



Guide to Corporate Entities and Partnerships in the Cayman Islands

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PREFACE

Appleby is the longest established law firm in the Cayman Islands. Our success is built on giving timely, clear and sound advice that reflects an understanding of our clients' business needs. We regularly work with – and many of our lawyers come from – the world's leading international firms. We aim to provide world-class quality of service and expertise, combining in-depth knowledge of Cayman Islands laws and regulations with international experience.

CAYMAN ISLANDS – JURISDICTION OF CHOICE

Over the years, the Cayman Islands has gained worldwide recognition as a jurisdiction of the highest quality and continues to preserve this position as confirmed by Moody's Investor Services report of June 2009. The highly respected rating organization maintained the country's Aa3 foreign currency country ceiling and continues to describe the outlook for the Cayman Islands as stable. The Cayman Islands' respectable rating is largely due to its strong offshore financial services industry, of which mutual funds is a cornerstone, and the country's solid macroeconomic fundamentals.

Historically, the use of offshore holding companies was driven largely by taxation. Recently, however, the motivation for using offshore jurisdictions is not only directed at reducing taxation but also for introducing a greater flexibility with regard to the operation of international corporations and corporate group structures. Other than the globalization of business transactions, this trend has also been prompted by the development of offshore jurisdictions in terms of infrastructure and recognition. The Cayman Islands are a prime example of such development and recognition.

There are many reasons why the Cayman Islands are the jurisdiction of choice for the establishment of offshore investment vehicles, special purpose vehicles and other corporate structures. Leading financial institutions from across the globe, particularly from the Americas, Europe and Asia have chosen Cayman as the jurisdiction for establishing their fund and capital markets products for many reasons, including the following:

Flexibility in structure – Cayman corporate structures can be companies or partnerships according to client requirements, which are often tax related in their home jurisdiction. Cayman is an ideal jurisdiction from the point of view of corporate structuring, not just for establishing vehicles for structured transactions or for direct investments, but also for providing solutions towards corporate group planning. For instance, Cayman companies, if provided in their constitutional documents, can issue shares which can be repurchased or redeemed, can repay premium on shares out of share capital, share premium account or capital if, after such payment is made, the company is able to satisfy a solvency test. Dividends can be paid out of surplus (profits) or share premium if the company satisfies a solvency test.

Speed of establishment – A Cayman company can be incorporated within a day.

Central Time Location – The Cayman Islands' central time location (GMT-5) is ideal for organizations operating their businesses from Asia, Europe and the Americas in that travel times and costs can be reduced.

No direct taxes – Cayman has no capital gains, income, profits, corporation or withholding taxes (whether on the offshore vehicle or on holders of securities issued by such vehicle). If the offshore vehicle is incorporated as an exempted company (the typical form of vehicle for corporate and financing transactions) it can obtain an undertaking from the Cayman Islands Government that it will remain tax-free for a 20-year period and in the case of exempted trust or an exempted limited partnership the period is up to 50-years.

Investors/shareholders of Cayman vehicles must always obtain advice on the impact of taxation in the jurisdiction in which they are tax resident before investing into a Cayman vehicle.

Availability of world-class professional services – Cayman has a wealth of lawyers, accountants and other service providers with renowned expertise.

Stock Exchange Listing – The Cayman Islands Stock Exchange (www.csx.com.ky) hosts a significant number of special purpose vehicles and mutual funds and has been recognised by the London Stock Exchange as an

“approved organisation”. Cayman companies are also often listed on foreign stock exchanges like NASDAQ, the Irish and the Hong Kong Stock Exchanges.

Trustworthy and reliable legal system – Cayman law, derived from English common law and supplemented by local legislation, ensures that Cayman companies are structured as internationally accepted vehicles. The Cayman court system is well developed with appeals ultimately going to the Privy Council in London.

Anti-money laundering culture – The Cayman Islands have long been committed to implementing best international practice and are fully compliant with the requirements of the Organisation of Economic Cooperation and Development (OECD) and Financial Action Task Force (FATF).

Tax Information Exchange Agreements (“TIEAs”) – The international media has frequently reported on the OECD, TIEAs and lists of countries that have been categorised as “black”, “grey” or “white”. For the Cayman Islands these reports culminated in a positive announcement on 13 August 2009 when the Islands were elevated to the OECD white list. The OECD places a jurisdiction on the white list if it has entered into a minimum of 12 bilateral agreements to exchange tax information with foreign governments. The key negotiating points for countries in signing TIEAs are the distribution of costs incurred in complying with requests and the criteria for making requests to ensure that the request is based upon a strong case and to prevent “fishing expeditions”. The TIEAs provide for the type of information to be exchanged, the timing and route of information, the protection of individual and corporate rights under the laws of each jurisdiction and extensive safeguards to protect the confidentiality of the information exchanged.

In actively implementing the TIEAs and continuing to engage in international economic dialogue, the Cayman Islands demonstrates its status as a well-regulated, forward-looking and leading offshore financial jurisdiction. Its white list status is but one example of the Cayman Islands’ willingness to be at the forefront of compliance and transparency standards. The Cayman Islands has entered into more than 17 TIEAs.

Stable and business oriented government – The Cayman Islands are a British Overseas Territory and have a history of stable government, committed to promoting the financial services industry.

The Cayman Islands Monetary Authority – (www.cimoney.com.ky) – The Authority’s mission is to regulate and supervise the financial services industry in order to maintain a first class financial system that includes safeguarding the interests of mutual fund investors from undue loss. The Authority has regard to international standards, the need for operational freedom by financial services providers and for the maintenance of a dynamic and competitive industry.

Exchange Controls – There are no exchange control regulations in the Cayman Islands. As such, money and securities in any currency may be freely transferred to and from the Cayman Islands.

Financial Assistance – Financial assistance is not prohibited under the laws of the Cayman Islands and accordingly financial assistance may be provided for the acquisition of shares in Cayman companies.

Creditor Friendly Legal System – The legal system in the Cayman Islands is ideally suited for corporate finance and structured transactions. The Cayman Islands do not have a statutory system of corporate rehabilitation such as the English administration procedure or the US Chapter 11 proceedings where the rights of creditors can be frozen but the Cayman courts have in appropriate cases been prepared to appoint liquidators on a provisional basis pending the implementation, with requisite creditor approval, of a scheme of arrangement. Liquidators of Cayman companies cannot disclaim onerous contracts. Contract rights of creditors continue to

exist following liquidation. Secured creditors can enforce their security upon the liquidation of a Cayman company. Netting and set-off arrangements are recognised by express statutory provisions and are enforced pre and post insolvency.

Legal Opinions – Cayman Islands legal opinions are regularly accepted in capital market transactions.

This extensive portfolio of advantages makes the Cayman Islands the premier jurisdiction for the establishment of investment and special purpose vehicles.

LEGAL FRAMEWORK & CORPORATE ENTITIES

Generally

Cayman Islands companies are regulated by the Companies Law, as amended from time to time (“Companies Law”). A Cayman Islands company is similar in most respects to companies and corporations formed elsewhere in the world in that members’ liability is usually limited, although it can be unlimited or limited by guarantee, and the business of the company is managed by its directors. A Cayman company is usually limited by shares and is incorporated by filing with the Registrar of Companies (“Registrar”) in the Cayman Islands the Memorandum of Association (which defines the powers and objects of a company and includes its authorised share capital) and the Articles of Association (which define the internal procedures by which the company acts and is administered).

There are three types of Cayman Islands companies: exempted companies, ordinary non-resident companies and ordinary resident companies. The first two types of companies are considered offshore companies and may carry on business in any part of the world except the Cayman Islands. Ordinary resident companies, on the other hand, may carry on business in any part of the world including the Cayman Islands.

Every Cayman company must maintain a registered office in the Cayman Islands. Such service can be provided by Appleby Trust (Cayman) Ltd. (“ATCL”) or another service provider in the Cayman Islands. The registered office usually keeps originals of the incorporation documents, a Register of Directors and Officers, a Register of Mortgages, usually a Register of Members and a Minute Book in which originals or copies of all minutes and resolutions of Directors and Shareholders should be filed. There is no requirement for the Register of Members to be kept in the Cayman Islands or at the registered office of the Cayman company (unless the company is an ordinary company).

Prior to incorporation, the proposed name of a Cayman company should be approved by the Registrar and, upon payment of a fee, may be reserved. The name of the company must end with the word “Limited” or its abbreviation “Ltd.”. There is no such requirement for exempted companies. There are other restrictions on names that might imply that the company is carrying on business as a bank, trust company or insurance company (unless it is licensed in the Cayman Islands under the relevant laws governing those types of companies) or that the company has connections with royalty etc.

There is no requirement for a Cayman Islands company to appoint resident directors or officers or any other service providers in the Cayman Islands. If ATCL acts as registered office we would recommend that ATCL be appointed as secretary or assistant secretary of a company to facilitate filings with the Registrar and other regulatory bodies in the Cayman Islands.

Directors of Cayman companies are required to keep proper accounts but there is no requirement that such accounts be audited or that any accounts be filed with the Registrar or any other regulatory authority in the Cayman Islands. The memorandum and articles of the Cayman company and the listing rules, if applicable, govern such matters.

Companies carrying on business in the Cayman Islands have to comply with strict licensing requirements. Operating a bank account in the Cayman Islands or owning and renting a piece of property in the Cayman Islands is not considered as carrying on business in the Cayman Islands. There are licensing requirements for carrying on banking, trust company and insurance business. Appleby can advise you as to which licensing requirements would have to be satisfied by a company in order for it to commence carrying on a particular kind of business in the Cayman Islands.

Exempted Company

Exempted companies are established under the Companies Law and are the most common form of legal entity used in the Cayman Islands for international business transactions, as investment vehicles and as special purpose vehicles (“SPVs”) in capital markets transactions. An exempted company, although prohibited from trading in the Cayman Islands, may enter into and conclude contracts in the Cayman Islands and exercise all its powers for the purpose of carrying on business outside the Cayman Islands.

An exempted company can conduct business activities from the date of its incorporation and pre-incorporation contracts made on behalf of the exempted company prior to its incorporation may be ratified.

An undertaking from the Cayman Islands Government may be obtained confirming that, for a 20 year period, in the event of imposition of income, capital gains or inheritance taxes, the company and its shareholders will not be taxed (“Tax Exemption Undertaking”).

The authorised share capital of an exempted company is generally divided into shares of a fixed par value amount or it may have shares of no par value or it may have several classes of shares with each class having different class rights and different par values. An exempted company is also able to issue bearer shares although such shares are required to be held by an authorised custodian within the Islands pursuant to the Companies Law. An exempted company may express its authorised share capital in foreign currencies. The registration fee and the annual return fee are computed on the basis of the company’s authorised share capital.

An exempted company only has to satisfy minimal requirements under the Companies Law. The company must have at least one shareholder of record, details of its directors and officers must be furnished to the Registrar (such details are kept confidential by the Registrar), and each year a return must be filed confirming that the company has conducted its business activities outside the Cayman Islands.

An exempted company must maintain its registered office in the Cayman Islands. There is no requirement for directors of an exempted company to meet in the Cayman Islands.

Limited Duration Company

The Companies Law allows for the establishment of or the re-registration of an exempted company as a limited duration company (“LDC”). An LDC must satisfy certain requirements under the Companies Law. It must have at least two subscribers or shareholders, it must be limited to a duration of 30 years or less and the name of the company must include “Limited Duration Company” or “LDC”.

The Companies Law permits an LDC to incorporate interesting features into its constitutional documents. For instance, the management of the LDC can be vested in its shareholders either equally per capita or in proportion to the shareholding or ownership interest in the LDC. In such circumstances, the shareholders of the LDC are considered automatically to be the directors of the company, but with the power, if provided in the Articles of Association, to delegate management of the company to a board of directors.

An LDC can contain provisions in its constitutional documents that can assist the LDC to be treated as a partnership for United States tax purposes.

Segregated Portfolio Companies

The Companies Law permits an exempted limited company to take the form of a segregated portfolio company (“SPC”) which provides an attractive corporate structure with far reaching applications and shows the versatility and efficiency of exempted limited companies as investment fund vehicles.

The Companies Law provides that, whilst retaining its corporate existence as a single legal entity, a segregated portfolio company may be registered as having segregated portfolios of assets, which may be traded independently and which, during the life of the company and on liquidation, are protected from creditor claims arising with respect to liabilities of other segregated portfolios or the company generally. A segregated portfolio of or within a segregated portfolio company does not constitute a legal entity separate from the company.

The use of segregated portfolio companies provides an attractive solution for restructuring multinational corporations by providing the ability to operate in a way analogous to a corporate group while utilizing just a single legal entity.

Ordinary Non-Resident Company

The provisions in the Companies Law for ordinary non-resident companies are the same as for ordinary companies with the exception that the company must be designated as a non-resident company in its certificate of incorporation. With this type of company the authorised share capital must be divided into shares of a fixed amount.

Although the minimum number of shareholders is one, the Register of Shareholders is a public document. The Register of Directors and Officers remains confidential but details must be furnished to the Registrar.

An ordinary non-resident company can be reregistered as an exempted company under the Companies Law.

Differences and Similarities between Exempted and Ordinary Non-Resident Companies

The main differences between these two legal entities are as follows:

- An exempted company can apply to obtain a Tax Exemption Undertaking whereas an ordinary non-resident company cannot. Presently, however, neither type of company is required to pay any Cayman Islands taxes.
- Information on the shareholders of an exempted company is kept confidential whereas such information for ordinary non resident companies is publicly available. Only the use of nominee shareholders will preserve confidentiality of shareholders in an ordinary non resident company.

- There is more flexibility in the name of an exempted company which does not need to have the word "Limited" or "Ltd." in its name.

Both legal entities have the following similarities:

- The amount of shares to be issued to each shareholder is determined by the capital requirements from time to time and the total authorised share capital need not be and is usually not issued in its entirety. It is usual to issue, for example, 100 shares either at par or at a premium with any other funds being invested in the company being treated as loans to it. Subject to satisfying certain requirements under the Companies Law, a company can redeem or repurchase its own shares.
- The number of directors is a matter of choice but two is recommended, one of who can be Chairman of the Board. A secretary is not a requirement under the Companies Law, but it is recommended that one be appointed. The minimum number of directors is one. It is not recommended that a sole director also act as secretary.

Ordinary Company

Ordinary companies are established under the Companies Law and are used, primarily, for conducting business in the Cayman Islands. The Companies Law contains additional requirements for the establishment of such companies.

The minimum number of shareholders is one and the minimum number of shares required to be issued is one share. A Register of Shareholders must be maintained, usually at the registered office, and must be made available for public inspection. Only the use of nominee shareholders will preserve confidentiality of shareholders in an ordinary resident company.

An ordinary resident company is required to hold an Annual General Meeting of its shareholders in each year, which meeting may be held anywhere in the world. In addition it must file with the Registrar in January of each year, an Annual Return of its shareholders stating the number of shares held by each shareholder and the date of the last Annual General Meeting.

If ATCL provides the registered office for a particular ordinary resident company copies of the company's accounts should be delivered to ATCL.

Foreign Companies

The Companies Law provides that all bodies corporate incorporated outside the Cayman Islands, which establish a place of business or commence carrying on business within the Cayman Islands, are subject to the Companies Law. "Place of business" includes a share transfer or share registration office. No body corporate incorporated outside the Cayman Islands has the power to hold land in the Cayman Islands until it is registered as a foreign company.

Large multinational corporations, financial institutions and banks in order to enable the establishment of a branch in the Cayman Islands and enable the branch to enter into commercial transactions on behalf of the corporation, usually register such foreign companies in the Cayman Islands.

A foreign company, which ceases to carry on or have a place of business in the Cayman Islands, is required to give notice of that fact to the Registrar. The obligation of the company to deliver any document to the Registrar ceases on that date (or on the date when the Registrar is satisfied by any other means that the company has ceased to carry on business or have a place of business in the Cayman Islands).

Under Cayman Islands conflicts of law principles, the jurisdiction of incorporation or establishment of such company governs the execution of contracts, agreements and other documents by a foreign company. For instance, an instrument executed by a foreign company outside the Cayman Islands is treated as a deed or instrument under seal if sealed or expressed to be executed as a deed and is executed in conformity with any requirement imposed by the laws of the jurisdiction of its incorporation and with its constitutional documents. A foreign company may by deed or instrument under seal appoint any person to execute deeds or instruments under seal in the Cayman Islands.

There are certain requirements that a foreign company is required to adhere to under the Companies Law. They include the following:

- In every prospectus inviting subscriptions for its shares or debentures in the Cayman Islands it must state the country in which it is incorporated.
- It must conspicuously exhibit its name and country of incorporation on every place where it carries on business in the Cayman Islands.
- It must cause its name and country of incorporation to be stated in legible characters on all billheads, letter paper, notices, advertisements and other official publications.
- If the liability of its members is limited, it must cause notice of that fact to be stated in every such prospectus, bill heads, letter paper, notices, advertisements and other official publications in the Islands and to be affixed wherever it carries on its place of business in the Cayman Islands.

FIDUCIARY AND OTHER DUTIES OF DIRECTORS

The duties and liabilities of directors of Cayman companies are governed by the Companies Law as supplemented by English common law in so far as common law has not been amended by statutory provisions. English case law is considered as highly persuasive in the courts of the Cayman Islands

A Cayman company can only act by agents, most usually by directors. Under English common law, directors have certain duties of care, diligence and skill and also a fiduciary duty to act in the best interests of the company. The fiduciary duty of directors differs considerably from that of ordinary trustees, however, because trustees have a duty to be cautious and not to take risks, which duties obviously do not apply to directors of a commercial operation such as a company.

Statutory Duties of Directors

The Companies Law does not specify the duties owed by directors of Cayman companies, but rather sets out certain statutory requirements that directors must comply with on behalf of Cayman companies. For instance, directors of Cayman companies are required to ensure that a company keeps certain statutory registers (register of members, register of directors and officers, register of mortgages) and ensure that such registers are maintained at the appropriate place and kept in good order. Directors must also ensure that companies comply with their filing

obligations under the Companies Law (i.e. notifying the Registrar of changes to directors and officers, any change in the name or registered office of a company, filing of annual returns).

Directors as Agents

A director's duties of care, diligence and skill are akin to those of a non-professional agent and can be generally summarised as follows:

- A director need not exhibit in the performance of his duties a greater degree of skill than may reasonably be expected from a person of his knowledge and experience. The test is partly objective (the standard of the reasonable man) and partly subjective (the reasonable man is deemed to have the knowledge and experience of the particular director). A director is therefore not expected to exercise skill that he does not possess.
- A director must exercise reasonable care and diligence but is not liable for errors of judgment. Directors therefore can rely upon opinions and advice of outsiders but they must still exercise their business judgment based upon such advice.
- A director may reasonably rely on co-directors and other officers or managers of the company. Consideration must be given to the nature and demands of the company's business. Such reliance of a director, however, should not be unquestioning and the director must have no ground for suspicion that the other director, officer or manager on whom he is relying is performing his duties other than honestly.
- A director is not bound to give continuous attention to the affairs of the company. He is not bound to attend all board meetings although he should attend whenever he is reasonably able to do so. Even where a director has been shown to be negligent as a result of non-attendance at board meetings, it may be difficult to demonstrate that any particular loss has accrued to the company as a result of such non-attendance.

Directors' Fiduciary Duties

The fiduciary relationship of a director is with the company and a director therefore does not usually owe a fiduciary duty to individual shareholders. However, directors can by their actions place themselves in a relationship with the shareholders by virtue of which they will owe fiduciary duties to the shareholders as well as to the company. English courts have held directors to be under a duty to act in good faith when giving shareholders advice whether to accept a take-over offer for their shares or whether to sanction a scheme for the purchase of a large block of assets from another company. The directors have no obligation to give such advice but if they give it, the advice should not be given for their own improper reasons.

In determining what is meant by the company to whom the directors owe the duty, this is normally interpreted to mean the shareholders of the company as a whole, both present and future. It may also be that where a company becomes insolvent, the duty of the directors may be extended to include the interests of the creditors as well. This view is supported by a number of Commonwealth case authorities. English statutory extensions of the duty to employees do not apply to Cayman companies.

The fiduciary duties of directors can be summarised as follows:

- Good Faith

The duty imposed upon directors to act bona fide in the interests of the company is a subjective one and is generally left to the business judgment of the directors to decide how the interests of the company may best be promoted. The courts will interfere only if no reasonable director could have concluded that a particular course of action was in the interests of the company.

- Proper Purpose

If directors take actions that are within their powers but for purposes other than those for which such powers were conferred, they may be liable. A common example is the exercise by directors of their power to issue shares for purposes of maintaining their control over the affairs of the company. However, an exercise by the directors of their powers for a proper purpose that has the incidental and desired result, for example, of diluting a voting majority of shareholders would not be sufficient to make the purpose improper.

- Conflict of Duty and Interest

The general rule is that directors are required not to put themselves into a position where there is a conflict (actual or potential) between their personal interests and their duties to the company or between their duty to the company and a duty owed to another person. At common law, however, and therefore in Cayman, the company is at liberty to waive completely the rules protecting it as principal in dealings in which the directors have an interest. Most Cayman companies have Articles of Association that allow directors to attend, be counted in the quorum and usually also to vote on transactions in which they have an interest so long as their interest is disclosed. There are no statutory disclosure requirements in the Cayman Islands. Generally, however, directors should not use for their own profit the company's assets, opportunities or information.

- Unfettered Discretion

Directors cannot validly contract (either with one another or with third parties) as to how they shall vote at future meetings of directors. This is so even though there is no improper motive or purpose and no personal advantage to the directors under the voting agreement. This does not prevent the directors, having determined to enter into a transaction, from voting to take all further action necessary to complete the transaction.

Group Benefit

The English case of *Charterbridge Corporation v. Lloyds Bank Ltd.* determined that the interests of the group of companies as a whole must not guide a director if this might be detrimental to the interests of his own company, particularly if his company has separate creditors. If, however, the intended measure does not conflict with the interests of his company, it is not a breach of duty to his own company that he has taken into account the benefit of the group as a whole. Further, a director cannot be compelled to take into account the interests of the group of companies.

Duties in Structured Transactions

A director's duty is not limited by the mere fact of a Cayman entity being established as an SPV for structured transactions. Indeed, the corporate integrity of an SPV is dependent upon the observance of corporate formalities and the maintenance of professional standards by its directors who must have a thorough understanding of the transaction in which the SPV is involved. Understanding the transaction in question is paramount if the arrangements in which the SPV are involved are to withstand court scrutiny. A director's failure to observe corporate formalities would not only constitute a breach of such director's duties but the entire transaction for which the SPV was established could be at risk.

With the complexity of structured transactions increasing, it is no longer safe for a director to rely on such expertise, as that director happens to possess. Participants in such transactions expect directors, even those appointed by financial service providers, to understand and assess the risks related to an SPV's role in the transaction in question. Although SPVs and their directors take such commercial risks all the time and although they tend to be small, directors must calculate them in order to approve the transaction as being in the best interests of the company. The difficulty lies in identifying, calculating and evaluating such risks.

Segregated Portfolio Companies

The Companies Law prescribes additional duties and liabilities for directors of an SPC. Such duties include the duty to establish and maintain the segregation of each portfolio's assets from those of other segregated portfolios and from the general assets of the SPC. In addition, directors of an SPC must ensure that when transacting for a particular segregated portfolio of the SPC the transaction documentation is executed by the SPC on behalf of the specific segregated portfolio otherwise the directors can incur personal liability for the liabilities of the SPC and the segregated portfolio.

PROTECTION OF MINORITY SHAREHOLDERS

Cayman companies operate on the principle of a majority rule otherwise known as the rule in *Foss v Harbottle*. The justification for the rule is the need to preserve the right of the majority to decide how a company's affairs are managed. Thus, for example, where directors of a company have breached their duties to the company, the company may bring an action against them. Where the directors of the company contain a majority of errant directors unlikely to initiate litigation against themselves, the shareholders can replace the directors who can then initiate the action. A receiver or liquidator may also, of course, commence such litigation. It is also possible for the shareholders in general meeting by ordinary resolution to bring litigation in the name of the company, at least where the directors are alleged to be a party to the wrongdoing.

Personal Actions

If a shareholder can show breach of duty owed to the shareholder personally by directors, the shareholder may bring an action. Such action may be brought in a representative form where other shareholders have a common interest. Most actions against directors for breach of their duties, however, are sought to enforce a right belonging to the company rather than to any individual shareholder or shareholders.

Derivative Actions

If an individual shareholder without authority from the company to do so initiates litigation in the company's name, the company may apply to strike out the name of the company. This usually results in the proceedings

being adjourned whilst the meeting of shareholders is held to see if the company supports the litigation. If a majority of shareholders do not support the litigation, the action will be struck out.

Therefore, the more usual procedure is for the individual shareholder to seek to enforce the company's rights by suing in representative form on behalf of him and all other shareholders of the company except the wrongdoers. This is not a true representative action but is better described as a derivative action because the right of action is derived from the company.

The alleged wrongdoers are made defendants in the action and the company itself is joined as defendant so that it will be bound by the judgment. If the action succeeds, any property of damages recovered will go to the company. The English courts have determined that a shareholder bringing such a derivative action can be indemnified by the company for its costs if, at a preliminary stage, it is determined that the proceedings have an even chance of success or that the action is supported by a majority of the independently held shares.

Exceptions to the rule in *Foss V. Harbottle*

The rule in *Foss v. Harbottle* is used to refer to the principle that, where a wrong is alleged to have been done to a company, prima facie, the only proper plaintiff is the company itself. The exceptions to the rule in respect of which a derivative action can be brought by an aggrieved shareholder are as follows:

- An action that is ultra vires the company or illegal.
- An act that constitutes a fraud on the minority and the wrongdoers are themselves in control of the company.
- An irregularity in the passing of a resolution that requires a special majority.
- An act that infringes the personal rights of an individual shareholder.

Fraud on the Minority

The phrase "fraud on the minority" (being one of the exceptions to the Rule in *Foss v. Harbottle* above) is misleading. First, fraud is not confined to common law fraud (i.e. deceit) but embraces a wider equitable meaning. Secondly, fraud is not so much committed on the minority as on the company.

Fraud embraces all cases where the wrongdoers are endeavouring, directly or indirectly, to appropriate to themselves money, property or advantage that belongs to the company or in which the other shareholders are entitled to participate. An action will be a fraud on a minority if it is not bona fide for the benefit of the company as a whole or its effect is to discriminate between the majority and minority shareholders. An element of dishonesty or at least impropriety must be involved. Thus, derivative actions have been allowed where the wrongdoers made a considerable profit on the sale of property to the company or where they diverted business from the company to another in which they were interested. However, fraud does not extend to include negligence without some misappropriation of corporate assets.

In order to bring such a derivative action in a case of fraud, the plaintiff must also be able to show that the alleged wrongdoers control the company. In the absence of such control, the general meeting of shareholders will be entitled to decide whether it is in the company's interests to embark upon the litigation or not. The ownership of sufficient shares with voting rights will be sufficient proof of control for these purposes without the necessity of the shareholder demanding that the wrong-doers institute proceedings and their refusing to do so.

MORTGAGES OF SHARES IN CAYMAN COMPANIES

In obtaining a security interest in shares in a Cayman Islands company, it is advisable for the security holder to obtain a share mortgage document reflecting the terms of the security arrangement. Mere delivery of a share certificate may be sufficient evidence of a pledge of the shares but does not evidence the detailed terms and conditions of the security arrangements. Furthermore, such a pledge by way of delivery of the share certificate is extremely difficult to enforce and will almost always involve resorting to the Courts for enforcement.

The Companies Law defines a shareholder as the person registered in the Register of Members. A share certificate is only prima facie evidence of any shareholding reflected in the Register of Members. Without registration in the Register of Members, the owner or security holder will have difficulty exercising the rights of a shareholder. In fact, most Articles of Association of Cayman companies provide that the company need take no notice of any equitable or other interest in the shares and should look no further than the Register of Members. Therefore, only the registered shareholder can vote the shares and dividends are payable only to the registered shareholder or its order.

Apart from a simple pledge by delivery of the share certificate, there are two specific ways in which one can effect a security interest in shares of a Cayman company.

Legal Mortgages

Under a legal mortgage, the shares in the Cayman Islands company are actually transferred to and registered in the name of the mortgagee, but subject to the terms of the mortgage document. The disadvantage of this alternative is that the mortgagee will then appear to be the shareholder of the company even though the underlying mortgage documents evidence the true security nature of the transaction. The advantage of this alternative is that the enforcement of the share mortgage, usually upon the happening of an event of default, becomes much simpler because the mortgagee as the registered shareholder immediately has voting rights and the right to receive dividends. Such share mortgage document would usually provide for the mortgagee to give proxies and account for dividends to the real owner of the shares prior to the happening of an event of default.

Equitable Mortgages

With an equitable mortgage, the shares remain registered in the name of the real owner who enters into a mortgage document reflecting the terms of the security arrangements. The main disadvantage of this alternative is that the mortgagee will first have to become registered as the shareholder before being able to exercise voting and other rights as a shareholder of the Cayman company.

One difficulty with obtaining an equitable mortgage of shares involves the possibility of fraudulent action by the mortgagor where the mortgagor obtains a replacement share certificate for the mortgaged shares by, for example, alleging that the share certificate (which is actually in the possession of the mortgagee) has been lost and providing the Cayman company with the appropriate indemnities to enable the duplicate certificate to be issued. The mortgagor, in such circumstances, is able fraudulently to sell, mortgage or otherwise dispose of the shares in the Cayman company to a bona fide third party that acquires an interest in the shares without notice of the equitable mortgage arrangements.

REGISTRATION OF SECURITY INTERESTS

The Cayman Islands does not have a formal system for the registration of security interests in order to perfect or obtain priority. The Cayman Islands, however, does have registration systems in place for ships and aircrafts registered in the Cayman Islands, and for limited partnership interests of exempted limited partnerships.

Under the Companies Law, companies are required to keep an internal register of mortgages and charges and to lodge therein particulars of all security interests created by the Cayman company over its assets. However, failure to register particulars of the security interest in such register does not affect the creation of the security interest or its perfection or priority. Instead, creation of a security interest, its perfection and priority is dependant upon the application of Cayman Islands conflicts of law principles which looks upon the governing law of the security document, the law constituting the assets comprising the security or the law where the assets which are subject to the security are situated.

MERGERS, TAKEOVERS AND REORGANISATIONS

Forced Acquisition of Shares

The Companies Law provides for a "force-out" of shareholders holding 10% or less of the shares in a Cayman company, for example, a takeover situation. The procedures are set out in the Companies Law and are beyond the scope of this article.

The main disadvantage of this arrangement is that four months notice of the offer must be given before notice to dissenting shareholders can be given of the intention to acquire their shares in the Cayman company. In any application to the court by a dissenting shareholder, the onus will usually be on the dissenting shareholder to show that the offer is unfair.

Arrangements and Reconstructions

The Companies Law has recently been updated to include new provisions dealing with mergers and consolidations in addition to the existing provisions for arrangements and reconstructions.

For arrangements and reconstructions, the Law provides that there must be a compromise or arrangement between the company and its creditors or any class of creditors or between the company and its shareholders or any class of its shareholders, the purpose of which must be the re-construction of any company or companies or the amalgamation of any two or more companies, for example, where under the whole of the business or property of any company ("transferor") is to be transferred to another company ("transferee"). Any scheme under the Companies Law must have the sanction of the court before it is effective.

The procedures involved in obtaining the sanction of the court are prescribed in the Companies Law and once the scheme is sanctioned by the court, it is binding on all creditors or shareholders or the relevant classes thereof who were parties to the scheme, and on the company. The court has wide powers for facilitating the scheme, for example, the power to transfer all of the business of the transferor to the transferee. The court may also order the issue of any shares by the transferee provided for under the compromise or arrangement. The court may also order the dissolution of the transferor.

Merger and Consolidation

The Companies Law provides for existing constituent companies, except segregated portfolio companies, to merge or consolidate. A constituent company is an existing company incorporated in the Cayman Islands merging or consolidating with one or more Cayman incorporated companies or foreign companies. A consolidated company is a new company that results from the consolidation of two or more constituent companies whereby the undertakings, property and liabilities of such constituent companies are vested in the consolidated company. A merger is defined as two or more constituent companies which merge vesting their undertakings, property and liabilities in one of such companies as the surviving company.

The directors of each of the constituent companies participating in the merger or consolidation approve a written plan of merger or consolidation and present the plan to the shareholders who must approve it by resolution of a 75% majority. The consent of holders of a fixed or floating security interest in the constituent company must also be obtained. Once all consents are obtained, the plan is filed with the Registrar along with the relevant documents and appropriate fee. The merger or consolidation becomes effective on the specified date, or upon the occurrence of a specified event. Upon the merger or consolidation becoming effective, the Registrar strikes off the constituent company that is not the surviving company in a merger, or the constituent company that participates in a consolidation without having to be wound up.

Where a merger or consolidation occurs, an existing claim, cause or proceeding, whether civil (including arbitration) or criminal pending at the time of the merger or consolidation is not abated or discontinued by the merger or consolidation but continues against the surviving or consolidated company.

CONTINUATION OF COMPANIES

Migration into Cayman

A company with limited liability and having a share capital (“Transferring Foreign Company”) incorporated under the laws of a jurisdiction outside the Cayman Islands (“Foreign Jurisdiction”) may continue by way of transfer as an exempted company incorporated under the Companies Law provided that the laws of the Foreign Jurisdiction where it is incorporated permit or do not prohibit such a transfer. Such transfer by way of continuation does not create a new company or other new legal entity. The Transferring Foreign Company is effectively pulled up by its roots from the Foreign Jurisdiction and “replanted” in the Cayman Islands as the same legal entity but now governed by Cayman Islands law rather than the law of the Foreign Jurisdiction.

The Transferring Foreign Company may apply to the Registrar to be registered by way of continuation as an exempted company in the Cayman Islands. Various documents will need to be filed with the Registrar on making such application. In addition, the Registrar must be satisfied that the name of the Transferring Foreign Company is acceptable. This can be achieved by providing the name or list of proposed names of the company to the Registrar for prior approval. If the proposed name is unacceptable, e.g. if there is an existing company in the Cayman Islands with the same or a similar name, the Transferring Foreign Company must change its name within 60 days of registration.

Provisional registration is possible where certain of the conditions are not yet met upon payment of an additional fee.

Migration out of Cayman

As with a Transferring Foreign Company, an exempted company incorporated under the laws of the Cayman Islands with limited liability and a share capital (“Transferring Cayman Company”) may transfer by way of continuation as a company incorporated under another jurisdiction (“New Jurisdiction”) provided that the laws of that New Jurisdiction permit or do not prohibit such a transfer. Such transfer by way of continuation does not create a new company or other new legal entity.

TERMINATION OF CAYMAN COMPANIES

There are essentially two ways of terminating the registration and existence of a Cayman company after it has served its purpose.

Strike Off

The simplest alternative is for the Registrar to strike a company off the register of companies as a defunct company. The Registrar is empowered to do this under the Companies Law if the Registrar has reasonable cause to believe that a company is not carrying on business or is not in operation. The Registrar will often strike a company off the register, for example, if it has failed to pay its Government annual return fees. On a regular basis (usually three or four times a year), the Registrar will publish a list in the Cayman Islands Gazette of all companies to be struck off the register as at a date usually falling about one month after such publication. Unless any action is taken by the company to prevent its being struck off, the company will be struck on the date specified in the Cayman Islands Gazette. Such strike off does not affect the liability, if any, of any director or shareholder of the company and the company or any shareholder or creditor may apply to the courts within ten years of the strike off for the re-instatement of the company to the register. Any assets belonging to the company when it is struck off vest in the government for the benefit of the Cayman Islands.

The Registrar will list a company for strike off as a defunct company if the company makes application to the Registrar or its Cayman Islands service provider on behalf of the company. It is usually possible for a company to dividend out to its shareholders all of its profits (including share premium, subject to a solvency test) once its financial affairs are settled. If there is any substantial share capital left in the company and the company is solvent, it will be necessary to effect a repurchase of all but one of its outstanding shares in order to effect the distribution of most of such share capital to the shareholder. Once the company is left with only non-material assets and liabilities consisting of its minimal share capital, the registered office of the company may apply to the Registrar for the company to be struck off. The registered office will usually require written confirmation from its client of record that the company has ceased to carry on business and has no material assets or liabilities.

The main disadvantage of this alternative is that there is no control as to the timing of the dissolution which will depend upon when the Registrar includes the company in the Gazetted list of companies to be struck off. The other disadvantage is that this alternative cannot be used, for example, where the company has outstanding unsatisfied liabilities (although non-payment of the government fees may result in the Registrar striking the company off in due course in any event). The main advantage of this alternative is that it is relatively simple and inexpensive.

Voluntary Liquidation

The other alternative of terminating the existence of a Cayman company involves placing the company into voluntary liquidation and appointing a liquidator. The main advantage of a voluntary liquidation as opposed to

striking a company off as a defunct company is that the timing of the liquidation is definite and within the control of the shareholders and the liquidator rather than having to wait for the company to be listed for strike off. A voluntary liquidation is also the only way to properly deal with an insolvent company. The main disadvantage of this alternative is the cost involved. There are fees payable to the Registrar and the Cayman Islands Gazette for each of the required notices, there may be legal fees involved in dealing with the liquidation and there may also be other professional fees payable to the liquidator.

PARTNERSHIPS

Introduction

A partnership can be formed under the laws of the Cayman Islands and is defined as “the relationship that subsists between persons carrying on a business in common with a view of profit”. A corporation or an individual may be a partner but the partnership as such has no corporate identity or separate legal personality. Any ordinary or limited partnership should preferably always be created by written agreement or deed.

The general law relating to Cayman Islands partnerships is to be found in the Partnership Law by reference to English common law.

Limited partnerships may be registered in the Cayman Islands either under the Partnership Law or under the Exempted Limited Partnership Law (“Exempted LP Law”). The Exempted LP Law provides for an exempted limited partnership (“Exempted LP”), as distinct from a limited partnership (“Ordinary LP”) registered under the Partnership Law. The Exempted LP Law seeks to meet many of the shortcomings of the Partnership Law in regard to the Ordinary LP as a vehicle for offshore investment.

The Ordinary LP provided for in the Partnership Law was essentially conceived as a method of allowing investors (‘limited partners’) to invest with limited liability in certain restricted businesses subject to observing certain requirements perceived to offer protection to persons dealing with the Ordinary LP. Thus the Ordinary LP had to be registered; its registration had to be published in the Gazette; the role of limited partners was restricted to that of ‘silent partners’ in that they could take no active part in the partnership business; a change in its constitution had to be gazetted; a limited partner’s right to share in the profits was seemingly limited to taking interest at a fixed rate payable only out of profits; and a limited partner had a perpetual exposure to contribute in the event the Ordinary LP became insolvent even after he had withdrawn or transferred his interest. The Ordinary LP was thus a cumbersome vehicle.

Exempted Limited Partnerships

Beyond the liability of limited partners being limited to their partnership interests (unless the limited partners take part in the conduct of the partnership’s business), a partnership registered under the Exempted Limited Partnership Law has a number of novel features that enable it to be used as an offshore investment vehicle.

An exempted limited partnership may be formed for any lawful purpose to be carried out or undertaken either in or from within the Cayman Islands or elsewhere provided that the limited partnership does not undertake business with the public of the Cayman Islands.

An exempted limited partnership must maintain a registered office in the Cayman Islands and must have at least one general partner, or if more than one, one such general partner must be resident in the Cayman Islands or, if a

company, be registered under the Companies Law or if, a partnership, be registered under the Exempted LP Law.

Whilst a limited partner is precluded from taking part in the general conduct of the partnership business, a number of specific activities similar to those appearing in the U.S. law of limited partnership are deemed not to offend this principle.

The partnership is not dissolved or disrupted by a change in the identity of the partners, the assignment of a limited partnership interest or the death or bankruptcy or incapacity of a limited partner and the rights to assign and to mortgage a limited partnership interest are specifically recognised under the Exempted LP Law.

Registration as an exempted limited partnership is accomplished by filing with the Registrar a statutory statement signed by or on behalf of the general partner. The general partner has the responsibility for maintaining (or causing to be maintained) a register of partnership interests recording the name and address and contribution of each partner, the amount of any capital returns and the dates thereof. Such register must be maintained at the registered office of the exempted limited partnership. The register is open to public inspection and must be kept up to date.

Unless the partnership agreement provides otherwise, a limited partner may demand and shall receive accounts from the general partner, proceedings are instituted by or against the general partners and not by or against limited partners and the return of limited partners' capital contributions is permissible so long as the partnership is solvent immediately following such return of capital. However, each limited partner is contingently liable to repay a returned capital contribution if, and to the extent, necessary to settle partnership debts if the return of capital is not justified and took place within six months of the partnership's insolvency.

A partner or creditor can apply to the court for an order for dissolution of an exempted limited partnership on just and equitable principles. The death, bankruptcy or incapacity of the last remaining general partner by law terminates the partnership unless the limited partners take steps to replace such general partner.

As with exempted companies, the Governor can grant a tax exemption undertaking with respect to an exempted limited partnership and the interests of the partners thereto for a period of fifty years as opposed to 20 years for an exempted company. The general partner is required to make an annual return to the Registrar regarding compliance with the Exempted LP Law.

In general, the Exempted LP Law goes some distance to bringing to the Cayman Islands a concept of partnership akin to one formed under the U.S. Uniform Limited Partnership Act 1987. Indeed, certainly some of the features of the Exempted LP Law resemble those of its U.S. counterpart.

Advantages of an Exempted LP over an Ordinary LP

The following is a summary of the differences between the two types of limited partnerships available in the Cayman Islands:

- **Mutations & Transfers**

An Exempted LP is not disrupted by a change in the composition or character of the limited partners. There is also no obligation to report to the Registrar immediately on a change in limited partners nor to advertise in the Cayman Islands Gazette any change in general partner, as is the case with an Ordinary LP. Instead, the

general partner of an Exempted LP is required to keep a register of partnership interests, which must be updated periodically within 21 business days of the change, and any change in general partners must be notified to the Registrar. The register of partnership interests is not open to the public. Filings made with the Registrar in respect of an Exempted LP are also not public. The right to transfer and to mortgage a limited partnership interest is specifically recognised.

- **Withdrawal of Contributions and Distributions of Capital Gains & Profits**

Whereas under an Ordinary LP there is a virtual prohibition against the return of contributions made by a limited partner and the limited partner remains perpetually accountable to the partnership, under the Exempted LP Law contributions can be returned to a limited partner. This has two features, namely that not only can the limited partnership interest be returned (i.e. the position be liquidated) but also by virtue of the definition of a "contribution" it means also that a capital growth or other profit can be distributed with impunity if the partnership agreement so provides.

The restriction on "returning the contribution" is that the Exempted LP remains solvent immediately following the return and will continue to be solvent for 6 months after the return.

The concept of "profit sharing" is innovative. Under an Ordinary LP, in theory, a limited partner had to content himself with "interest" on his contribution. Under the Exempted LP Law there are no statutory provisions regulating profit sharing and the definition of "partnership interest" recognises the concept of profit as an entitlement of a limited partner.

- **Ability to Conduct Foreign and Other Business**

It is recognised that an Exempted LP can undertake all types of business including business abroad. Indeed, offshore enterprise must be the principal purpose of an Exempted LP. This was not clearly within the purview of the Partnership Law when incorporating the provisions for Ordinary LPs. It is to be noted, however, that in so far as the promoters of an Exempted LP may seek to offer limited liability protection to investors in limited partnership interests, they would be well advised to register the Exempted LP as a limited partnership in such jurisdictions abroad as they contemplate doing business or otherwise to register a limited liability company as the vehicle through which trading is carried on in those jurisdictions. Cayman will not recognise a foreign limited partnership as such (it must register here to be recognised here) and in the absence of such recognition of foreign limited partnerships by the Cayman Courts, in all probability a Cayman Exempted LP would not be recognised if not registered in the foreign jurisdiction in which it carries on business.

It is still possible to register an Exempted LP that would have as its primary purpose investment in a Cayman non resident company. The Exempted LP law allows for "any lawful purpose ... to be carried out or undertaken either in the Islands or ..." and the proviso against undertaking business with the public in the Cayman Islands would not apply to the taking of shares in a non resident company under a private offering. Thus an Exempted LP may have special attractions to investors resident in jurisdictions the tax laws of which offer advantages to investors in partnerships that are not available to investors in companies.

- **Local Presence**

As the concept of the Exempted LP is to cater for the offshore investor, it is necessary to give the Exempted LP a 'local presence'. The Exempted LP Law does this by requiring that at least one general partner, whether an individual, a company or itself a partnership, be 'resident' here. This is not the case with an Ordinary LP.

Local presence is a logical requirement so that Cayman courts may be vested with jurisdiction over the partnership and so that the partners are rendered more readily accountable to the provisions of the Exempted LP Law and thus giving the concept legitimacy.

- **Limited Partner's Role Expanded**

The U.S. Limited Partnership Act recognises that a limited partner may act as agent for the general partner without violating its limited liability. Under the Exempted LP Law there is express statutory confirmation that this duality is permissible under Cayman Islands Law in the case of an Exempted LP.

Conclusion

The Exempted LP is an innovative vehicle for meeting the needs of offshore investors, particular as an alternative to corporate mutual funds and unit trusts. There is provision for re registering an existing ordinary LP as an Exempted LP and serious regard should be given to this possibility in the case of each ordinary LP now used in the offshore investment community.

ANTI-MONEY LAUNDERING OBLIGATIONS

The Cayman Islands legal system incorporates anti-money laundering laws and regulations in accordance with modern international best practice. Appleby and its affiliated corporate management provider, Appleby Trust (Cayman) Ltd., have always required certain information from our clients in all cases. Beyond that, we are required to obtain and keep on file extensive documentation of the identity of each client for whom certain specified types of business are conducted. In certain cases, it may be possible to rely on an exemption or on client identification carried out by another regulated service provider, and we will do so where appropriate. However, it will often be necessary to ask clients or prospective clients for documentary evidence of their identity, and often also that of related parties, as well as certain references.

We ask for the co-operation and understanding of our clients in this process, which is an important element of the drive by leading financial centres such as the Cayman Islands to ensure that they are not used for unlawful purposes.

THE CAYMAN ISLANDS STOCK EXCHANGE

With currently just over 1,000 listings and growing and over US\$140 billion in total market capital, the Cayman Islands Stock Exchange (“CSX”) (www.csx.com.ky) has become one of the world’s fastest growing exchanges and an integral part of the Cayman Islands success story. The CSX was established to provide a listing facility for the specialist products of the Cayman Islands, being mostly offshore mutual funds and specialist debt securities.

The CSX is firmly focused on international capital markets and providing an efficient and sophisticated listing regime. Many of the world’s leading financial institutions have listed their products on the exchange. The CSX

is recognised and accepted by leading institutions and market players as a “blue chip” listing environment, which assists in providing investors with the necessary degree of comfort to invest in a fund.

The listing rules are sophisticated and tailored to meet the needs of issuers and to accommodate the latest structures and products. The rules emphasise the disclosure of all relevant information, without imposing unnecessarily onerous conditions.

When a company is listed, it is given space to publish its marketing materials on the CSX website. The site can provide hyper-links to the company’s own website or to other sites providing analytical data for the company. The CSX also automatically updates Bloomberg with any public information given to it.

The CSX has been admitted to membership of the European Securitisation Forum (an independent initiative of The Bond Market Association) and has entered into a working relationship with Euroclear which allows CSX participants access the Fund settle system for enhanced transparency and communication with investors. Appleby is a listing agent for CSX and has significant experience in the listing of investment funds on this exchange and numerous other global stock exchanges.

For more specific advice on Corporate entities and Partnerships in the Cayman Islands, we invite you to contact one of the following:

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Appleby is the leading provider of offshore legal, fiduciary and administration services. With an unparalleled presence in the key offshore jurisdictions of Bermuda, the British Virgin Islands, the Cayman Islands, Guernsey, Isle of Man, Jersey, Mauritius and the Seychelles, the group offers advice on offshore law. We also have offices in the international financial centres of London, Hong Kong, Zurich and Bahrain.

Over 800 lawyers and professional specialists deliver sophisticated, specialised services, primarily in the areas of Corporate and Commercial; Litigation and Insolvency; Private Client and Trusts; and Property. We advise global public and private companies, financial institutions, and high net worth individuals, working with them and their advisers to achieve practical solutions, whether in a single location or across multiple jurisdictions.

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