will be prohibited from making any invitation to the public in the

Cayman Islands to subscribe for its securities (including debt securities), unless such issuer is listed on the Cayman Islands Stock Exchange (the CSX); and
- if the debt issuer is not incorporated or established in the Cayman Islands, it will be permitted to market and sell its debt securities to investors established in, or operating out of, the Cayman Islands, subject to the proviso that if those activities result in the debt issuer being considered to have established a place of business or commenced carrying on business in the Cayman Islands, the debt issuer will need to register as a foreign company in the Cayman Islands and may be subject to certain licensing laws in the Cayman Islands.

It is possible (for both Cayman and non-Cayman issuers) to list certain debt securities on the CSX. The relevant rules of the CSX applicable to such listing will depend on the nature of the debt securities being listed.

15.2 Debt Trading Practices

Both the sale of one or more participations in a loan and the on-sale of a loan to a Cayman Islands company are relatively commonplace.

However, due to the nature of international finance transactions involving Cayman Islands borrowers and issuers, these arrangements are almost exclusively governed by the laws of a foreign jurisdiction (most typically, English law, New York law or California law). The sale, transfer or participation of such loans will be governed by the same law as that of the underlying credit agreement. In such cases, whether customary forms of documentation are used (such as LMA or LSTA forms) will depend on the practice in the jurisdiction of the underlying governing law. There are no trade association standardised terms for Cayman Islands law-governed debt documents.

There are certain offences contained in the Cayman Islands Securities Investment Business Law (as revised) of creating a false or misleading market, and insider dealing. These offences are relevant in relation to any dealings involving the CSX or securities listed on the CSX.

The following debt-trading analysis would apply to on-sale and participation transactions where the debt obligations are governed by Cayman Islands law.

Sale

If a loan is to be sold, the purchasing lender would step into the selling lender's shoes under a transfer or novation agreement to be entered into by the existing lender, the new lender and, in certain cases, the borrower (or an obligor's agent appointed under the credit agreement). The transfer or novation agreement would provide that the selling lender is released from all its obligations and liabilities under the credit agreement, with the purchasing lender assuming such obligations and liabilities, together with all the rights and benefits of the existing lender, each from a specified effective date. The effective date could be the date of execution of the transfer or novation agreement, or it could be the date of satisfaction of any conditions precedent to the transfer.

If no security agent or trustee has been appointed to hold collateral for all the lenders, and the collateral is held directly by the selling lender (which would typically only be the case in small bilateral credit agreements), any related security interests would either vest automatically for the benefit of the purchasing lender (if the relevant security documentation provides for this) or would otherwise need to be released (with new security then being granted in favour of the purchasing lender). In these circumstances, the potential for restarting hardening periods for such security should be considered by the new lender when considering the acquisition of the loan.

Participation

In a participation structure, the lender of record that is party to the credit agreement is able to transfer the risk associated with the loan to a third party. Such participations can be:

- funded (where the sub-participant reimburses the lender of record for its agreed participation in the loan together with any related costs, expenses and indemnity payments); or
- risk-based (where the sub-participant agrees only to reimburse the lender of record for a certain percentage of any monies not paid by the borrower under the credit agreement).

Any security interests granted directly to the lender of record in any participated structure should remain unaffected.

There is no law, regulation or practice in the Cayman Islands which would restrict the ability of participants to enter into "Big-Boy Letters" or otherwise trade on an agreed basis of inequality of information.

15.3 Loan Market Guidelines

No such guidelines are applicable to the trading of private loans as a matter of Cayman Islands law. However, these issues may be impacted by, among other things, internal lending policies. It is also worth noting that the use of bank loan proceeds by a debtor is generally not regulated under Cayman Islands law.

However, if bank loan proceeds, or any property received or disposed of by a debtor in connection with the use of bank loan proceeds, constitutes or will constitute criminal property, as defined in the Cayman Islands Proceeds of Crime Law (as revised), or terrorist property, as defined in the Cayman Islands Terrorism Law (as revised), then an offence may be committed under Cayman Islands law pursuant to such legislation.

15.4 Enforcement of Guidelines
As mentioned in **15.3 Loan Market Guidelines** above, no such guidelines apply in the Cayman Islands.

15.5 Transfer Prohibition
As mentioned in **15.2 Debt Trading Practices** above, due to the nature of international finance transactions involving Cayman Islands borrowers and issuers, these arrangements are almost exclusively governed by the laws of a foreign jurisdiction (most typically, English law, New York law or California law).

For credit agreements governed by Cayman Islands law, the extent of any transfer rights and restrictions will be a negotiated position and, as such, the relative strength of each party's negotiating position will be relevant.

15.6 Navigating Transfer Restrictions
There are no issues with using trusts or synthetic structures to navigate transfer restrictions, as a matter of Cayman Islands law.

16. The Importance of Valuations in the Restructuring and Insolvency Process

16.1 Role of Valuations in the Restructuring and Insolvency Market
Valuations are often required in the restructuring and insolvency process in the Cayman Islands. Valuations may, for example, be relevant in relation to:

- valuing assets for the purpose of preparing a liquidation analysis as the relevant comparator in a restructuring;
- valuing claims of stakeholders with regards to a scheme of arrangement to ensure that the statutory majorities have been passed (see **6.1 The Statutory Process for Reaching and Effectuating a Financial Restructuring/Reorganisation** above, and Re Hawk Insurance Company Ltd (2001 EWCA Civ 241);
- valuing assets to be sold by a liquidator; or
- valuing offers to purchase a petitioner's shares in the context of winding-up proceedings (see O'Neill and Another v Phillips and Others (1999, 1 WLR 1092).

Campbells
Floor 4, Willow House, Cricket Square
George Town
Grand Cayman KY1-9010
Cayman Islands

Tel: +1 345 949 2648
Fax: +1 345 949 8613
Email: jwolf@campbellslegal.com
Web: www.campbellslegal.com

Valuations are not relevant in relation to the test for insolvency, as this is not a balance sheet test but a cash flow test which only takes into account debts that are due and payable by the company presently or in the reasonably near future.

16.2 Initiating Valuation
Valuations would typically be initiated by an office holder in relation to assets of the company over which they are appointed, but this would depend on the circumstances of the case.

16.3 Jurisprudence Related to Valuations
There is relatively little Cayman Islands valuation jurisprudence in a restructuring and insolvency context, but the Grand Court would be likely to follow such jurisprudence from, for example, the English courts. There have, however, been a number of recent Grand Court decisions concerning valuations of companies in the context of fair-value proceedings, commenced to determine the value of shares held by dissenting shareholders in a statutory merger procedure. These decisions would be relevant to the valuation of companies in a restructuring and insolvency context.

There are various valuation experts in the Cayman Islands who are regularly retained to give expert evidence on the valuation of a variety of asset types, but onshore valuation experts are also frequently used.

The result obtained from a sales/marketing process would form a critical part of the valuation evidence in most insolvency cases and is typically considered to be a more reliable indication of market value than a desktop valuation. Liquidators will sometimes seek the Grand Court's approval of any proposed bidding process.

Office holders and experts would generally tend to rely on multiple valuation methods to determine the valuation range of a particular asset. In a restructuring context, the Grand Court will require expert evidence in connection with the relevant comparator to the scheme, which is typically the estimated outcome of an insolvent liquidation of the company.