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Insolvency 2023

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Cayman Islands: Law & Practice and Trends & Developments

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CAYMAN ISLANDS

Law and Practice

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Baker & Partners is a specialist independent offshore litigation law firm, headquartered in Jersey, Channel Islands, with offices in the Cayman Islands, British Virgin Islands and London. Since 2003, the firm has acted in some of the most substantial offshore insolvency, asset recovery, commercial, and trust litigation. The firm has been responsible for recovering many hundreds of millions of pounds on behalf of corporations, individuals and governments; and has expertise in using insolvency tools to aid in the recovery of assets. The team has experience seeking disclosure and injunctive relief, as well as cross-border recognition of insolvency proceedings and officeholders, judgments and arbitral awards. The firm's senior lawyers have been at the forefront of some of the most complex and high-value offshore fraud, insolvency, commercial, and trust litigation, including the 1MDB international asset recovery efforts, AHAB v Saad, Brazil v Durant and Kildare, XiO Fund, and Crociani v Crociani.

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1. State of the Restructuring Market

1.1 Market Trends and Changes

In 2022, there were about 32 winding-up petitions filed in the Financial Services Division of the Grand Court of the Cayman Islands. From publicly available records, there have been five petitions for the appointment of a restructuring officer from the adoption of the new regime on 31 August 2022 until October 2023.

Restructuring Officer Regime – One-Year Update

Just over one year on from the introduction of the restructuring officer regime, it is interesting to note the developments that have taken place and how the court has dealt with certain aspects of the new regime. There have been a handful of applications made under the Companies Act (2023 Revision) (the "Companies Act") since the introduction of the new restructuring officer regime. The initial case, In the Matter of Oriente Group Limited (FSD 231 of 2022 (IKJ)) (Unreported, 8 December 2022) (Oriente), was the first application made seeking the appointment of a restructuring officer under Section 91B of the Companies Act on the grounds that:

"(a) it was presently unable to pay its debts and is therefore insolvent under section 93 of the Companies Act; and

(b) the company intends to present a compromise or arrangement to its creditors (or classes thereof) pursuant to section 86 and/or section 91I of the Companies Act, the law of a foreign country or by way of a consensual restructuring."

The court gave a lengthy and considered ruling, granting the first-ever restructuring officer appointment. Since Oriente, the court has dealt with several other restructuring officer petitions, and has recently refused an application in the case, In the Matter of Aubit International (FSD 240 of 2023 (DDJ)) (Unreported, 4 October 2023) (Aubit) because Aubit International failed to establish a credible intention to present a plan at the time of the presentation of the petition and at the time of the hearing.

In Oriente and Aubit, the court considered the applicability of case authorities under the previous "light touch" provisional liquidation restructuring regime under Section 104(3) of the Companies Act. The court found these cases to be both relevant and persuasive, noting that the grounds for appointing provisional liquidators for restructuring purposes are "expressed in the same terms" under the new restructuring officer regime.

Global Real Estate Crisis

One of the biggest developments globally, which has impacted and likely will continue to impact the Cayman Islands financial services industry, is the growing global real estate crisis, especially in China. The world has seen the Chinese real estate crisis escalate over the past few years, which has resulted in various restructuring efforts and insolvency proceedings involving Chinese real estate and property developers, including Evergrande, one of China's largest real estate groups. In August 2023, Evergrande filed for Chapter 15 protection in New York to undergo a debt restructuring exercise through scheme of arrangement proceedings commenced in the Cayman Islands, British Virgin Islands and Hong Kong.

Global real estate restructuring trends will be of particular interest as some analysts and commentators suggest that a commercial real estate crash may be on the horizon. There have

already been several scheme proceedings in the Cayman Islands resulting from the Chinese real estate crisis. It would be reasonable to expect a steady flow or uptick in insolvency and restructuring instructions if conditions in China continue to worsen, because many of the Chinese real estate companies utilise Cayman Islands entities in their corporate structures.

Digital Asset Insolvencies

Cryptocurrency-related insolvencies and litigation have remained fairly quiet in the Cayman Islands compared to other jurisdictions such as England, Singapore, and the British Virgin Islands. But, in early to mid-2023, the Cayman Islands experienced its first liquidation of a cryptocurrency enterprise, when two retail investors petitioned for the winding up of Atom Holdings, the Cayman Islands domiciled holding company of the defunct centralised cryptocurrency exchange, Atom Asset Exchange (AAX).

AAX offered cryptocurrency services to about two to three million investors worldwide (including the sale of its native token, the AAB token) and reportedly had a spot trading volume of USD57.2 billion in July 2022 and USD71.1 billion in September 2022. AAX abruptly shuttered its operations following the collapse of FTX on 11 November 2022. AAX sought to reassure customers that their deposits were not exposed to any risk as a result of FTX's collapse but did not resume operations and customers have been unable to withdraw any of their deposits.

It was alleged that one of AAX's former directors absconded with the private keys to cryptocurrency wallets holding AAX users' assets (at least USD30 million but likely more) and two top AAX executives were arrested by Hong Kong law enforcement. On 7 July 2023, the court granted the petition to wind up Atom Holdings because (i) Atom Holdings was insolvent, and (ii) it was just and equitable to wind up Atom Holdings based on the need for an investigation and because the company had lost its substratum.

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

2.1 Overview of Laws and Statutory Regimes

The Cayman Islands has a robust common law and statutory regime relevant to financial restructuring, reorganisations, liquidations, and insolvencies. The substantive laws relating to insolvencies and restructurings include:

- Companies Act;
- Companies Winding Up Rules (2023 Consolidation) (CWR);
- Insolvency Practitioners Regulations (2023 Consolidation);
- Foreign Bankruptcy Proceedings (International Cooperation) Rules (SL 92 of 2017); and
- Exempted Limited Partnership Act (2021 Revision).

The Cayman Islands legal system is a common law system based on the doctrine of judicial precedent. If there is insufficient local precedent to determine an issue, the Cayman Islands courts will look to English law, which is highly persuasive but not binding. Case law from other Commonwealth jurisdictions will also be persuasive (although not binding).

New Restructuring Regime

In 2022, the Cayman Islands implemented a freestanding restructuring regime. The key aspects of the new restructuring regime include:

- the ability to appoint a restructuring officer;
- an automatic worldwide stay of proceedings upon the filing of the petition; and
- the ability for a company's directors to petition for the appointment of a restructuring officer without express authority in its articles of association or by a resolution of its members.

2.2 Types of Voluntary and Involuntary Restructurings, Reorganisations, Insolvencies and Receivership

The Cayman Islands has a variety of insolvency, restructuring and receivership proceedings, including:

- voluntary (solvent) liquidation;
- official liquidation;
- provisional liquidation;
- restructuring through the appointment of a restructuring officer and scheme of arrangement;
- scheme of arrangement through Section 86 of the Companies Act, without the appointment of a restructuring officer; and
- court appointed receivership or receivership pursuant to a contract.

2.3 Obligation to Commence Formal Insolvency Proceedings

There are no obligations for companies to commence formal insolvency proceedings. Nor are there any wrongful/insolvent trading provisions which would penalise directors for allowing an insolvent company to continue operating. Directors of Cayman Islands companies owe a common law fiduciary duty to act in good faith and in the best interests of the company. This duty shifts in favour of the company's creditors at the point where the directors know, or ought to know, that the company is insolvent or bordering on insolvency, or that an insolvent liquidation is probable. Where an insolvent liquidation is inevitable, this duty towards the company's creditors crystalises. Under those circumstances, and as detailed in **10.1 Duties of Directors**, directors should consider whether to commence insolvency proceedings where it is in the best interests of the creditors to do so.

In the circumstances where a company is placed into voluntary liquidation, a voluntary liquidator must apply to the court within 35 days of the commencement of the voluntary liquidation, for an order that the voluntary liquidation be placed under the supervision of the court if the company's director(s) have not signed a declaration of solvency.

2.4 Commencing Involuntary Proceedings

Official Liquidation

Section 94 of the Companies Act states that a petition to wind up a company can be presented by:

- the company;
- any creditor or creditors (including contingent and prospective creditors);
- any contributory; or
- the Cayman Islands Monetary Authority (CIMA) (in certain circumstances).

The court may grant a winding-up petition on the grounds below, as set out under Section 92 of the Companies Act where:

- a company has passed a special resolution requiring the company to be wound up by the court;
- the company does not commence business within a year from its incorporation, or suspends its business for a whole year;
- the company's articles of association require the company to be wound up;
- the company is unable to pay its debts (insolvent); or
- the court is of the opinion that it is just and equitable for the company to be wound up.

The court has jurisdiction to make winding-up orders in respect of:

- a company incorporated under the Companies Act;
- a body incorporated under any other law in the Cayman Islands;
- a foreign company which:
  (a) has property located in the Cayman Islands;
  (b) carries on business in the Cayman Islands;
  (c) is the general partner of a limited partnership; or
  (d) is registered as a foreign company under Part IX of the Companies Act.

Under Section 93 of the Companies Act, a company is unable to pay its debts if:

- a creditor serves on the company a statutory demand and the company neglects to satisfy the debt within 21 days of the date on which the statutory demand was served;
- execution of other process issued on a judgment, decree or order obtained in the court in favour of any creditor is unsatisfied in whole or in part; or
- it is proved to the satisfaction of the court that the company is unable to pay its debts as they fall due ("cash-flow test" of insolvency).

The cash flow solvency test includes debts that are immediately due and debts which will become due in the reasonably near future.

Provisional Liquidation

An application for the appointment of a provisional liquidator under Section 104 of the Companies Act can be made at any time after the presentation of a winding-up petition but before the court makes a winding-up order. This type of application can be made ex parte in appropriate circumstances. A creditor, contributory or CIMA (in certain circumstances) can apply for the appointment of a provisional liquidator on the following grounds:

- there is a prima facie case for making a winding-up order; and
- the appointment is necessary in order to:
  (a) prevent the dissipation or misuse of the company's assets;
  (b) prevent the oppression of minority shareholders; or
  (c) prevent mismanagement or misconduct on the part of the company's directors.

Under Section 104(3) of the Companies Act, the court may grant a company's application for the appointment of a provisional liquidator if the court considers it appropriate to do so.

2.5 Requirement for Insolvency

The grounds for making an application to wind up a company are not solely limited to the company being insolvent. A company's insolvency is only one of the five enumerated statutory grounds

in Section 92 of the Companies Act (see **2.4 Commencing Involuntary Proceedings**).

Voluntary liquidations must be solvent liquidations; otherwise, the voluntary liquidator must place the liquidation under the court's supervision.

See **2.4 Commencing Involuntary Proceedings** for an overview of how insolvency is defined and shown.

In the circumstances when a party seeks to have a receiver appointed over a segregated portfolio of a segregated portfolio company, the solvency test under Section 224 of the Companies Act is a flexible balance sheet test.

2.6 Specific Statutory Restructuring and Insolvency Regimes

There are no specific statutory restructuring and insolvency regimes related to any specific industry sector. That said, there are unique features under the Companies Act and other legislation which require different treatment of debtor companies and other stakeholders. For example:

- the preferential debt treatment of eligible depositors who have deposits with a Cayman Islands company which hold a class "A" licence issued under the Banks and Trust Companies Act (as amended); and
- the approach over the winding up or receivership of segregated portfolio companies and the segregated portfolios within those companies. Segregated portfolio companies are often used for captive insurance entities.

See **2.1 Overview of Laws and Statutory Regimes** and **6.1 Statutory Process for a Financial Restructuring/Reorganisation**.

3. Out-of-Court Restructurings and Consensual Workouts

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

Companies can pursue consensual and out-of-court workouts and restructurings, which may be the preferred strategy to minimise expense and preserve value for all stakeholders. It is common for companies to secure standstill agreements with creditors to pursue out-of-court workouts. But circumstances may require a company to consider a statutory/court process, particularly where the company is facing increasing creditor pressure and potential winding-up proceedings.

There is no formal requirement for a company to pursue consensual restructuring negotiations before commencing a formal statutory process (see **2.3 Obligation to Commence Formal Insolvency Proceedings** for a discussion on when formal insolvency proceedings may be necessary). Yet consensual restructuring negotiations and an initial outline for a restructuring plan may be needed to satisfy one of the grounds a company must prove for the appointment of a restructuring officer — the intention to present a compromise or arrangement to its creditors.

The viability of an out-of-court workout or restructuring and the willingness of banks, credit funds and other lenders to work with distressed companies depends on market conditions and the jurisdiction in which the stakeholders are located. Given the nature of the Cayman Islands financial services industry, the stakeholders will

likely be in overseas jurisdictions including the United States, Hong Kong and the PRC.

An out-of-court workout or restructuring is not generally affected by Cayman Islands insolvency laws. That said, creditors' rights and remedies will impact a company's ability to secure new financing. A formal statutory restructuring may be required to cram-down uncooperative/dissenting creditors, subject to the statutory thresholds being met (see **6.1 Statutory Process for a Financial Restructuring/Reorganisation**).

3.2 Consensual Restructuring and Workout Processes

See **3.1 Consensual and Other Out-of-Court Workouts and Restructurings** and **3.5 Out-of-Court Financial Restructuring or Workout**. Since a new money lender would be subordinated to senior secured lenders or be treated pari passu with other unsecured lenders, it may be necessary to utilise intercreditor agreements to grant new money lenders priority. Subject to the terms of a company's memorandum and articles of association, it is possible to effect a debt for equity swap, which may require the consent of shareholders.

3.3 New Money

See **3.1 Consensual and Other Out-of-Court Workouts and Restructurings** and **3.2 Consensual Restructuring and Workout Processes**.

3.4 Duties on Creditors

Creditors do not owe duties to other creditors during a consensual restructuring unless there are private contractual relationships between the creditors. Creditors are owed a duty when a company is insolvent or bordering on insolvency (see **10.1 Duties of Directors**).

In the circumstances where stakeholders enter into contractual relationships based on misrepresentations, the stakeholders may have common law and equitable claims for negligent or fraudulent misrepresentation.

The Cayman Islands does not have a freestanding oppression and unfair prejudice statutory regime. However, an aggrieved shareholder could present a winding-up petition on just and equitable grounds, and apply for alternative relief under Section 95(3) of the Companies Act for an order:

- regulating the conduct of the company's affairs in the future;
- requiring the company to refrain from doing or continuing to do an act;
- authorising civil proceedings to be brought in the name and on behalf of the company by the petitioner; or
- providing for the purchase of shares of any members of the company by other members or by the company itself.

Under Section 147 of the Companies Act, there is a prohibition against fraudulent trading which may apply to directors and officers of a company (see **10.1 Duties of Directors**). See also **11.1 Historical Transactions** for a discussion of voidable preferences or undervalue/fraudulent dispositions.

3.5 Out-of-Court Financial Restructuring or Workout

An out-of-court financial restructuring or workout will require the consent of all creditors. There are no statutory provisions which provide the ability to cram-down non-consenting creditors. If the out-of-court restructuring involves a merger or consolidation, shareholders who dissent from the merger or consolidation may apply to

the court to seek fair value for their shares under Section 238 of the Companies Act.

4. Secured Creditor Rights, Remedies and Priorities

4.1 Liens/Security

The types of liens and security available in the Cayman Islands include the following.

- A legal mortgage and an equitable mortgage can be used to secure real estate (both freehold and leasehold) and shares.
- Fixed and floating charges are typically used to secure tangible property (including trading stock, shipping vessels and aircraft).
- Liens and pledges are other forms of security interests that are recognised in the Cayman Islands.

The most common forms of security which will apply to shares and other tangible moveable property are legal mortgages or equitable mortgages. Charges and assignments of the rights attaching to shares may also be used, particularly where intermediaries have custody of those shares.

Security can also be granted in favour of debts and other rights arising from a contract. Such debts may be secured by mortgage, or by fixed or floating charges.

As for intellectual property (IP), the most common means to secure IP is trade marks, which can be mortgaged or charged.

4.2 Rights and Remedies

The rights and remedies available to secured creditors will be largely determined by the security documents and will therefore be a matter of contract. Subject to the governing terms, security may be enforced by way of possession, sale, set-off, or by way of receivership.

There is no stay of proceedings against secured creditors in respect of insolvency and restructuring proceedings, and a secured creditor can enforce its security without leave of the court and without reference to a liquidator. If a secured creditor's debt exceeds the value of its security, the secured creditor can submit a proof of debt for the unsecured portion of debt.

4.3 Special Procedural Protections and Rights

As mentioned above, secured creditors who elect to enforce their security outside an insolvency process will be entitled to receive the full value of the secured assets. See **4.2 Rights and Remedies**.

5. Unsecured Creditor Rights, Remedies and Priorities

5.1 Differing Rights and Priorities

The waterfall of priorities among various classes of secured creditors, unsecured creditors and members is as follows:

- secured creditors (fixed charge) rank in priority to all other creditors (as mentioned above);
- preferred creditors as described in Schedule 2 to the Companies Act (certain debts due to employees, bank depositors, and taxes due to the government);
- floating charge secured creditors;
- liquidation expenses;
- unsecured creditors;
- non-provable debts;
- statutory interest payable on proved debts;

- subordinated creditors (unpaid redemption proceeds; debts due to members by way of dividends, profits or otherwise); and
- remaining sums, if any, are payable to shareholders in accordance with their rights and interests at the commencement of the winding-up proceedings.

Section 140(1) of the Companies Act says that the property of a company must be applied in satisfaction of the company's liabilities on a pari passu basis.

5.2 Unsecured Trade Creditors

The payment of unsecured trade creditors during the restructuring process will depend on the nature of the restructuring and will vary case by case. A company can, in its petition for the appointment of a restructuring officer, seek the court's approval of ongoing payments to trade creditors. Trade creditors may rely on retention of title clauses to ensure payment of their debts.

5.3 Rights and Remedies for Unsecured Creditors

In the restructuring context, an automatic world-wide stay of proceedings is granted upon the presentation of a petition for the appointment of a restructuring officer. An unsecured creditor (or creditor group) could influence the viability of a scheme of arrangement if that unsecured creditor (or group) holding more than 25% of the company debt, in any class, opposes the scheme.

In other insolvency contexts, when a provisional liquidator is appointed or when a winding-up order is made, all proceedings against the company are stayed and no fresh proceedings or actions can be commenced without leave of the court.

After a winding-up petition is filed but before a winding-up order is granted, an unsecured creditor could seek to have the petition dismissed or adjourned (conditionally or unconditionally).

Once a winding-up order is granted, an unsecured creditor can become involved and influence an involuntary liquidation process by seeking a role on the liquidation committee. Section 111 of the Companies Act permits the liquidator or any creditor or contributory to apply to the court for an order staying winding-up proceedings entirely or for a short time.

5.4 Pre-judgment Attachments

Pre-judgment attachments are unavailable in the Cayman Islands. But creditors may obtain equivalent relief by applying for a freezing injunction.

5.5 Priority Claims in Restructuring and Insolvency Proceedings

See **5.1 Differing Rights and Priorities** and **6.10 Priority New Money**. Section 40(1) of the Labour Act (2021 Revision) says that in the event of the winding up of an employer, liability for severance pay must be paid in priority to all secured and unsecured debts; and should be paid in full unless the company's property is insufficient to pay severance pay in full.

Within liquidation proceedings, litigation funding is treated as a liquidation expense and is given priority over unsecured creditor claims.

6. Statutory Restructuring, Rehabilitation and Reorganisation Proceedings

6.1 Statutory Process for a Financial Restructuring/Reorganisation

Restructuring Officer Regime

On 31 August 2022, the new restructuring officer regime came into force, allowing a debtor company to restructure by way of a scheme of arrangement under the supervision of a restructuring officer.

The principal tool for restructuring outside the protection of the restructuring officer regime is a scheme of arrangement (under Section 86 of the Companies Act).

Appointment of a restructuring officer

A company can present a petition seeking the appointment of a restructuring officer under Section 91B(1) of the Act where the company:

- is or is likely to become unable to pay its debts; and
- intends to present a compromise or arrangement to its creditors (or classes thereof) either, under the Companies Act, the law of a foreign country, or by way of a consensual restructuring.

The new regime provides the ability for directors of a company to present a petition for the appointment of a restructuring officer without the need for shareholder approval or explicit authorisation within the company's articles of association (Section 91B(2)).

Restructuring officers must be qualified insolvency practitioners. They are considered officers of the court whose powers upon appointment will be detailed in the appointment order. Restructuring officers can be appointed jointly, similarly to official liquidators, but a foreign restructuring officer can only be jointly appointed with a Cayman Islands qualified practitioner.

The scope of the powers given to a restructuring officer will depend on the level of oversight required or deemed appropriate. The restructuring officer could take on a more advisory role with the directors remaining in place in a debtor-in-possession style restructuring or have more authority over the management and control of the company.

The restructuring officer regime provides for a worldwide automatic stay of proceedings (restructuring moratorium) when the petition is presented (Section 91G of the Companies Act).

Procedure for appointing a restructuring officer

After a petition is presented, it must be advertised once in a newspaper within the Cayman Islands. If a company carries on its business outside the Cayman Islands, the petition must be advertised in the different country (or countries) the petition is most likely to come to the attention of the company's creditors (including contingent and prospective creditors) and contributories. The advertisement must be published in the official language of that country. The petition must be advertised not more than seven business days after the petition is filed at court and not less than seven business days before the hearing of the petition. The hearing of the petition should be held within 21 days of the petition being filed unless the court orders otherwise.

Interested stakeholders wishing to appear/be heard at the petition hearing must provide three days' notice in the prescribed court form. If a stakeholder intends to oppose the appoint-

ment of a restructuring officer, they must, not less than three days before the hearing of the petition, provide details of their proposed alternate nominee(s) and file and serve a supporting affidavit on the company, petitioner's attorneys and, where the company is regulated, on CIMA.

The company may also make an ex parte application (Section 91C(1) of the Companies Act) to seek the appointment of an interim restructuring officer, where it is in the best interests of the company to make such an application, pending the hearing of the petition under Section 91B(1) of the Companies Act.

Within 28 days of their appointment, unless ordered otherwise, the restructuring officer must provide a report to the creditors and contributories outlining steps taken in the restructuring and further steps to be taken, the financial position of the company and the work they have done and their remuneration (CWR Order 1A, Rule 8).

Successful restructuring

Where a scheme of arrangement has been completed, the restructuring officer appointment can be discharged. Once discharged, the company will continue its business in the normal way.

Unsuccessful restructuring

Where a scheme has been unsuccessful, the court can discharge the restructuring officer under Section 91E of the Companies Act. These applications will likely be made by the restructuring officer (where they consider it improbable that a scheme can be achieved), or creditors or contributories who seek to make a winding-up petition.

If a restructuring fails and a winding-up order is obtained before the discharge of the order appointing a restructuring officer, the winding up of a company is deemed to commence on the date of the presentation of the petition to appoint a restructuring officer (Section 100 of the Companies Act).

Scheme of Arrangement

It is possible to cram-down stakeholders, provided the statutory thresholds outlined below are met. There is, however, no ability for a cross-class cramdown. An "arrangement" under Section 91I(6) and Section 86(5) of the Companies Act includes a reorganisation of the share capital of the company via the consolidation of shares of different classes or by the division of shares into shares of different classes, or by a combination of both.

Shareholders threshold

Under Section 86(2A) and Section 91I(3) of the Companies Act, there is a new threshold requirement for approval by shareholders of a proposed scheme of arrangement. The "head count" test has been removed in relation to shareholder schemes and the new threshold requirement is as follows:

- 75% in value of the members or class of members, as the case may be, present and voting either in person or by proxy at the meeting. If approved by shareholders holding 75% in value and sanctioned by the court, then the scheme shall be binding on all members or classes of members and on the company.

Creditor threshold

Under Section 86(2) and Section 91I(2) of the Companies Act, a creditor scheme must receive support by more than 50% in number and 75% in value of creditors, and be sanctioned by the court, to be binding on all creditors or class of creditors and on the company.

Procedure for filing a scheme

The procedure and rules around filing a scheme are found in both the Grand Court Rules (2023 Revision) (GCR) and the CWR. GCR Order 102, Rule 20 and Practice Direction No 2 of 2010 (PD.2 of 2010) outline the procedure that should be followed no matter if the scheme proceeds under Section 86 or Section 91I. The rules provide for the following.

- A petition seeking sanction of a scheme must be filed together with a summons (which provides for directions) and a supporting affidavit detailing all relevant information required by the court to assess and sanction a scheme, including exhibiting the scheme proposed and explanatory statement (setting out the timetable of events).
- When shares are listed or there are debt instruments, then another affidavit dealing with these is required and reference must be made to the requisite rules regarding listing.
- The court will give directions relating to statutory majorities required at the scheme meeting.
- The directions hearing is held in chambers (the "convening hearing") where the court will, amongst other things, consider the composition of classes in the scheme proposal.
- A scheme meeting is then held (or meetings depending on the number of classes involved) and within seven days following that meeting an affidavit must be filed detailing that the meeting took place and that the court's directions were adhered to and relevant majorities approved as appropriate.
- The petition hearing is usually held in open court (the "sanction hearing") and any of those who voted at the scheme meeting are entitled to be heard at the sanction hearing. The court also has the discretion to hear any other person who demonstrates a substantial economic interest in the shares or debt to which the scheme relates (PD.2 of 2010).

Objections relating to the composition of classes are usually made at the convening hearing.

At the sanction hearing, the court will either sanction the scheme as proposed and voted upon or refuse sanction. The scheme is treated as effective once the court order sanctioning the scheme has been filed with the Registrar of Companies.

Depending on various factors, it may take between two and three months or more from the commencement of the scheme proceedings until a sanction order is made.

6.2 Position of the Company

See **6.1 Statutory Process for a Financial Restructuring/Reorganisation** for a discussion of automatic stays. The restructuring officer will either act in an advisory capacity supervising a debtor-in-possession (management remain in place) or potentially a more invasive role depending on the appropriateness of this as provided for in any order made by the court. The company will continue in operation.

A company may borrow money during the restructuring process, which will require court sanction. See **6.10 Priority New Money**.

6.3 Roles of Creditors

The roles of creditors and the threshold for creditor approval of a scheme are described in **6.1 Statutory Process for a Financial Restructuring/Reorganisation**. Class composition and the court's approval of the same is an important procedure in scheme proceedings because an incorrect composition of the classes may

prevent the court from sanctioning a scheme (In re Ocean Rig UDW Inc. 2017 (2) CILR 495).

At the convening hearing, the court will consider the proposed scheme and any objections to the same or composition of classes of creditors where contested. When considering class composition, the court will consider the similarity and dissimilarity of legal rights against the company (In re Ocean Rig UDW Inc. 2017 (2) CILR 495). The members of a class of creditors should be able to consult effectively together regarding their similar legal rights against the company.

There are no provisions under the scheme or restructuring regime contained within the Companies Act or rules that state that a committee must be formed. But the court could approve an ad hoc committee.

Creditors are provided with scheme documents and can participate throughout the scheme approval process. They can object to scheme approval at a sanction hearing. Typical objections at the sanction hearing include the company's failure to comply with notice and other procedural requirements, improper class composition, and the unfair treatment of stakeholders.

6.4 Claims of Dissenting Creditors

It is possible to cram-down dissenting creditors, within a particular class, as long as the majority in number and 75% in value threshold is met. There is no ability for a cross-class cram-down under Cayman Islands law.

6.5 Trading of Claims Against a Company

There is generally no restriction on trading claims. As such, claims can be traded throughout the restructuring process. In order to ensure effectiveness of the transfer of any claims, notice of the assignment/transfer would have to be provided to the company.

6.6 Use of a Restructuring Procedure to Reorganise a Corporate Group

A corporate group can be restructured through the scheme of arrangement process, but this will require separate scheme proceedings and court approval for each entity in the group. That said, the court and parties can benefit from efficiencies if the scheme proceedings are dealt with at the same time (eg, combined hearings).

6.7 Restrictions on a Company's Use of Its Assets

Under the new restructuring officer regime, there are restrictions on the company's use of its assets – which is similar to when restructuring was sought within the previous "light touch" provisional liquidation context. The court would need to approve any such use or disposition of assets, which can be done in the initial appointment order or in later orders.

6.8 Asset Disposition and Related Procedures

In a restructuring outside the restructuring officer regime (under Section 86 of the Companies Act), the directors of a company can execute the sale of any company assets. Such a sale will be subject to the terms of the scheme. Within the restructuring officer regime, the disposition of company assets will require court sanction, whether in the appointment order or subsequent order. The purchaser of a company's assets will only acquire the rights and interests which the company had, subject to any existing claims against those assets unless such claims were extinguished under the scheme.

There are no specific legislative prohibitions on credit bidding and stalking horse bidding.

Appropriate sales processes and bidding requirements will be determined by the officeholder, and sale process/sale will be subject to court approval. There are also no statutory provisions providing for a pre-packaged restructuring, but the court can approve a pre-packaged restructuring in appropriate circumstances.

6.9 Secured Creditor Liens and Security Arrangements

A scheme could include a release of secured creditor liens and security arrangements. But, as noted in **4.2 Rights and Remedies**, a secured creditor may enforce its security without reference to the scheme and restructuring officer.

6.10 Priority New Money

There are no specific statutory provisions which provide for debtor-in-possession financing or new money. A new money lender can be given priority over existing lenders under a scheme of arrangement.

6.11 Determining the Value of Claims and Creditors

There are no statutory provisions for determining the value of claims. The proposed scheme can include provisions addressing the value of claims and disputes related to claims.

6.12 Restructuring or Reorganisation Agreement

Once the requisite threshold approvals have been obtained from various classes involved in the restructuring, as outlined in **6.1 Statutory Process for a Financial Restructuring/Reorganisation**, the court will determine at the sanction hearing whether:

- the scheme companies complied with the terms of the convening order and statutory requirements;
- each class was fairly represented at the scheme meeting and whether the majority acted in a bona fide matter; and
- the scheme is one in which an intelligent and honest creditor could reasonably approve.

A company or a restructuring officer cannot disclaim onerous contracts.

6.13 Non-debtor Parties

Non-debtor parties such as guarantors may be released from liability under a scheme of arrangement in some cases where there is a close connection between the release and the subject matter of the scheme (In re SPhinX Group [2010] (1) CILR 452). In the matter of Re La Seda de Barcelona SA [2010] EWHC 1364 (Ch), the English High Court approved the release of a third-party guarantor because the release gave rise to a "give and take" between the company and scheme creditors, and because the release benefited the scheme creditors as it improved the financial position of the company and other companies within the corporate group.

6.14 Rights of Set-Off

Rights of set-off (or offset or netting) should remain enforceable within a liquidation if they arose before the liquidation. In a restructuring proceeding, the rights of set-off (or offset or netting) could be compromised or altered under a scheme of arrangement.

6.15 Failure to Observe the Terms of Agreements

As mentioned in **6.1 Statutory Process for a Financial Restructuring/Reorganisation**, a scheme becomes effective and binding following sanction by the court and the sanction order

being filed with the Registrar of Companies. The implications of the company or creditor failing to observe the terms of a scheme of arrangement depend on the circumstances. A company's failure to comply with the terms of a scheme could result in the company being subjected to a winding-up petition. Court intervention may be required to remediate any breaches of the scheme.

6.16 Existing Equity Owners

Existing equity owners can receive or retain ownership under the scheme.

7. Statutory Insolvency and Liquidation Proceedings

7.1 Types of Voluntary/Involuntary Proceedings

Cayman Islands insolvency legislation provides for three types of liquidation proceedings:

- voluntary liquidations;
- official liquidations; and
- provisional liquidations.

Stay of Proceedings

There is a stay of proceedings upon the court granting a winding-up order or appointing a provisional liquidator, except for secured creditors (see **4.2 Right and Remedies**). There is no moratorium on claims in a voluntary liquidation.

Voluntary Liquidations

Overview and commencement

A voluntary liquidation is used to wind up a solvent company and carried out independently, without sanction of the court. Under Section 116 of the Companies Act, a company incorporated or registered under the Companies Act may be placed into voluntary liquidation:

- if by a special resolution, the company resolves to be wound up voluntarily;
- if by an ordinary resolution in a general meeting it resolves to be wound up voluntarily because it is unable to pay its debts; or
- upon the expiry of the period for the duration of the company or the occurrence of the event specified in the company's memorandum and articles of association.

The company stops carrying on its business, save for matters beneficial for its winding up, from the commencement of the voluntary winding-up, but maintains its corporate status and powers until it is dissolved.

One or more voluntary liquidators (in the latter case, acting jointly and severally) may be appointed to wind up the company and distribute its assets and, at that time, the directors' powers are displaced, unless the company resolves in a general meeting, or the liquidator sanctions the directors' continuance. See **9.1 Types of Statutory Officers** for an outline of who can act as a voluntary liquidator.

Winding up under court supervision

It is a statutory requirement that for a voluntary liquidation to proceed the director(s) of the company must sign a declaration of solvency attesting that a full enquiry into the company's affairs has been made and that the director believes the company will be able to pay its debts in full with interest within a period not exceeding 12 months from the commencement of the winding-up. Where a director is unable to provide this confirmation within 28 days from commencement then the voluntary liquidator must apply to the court for an order

that the voluntary liquidation continue under the supervision of the court where the process continues under official liquidators (see **2.3 Obligation to Commence Formal Insolvency Proceedings**).

Voluntary liquidation process

Within 28 days of the commencement of the voluntary liquidation, the voluntary liquidator must publish the notice of the winding-up and file the following with the Registrar:

- a notice of the winding-up;
- the liquidator's consent to act; and
- declaration of solvency.

Where a company is a regulated business, notice of the winding-up must be served on CIMA. If these requirements are not complied with, the liquidator can be liable for a fine of KYD10,000. Creditors are then paid in full in voluntary liquidations, and there are no provisions for setting-off or netting-off.

The voluntary liquidator must comply with various reporting requirements (generally to shareholders). Once the affairs of the company have been fully wound up, the voluntary liquidator must prepare final report and final accounting, and send the same to the company's members. The voluntary liquidator must then hold a final general meeting to seek the approval of the final resolutions. The voluntary liquidator must file the final return with the registrar within seven days of the final meeting. The company is deemed to be dissolved three months from the filing of the final return.

Official Liquidation

Overview and commencement

An official liquidation is the principal regime for the winding up of companies. See **2.4 Commencing Involuntary Proceedings** for an overview of the commencement of official liquidations.

Roles and duties

The main role of an official liquidator is to:

- realise, collect and distribute the company's assets for the benefit of its creditors and others where appropriate; and
- investigate the affairs of the company.

The official liquidator's powers are set out in Section 110 and Part I of Schedule 3 (powers exercisable with court sanction) and Part II of Schedule 3 (powers exercisable with or without court sanction) to the Companies Act.

The official liquidator will use a liquidation committee as a sounding board in relation to important decisions but the official liquidator does not have to follow their views (see **7.3 Organisation of Creditors or Committees**). Once a winding-up order is made, the directors are displaced.

Treatment of claims

Creditors (including contingent and prospective creditors) can submit proof of debt to the official liquidator who will adjudicate the claim in a quasi-judicial capacity. The official liquidator can accept, reject or partially reject the proof of debt. If the official liquidator rejects a proof of debt, the creditor can appeal the rejection, which will be heard by the court as a de novo adjudication of the proof of debt. See **5.1 Differing Rights and Priorities** for a discussion on priorities of claims.

An official liquidator must account for set-off and netting rights which arose prior to the commencement of the liquidation.

There are no claims bar dates in the Cayman Islands. The official liquidator will provide stakeholders with a notice of their intention to make interim and final distributions. If a creditor fails to submit a proof of debt before an interim or final distribution, they will miss out on the distributions.

An official liquidator cannot reject or disclaim onerous contracts.

Conclusion

Once the official liquidator has completed any investigations, collected the company's assets, made distributions to creditors, and paid surplus funds to members (if any), the official liquidator can proceed with a dissolution application and seek to be discharged.

Provisional Liquidation

Overview and commencement

A provisional liquidation is intended to "hold the ring" pending the determination of a winding-up petition. An application to appoint a provisional liquidator can be made at any time after the presentation of a winding-up petition and before the winding-up order is made. See **2.4 Commencing Involuntary Proceedings** for a discussion on the commencement of provisional liquidations.

Roles and duties

The provisional liquidator's powers and obligations are set out in the appointment order, including any reporting requirements and whether the provisional liquidator should establish a provisional liquidation committee. The appointment order can limit the powers of the directors or remove their powers altogether.

A liquidator can obtain court sanction to sell company assets (see **7.2 Distressed Disposals**).

Treatment of claims

The are no provisions regarding setting off or netting off any claims and any creditors' claims are generally not adjudicated upon within a provisional liquidation. A provisional liquidator cannot disclaim onerous contracts.

Conclusion of provisional liquidation

A provisional liquidation is terminated upon the court making a winding-up order, if the petitioner withdraws the winding-up petition, or if the provisional liquidator is discharged upon the application of the petitioner, creditor, contributory, the company acting by its directors, CIMA (in certain circumstances), or the provisional liquidator.

7.2 Distressed Disposals

An official liquidator and provisional liquidator assume the responsibility for the collection, realisation, and distribution of assets of the company to creditors, and if a surplus, to contributories. They are only permitted to sell company property by public auction or private sale with the sanction of the court under Section 110(2)(a) of and Part I of Schedule 3 to the Companies Act. When seeking court sanction, the court will give considerable weight to the views of the liquidator unless the evidence reveals substantial reasons for not accepting a liquidator's commercial judgment.

A liquidator's primary duty is to "take reasonable care and obtain the best price possible in the circumstances" (Re Trident Microsystems (Far East) Ltd [2012] (2) CILR 414). Depending on the circumstances of the liquidation, a liquidator can seek initial approval of a sale before a liquidator begins the process, or a liquidator can first undertake the sales process and seek court sanction once a sale is tentatively agreed.

The purchaser of a company's assets will only acquire the rights and interests which the company had, subject to any existing claims against those assets.

See **6.8 Asset Disposition and Related Procedures** for discussion on credit bidding and stalking horse bidding.

Whilst the circumstances of an official liquidation and a provisional liquidation would not ordinarily give rise to a pre-negotiated sales transaction, there are no statutory provisions which would prohibit a pre-negotiated sale. But the court will be concerned with whether a robust sales process was followed and whether the liquidator has obtained the best price in the circumstances.

7.3 Organisation of Creditors or Committees

A liquidation committee must be appointed in an official liquidation unless the court directs otherwise. Under the CWR, if the company is insolvent, the liquidation committee shall comprise at least three nor more than five creditors elected at the first meeting of creditors (CWR Order 9, Rule 1(4)). If the official liquidator determined that the company is solvent, the liquidation committee shall comprise at least three nor more than five contributories of the company elected at the first meeting of the contributories (CWR Order 9, Rule 1(5)).

Where a company is of doubtful solvency, the liquidation committee must comprise at least three nor more than six members, the majority of whom must be creditors elected at a creditors' meeting and at least one contributory elected at a meeting of contributories.

The liquidation committee does not have any express powers save as to act as a sounding board for the liquidator. The liquidation committee has to review the liquidator's remuneration. The liquidation committee may instruct legal counsel, and the legal fees and expenses reasonably and properly incurred will be paid out of the assets of the liquidation estate as a liquidation expense.

Members of the liquidation committee will be reimbursed for their travelling expenses and telephone charges reasonably and properly incurred in attending committee meetings. Unless the liquidation committee or the liquidator approves it, no other expenses incurred by any committee member in connection with the liquidation will be reimbursed.

There is no express requirement for a liquidation committee in a provisional liquidation but the court may order that one be formed. There are no requirements for the formation of a liquidation committee for a voluntary liquidation.

8. International/Cross-Border Issues and Processes

8.1 Recognition or Relief in Connection With Overseas Proceedings

The Cayman Islands has not adopted the UNICTRAL Model Law on Cross-Border Insolvency. However, the court has an inherent jurisdiction at common law to recognise and assist foreign insolvency proceedings and officeholders, including liquidators, appointed by an order of a competent court (Singularis Holdings Ltd v PriceWaterhouseCoopers [2014] UKPC 36). Common law assistance is based on the principles of comity and modified universalism.

There is also statutory jurisdiction under Section 241 of the Companies Act to make orders ancillary to a foreign bankruptcy proceeding to:

- recognise the right of the foreign representative to act in the Cayman Islands on behalf of, or in the name of, a debtor;
- enjoin the commencement or stay proceedings against the debtor;
- stay the enforcement of any judgment against a debtor;
- require a person in possession of information relating to the business or affairs of a debtor to be examined by or produce documents to the foreign representative; and
- order that any property belonging to a debtor be turned over to the foreign representative.

The Companies Act provides that the court will exercise its statutory discretion in a manner that will assure an economic and expeditious administration of the debtor's estate, consistent with:

- the just treatment of all holders of claims against or interests in a debtor's estate;
- the protection of claim holders in the Cayman Islands against prejudice and inconvenience in the processing of claims in the foreign bankruptcy proceedings;
- the prevention of preferential or fraudulent dispositions of property;
- the distribution of the debtor's estate amongst creditors substantially in accordance with the order of priority prescribed by the Companies Act;
- the recognition and enforcement of security interests created by the debtor;
- the non-enforcement of foreign taxes, fines, and penalties; and
- comity.

This statutory jurisdiction is only available where the foreign representative is appointed in the place of incorporation (per the definition of "debtor" under Section 240 of the Companies Act).

The recognition of foreign appointed receivers falls outside the statutory recognition or modified universalism routes. That said, the court has the inherent common-law jurisdiction to recognise a receiver appointed by a foreign court where there is a sufficient connection between the subject of the receivership and the foreign jurisdiction (In the Matter of Silk Road Funds Ltd (FSD 234 of 2017 (ASCJ)) (Unreported, 8 February 2018).

8.2 Co-ordination in Cross-Border Cases

Officeholders and parties are encouraged to enter into protocols or other arrangements with foreign courts to co-ordinate cross-border proceedings.

Under CWR Order 21, Rule 1, an official liquidator has a duty to consider whether to enter into an international protocol with any foreign officeholder to promote the orderly administration of the estate of the company and avoid duplication of work and conflict between the official liquidator and the foreign officeholder.

Practice Direction No 1 of 2018 (PD.1) describes the use and adoption of two main sets of guidelines for court-to-court communications and co-operation in the Cayman Islands: (i) the American Law Institute/International Insolvency Institute Guidelines Applicable to Court-to-Court Communications in Cross-Border Cases and (ii) the Judicial Insolvency Network (JIN) Guidelines for Communication and Co-operation between Courts in Cross-Border Insolvency Matters (collectively, the "Guidelines").

Whilst CWR Order 21, Rule 1 is directed only at official liquidators, PD.1 encourages other Cay-

man Islands officeholders or companies subject to restructuring proceedings supervised by the court to enter into a protocol incorporating the Guidelines or may apply for an order adopting them (at which time PD.1 will apply).

Practice Direction No 2 of 2019 adopts the JIN Modalities for Court-to-Court Communications, which provide a practical guide for facilitating communications between judges in cross-border insolvency cases.

Past co-operation and co-ordination between the Cayman Islands court and foreign courts has been grounded in the court's common law duty to assist a foreign court. In the case, In re LATAM Finance Limited et al (FSD 104, 106 and 154 of 2020 (IKJ)) (Unreported, 24 August 2020), the court approved the first court-to-court communications protocol, confirming the court's jurisdictional basis to grant such relief.

8.3 Rules, Standards and Guidelines

The Cayman Islands courts deal with insolvency matters in a pragmatic, sensible and collaborative manner. The overriding objective under the GCR is to deal with matters in a just, expeditious and economical way. As referred to in **8.1 Recognition or Relief in Connection With Overseas Proceedings**, comity is the overarching principle for cross-border insolvency proceedings.

8.4 Foreign Creditors

A foreign creditor is treated the same as a domestic creditor. They are required to prove their debt just like a locally domiciled creditor.

8.5 Recognition and Enforcement of Foreign Judgments

Foreign judgments may be enforceable in accordance with the Foreign Judgments Reciprocal Enforcement Act (1996 Revision) (the "Foreign Judgments Act") or under English common law principles. The Foreign Judgments Act has only been extended to certain Superior Courts of Australia and its external territories.

For a foreign judgment to be enforced at common law it must be final and conclusive on the merits, made by a court of competent jurisdiction, for a definite sum of money (in respect of a foreign money judgment), not contrary to public policy, and the principles of comity require enforcement (in respect of foreign non-money judgment – see Bandone v Sol Properties Incorporated [2008] CILR 301).

The grounds for recognition and enforcement under the Foreign Judgments Act require the foreign judgment to be:

- final and conclusive (notwithstanding a pending appeal, or if it is subject to an appeal in the courts of the foreign jurisdiction);
- for a debt or definite sum of money (not in respect of taxes, fines or other penalties);
- handed down after the Foreign Judgments Act came into force on 22 October 1996;
- delivered by one of the jurisdictions to which the Foreign Judgments Act applies; and
- at the date of the application to the court, the foreign judgment must not already be satisfied or enforced, and must still be capable of enforcement in the country where it was made.

Once a foreign judgment is recognised (and it is not set aside), the judgment creditor can take enforcement actions as if it is a judgment as a matter of Cayman Islands law including:

- appointing a receiver;

- obtaining a charging order or garnishee order; and
- seeking to wind up the judgment debtor.

9. Trustees/Receivers/Statutory Officers

9.1 Types of Statutory Officers

One (or more) qualified insolvency practitioner(s) in the Cayman Islands may be appointed as official liquidator, provisional liquidator or restructuring officer. A foreign practitioner cannot be appointed as sole official liquidator, provisional liquidator or restructuring officer but may be appointed together with a local qualified insolvency practitioner as a joint official liquidator, joint provisional liquidator or joint restructuring officer.

An official liquidator acts as the liquidator of a company that is being wound up under an order of the court or under the supervision of the court.

A restructuring officer may be appointed where a company is unable to pay its debts and intends to present a compromise or arrangement to its creditors (Section 91B(1) of the Companies Act).

Anyone, including a director or officer of the company, may be appointed as its voluntary liquidator, whether or not they are resident in the Cayman Islands (Section 120 of the Companies Act).

9.2 Statutory Roles, Rights and Responsibilities of Officers

Officeholders such as provisional liquidators, official liquidators and restructuring officers are officers of the court and are therefore subject to court supervision.

Provisional liquidators are required to carry out the functions conferred upon them by the court and their powers are limited by the order appointing them (Section 104(4) of the Companies Act).

One of the key functions of an official liquidator is 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. The official liquidator is also responsible for reporting to the company's creditors and contributories upon the affairs of the company and the manner in which it has been wound up. An official liquidator also has broad powers to investigate the affairs of a company, including reasons for its failure.

Voluntary liquidators are officers of the company to which they are appointed. The main purpose of their appointment is to wind up the company's affairs and distribute its assets (Section 119(1) of the Companies Act).

9.3 Selection of Officers

A provisional liquidator, official liquidator, and restructuring officer may be appointed by the court upon the nomination by the petitioner. Other stakeholders can challenge the identity of the proposed officeholder and nominate a different officeholder.

A voluntary liquidator is appointed pursuant to a company's memorandum or articles of association or at a general meeting of the company (or as otherwise specified in the memorandum or articles).

There are statutory mechanisms in the Companies Act which permit the removal and replacement of officeholders, as well as the appointment of additional officeholders in appropriate situations (eg, where there is a conflict or

perceived conflict). In an official liquidation, the stakeholder with the ultimate interest (creditors in an insolvent liquidation and contributories in a solvent liquidation) may apply for the removal of an official liquidator based on good reasons, which include a conflict of interest, if the official liquidator pursues an action against the wishes of a creditor, or the official liquidator has acted in an improper manner or was guilty of some form of misconduct.

See **9.2 Statutory Roles, Rights and Responsibilities of Officers** for an outline as to who can serve as an officeholder.

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

10.1 Duties of Directors

Directors have a duty to act in good faith and in the best interests of the company. During a time of financial distress where a company is insolvent or bordering on insolvency, the directors must consider the interests of creditors as paramount over those of the shareholders (BTI 2014 LLC v Sequana SA and Others [2022] UKSC 25).

Directors may breach their duty to act in the bests interests of the company and could be held personally liable by causing the company to take steps that are not in the best interests of the creditors (eg, continuing to trade and incurring further debts when the company is in the "zone of insolvency" or is insolvent).

Directors can face criminal and civil liability for their actions leading to a company's insolvency, including in the following circumstances.

- Fraudulent trading: under Section 147 of the Companies Act, the court can make a declaration that anyone (director or otherwise) was knowingly party to the business of a company being carried on with the intent to defraud creditors of the company or creditors of any other person, or for any fraudulent purpose, requiring such person to contribute to the company's assets as the court thinks proper.
- A director (the company or a manager) can be found liable on summary conviction to a fine of KYD15,000 and five years' imprisonment if they cause a distribution or dividend to be paid to members out of the share premium account at a time when the company is insolvent.

10.2 Direct Fiduciary Breach Claims

When a company is in official liquidation, the official liquidator will be able to pursue breach of fiduciary duty claims against the directors. In Re SPhinX Group [2014] (2) CILR 131, the court held that creditors or contributories could be granted permission to pursue litigation on behalf of a company in appropriate circumstances where a liquidator refuses to act. Creditors or contributories have to establish that the prospective claim has a solid foundation and gives rise to a serious issue to be tried; and they would have to indemnify the company regarding costs.

It is common for a company's articles of association and for directors' services contracts to contain exculpation and indemnity clauses, so claims against directors are rare. Even so, a director will remain liable for breaches of duties, and for fraud or wilful neglect/gross negligence.

11. Transfers/Transactions That May Be Set Aside

11.1 Historical Transactions

There are various provisions in the Companies Act which permit the court to set aside/annul historical transactions, including Section 99 (validation orders), Section 145 (voidable preferences) and Section 146 (undervalue/fraudulent dispositions).

Validation Orders

Section 99 of the Companies Act is intended to preserve the status quo and prohibits the disposition of a company's property, transfer of shares or the alteration in the status of the company's members after the commencement of the winding-up without sanction of the court. A validation order enables a company to continue to operate in the ordinary course of business prior to the hearing of the winding-up petition and appointment of a liquidator.

Voidable Preferences

A company's liquidator can apply to the court under Section 145 of the Companies Act to set aside any conveyance or transfer of a company's property, or charge thereon, in favour of a creditor at a time when the company was insolvent, with the view (the dominant intention) to giving that creditor a preference over other creditors. A payment to a related party (a creditor who has the ability to control or exercise significant financial and operational influence over a company) is deemed to have been made with the view of giving a creditor a preference.

Undervalue/Fraudulent Dispositions

Section 146 of the Companies Act provides that every disposition of property made at an undervalue by or on behalf of a company with intent to defraud its creditors shall be voidable at the instance of its official liquidator. The liquidator has the burden of proving the intention to defraud a creditor but is not required to prove that the dominant or sole intention was to defraud a company's creditors.

If a disposition is set aside, a transferee of the company's property (if they did not act in bad faith) shall be given a first charge over the property (subject of the disposition) in an amount equal to the entire costs properly incurred by the transferee in defence of the set-aside proceedings.

11.2 Look-Back Period

Section 145 (voidable preference) applies to transactions made within the six-month period preceding the commencement of the company's liquidation. Section 146 (undervalue/fraudulent dispositions) permits a liquidator to apply to the court to set aside an undervalue disposition within six years of the disposition.

11.3 Claims to Set Aside or Annul Transactions

See **11.1 Historical Transactions**. Outside the liquidation context, a creditor may bring an application to set aside a fraudulent disposition under the Fraudulent Dispositions Act (1996 Revision) (FDA). Section 4 of the FDA states that "every disposition of property made with an intent to defraud and at an undervalue shall be voidable at the instance of a creditor" prejudiced by the disposition. An action to set aside a fraudulent disposition must be commenced within six years of the disposition.

Trends and Developments

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Baker & Partners

Baker & Partners is a specialist independent offshore litigation law firm, headquartered in Jersey, Channel Islands, with offices in the Cayman Islands, British Virgin Islands and London. Since 2003, the firm has acted in some of the most substantial offshore insolvency, asset recovery, commercial, and trust litigation. The firm has been responsible for recovering many hundreds of millions of pounds on behalf of corporations, individuals and governments; and has expertise in using insolvency tools to aid in the recovery of assets. The team has experience seeking disclosure and injunctive relief, as well as cross-border recognition of insolvency proceedings and officeholders, judgments and arbitral awards. The firm's senior lawyers have been at the forefront of some of the most complex and high-value offshore fraud, insolvency, commercial, and trust litigation, including the 1MDB international asset recovery efforts, AHAB v Saad, Brazil v Durant and Kildare, XiO Fund, and Crociani v Crociani.

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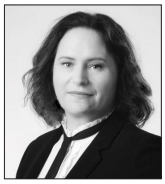

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Introduction

There have been a number of important trends and developments within the Cayman Islands and globally which have affected the Cayman Islands through the latter half of 2022 and throughout 2023. The main areas include:

- global real estate crisis;
- restructuring officer regime – one-year update;
- global and local digital asset developments; and
- changes to the beneficial ownership regime.

Global Real Estate Crisis

One of the biggest developments globally, which has impacted and likely will continue to impact the Cayman Islands financial services industry, is the growing real estate crisis.

The world has seen the Chinese real estate crisis escalate over the past few years, which has resulted in various restructuring efforts and insolvency proceedings involving Chinese real estate and property developers, including Evergrande, one of China's largest real estate groups. In August 2023, Evergrande filed for Chapter 15 protection in New York to undergo a debt restructuring exercise through scheme of arrangement proceedings commenced in the Cayman Islands, British Virgin Islands and Hong Kong.

The war in Ukraine, which commenced during a period of post-pandemic global recovery, has also contributed to a global increase in inflation which has, in turn, raised borrowing rates, and made corporate refinancing efforts more costly for businesses and tougher to secure.

During the COVID-19 pandemic, consumer purchasing preferences shifted further towards online shopping and businesses also needed to implement new working from home arrangements to accommodate pandemic-related restrictions. Many businesses have maintained, to some extent, these flexible working policies. As such, businesses are requiring less commercial space (whether retail or office) and it is believed that this weakening demand is partly responsible for the collapsing value of commercial real estate. For example, it is estimated that New York City's commercial real estate market has lost USD76 billion in value at the time of writing.

Furthermore, the cost of borrowing has increased against these depreciating assets and businesses are having to decide whether to refinance or permit lenders to foreclose on them.

Globally, it is believed that outstanding commercial real estate debt amounts to around USD6 trillion, with a significant share maturing in 2023–26.

In the United States, USD270 billion in commercial real estate loans held by banks are set to mature in 2023 and it is believed that commercial real estate debt maturities will peak at USD550 billion in 2027. It is also estimated that USD1.5 trillion in debt held by commercial property owners will fall due by the end of 2025.

Similar levels of commercial real estate debt have been reported in Europe, amounting to approximately EUR1.5 trillion. However, it is generally considered that European Banks' (with the apparent exception of some Nordic banks) exposure to commercial real estate is lower than that of the United States.

Global real estate restructuring trends will be of particular interest as some analysts and com-

mentators suggest that a commercial real estate crash may be on the horizon.

In any event, it would be reasonable to expect a steady flow or uptick in insolvency and restructuring instructions if conditions in China continue to worsen, because many of the Chinese real estate companies utilise Cayman Islands entities in their corporate structures.

Restructuring Officer Regime – One-Year Update

The new restructuring officer regime has now been in place since 31 August 2022 in the Cayman Islands. Just over one year on from its introduction, it is interesting to note the developments that have taken place and how the court is dealing with certain aspects of the new regime.

Oriente

There have been a handful of applications made under the Companies Act (2023 Revision) (the "Act") since the introduction of the new restructuring officer regime. The initial case, In the Matter of Oriente Group Limited (FSD 231 of 2022 (IKJ)) (Unreported, 8 December 2022) (Oriente), was the first application made seeking the appointment of a restructuring officer. The company's petition sought the appointment of a restructuring officer under Section 91B of the Act on the grounds that:

"(a) it was presently unable to pay its debts and is therefore insolvent under s. 93 of the Act; and

(b) the company intends to present a compromise or arrangement to its creditors (or classes thereof) pursuant to s. 86 and/or s.91I of the Act, the law of a foreign country or by way of a consensual restructuring."

The court considered the applicability of case law authorities emanating from Section 104(3), which was the previous restructuring regime through the use of "light touch" provisional liquidations. The court found these cases to be both relevant and persuasive, noting that the grounds for appointing provisional liquidators for restructuring purposes are "expressed in the same terms" under the new restructuring officer regime.

Aubit

More recently, Doyle J in his judgment In the Matter of Aubit International (FSD 240 of 2023 (DDJ)) (Unreported, 4 October 2023) (Aubit) echoed the judgment in Oriente as well as other previous case law stemming from the "light touch" provisional liquidation regime, which he confirmed gave valuable judicial and legal experience within the same commercial sphere. Doyle J summarised the relevant law and procedure, noting the factors to be considered when applications are made for the appointment of restructuring officers. The petitioning company has the burden of meeting the two limbs of Section 91B. The court found that the company was unable to pay its debts, but the company struggled to meet the second limb of the test. The company must establish a credible intention to present a plan at the time of the presentation of the petition to appoint a restructuring officer and at the time of the hearing.

The company argued that restructuring officers should be appointed, and then undergo a two-phase process (first, to gather assets, documents and information, commence any appropriate legal proceedings to recover assets, complete forensic investigations; and, secondly, to present a restructuring plan) as the company had insufficient information available to provide even an outline of a restructuring plan. The com-

pany also argued that there was some creditor support for this two-phase approach.

The court was presented with conflicting positions on who was to blame for the lack of clarity as to the company's financial status. In any event, the court disagreed with the company's proposed approach, stating it was not a proper use of the new restructuring officer regime. The court also noted that it was incumbent on the company to provide sufficient evidence of the proposed restructuring (including independent third-party evidence in support) as the court must be satisfied that the company harbours an intention to undertake a genuine and realistic restructuring. In this case, the court considered that there was insufficient evidence to establish a genuine intention to restructure.

Doyle J held that the court recognised "the need to guard against potential abuse of the new restructuring regime". The court dismissed the restructuring officer petition, holding that the company failed to prove a credible intention to present a plan at the time of the presentation of the petition and at the time of the hearing. Furthermore, the court was not persuaded that there was a real prospect of restructuring benefiting the creditors; and found that, although there appeared to be some creditor support, this support could not have been in support of a restructuring plan as there was no meaningful restructuring plan outline provided to the court. The role of the new restructuring officer regime is to "facilitate and finalise a financial restructuring", and not to recover assets and to forensically investigate the company – which, if permitted, would be an abuse of the restructuring officer regime.

Prospects of a restructuring plan

The court could still appoint a restructuring officer to prepare a report on the prospects of a restructuring plan if there was any doubt as to the company's viability, even if the company did not have a pre-formulated plan or evidence of a viable plan (as seen in Sun Cheong regarding the appointment of joint provisional liquidators in that case). The company must establish at least the "bare genuine bones of a restructuring plan" to persuade the court to appoint a restructuring officer. In prior cases involving the appointment of "light touch" provisional liquidators, a company had to establish a detailed proposed plan, an investor waiting in the wings to provide significant funding (Sun Cheong) or at least a credible outline of a restructuring plan (which was a burden that the company in Aubit was unable to meet). In Oriente, joint restructuring officers were appointed even without a detailed restructuring plan, because the company presented an outline of a restructuring plan. The court in Aubit made it clear that there needs to be "meat on the bones" of any proposed restructuring plan, and that an application made prematurely which left the court to "feast on the bones", would likely result in the application being dismissed.

Whilst the court must guard against potential abuses of the new regime, it is important for the development of the Cayman Islands corporate rescue regime that the court empowers distressed companies (with the benefit of time under the protection of an automatic stay of proceedings) to negotiate with creditors and develop a viable restructuring plan. This can be balanced against short time periods for a return hearing where the restructuring officer can report to the court and the court can assess the ongoing viability of a company presenting a compromise or arrangement.

Untested benefit of the new regime

One of the key benefits to the new restructuring officer regime touted by several supporters is the ability to dodge the rule in Gibbs and compromise English law governed debt, which may be achieved through a Cayman Islands scheme of arrangement followed by recognition in England under Section 426 of the UK Insolvency Act. This currently remains untested from a Cayman Islands perspective, but was achieved in 2021 in the Norwegian Air proceedings, which involved an Irish scheme of arrangement followed by recognition of the Irish Scheme under Section 426 of the UK Insolvency Act.

Looking forward, in order to bolster the corporate rescue regime in the Cayman Islands beyond the benefits achieved under the recent amendments adopting the restructuring officer regime, further amendments should be considered including:

- an automatic stay of proceedings against secured creditors, not just unsecured creditors;
- the ability for a cross-class cram-down like in the United States, England & Wales, and Singapore;
- codifying a debtor-in-possession (DIP) financing regime, with the ability to "prime" the new money lender, rather than handling DIP financing on an ad hoc basis.

Digital Assets (Global)

The volatility in the digital asset space has created significant turmoil in the industry, leading to what has been labelled the crypto winter, throughout which the crash and subsequent insolvency filings by some of the largest players including FTX, Genesis, Three Arrows Capital, BlockFi, Voyager Digital and Celsius have been observed.

Increased regulator activity and regulatory uncertainty in the United States and elsewhere is causing further concerns in the market. As an example, various regulatory proceedings brought by the United States' Securities and Exchange Commission have led US-based digital asset providers and businesses to consider re-domiciling their operations or wait for regulatory clarity pending the outcome of these regulatory actions.

In September 2023, the United States Bankruptcy Court for the District of Delaware approved an application made on behalf of the collapsed crypto-exchange FTX, to sell and invest cryptocurrency holdings valued at over USD3 billion to repay over one million potential creditors. Whilst good news for creditors, there are concerns that a mass sale of FTX's holdings could devalue certain cryptocurrencies and tokens if high volumes are released back into the market (up to USD200 million per week). Consumers have been known to trigger runs on various exchanges in response to collapsing values of certain tokens and coins, but it remains to be seen whether these consumer behaviours will resurface because of this recent decision.

Against this backdrop of uncertainty, the Cayman Islands is experiencing a surge in corporate activity involving virtual asset services providers. According to statistics provided by the Cayman Islands Monetary Authority (CIMA), the Cayman Islands experienced a 200% increase in the registration of virtual asset service providers from Q1 2022 to Q1 2023, with the addition of three trading exchanges and platforms, seven custody service providers, and five virtual asset dealers.

With the continuing crypto winter and the increase of corporate activity in the virtual asset

market in the Cayman Islands, there may be an increase in crypto-related insolvencies and litigation.

Digital Assets (Cayman Islands)

Notwithstanding the increase in virtual asset service providers, crypto-related insolvencies and litigation has remained fairly quiet compared to other jurisdictions such as England, Singapore, and the British Virgin Islands.

But, in early to mid-2023, the Cayman Islands experienced its first liquidation of a cryptocurrency enterprise, when two retail investors petitioned for the winding-up of Atom Holdings, the Cayman Islands domiciled holding company of the defunct centralised cryptocurrency exchange, Atom Asset Exchange (AAX) (the "Petition").

AAX offered cryptocurrency services to about two to three million investors worldwide (including the sale of its native token, the AAB token) and reportedly had a spot trading volume of USD57.2 billion in July 2022 and USD71.1 billion in September 2022.

AAX abruptly shuttered its operations following the collapse of FTX on 11 November 2022 when customers were initially informed that AAX's website was undergoing regular maintenance, and later a systems upgrade. AAX sought to reassure customers that their deposits were not exposed to any risk as a result of FTX's collapse but did not resume operations and customers have been unable to withdraw any of their deposits.

It was alleged that one of AAX's former directors absconded with the private keys to cryptocurrency wallets holding AAX users' assets (at least USD30 million but likely more) and two top AAX executives were arrested by Hong Kong law enforcement.

When appointing joint provisional liquidators on 8 March 2023, the court agreed to waive the legislative requirement that the petitioners are to provide a cross-undertaking in damages because the petitioners were of limited means and because this requirement posed a barrier to the petitioners' unequivocal rights to access justice in Cayman Islands' insolvency proceedings.

On 7 July 2023, the court granted the petitioners' application to place Atom Holdings into Official Liquidation, because (i) Atom Holdings was insolvent; and (ii) it was just and equitable to wind up Atom Holdings based on the need for an investigation and because the company had lost its substratum.

This novel case dealt with several public law and interest issues. It affirms that the Cayman Islands maintains its reputation as a creditor-friendly jurisdiction, which extends to the digital asset space. It also affirms that the court is prepared to use its inherent discretion and grant relief in a manner consistent with the "recognised public interest in protecting the reputation of the Cayman Islands as a well-regulated financial centre".

Changes to the Beneficial Ownership Regime

There has also been a notable development with regards to the proposed changes to the beneficial ownership regime in the Cayman Islands, in support of commitments undertaken by the Cayman Islands government to comply with certain recommendations issued by the Financial Action Task Force (FATF). The Beneficial Ownership Transparency Bill, 2023 (the "Bill") proposes to bring into force the Beneficial Ownership Transparency Act, 2023, which is intended to enhance

and consolidate the existing Cayman Islands' beneficial ownership legislative framework into a singular act.

The Bill will expand the scope of the current beneficial ownership regime by, amongst other things:

- adding exempted limited partnerships and limited partnerships to the list of entities within the scope of the requirements; and
- removing the exemptions available for entities registered with CIMA under the Virtual Asset (Service Providers) Act and the Securities Investment Business Act, requiring these entities to maintain a beneficial ownership register.

Registrable beneficial owners under the Bill are defined as (with certain exceptions):

- those who ultimately own or control (whether directly or indirectly) 25% or more of a legal person's shares, voting rights or partnership interests;
- the individual otherwise exercising ultimate effective control over the management of the legal person; and
- the individual identified as exercising control of the legal person through other means, including as a senior managing official, where no individual exerts control.

Under the current beneficial ownership regime, beneficial ownership information for in-scope entities is privately available to the competent authority (the "General Registry") and upon request to CIMA, the Financial Reporting Authority, the Anti-Corruption Commission, and the Tax Information Authority.

In 2019, the Cayman Islands government committed to instituting a public beneficial ownership registry. The Bill provides a framework for a public beneficial ownership registry, pending the government's future approval of the necessary regulations. The Cayman Islands government stated in a recent press release that it is undergoing further consultations on the public registry regime following the release of the ruling by the Court of Justice of the European Union (CJEU) in November 2022, in which the CJEU held that "the general public's access to information on beneficial ownership constitutes a serious interference with the fundamental rights to respect for private life and to the protection of personal data".

The Cayman Islands Ministry of Financial Services announced in 2023 that the Cayman Islands has satisfied the action plan given to it by the FATF. On 27 October 2023, the Cayman Islands was removed from the FATE grey list.

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