



# The Legal 500 Country Comparative Guides

## Cayman Islands: Restructuring & Insolvency

This country-specific Q&A provides an overview to restructuring & insolvency laws and regulations that may occur in Cayman Islands.

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1. **What forms of security can be granted over immovable and movable property? What formalities are required and what is the impact if such formalities are not complied with?**

The most common types of security are:

**Mortgage.** A mortgage is a transfer of an interest in a property subject to redemption rights. Historically, a mortgage required a transfer of the property that was subject to the mortgage. However, currently a transfer is not always required. Where a property is the subject of a mortgage but is not transferred to the lender, an equitable mortgage is created which can be defeated by a third party buyer with no notice of the lender's interest.

**Charge.** A charge conveys nothing and merely gives the person entitled to the charge certain rights over the property as security for debt. A charge given by a company over its assets is generally created by debenture. It is also possible to take fixed or floating charges over assets held by a company borrower:

**Fixed charges.** These are attached to specified assets which then cannot be disposed of by the borrower;

**Floating charges.** These can be used when the borrower holds a number of assets which it needs to be able to deal with freely (for example, shares in a portfolio and trading stock). The borrower can deal with those assets despite the charge. On default, the charge crystallises over the assets that are held by the borrower at the time of default. The charge then becomes a fixed charge, entitling the creditor to sell the assets to recover the amount owed.

**Lien.** A lien can be used when a creditor has lawful possession of an asset and monies are due to the creditor for services provided. For example, where a repairer has possession of property to repair it, he is automatically entitled to keep possession until the account is paid. A lien arises by operation of law based on lawful possession. If possession is relinquished, so is the lien. No rights in the property are created in the creditor's favour. Therefore, the retained property cannot be sold to obtain funds for payment of the debt.

**Pledge.** In a contract to pawn or pledge, goods are deposited as security for the debt and the right to the property vests in the creditor to the extent necessary to secure the debt. The creditor can sell the goods if the borrower defaults on its obligations.

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

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

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

### **Effects of non-compliance.**

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

1. the security will not be binding on the company; and/or
2. a third party will acquire the asset free of the creditor's security interest or acquire a higher ranking security interest over the asset.

### **2. What practical issues do secured creditors face in enforcing their security (e.g. timing issues, requirement for court involvement)?**

A legal mortgage can be enforced by the appointment of a receiver, exercising the power of sale, foreclosure or enforcing an immediate right to possession. An equitable mortgage does not confer a right to possession and so an application to court will normally be required. A pledge can be enforced by exercising the power of sale.

Section 142 of the Companies Law (2020 Revision) (**the "Law"**) and Order 17 of the Companies Winding-up Rules, 2018 ("**CWR**") 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 on the enforcement of security, although the secured creditor's exercise of its rights would be subject to the applicable terms of any inter-creditor agreement entered into by the secured creditor.

### **3. What is the test for insolvency? Is there any obligation on directors or officers of the debtor to open insolvency procedures upon the debtor becoming distressed or**

## **insolvent? Are there any consequences for failure to do so?**

The test of insolvency in the Cayman Islands is a cash-flow test. The company's balance sheet is irrelevant in this context. Based on earlier authorities, the cash-flow test in the Cayman Islands was generally regarded as being confined to debts which were presently due and payable. However, in *Conway and Walker (as joint official liquidators of Weaving 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. Although the case was subsequently appealed to the Privy Council, the Privy Council did not provide guidance on this point, as it found that it did not need to decide what future debts should be taken into account by the courts in the test for insolvency.

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-established 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 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.

#### **4. What insolvency procedures are available in the jurisdiction? Does management continue to operate the business and/or is the debtor subject to supervision? What roles do the court and other stakeholders play? How long does the process usually take to complete?**

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 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 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. The official liquidators must be qualified insolvency practitioners under Cayman Islands law. Voluntary liquidators will therefore be replaced if they are not qualified insolvency practitioners or if their appointment as official liquidators is successfully opposed on other grounds.

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 Law, following the presentation of a winding-up petition.

Applications by creditors, shareholders or the Cayman Islands Monetary Authority ("**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 considered 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.

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 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 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 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;
- 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 **Question 3** 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 creditors' views on whether a winding-up order should be made and who should be appointed may 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.

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.

**5. How do creditors and other stakeholders rank on an insolvency of a debtor? Do any stakeholders enjoy particular priority (e.g. employees, pension liabilities)? Could the claims of any class of creditor be subordinated (e.g. equitable subordination)?**

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; and 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 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.

**6. Can a debtor's pre-insolvency transactions be challenged? If so, by whom, when and on what grounds? What is the effect of a successful challenge and how are the rights of third parties impacted?**

The principal 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 Law. These sections only apply in official liquidations.

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 a 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 a preference then the liquidators may bring a proprietary claim to recover the asset or its proceeds (where identifiable) or a personal claim in unjust enrichment to recover the amount of the payment or value of the asset. Upon making payment or returning the asset the creditor may file a proof of debt for the amount of its claim in the liquidation and will rank *pari passu* with the other unsecured creditors.

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.

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.

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

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.

Claims to set aside or annul transactions must be brought in the name of the company (acting by its liquidators) or in certain cases in the names of the official liquidators.

Creditors cannot bring claims on behalf of a company in a liquidation. However, outside 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.

7. **What form of stay or moratorium applies in insolvency proceedings against the continuation of legal proceedings or the enforcement of creditors' claims? Does that stay or moratorium have extraterritorial effect? In what circumstances may creditors benefit from any exceptions to such stay or moratorium?**

### **Voluntary Liquidation**

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.

### **Provisional Liquidation**

On the appointment of provisional liquidators, a statutory stay automatically takes effect pursuant to Section 97 of the 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.

### **Official Liquidation**

At any time between the presentation of a winding-up petition and the making of a winding-up order the company or any creditor or 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. The stay does not prohibit secured creditors from enforcing their security.

The moratoria described above are deemed to have extraterritorial effect under Cayman law, however, in order for that to take effect outside of the Cayman Islands in practice, the liquidators will usually need to apply for recognition and enforcement of the stay in the Courts of any relevant foreign jurisdiction, if that is possible in accordance with the law of that jurisdiction.

There are generally two principal categories into which cases where the Courts have granted leave to commence or continue proceedings against a company in liquidation fall: (1) cases where there is a proprietary claim; and (2) cases where the balance of convenience favours the lifting of the stay.

**8. What restructuring and rescue procedures are available in the jurisdiction, what are the entry requirements and how is a restructuring plan approved and implemented? Does management continue to operate the business and/or is the debtor subject to supervision? What roles do the court and other stakeholders play?**

The principal restructuring tool in the Cayman Islands is the scheme of arrangement under Section 86 of the 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 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.

No moratorium is available if the scheme is initiated when the company is not in liquidation. If a moratorium is required during the scheme process then the company will need to present a winding-up petition and apply for an order appointing provisional liquidators prior to filing the scheme petition. 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 directors remain in control of the company if the scheme is proposed outside of liquidation. Assuming that they are to be included in the scheme, employees will be treated in the same way as other creditors for determining whether or not they form part of a separate class.

If the scheme is promoted within a provisional liquidation then the management of the scheme process will depend on the terms of the order appointing the provisional liquidators. In some cases, the provisional liquidators will only be given the powers necessary to supervise the directors' promotion and implementation of the scheme. In other cases, the provisional liquidators will displace the directors entirely for the duration of the restructuring. In either case, the provisional liquidators will be subject to the Court's supervision, and the Court's involvement in the scheme process will be the same irrespective of whether the company is in provisional liquidation.

The Court takes an active role in administering, supervising and managing a scheme. It will order the convening of the scheme meetings and ultimately sanction the scheme.

**9. Can a debtor in restructuring proceedings obtain new financing and are any special priorities afforded to such financing (if available)?**

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.

**10. Can a restructuring proceeding release claims against non-debtor parties (e.g. guarantees granted by parent entities, claims against directors of the debtor), and, if so, in what circumstances?**

In certain circumstances, a scheme 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].

**11. Is it common for creditor committees to be formed in restructuring proceedings and what powers or responsibilities do they have? Are they permitted to retain advisers and, if so, how are they funded?**

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.

**12. How are existing contracts treated in restructuring and insolvency processes? Are the parties obliged to continue to perform their obligations? Will termination, retention of title and set-off provisions in these contracts remain enforceable? Is there any ability for either party to disclaim the contract?**

Other than contracts of employment (in respect of which, see below), the winding up process *per se* will not have any effect on contracts unless there is a specific contractual provision to that effect. Retention of title provisions remain enforceable. Further, liquidators have no statutory power to disclaim onerous contracts under Cayman law. The parties are therefore obliged to perform their outstanding obligations, although in practice a liquidator might elect not to do so and instead to adjudicate whatever claim the contractual counterparty seeks to prove in the liquidation as a result of the breach. Liquidators are required to give effect to any contractual rights of set-off or netting of claims between the company and any persons, subject to any agreement to waive or limit such rights. In the absence of any set-off provision, account must be taken of what is due from each party to the other in respect of their mutual dealings, and set-off is applied in relation to those amounts.

A voluntary or provisional liquidation would have no legal effect on employees save to the extent, if any, provided for in their employment agreement. Under the common law, a winding up order serves to terminate all contracts of employment of the company in official liquidation.

Outside a provisional liquidation, the impact of a scheme on existing contracts, and whether the parties will be obliged to perform outstanding obligations under those contracts or whether they will be terminated, will depend on the terms of the scheme (in particular the extent to which it purports to compromise rights under those contracts) and the terms of the contracts.

**13. What conditions apply to the sale of assets / the entire business in a restructuring or insolvency process? Does the purchaser acquire the assets “free and clear” of claims and liabilities? Can security be released without creditor consent? Is credit bidding permitted? Are pre-packaged sales possible?**

There is no statutory process for the sale of assets in liquidation, but the liquidator has a common law duty to obtain the best price available in the circumstances. Within a liquidation, the sale of a company's assets (or the business itself) is effected by the liquidator and all contractual agreements relating to the sale will need to be executed by the company acting by its liquidator (as agent of the company and 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, such that any existing proprietary claims by third parties would continue to be enforceable. Liquidators also cannot release any security without the consent of the secured creditor.

**14. What duties and liabilities should directors and officers be mindful of when**

**managing a distressed debtor? What are the consequences of breach of duty? Is there any scope for other parties (e.g. director, partner, shareholder, lender) to incur liability for the debts of an insolvent debtor?**

See **Question 3** above. Case law recognises the difficulty in determining the precise point at which the directors' duties will shift from the company's shareholders to its creditors. In English case law, this point has been expressed in several different ways, but what is clear is that directors' fiduciary duties to a company's creditors will arise *prior* to the actual point of technical insolvency. This realm of doubtful solvency may be commonly referred to as the "zone of insolvency", in line with the US law concept.

Depending on the circumstances, directors, partners, parent entities (domestic or foreign) and other third parties can all be held liable for an insolvent debtor's debts. If the debtor entity is a partnership then its partners may be liable for the partnership's debts. Further, parties (such as other group entities) may be liable for the debtor's debts pursuant to any contractual agreements that had been entered into. Third parties may enter into guarantee agreements pursuant to which they would assume liability for some or all of the debtor entity's debts. Directors could be liable for the company's debts for a number of reasons, including:

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

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

**Common law or equitable duties.** As set out above, a director has a duty to act in the best interests of the company at all times. If a director acts in breach of his fiduciary duties to the company he is liable to the company for damages in relation to that breach. Damages are assessed by reference to the loss that the company has suffered as a result of the breach.

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

However, 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.

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.

15. **Do restructuring or insolvency proceedings have the effect of releasing directors and other stakeholders from liability for previous actions and decisions?**

Liquidation proceedings do not affect the existing liability of directors and stakeholders for their previous actions and decisions, although it is possible for a Cayman scheme to include releases for directors and other stakeholders where the releases include the necessary element of “*give and take*” between the parties (*Re Sphinx* [2014 (2) CILR 132]).

16. **Will a local court recognise concurrent foreign restructuring or insolvency proceedings over a local debtor? What is the process and test for achieving such recognition? Has the UNCITRAL Model Law on Cross Border Insolvency or the UNCITRAL Model Law on Recognition and Enforcement of Insolvency-Related Judgments been adopted or is it under consideration in your country?**

The Cayman Islands has not adopted the UNCITRAL Model Law. Accordingly, a foreign insolvency or restructuring proceeding of a Cayman Islands incorporated company or any resulting stay on proceedings will not be recognised by the Cayman Islands Court other than in exceptional circumstances. Further, the Cayman Islands are not a signatory to any international treaties relating to bankruptcy or insolvency.

However, there are two main set of guidelines (“**Guidelines**”) for court to court communications and cooperation which may be used and adopted in cases pending before the Grand Court where the insolvency or restructuring proceedings are being supervised by, or involve related applications to, courts in more than one jurisdiction: the American Law Institute/International Institute Guidelines Applicable to Court-to-Court Communications in Cross-Border Cases (known as the “**American Guidelines**”) and The Judicial Insolvency Network Guidelines for Communication and Cooperation between Courts in Courts in Cross-Border Insolvency Matters (known as the “**JIN Guidelines**”).

The Guidelines cover communications between the courts involved, the appearance of counsel in each court, notification to parties in parallel proceedings, the acceptance of official documents or orders made in the foreign jurisdiction or court and joint hearings. The Guidelines are to be applied either by being incorporated in a protocol between the respective officeholders which is then approved by the Grand Court and the applicable foreign court or authority or by a separate order of the Grand Court and the applicable foreign court without a protocol. In addition, a practice direction requires Cayman Islands-appointed officeholders to consider, at the earliest opportunity, whether to incorporate some or all of the Guidelines with suitable modification either into:

- an international protocol to be approved by the court; or
- by an order of the court adopting the guidelines.

Order 21 of the CWR also deals with international protocols in relation to Cayman companies in liquidation which are the subject of concurrent bankruptcy proceedings under the law of a foreign country or where the assets of a Cayman company in liquidation located in a foreign country are the subject of a foreign bankruptcy proceeding or receivership. Order 21 obliges Cayman Islands Official Liquidators to consider whether or not it is appropriate to enter into an international protocol with a foreign officeholder and provides for such a protocol to be approved by the Cayman and foreign courts.

**17. Can debtors incorporated elsewhere enter into restructuring or insolvency proceedings in the jurisdiction?**

Winding-up petitions and provisional liquidation applications may be presented against foreign companies which:

1. carry on business or have property located in the Cayman Islands;
2. are the general partner of a limited partnership registered in the Cayman Islands; or
3. are registered as foreign companies under Part IX of the Law.

In addition, the Grand Court has jurisdiction to sanction a scheme in respect of a company that is liable to be wound up by the Cayman Islands court. The recent restructuring of four companies in the Ocean Rig group shows that the Grand Court has jurisdiction to scheme foreign incorporated companies and that it will do so in appropriate circumstances. The Ocean Rig restructuring is particularly notable as it also involved a pre-filing shift of the scheme companies' centre of main interests from the Marshall Islands to the Cayman Islands (where the companies had no longstanding connections) in order to ensure that recognition of the scheme and the associated Cayman provisional liquidations was obtained in the United States Bankruptcy Court. Cayman Islands schemes of arrangement can be used to compromise the domestic and foreign debt of both Cayman Islands and non-Cayman Islands entities.

**18. How are groups of companies treated on the restructuring or insolvency of one of more members of that group? Is there scope for cooperation between office holders?**

Concurrent liquidation proceedings in respect of several group companies can be coordinated by the Grand Court to avoid duplication and improve efficiency and cost effectiveness. Further, the Grand Court has indicated that, in appropriate circumstances where no conflict exists, it would be preferable for the same official liquidators to be appointed over both Master and Feeder funds in the same structure. In certain circumstances the Grand Court may order the pooling of assets and liabilities of group companies, but this is rare in practice.

**19. Is it a debtor or creditor friendly jurisdiction?**

The Cayman Islands has traditionally been regarded as a creditor-friendly jurisdiction and that remains the case. Creditors (of the same class) are treated equally irrespective of where they are domiciled.

**20. Do sociopolitical factors give additional influence to certain stakeholders in restructurings or insolvencies in the jurisdiction (e.g. pressure around employees or pensions)? What role does the state play in relation to a distressed business (e.g. availability of state support)?**

There is no state support available to distressed businesses and sociopolitical factors do not generally play any role in restructurings or insolvencies.

**21. What are the greatest barriers to efficient and effective restructurings and insolvencies in the jurisdiction? Are there any proposals for reform to counter any such barriers?**

As a result of conflicting decisions of the Grand Court there is currently a degree of uncertainty about the circumstances in which a company's directors are entitled to present a winding-up petition in respect of certain companies. Given the need for most Cayman restructurings to take place within a provisional liquidation, this issue has also caused some confusion about directors' ability to commence formal restructuring proceedings in certain situations.

Legislative reforms have been proposed with a view to making it easier for directors of distressed Cayman companies to commence restructuring proceedings without first having to obtain shareholder approval, and also to obtain the protection of a statutory moratorium outside a provisional liquidation. 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.