

'Restructuring' Restructured: Cayman's New Insolvency Regime

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In the current economic circumstances the modern trend among insolvency professionals to avoid the term 'insolvency' in favour of the more optimistic 'restructuring' may have a ring of Orwellian doublespeak about it. Call it what you will, the system in the Cayman Islands for dealing with companies that cannot pay their debts has itself been through a restructuring. After several years' work by various committees, the Law Reform Commission and the Government, a complete overhaul of this critical area of law came into force on 1 March 2009.

The changes comprise a replacement of Part V of the Companies Law dealing with the winding up of Cayman Islands companies, and the introduction of new rules and regulations, which introduce specific Cayman rules where previously United Kingdom rules were used, regulate areas not previously regulated, or implement newly-introduced concepts. At the same time, a new Part XVI has been introduced. That Part, and the corresponding new rules, deal with how the

Cayman Islands court will provide support and assistance to representatives of companies that are in bankruptcy or similar proceedings in *other* countries: those changes are the subject of a separate article in this issue,

THE COMPANIES LAW: KEY CHANGES

- **Foreign companies:** Local branches of foreign companies may now be wound up.
- **Shadow directors:** Concept is introduced into Cayman Islands law by adopting the definition in s. 741 of the English Companies Act 1985 – essentially a person in accordance with whose instructions the directors are accustomed to act.
- **Automatic liquidation:** Resolves an ongoing debate about whether a provision in a company's articles of association that it should automatically be wound up after a given time is effective, clearly establishing that it is.

- **Standing to petition:** Previously, contingent and prospective creditors had no standing to present a winding-up petition. The new s. 94 reverses this rule. Additionally, for companies incorporated after commencement of the new law, and where the articles specifically provide, directors can be empowered to present a petition without the sanction of a resolution passed at a meeting of the shareholders. The right of a contributory to petition is restricted somewhat by the introduction of a requirement that he must (with minor exceptions) have held his shares for at least six months; this will affect 'vulture funds' and others who buy shares with the intention of liquidating the company. Finally, the Cayman Islands Monetary Authority, which already has power to petition to wind up any entity licensed or regulated under the Islands' financial services regulatory laws, can now be given a new corresponding power in relation to companies unlawfully carrying on business without being licenced.
- **Non-petition covenants:** In structured finance transactions in particular it is often important for a special purpose vehicle to be 'bankruptcy remote' – protected from being subject to winding up in the event of the bankruptcy of the originator of the transaction. This has been achieved by incorporating covenants not to petition in the structure documents, in addition to the usual 'limited recourse' language. The debate about the effectiveness of these covenants is resolved by providing that the Court shall dismiss a petition brought by a person who is contractually bound not to present one.
- **Shareholders' petitions:** The Court has the power, on the presentation of a petition by a contributory on the 'just and equitable' ground, to make alternative orders regulating the conduct of the company's affairs, requiring it to do or refrain from doing a particular act, restricting changes to its articles of association, or requiring the purchase of the shares of a shareholder by other

shareholders or by the company itself. These provisions are broadly equivalent to ss. 459 to 461 of the English Companies Act 1985.

- **Interest on debts:** S. 49 (which is based on s. 189 of the English Insolvency Act 1986) provides for the payment, after debts proved in the liquidation but in priority to shareholder claims, of interest at either the prescribed rate or any applicable contractual rate, whichever is higher.
- **Fraudulent trading:** This concept is introduced into Cayman Islands law by means of provisions equivalent to s. 213 of the English Insolvency Act 1986.

NEW RULES AND REGULATIONS:

The Companies Winding-up Rules 2008

The first procedural rules for insolvency matters specifically adopted for the Cayman Islands, these rules replace the United Kingdom's Insolvency Rules 1986 (S.I. 1986/1925) in relation to all proceedings commenced, and all steps taken in existing proceedings, after 1 March 2009. In many areas the rules follow the English position, but there are notable differences and some special rules to address specific local circumstances. These include:

- Special rules for petitions by the Monetary Authority in relation to regulated entities or companies conducting regulated business without being licenced.
- A specific regime for applications by official liquidators for the Court's approval of a specific course of action, or by the liquidation committee or specific creditors to compel or prevent such a course of action, collectively defined as 'sanction applications'.
- A new duty on official liquidators of Cayman companies that are the subject of parallel insolvency proceedings in another jurisdiction, or whose assets overseas are subject to foreign bankruptcy or receivership proceedings, to consider whether it is appropriate to enter into an

international protocol with any foreign officeholder.

- A specific regime to deal with the issue of unclaimed dividends and undistributed assets of a post-liquidation trust.

THE INSOLVENCY PRACTITIONERS' REGULATIONS 2008

Official liquidators, in order to be eligible for appointment, must meet defined criteria in four areas: professional qualifications (by reference to designated overseas qualifications, in place of the system whereby the Grand Court was simply empowered to appoint such persons as it thought fit), residence in the Cayman Islands, independence from the debtor company and sufficiency of insurance cover. The regulations also cover, in some detail, the remuneration of official liquidators.

THE FOREIGN BANKRUPTCY PROCEEDINGS (INTERNATIONAL COOPERATION) RULES 2008

The main focus of these Rules is the implementation of the provisions of the new Part XVI of the Companies Law relating to co-operation with foreign insolvency representatives. That subject is addressed in the article entitled: Developments in Cayman Islands Cross-Border Insolvency Law. However the Rules are also significant for Cayman companies, and foreign companies registered in Cayman: any such company that is made the subject of foreign bankruptcy proceedings comes under a new duty to give notice of that fact to the Registrar and advertise it in the Cayman Islands Gazette.

THE GRAND COURT (AMENDMENT NO. 2) RULES 2008

These rules replace the existing Orders 1 and 102 of the Grand Court Rules with new versions. The changes are relatively minor and entirely consequential upon the introduction of the Companies Winding-up Rules 2008. They also revoke Practice Directions 1 of 2003 (Official Liquidators: Security for the Due Performance of their Duties) and 1 of 2006 (Liquidators' Remuneration), both of which subjects are now dealt with by the Insolvency Practitioners' Regulations 2008.

The new rules and regulations, together with the replacement of Part V of the Companies Law and the introduction of Part XVI, represent a major enhancement of the Cayman Islands' legislative framework. They provide the jurisdiction with an up-to-date and well thought-out insolvency regime specifically tailored to meet the needs of users of the Cayman Islands as a major financial centre.

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