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Insolvency 2021

Cayman Islands: Law & Practice
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CAYMAN ISLANDS

Law and Practice

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1. STATE OF THE RESTRUCTURING MARKET

1.1 Market Trends and Changes

There has been a notable increase in Cayman Islands insolvency and restructuring cases since the advent of COVID-19 and this trend is expected to increase as the effects and consequences of the pandemic continue to develop.

In circumstances where the Cayman Islands borders have essentially remained closed since March 2020, the Cayman courts have implemented various procedural changes to address the challenges of having parties (and judges) being located off-island, and to allow judicial proceedings to continue effectively. Financial Services proceedings – including lengthy trials – are now routinely being conducted via video-conference and a highly effective e-filing system has been introduced.

Grand Court Decisions

At the same time, the Grand Court has often been reluctant to allow parties to gain an advantage from the pandemic where it would be unfair to do so. In one recent case (*Re Obelisk Capital Management Limited* (FSD 93 of 2020 (IKJ), unreported), a petitioner presented a winding-up petition on the basis of an unpaid statutory demand presented in February 2020. The company argued that the restrictions on its business implemented as a result of COVID-19 represented an exceptional circumstance which justified its inability to pay the statutory demand. However, the petitioner was able to show that the relevant restrictions post-dated the date on which payment was in fact due and, accordingly, the court determined that it was appropriate to make a winding-up order.

In *Re GBC Oil Company Limited* (FSD 19 of 2021 (NSJ), unreported) the debtor company sought an adjournment for reasons including difficul-

ties caused by the COVID pandemic and illness, which had delayed its attempts to retain Cayman attorneys and its ability to prepare for the hearing and respond to the winding-up petition. Whilst expressing its sympathy for those suffering from COVID-19 and acknowledging that real difficulties can be caused by COVID-19 restrictions, the Court held that an adjournment will not be granted simply because a party claims in a brief email to be suffering from such difficulties. In *GBC Oil*, the Court declined to adjourn the proceedings having regard to the fact that the company had failed to instruct Cayman counsel (despite being invited by the Judge to do so) and had filed no evidence to substantiate any of the reasons it had put forward for seeking an adjournment.

2. STATUTORY REGIMES GOVERNING RESTRUCTURINGS, REORGANISATIONS, INSOLVENCIES AND LIQUIDATIONS

2.1 Overview of Laws and Statutory Regimes

Corporate insolvency in the Cayman Islands is governed by Part V of the Companies Act (2021 Revision) (the Companies Act) 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 Act and, pursuant to Section 36 of the Exempted Limited Partnership Act (2018 revision), to the winding up of exempted limited partnerships in the Cayman Islands.

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.

Where there is no applicable Cayman Islands case law, the Cayman courts will look to English authorities. Decisions of English courts are not binding, but as a general rule they will be followed to the extent that they are not inconsistent with 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 Restructurings, Reorganisations, Insolvencies 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

If a Cayman company is insolvent or of doubtful solvency, its directors have a fiduciary duty to act with regard to the interests of its creditors. Therefore, in these circumstances they must have regard to whether it is in creditors' interests for insolvency proceedings to be instigated.

Directors also have a duty to commence insolvency proceedings if directed to do so by a resolution of the shareholders or a provision within the company's articles. Failure to commence insolvency proceedings could expose the directors to a liability in damages for losses suffered

by the company as a result of their breach of duty.

The only statutory obligation to commence insolvency proceedings arises when a company goes into voluntary liquidation and directors have not unanimously sworn declarations to the company's solvency within 28 days. In these circumstances, 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.

While the Companies Act does not impose a penalty on a voluntary liquidator for failure to file a petition, it does impose a penalty of up to KYD10,000 (approximately USD12,200) and imprisonment for up to two years on directors who make a declaration of solvency without reasonable grounds.

2.4 Commencing Involuntary Proceedings

Provisional Liquidation

Initiation

Provisional liquidation is available to companies liable to be wound up under the Companies Act, 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 Act (or which existed prior to the enactment of the Companies Act);
- bodies incorporated under any other law; and
- foreign companies which carry on business or have property located in the Cayman Islands, are the general partner of a limited partnership registered in the Cayman Islands, or are registered as foreign companies under Part IX of the Companies Act.

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) the CIMA may apply (usually ex parte) if 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 if 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) the 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 in the company's register of members and have either inherited, 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 under any of the grounds set out in Section 92 of the Companies Act. Most commonly, companies are wound up on the grounds that:

- the company is unable to pay its debts (see **2.5 Requirement for Insolvency**); and
- it is just and equitable for the company to be wound up.

2.5 Requirement for Insolvency

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 **2.4 Commencing Involuntary Proceedings**.

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 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". What constitutes

the “reasonably near future” will be specific to each case.

2.6 Specific Statutory Restructuring and Insolvency Regimes

Although there are no statutory restructuring and insolvency regimes applicable to specific types of entity or business, the CIMA does have the power to appoint controllers (with a wide range of powers) over banks, trust companies, regulated mutual funds and licensed fund administrators.

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 invariably based onshore. As such, their views and preferences on consensual work-outs 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 interact to a significant extent with the viability, desirability or choice of informal and consensual out-of-court restructuring and work-out 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.

As noted in **2.3 Obligation to Commence Formal Insolvency Proceedings**, if a company is

insolvent or of doubtful solvency, its directors have a fiduciary duty to act with regard to the interests of its creditors.

3.2 Consensual Restructuring and Workout Processes

As noted in **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 invariably based onshore. As such, the processes adopted in a consensual restructuring will tend to vary, based on the prevailing processes in the onshore jurisdiction(s) where the majority of the participants are based.

3.3 New Money

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

3.4 Duties on Creditors

Consensual/out of court restructurings in Cayman require the agreement of 100% of creditors; in most circumstances, 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 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 achieved 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 Act. 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 Consensual Restructuring and Workout Processes**.

4. SECURED CREDITOR RIGHTS, REMEDIES AND PRIORITIES

4.1 Liens/Security

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

4.2 Rights and Remedies

Section 142 of the Companies Act 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 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.

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 Special Procedural Protections and Rights

See **4.2 Rights and Remedies**.

5. UNSECURED CREDITOR RIGHTS, REMEDIES AND PRIORITIES

5.1 Differing Rights and Priorities

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 some 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; 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.

Pursuant to Section 140 of the Companies Act, the collection and distribution of the company's assets is without prejudice to:

- any valid subordination agreements between the company and any creditors;
- any contractual rights of set-off or netting of claims between the company and any person or persons; and
- any agreement between the company and any person or persons to waive or limit the aforementioned claims.

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.

Also see **4.2 Rights and Remedies**.

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 company. Whether trade creditors are kept whole during the restructuring will, therefore, typically depend upon any prevailing practice in the applicable onshore jurisdiction and the circumstances of the case.

5.3 Rights and Remedies for Unsecured Creditors

A moratorium on unsecured creditors' claims in a restructuring will only arise if provisional liquidators are appointed. Without this moratorium, unsecured creditors may 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 if the debt were undisputed. Although an unpaid creditor of an insolvent company is entitled to a winding-up order *ex debito justitiae* (as of right), 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 due to proposed restructuring.

If a company is placed into official liquidation, the Grand Court has 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 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.

5.5 Priority Claims in Restructuring and Insolvency Proceedings

See **5.1 Differing Rights and Priorities** and **6.10 Priority New Money**.

6. STATUTORY RESTRUCTURING, REHABILITATION AND REORGANISATION PROCEEDINGS

6.1 Statutory Process for a Financial Restructuring/Reorganisation Scheme of Arrangement

The principal restructuring tool in the Cayman Islands is the scheme of arrangement under Section 86 of the Companies Act. 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, 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 10 to 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 raised and the scheme document, detailed explanatory memorandum, evidence and other documentation are prepared.

Filing a Scheme of Petition

Order 102, Rule 20 of the 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. In broad terms:

- first, there must be an application to the Grand Court for an order convening meetings of creditor/classes of creditors or members/classes 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; and
- third, if approved at the meeting or meetings, there must be a further application to the court to obtain sanction of the scheme – 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 each meeting;
- 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.

The scheme process comes to an end once all compromise or arrangement terms to which it relates have been complied with.

6.2 Position of the Company

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

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

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, an automatic stay prohibits the commencement or continuance of any suit, action or other proceeding against the company without the Grand Court's leave.

6.3 Roles of Creditors

As noted in **6.1 Statutory Process for a Financial Restructuring/Reorganisation**, a scheme must be approved by a majority in number representing at least 75% by value of each class of scheme creditors. The Grand Court considers the class composition of scheme creditors at the 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, 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 sound-

ing 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 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, it is likely that the Grand Court will also require the provisional liquidators to report to the court and the creditors periodically.

6.4 Claims of Dissenting Creditors

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 against a Company

There is no statutory prohibition on the trading of creditor claims, but notice of the assignment must be given to the company.

6.6 Use of a Restructuring Procedure to Reorganise a Corporate Group

A restructuring procedure may be utilised to reorganise a corporate group on a combined basis. 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 a Company's Use of Its Assets

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 those estab-

lished in a contract. If the company is in provisional liquidation, any disposition of assets would be subject to the approval of the Grand Court. 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, 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 any 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 a pre-packaged sale of assets could be arranged. Grand Court approval would be required if the company is in provisional liquidation.

6.9 Secured Creditor Liens and Security Arrangements

Secured creditor liens and security arrangements may be released pursuant to a scheme, but it is very unlikely that secured creditors

and unsecured creditors would be in the same scheme class and, therefore, secured creditors' rights could be crammed down by the votes of unsecured creditors.

6.10 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 Determining the Value of Claims and Creditors

The process is not prescribed by statute, but if there are disputed, contingent or unliquidated claims, the scheme document will include an adjudication mechanism.

6.12 Restructuring or Reorganisation Agreement

As noted in **6.1 Statutory Process for a Financial Restructuring/Reorganisation**, the scheme, as embodied in the scheme document, must be approved by the requisite majorities in each scheme class and sanctioned by the Grand Court, which will not do so unless satisfied as to the fairness of the scheme terms.

6.13 Non-debtor Parties

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 'In the matter of the SPInX Group of Companies' [2010 (1) CILR 452].

6.14 Rights of Set-Off

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.

6.15 Failure to Observe the Terms of Agreements

The implications of a company/creditor failing to observe the terms of a scheme would depend on the particular circumstances.

6.16 Existing Equity Owners

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 Voluntary/Involuntary 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 Act (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, creditors are paid in full and its remaining assets or the proceeds of their realisation are distributed to 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 if the company (through a general meeting) or the voluntary liquidator sanctions the continuance of the directors' powers. The directors may 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 they may apply to the court under Section 129 of the Companies Act to determine any question that arises during the winding-up process.

A voluntary liquidator must apply to the Grand Court within 35 days of the commencement of the voluntary liquidation 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. Even then, the liquidator or any creditor or shareholder can apply to bring the liquidation under the Grand Court's supervision on the grounds of insolvency or on the basis that court supervision will facilitate a more effective, economic or expeditious liquidation.

If a voluntary liquidation is brought under the supervision of the Grand Court, it continues as an official liquidation deemed to have com-

menced 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 so qualified or if their appointment as official liquidators is successfully opposed on other grounds.

Moratorium

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

Claims

There is no statutory set-off or netting-off which applies during voluntary liquidation, nor is there any procedure for adjudicating creditors' actual or contingent claims. The voluntary liquidator is required to pay claims in full. 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, in connection with each annual general meeting and for 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 is typically shorter than an official liquidation.

Conclusion

As soon as the affairs of a company in voluntary liquidation have been fully wound up, the liqui-

dator must call a general meeting of the company to present their account of the voluntary liquidation. The liquidator must file a return with the Registrar of Companies 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 Act, following the presentation of a winding-up petition.

Applications by creditors, shareholders or the 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 (if properly authorised) can 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.

Initiation

Creditors, shareholders or (in respect of regulated businesses) the 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 previously mentioned, the company may, if properly authorised, apply to appoint provisional liquidators on the grounds that the company is, or 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 who, if anyone, 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, 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 Act. 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.

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. 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 provisional 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 assets pending the hearing of a winding-up petition, 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 viability. If it does not appear viable, the company will typically be wound up at that first hearing. If it appears that a restructuring may indeed be viable, the Grand Court will typically adjourn the petition for one or more fixed periods to allow the restructuring to proceed.

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 with-

drawing the winding-up petition (in which case, the company continues to exist).

The court can order an earlier termination of the provisional liquidator's appointment either on application by the provisional liquidator, the petitioner, the company or 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 Act (or predecessor laws);
- bodies incorporated under any other law; and
- certain foreign companies.

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 a registered shareholder for at least six months.

CIMA may 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 **2.5 Requirement for Insolvency**).

If the debt claimed in the demand is disputed by the company in good faith and on substantial grounds, 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 may be taken into account by the Court.

Supervision and control

Official liquidators must be a qualified insolvency practitioner 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

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.

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.

Claims

Creditors (including contingent creditors) claim in an official liquidation by submitting a "proof of debt" for adjudication by the official liquidator who has a duty to ascertain the liabilities of the company. 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 (in full or in part) or rejecting the claim. When adjudicating claims, the liquidator acts in a quasi-judicial function.

A creditor has a right of appeal to the Grand Court against the rejection or partial rejection of its proof of debt. In addition, other creditors (or the liquidator themselves) 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 are admissible. Official liquidators are required to make a just estimate, so far as is possible, of the value of all such debts or claims which are contingent or otherwise of uncertain value.

The collection and application of the property of the company is without prejudice to:

- the rights of preferred and secured creditors (and to any agreement between the company and any creditors);
- any contractual rights of set-off or netting of claims between the company and any person or persons; and
- any agreement between the company and any person or persons to waive or limit those claims.

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 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 and complex liquidations can take several years.

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

Upon the making of a winding-up order, the custody and control of all the property and choses in action of the company are transferred to the liquidators charged with the statutory duty of dealing with the company's assets in accordance with the statutory scheme. All powers of dealing with the company's assets are exercisable by the liquidator alone. In a provisional or official liquidation, the power to sell the company's property may only be exercised by liquidators with the sanction of the Grand Court.

A purchaser would only obtain such a right, title and interest in any assets sold as the company itself holds, and the liquidator would be unlikely to give any representations or warranties as to the title of such assets.

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

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 and the liquidator must demonstrate that the sale price was the best achievable, having regard to all circumstances.

7.3 Organisation of Creditors or Committees

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 official liquidations, a liquidation committee must be appointed unless the Grand Court orders otherwise. The committee must comprise of certain numbers of creditors and/or shareholders, depending on whether the company is solvent, insolvent or of doubtful solvency. 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 not remunerated, but they are 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

they have been approved by the committee and the liquidator before being incurred.

8. INTERNATIONAL / CROSS-BORDER ISSUES AND PROCESSES

8.1 Recognition or Relief in Connection with Overseas 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 foreign debtor;
- grant a stay of proceedings or the enforcement of a judgment against the foreign debtor;
- require certain persons with information concerning the foreign debtor's business or affairs to be examined by, and produce documents for, the foreign representative; and/or
- order that the foreign 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 foreign 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 foreign 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 foreign debtor;
- the non-enforcement of foreign taxes, fines and penalties; and
- comity (mutual recognition and co-operation concerning legal decisions).

8.2 Co-ordination in Cross-Border Cases

Order 21 of the CWR deals with international protocols in relation to Cayman companies in liquidation which are the subject of concurrent bankruptcy proceedings under the laws 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 office-holder and provides for this protocol to be approved by the Cayman and foreign courts.

On 30 July 2018, the Cayman Islands adopted the use of the Judicial Insolvency Network (JIN) Guidelines pursuant to Practice Direction No 1 of 2018 (the 2018 Practice Direction). The 2018 Practice Direction requires Cayman Islands-appointed office-holders 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.

Under Part XVII of the Companies Act, the Grand Court also has a statutory jurisdiction to recognise and assist foreign representatives appointed in the place of a company's incorporation.

8.3 Rules, Standards and Guidelines

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.

8.5 Recognition and Enforcement of Foreign Judgments

The Foreign Judgments Reciprocal Enforcement Act (1996 Revision) provides a statutory regime for recognition and enforcement of foreign judgments but, to date, its application only extends to judgments from certain courts of Australia and its territories. As such, almost all foreign judgments are enforced under common law rules. As set out in *Banco Mercantil del Norte SA v Cabal Peniche* [2003] CILR 343, the Grand Court may enforce a foreign judgment where:

- the foreign judgment was given by a court of competent jurisdiction in accordance with Cayman Islands conflicts of law rules;
- the foreign judgment is final and conclusive; and
- the foreign judgment has not been obtained by fraud, in opposition to natural justice or in contravention of the public policy of the Cayman Islands.

In *Bandone v Sol Properties* [2008] CILR 301, the Grand Court confirmed that the direct enforcement of foreign in personam judgments

and orders was no longer confined to those for debt, or definite sums of money. Non-money orders are therefore now capable of being recognised and enforced by the Grand Court, by way of equitable remedies such as specific performance, if the principles of comity require it.

9. TRUSTEES/RECEIVERS/ STATUTORY OFFICERS

9.1 Types of Statutory Officers

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 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 to any alternative nominees put forward by other stakeholders).

See 7.1 **Types of Voluntary/Involuntary Proceedings** for a description of how statutory officers interact with company management and directors and 9.1 **Types of Statutory Officers** for a description as to who can and cannot serve as a statutory officer.

10. DUTIES AND PERSONAL LIABILITY OF DIRECTORS AND OFFICERS OF FINANCIALLY TROUBLED COMPANIES

10.1 Duties of Directors

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 prescribed point 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.

10.2 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.

11. TRANSFERS/ TRANSACTIONS THAT MAY BE SET ASIDE

11.1 Historical Transactions

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 Companies Act. These sections only apply in official liquidations.

Section 99 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, 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.

Section 146 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, 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.

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.

11.2 Look-Back Period

See **11.1 Historical Transactions**.

11.3 Claims to Set Aside or Annul Transactions

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 of liquidation, any creditor of a company may apply, pursuant to the Fraudulent Dispositions Act (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.

Campbells advises on Cayman Islands and British Virgin Islands law, and has offices in Cayman (head office), the BVI and Hong Kong. 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,

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