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Cayman's new insolvency regime

The new insolvency regime represents a major enhancement of the Cayman Islands' legislative framework. It provides 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.

After several years' work by various committees, the Law Reform Commission and the government, a complete overhaul of Cayman's domestic insolvency regime came into force on 1 March 2009. The changes comprise a replacement of Pt V of the Companies Law dealing with the winding up of Cayman Islands companies, the introduction of Pt XVI dealing with cross-border insolvency and the introduction of new domestic rules and regulations. The key changes introduced by the new provisions and rules are summarised below.

PART V COMPANIES LAW: KEY CHANGES

The key changes that were made to the Companies Law through substitution of a new Pt V, were:

- **Foreign Companies:** local branches of foreign companies may now be wound up.
- **Shadow Directors:** this concept is introduced into Cayman Islands law by adopting the definition in the former s 741 of the English Companies Act 1985 – essentially a person in accordance with whose instructions the directors are accustomed to act.
- **Automatic Liquidation:** 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, has been resolved, the new law clearly establishing that it is.
- **Voluntary liquidation:** voluntary liquidations may now only continue beyond 28 days of the resolution placing the company in voluntary liquidation where the company is solvent and the company's directors swear a declaration of solvency.
- **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 licensed.

- **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.

The provisions of the new Pt V potentially apply with retrospective effect. The transitional provisions will therefore need to be considered in relation to any petition or other proceeding initiated prior to 1 March 2009.

PART XVI COMPANIES LAW: CROSS-BORDER INSOLVENCY PROVISIONS

Part XVI applies to insolvency proceedings brought outside the Cayman Islands and to applications for recognition and assistance from the foreign representative of those proceedings.

In essence, Pt XVI gives legislative expression to well-established Cayman Islands cross-border insolvency principles and significantly resembles (but stops short of adopting) UNCITRAL's Model Law. The structure of Pt XVI of the Companies Law is as follows:

- The definitions that foreign representatives must satisfy in order to attain standing to seek ancillary relief from the court are set out in s 252.
- The kinds of ancillary orders that the court may, in its discretion, make are set out in s 253.
- The guiding principles and considerations for the court in deciding whether to exercise its discretion to grant ancillary orders are set out in s 254.

Biog box

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International Feature

- Certain notice obligations arising upon issue of foreign insolvency proceedings in respect of Cayman Islands incorporated companies, or foreign companies registered in the Cayman Islands, are set out in s 255.

Under Pt XVI, the court at all times retains its discretion to make orders ancillary to, or in assistance of, a foreign bankruptcy proceeding. The central issue under Pt XVI is the appropriateness of granting relief, not the question of where the debtor's COMI is located.

Section 252 of the Companies Law confers jurisdiction for an application for ancillary relief under Pt XVI based on the debtor's incorporation in the country of the foreign bankruptcy proceeding.

For those cases where the debtor is not incorporated in the jurisdiction where the proceedings are commenced, the proper construction of 'established' will be relevant. For an establishment to exist, a place of business is required, as opposed to simply the presence of assets within the jurisdiction, although a place of business can be the debtor's registered office.

In order to seek ancillary orders pursuant to s 253, there is no requirement for a foreign bankruptcy proceeding to be subject to control or supervision by the foreign court; this follows the approach taken by the Model Law.

The forms of ancillary relief that the court can provide to foreign representatives pursuant to s 253 are: recognising the right of a foreign representative to act in the Cayman Islands on behalf of or in the name of a debtor; enjoining the commencement or staying the continuation of legal proceedings against a debtor; staying the enforcement of any judgment against a debtor; requiring a person in possession of information relating to the business or affairs of a debtor to be examined by and produce documents to its foreign representative; ordering the turnover to a foreign representative of any property belonging to a debtor.

An ancillary order may only be made under sub-s (1)(d) against the debtor itself or a person who was, or is, a relevant person as defined in s 103(1) – that is, being connected with the debtor in one of the prescribed professional capacities or involved in the promotion or management of the company.

Section 253(1) of the new Pt XVI provides the full range of ancillary relief that is available under Model Law. The matters the court will consider in determining whether to make ancillary orders upon application by a foreign representative are set out in s 254.

Section 255 is directed at protecting Cayman Islands creditors of companies that become subject to foreign insolvency proceedings by giving local creditors sufficient notice to ensure that they are not disadvantaged relative to creditors in the debtor's home or other jurisdictions.

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 UK's Insolvency Rules 1986 (SI 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 licensed.
- 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 Pt XVI of the Companies Law relating to co-operation with foreign insolvency representatives. 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.

CONCLUSION

The new rules and regulations, together with the replacement of Pt V of the Companies Law and the introduction of Pt 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. ■