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Restructuring Across Borders

Cayman Islands:

Corporate restructuring and insolvency procedures | March 2020

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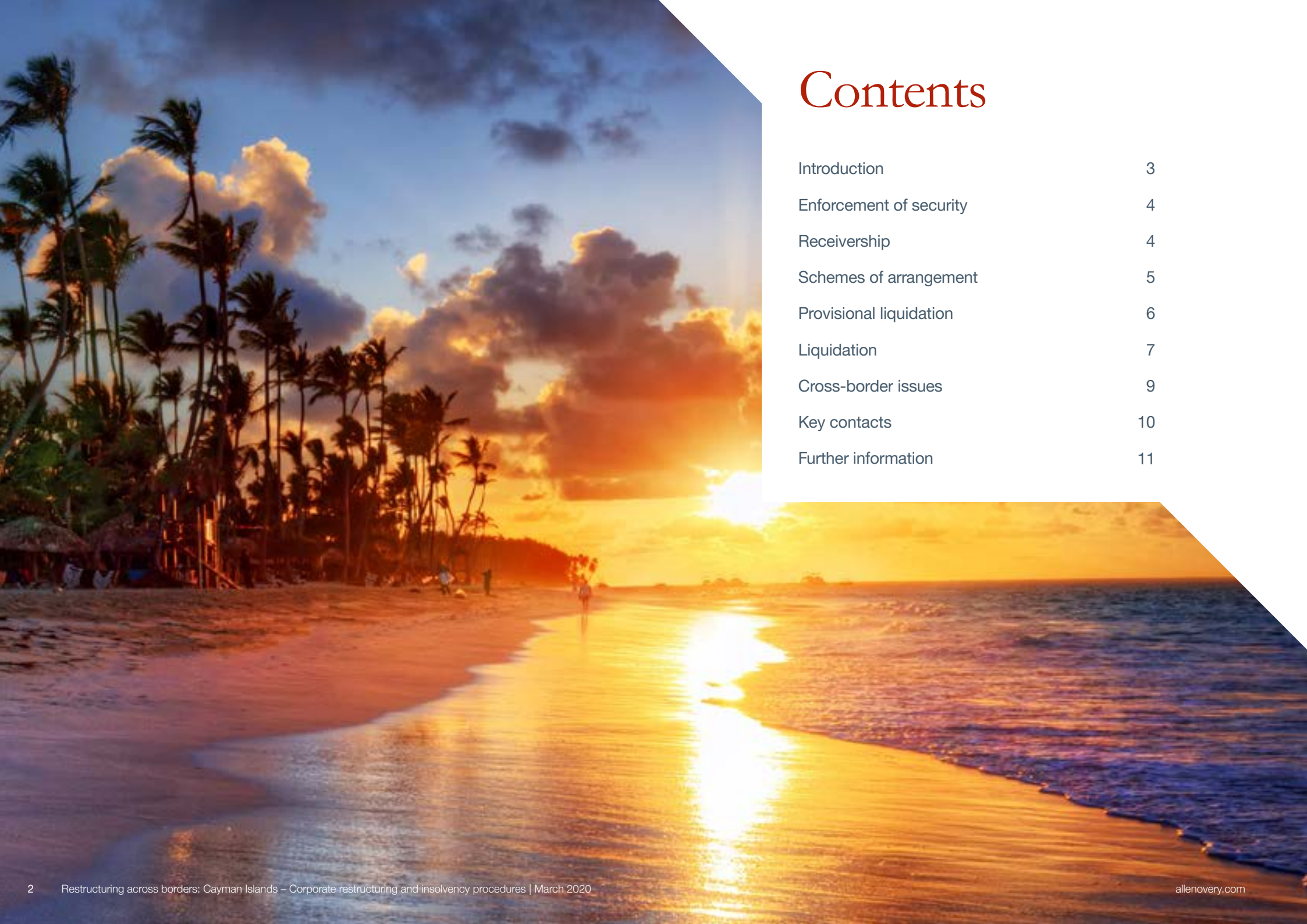

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Introduction

When a corporate borrower faces financial difficulties in the Cayman Islands, there are a variety of restructuring and insolvency options available.

The three principal restructuring and insolvency regimes for companies under Cayman Islands law are:

– receivership;

– scheme of arrangement; and

– liquidation (including provisional liquidation), also known as winding-up.

Insolvency and restructuring procedures in the Cayman Islands are primarily governed by the Companies Law (2020 Revision) (the **Companies Law**) and the Companies Winding Up Rules 2018 (as amended) (**CWR**). A number of other enactments may also be relevant, including the Insolvency Practitioners' Regulations 2018 (as amended) and the Foreign Bankruptcy Proceedings (International Cooperation) Rules 2018.

The Financial Services Division of the Grand Court of the Cayman Islands (the **Court**) is responsible for handling corporate insolvency and restructuring proceedings in the Cayman Islands.

From a creditor's perspective, the choice of procedure will depend on whether the debtor has granted security. If security has been granted, receivership may be the most appropriate choice. Receivership may be classified as a self-help remedy for secured creditors and, as a matter of Cayman Islands law (with the exception of registered land), is governed exclusively by the terms of the security document(s) and the common law. Cayman Islands insolvency law is very creditor friendly and will not prevent a secured creditor from enforcing its security in accordance with its terms.

Overall, the choice of procedure will depend on whether there is a business to be rescued. If so, an informal bank rescue or workout outside of any of the formal insolvency or restructuring procedures may be appropriate (ie the restructuring of the company on an informal, consensual basis by agreement between the company and its principal lenders and/or other creditors). Alternatively, a restructuring or rescue may be conducted via a formal scheme of arrangement (potentially in tandem with provisional liquidation proceedings).

If the company has no realistic chance of being rescued, it may be more appropriate to put the company into liquidation, and for a liquidator to realise the assets (which may include selling operating businesses or subsidiaries) and to distribute the proceeds to creditors and, if relevant, shareholders.

Enforcement of security

The main forms of security used in practice under Cayman Islands law are:

– legal and equitable mortgages;

– fixed and floating charges; and

– legal and equitable assignments.

For creditors who have taken security, it is possible to enforce certain security rights without a Court order (or, depending on the circumstances, the appointment of a receiver). The appropriate method of enforcement will depend on the type of security granted and the particular case in question.

Cayman Islands law recognises the concepts of a trust and a security power of attorney and it is possible to utilise a trust or a security power of attorney as a form of security.

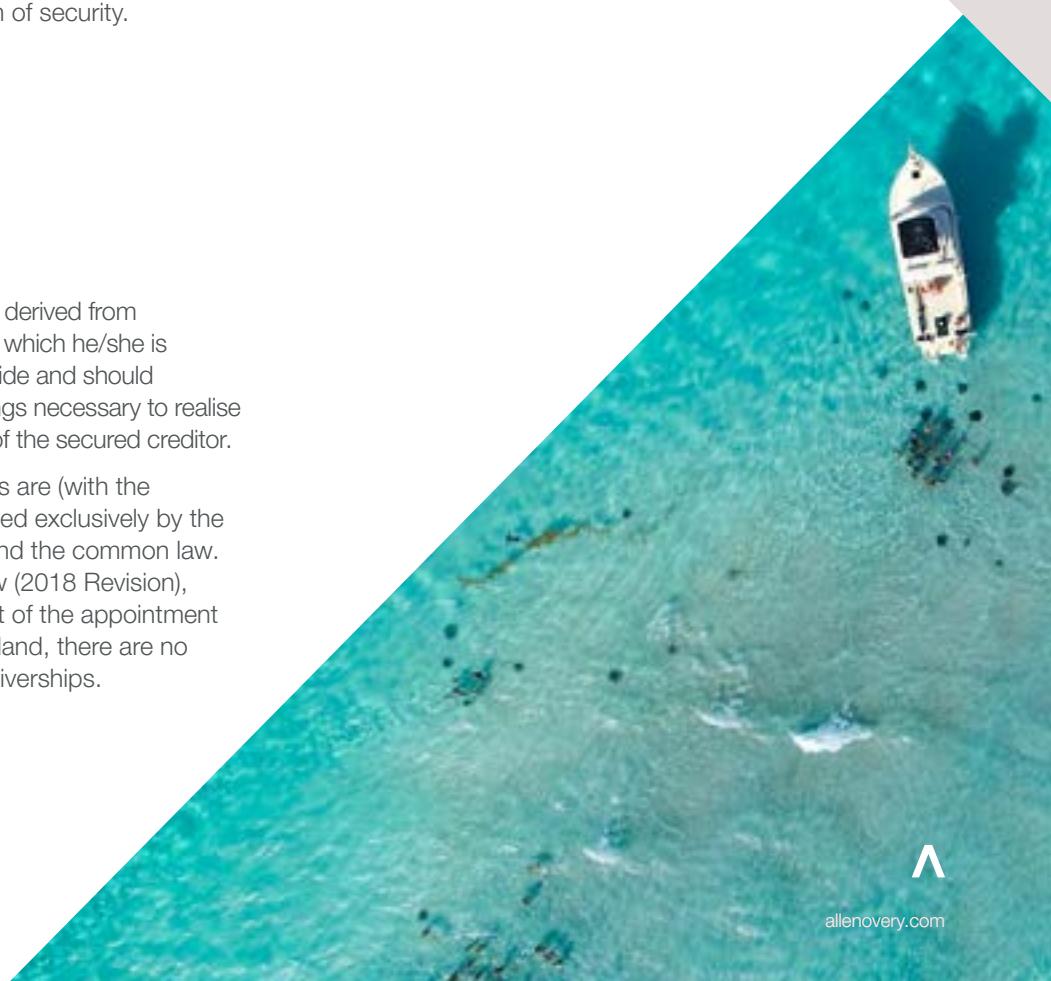
Receivership

Receivership is essentially a self-help remedy available to secured creditors. It is not a collective insolvency procedure but a method by which a secured creditor can enforce its security, realise the assets secured and obtain repayment of the debt outstanding. The receiver appointed acts principally in the interests of his/her appointor and not for the general body of creditors.

A receiver may be appointed by the secured creditor in accordance with the terms of the security document pursuant to which the appointment is to be made and without an order of the Court.

The powers granted to a receiver are derived from the security document(s) pursuant to which he/she is appointed. The powers are usually wide and should generally enable him/her to do all things necessary to realise the secured property for the benefit of the secured creditor.

Receiverships in the Cayman Islands are (with the exception of registered land) governed exclusively by the terms of the security document(s) and the common law. Other than the Registered Land Law (2018 Revision), which contains provisions in respect of the appointment of receivers in relation to registered land, there are no legislative provisions governing receiverships.



Schemes of arrangement

Schemes of arrangement involve a compromise or arrangement between a company and its creditors or members (or any class of them). In an insolvency or potential insolvency situation, schemes are principally used to: (i) restructure the company's debts when the company is in financial difficulties, with a view to the company continuing its operations (either on a stand-alone basis or within provisional liquidation proceedings); or (ii) reach a compromise with creditors following commencement of liquidation (the scheme being used as the mechanism for making distributions in the liquidation).

No protection from creditor action is afforded if a scheme of arrangement is used outside of liquidation or provisional liquidation proceedings. In the restructuring context, if a moratorium is likely to be beneficial, consideration should be given to a scheme of arrangement being used within a provisional liquidation (see further below).

A scheme may be initiated, on application to the Court, by the company itself (acting through its directors or a suitably authorised liquidator or provisional liquidator), or any creditor or member. Detailed scheme proposals will be put to the company's creditors and/or members. The terms of the scheme will vary from case to case; it is essentially a commercial deal between the company and its creditors and/or members. A scheme could, for example, vary the contractual rights of creditors including the amounts owed to them, the repayment dates or the methodology for determining their claims, and/or involve a complete write-off of debt and/or a debt for equity swap.

Where there are different classes of creditors or members involved, each class is required to hold separate meetings to vote on the scheme proposals. The scheme will be approved by the company's creditors/members if a majority (ie over 50%) in number, representing 75% in value of each class of creditors (and/or members), present and attending, either in person or by proxy, vote in favour of the scheme.

Once approved, the scheme will be required to be sanctioned by the Court and delivered to the Registrar of Companies to become binding on all affected parties, regardless of whether and how they voted at the class meetings. Essentially, the Court will sanction a scheme where the statutory provisions have been complied with and the arrangement is one that an intelligent and honest person, acting in respect of his/her interests, might reasonably approve.

Provisional liquidation

Outside of the restructuring context, a provisional liquidator may be appointed to preserve a company's assets or prevent mismanagement (effectively to hold the ring and to maintain the status quo) pending the hearing of the winding-up petition and the appointment of liquidators.

On the appointment of a provisional liquidator, a moratorium on unsecured creditor action arises as no action or proceeding can be commenced or continued against the company or its assets without leave of the Court. Importantly there is no stay on the enforcement of security by secured creditors.

Depending on the grounds for the appointment of provisional liquidators, provisional liquidation may be commenced by an application to the Court by: (i) a creditor (including a contingent or prospective creditor); (ii) a contributory (in essence, a shareholder); or (iii) the company by its directors (but only with a resolution of its shareholders or a provision in the company's articles of association allowing directors to present a winding-up petition).

Importantly, specific statutory provisions exist to enable provisional liquidation to be used as a restructuring proceeding in much the same way in practice as provisional liquidation has been used to restructure insurance companies in the UK. Where a winding-up petition has been presented, provisional liquidators may be appointed where the company: (i) is or is likely to become unable to pay its debts; and (ii) intends to present a compromise or arrangement to its creditors. This allows a restructuring of the company to be pursued with the benefit of the moratorium on creditor action. The restructuring may take the form of a scheme of arrangement or a consensual deal with creditors. Further, where a stay on creditor action in the Cayman Islands may be beneficial, a "restructuring" provisional liquidation may be used to support restructuring efforts in other countries, for example, a plan of reorganisation in U.S. chapter 11 proceedings.

The Court has broad powers in conducting a provisional liquidation (including in relation to the powers granted to provisional liquidators) and may adopt a flexible approach, including allowing the company's existing management to remain in control of the company's affairs subject to the provisional liquidator's supervision. Again, this may be useful if the provisional liquidation needs to be consistent with restructuring proceedings or efforts overseas.

Liquidation

Liquidation (or winding-up) is the dissolution procedure for companies under Cayman Islands law. Liquidation can take one of two forms:

– voluntary liquidation (with and without the supervision of the Court); or

– official liquidation (winding-up by the Court).

Voluntary liquidation

A voluntary liquidation is generally commenced by a members' special resolution at an extraordinary general meeting, during which one or more liquidators are required to be appointed for the purpose of winding up the company's affairs and distributing the company's assets. A voluntary liquidation may also commence automatically on a specified date or the happening of a specified event pursuant to any express terms to that effect in a company's articles of association.

A voluntary liquidator must apply to the Court for an order that the liquidation proceed under the supervision of the Court unless all of the directors of the company in question sign a declaration of solvency (in the prescribed form) within 28 days of the commencement of the liquidation. The declaration of solvency must confirm that a full enquiry into the company's affairs has been made and that, to the best of the directors' knowledge and belief, the company will be able to pay its debts in full together with interest within a period not exceeding 12 months from the commencement of the liquidation. The voluntary liquidator, any creditor or contributory may also make an application for the liquidation to continue under the Court's supervision even where a declaration of solvency has been made by the directors.

Criminal and/or civil sanctions may be applied against any director who knowingly makes a declaration of solvency without having reasonable grounds for believing that the company is in fact able to pay its debts in full.

No specific qualifications are required to serve as a voluntary liquidator. There is no automatic moratorium from creditor action in a voluntary liquidation because a company in voluntary liquidation ought to be solvent.

When a voluntary liquidation is brought under the supervision of the Court, it will continue as if it were an official liquidation and the requirements of an official liquidation (including the requirements as to the qualifications and independence of the liquidator) will apply.

Official liquidation

Any creditor (including a contingent or prospective creditor) or any contributory may present a petition to the Court for a compulsory winding-up of the company. Directors may present a winding-up petition on behalf of the company but only: (i) with a resolution of the company's shareholders; or (ii) if specifically permitted to do so by the company's articles of association. The Court has the discretion to make a winding-up order in a number of specified circumstances, including, among others, where it is proven that the company is unable to pay its debts (while the statutory test is not "unable to pay its debts as they fall due" the Cayman Islands Court of Appeal has held that a cash flow test, as a test of commercial insolvency, includes an element of futurity), or where the Court is of the opinion that it is just and equitable that the company should be wound up (balance sheet insolvency can be used as a ground to wind a company up on the just and equitable basis).

Where a winding-up order is made all transfers of shares or alteration in the status of the company's shareholders and all dispositions of the company's property made between the date of presentation of the petition and the order for winding-up (and following the order for winding-up) are void unless the Court otherwise directs.

Once the winding-up order has been made no action or proceeding can be commenced or continued against the company or its assets without leave of the Court. However, there is no stay on the enforcement of security by secured creditors.

Regardless of whether the liquidation is a voluntary liquidation or an official liquidation, the liquidator's role is to wind up the affairs of the company, realise the assets of the company, agree creditors' claims and distribute the assets in the statutory order of priority. The appointment of a liquidator will displace the directors save to the extent (in the case of a voluntary liquidation) that the company, by resolution of the members or the liquidator, sanctions the continuance of the directors' powers.

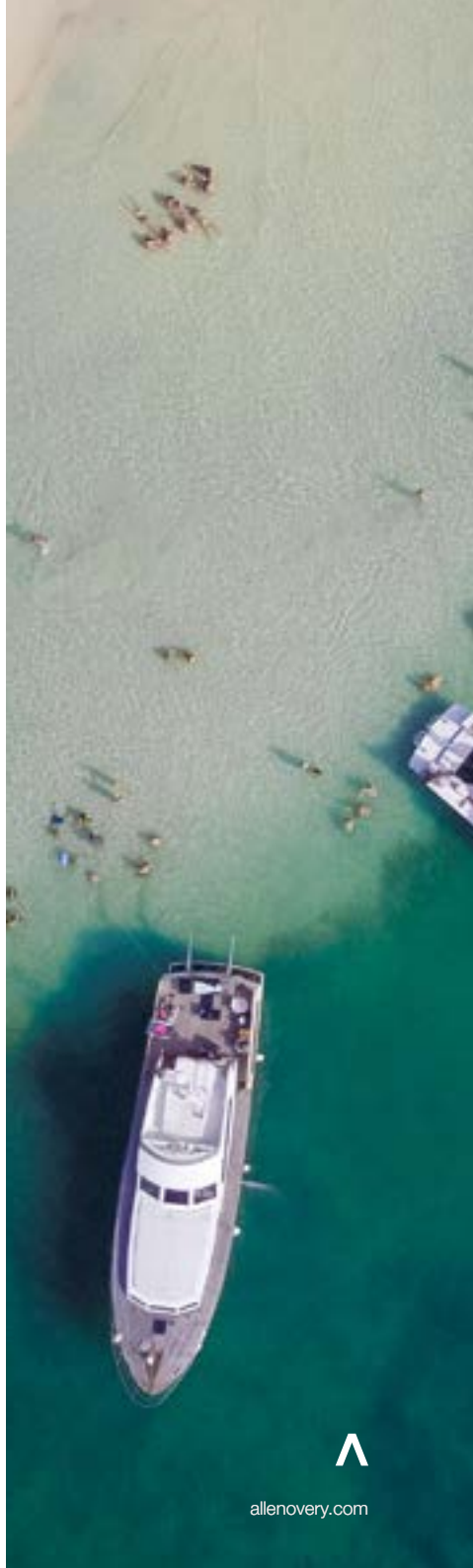
The Companies Law provides for the setting off of mutual claims between the debtor and the creditor provided that those claims arose prior to the commencement of the liquidation and the creditor did not have notice that a petition for the winding-up of the debtor was pending at the time such claims arose. However, this is subject to provisions in the Companies Law which provide that contractual set-off (or no set-off) and netting provisions contained in the relevant agreements trump the insolvency set-off rules. For example, a no set-off provision in a promissory note (effectively stipulating that all payments made by the borrower to the lender are to be made without set-off) will be recognised and displace the statutory rights of set-off for the borrower that would otherwise apply in insolvency.

Generally speaking, on a company's liquidation payments can be expected to be made following the statutory order of priorities, a high level summary of which is as follows:

1. costs and expenses of the liquidation (including the liquidators' remuneration);
2. preferential debts pursuant to the Companies Law;
3. unsecured, unsubordinated provable debts (eg ordinary unsecured creditors);
4. subordinated creditors;
5. post-liquidation interest (where the liquidation lasts more than six months);
6. shareholder claims pursuant to unpaid redemptions; and
7. shareholders.

In an official liquidation, the Court will need to be satisfied that the proposed liquidator is independent and has the qualifications to fulfil his/her functions.

Once the liquidation process is completed the company will be dissolved and it will not be possible to restore the company to the register.



Cross-border issues

The Cayman Islands have not adopted the UNCITRAL Model Law on Cross Border Insolvency.

The Court has jurisdiction to make a winding-up order in respect of a company incorporated outside of the Cayman Islands which: (i) has property located in the Cayman Islands; (ii) is carrying on business in the Cayman Islands; (iii) is the general partner of a limited partnership; or (iv) is registered as a foreign company in the Cayman Islands. Depending on the factual circumstances such proceedings may be ancillary to principal insolvency proceedings taking place in another jurisdiction. Where it is possible for a company incorporated outside of the Cayman Islands to be wound up by the Court, it should also be possible to have a scheme of arrangement of that company in the Cayman Islands.

The Court also has specific jurisdiction to wind up the business of a licensed foreign bank, trust or insurance company on the application of the Cayman Islands Monetary Authority pursuant to the Banks and Trust Companies Law (2020 Revision) and the Insurance Law, 2010 (as amended).

Part XVII of the Companies Law (together with the Foreign Bankruptcy Proceedings (International Cooperation) Rules 2018) contains specific provisions allowing the Court to recognise and provide assistance to foreign insolvency and restructuring proceedings that have been commenced in the jurisdiction where the company is incorporated.

Where a company is subject to both liquidation proceedings (including provisional liquidation proceedings) in the Cayman Islands and insolvency proceedings in another jurisdiction (which is common given that the majority of the companies incorporated in the Cayman Islands conduct their business and hold assets outside of the Islands) the CWR make it the duty of the Cayman Islands liquidator to consider whether it is appropriate to enter into a protocol with the foreign officeholder. Such a protocol will need to be approved by the Court and the relevant foreign court in order to become binding.

The Judicial Insolvency Network's Guidelines for Communication and Cooperation between Courts in Cross-Border Insolvency matters and the American Law Institute/International Insolvency Guidelines Applicable to Court-to-Court Communications in Cross-Border Cases (the **Guidelines**) were adopted by the Court on 31 May 2018 by way of Practice Direction No.1 of 2018. Cayman Islands officeholders are therefore required to consider, at the earliest opportunity, whether to incorporate some or all of the Guidelines either: (i) into an international protocol to be approved by the Court; or (ii) an order of the Court adopting the Guidelines.

There is no difference in treatment between foreign and domestic creditors in insolvency proceedings commenced in the Cayman Islands. At present, the Cayman Islands are not a signatory to any treaties on international insolvency. The Foreign Judgments (Reciprocal Enforcement) Law (1996 Revision) may provide some assistance to foreign creditors allowing the registration of foreign judgments in the Cayman Islands. To date, the law has only been enacted in relation to Australia and a number of its external territories.

Key contacts

This factsheet has been prepared with the assistance of Maples and Calder's Insolvency and Restructuring Team. Due to the general nature of its contents, it should not be relied or acted upon in any specific situation without appropriate legal advice. If you require advice on any of the matters raised in this document, please call any of our partners or your usual contact at Allen & Overy.

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Further information

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