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In the Courts 2015: Insolvency and Restructuring

Petitions: standing and requirements of petitioners

It had been thought, following the introduction in the Cayman Islands of a specific set of procedural rules for insolvency cases (the Companies Winding-Up Rules 2009) and the 2010 decision of Foster J. in *In Re Freerider Limited* 2010 (1) CILR 286, that the Court no longer had the power to order a foreign company petitioning to wind up a Cayman company to pay security for the costs of the proceedings. In a detailed decision handed down during its first sitting of 2015, the Cayman Islands Court of Appeal reviewed the legislative history and the authorities on the inherent jurisdiction of the court. It held, in its as yet unreported 20 February 2015 decision in *Dyxnet Holdings Limited v. Current Ventures II Limited and Current Ventures IIA Limited* (Court of Appeal, CICA 33/2013), that the court has an inherent jurisdiction to grant security for costs against a petitioning foreign company in winding up proceedings. Our eAlert on the case may be viewed here.

In a pair of cases that in passing neatly illustrate the continuing growth in proceedings involving offshore companies with connections to China, one of the more recently-appointed judges of the Grand Court of the Cayman Islands, Mrs Justice Mangatal, addressed questions relating to the standing of particular categories of petitioner.

First, in June, Mangatal, J. granted a winding up order on the petition of investors holding the beneficial interest in notes issued by a Cayman company without the involvement of the trustee of the notes, who was the immediate creditor. Although there was no written ruling in the case it appears that the court accepted in making its winding up order in *Re China Forestry Holding Co Ltd* (Grand Court, FSD 31/2015, 18 June 2015, unreported) that the investors were contingent creditors by reason of the rights they had to become certificated holders of the notes in certain circumstances, and therefore had standing to petition. The case is significant because it is relatively common for Cayman companies to be the debtor in Asian financing transactions, issuing notes to investors, which are typically held by a trustee on behalf of the investors. Where the issuer defaults, the trustee is commonly obliged to take certain actions on the demand of the investors, but requirement may need to be satisfied before this right can be invoked. The decision means that providing there is no contractual prohibition on doing so (as to which, read on) investors can petition to wind up even where the trustee cannot be compelled to, or is in breach of its obligation, to do so.

Then, towards the end of the year, Mangatal J. handed down a decision in *Re China Shanshui Cement Group Limited* (Grand Court, FSD 178/2014, 25 November 2015, unreported). In it, she disagreed with an earlier decision of Jones, J. in yet another Chinese case, *Re China Milk Products Group Limited* [2011] (2) CILR, which held that the directors of an insolvent company had an inherent authority to petition for its winding up, even if

they were not empowered to do so by the company's articles. Whilst this was a pragmatic interpretation of Cayman Islands law that resulted in a logical commercial outcome in that particular case (in which there was no shareholder opposition), the ruling in *China Milk* was criticised for giving directors a wider discretion than was clear on the terms of the legislation. In a carefully considered judgment handed down on 25 November 2015, Mangatal, J. disagreed with Jones, J.'s construction of the statutory provisions and struck out a winding up petition brought by the directors of an insolvent company who did not have the requisite authority from the shareholders to petition for the company's winding up. Click here for Appleby's more detailed article on the case.

Petitions: grounds for winding up

It is well established in most common law jurisdictions that a company can be wound up where it is 'just and equitable' to do so, and that this will be the case where the company has 'lost its substratum' for existence. The question of what this concept entails in the specific context of an open-ended mutual fund has exercised the courts of Cayman and BVI in particular in recent years, with a fine distinction emerging as to whether it must be 'impossible' or merely 'impractical' for the company to carry on its business in order to invoke this principle. The decision of Clifford, J. in *Re Harbinger Class PE Holdings (Cayman) Ltd* (Grand Court, FSD 80/2015, 10 November 2015, unreported) confirms that the traditional 'impossibility' test for loss of substratum will be applied in the context of any Cayman Islands company which is *not* an open-ended mutual fund. The Court distinguished the earlier decision of Jones, J. in *In the Matter of Belmont Asset Based Lending Limited* [2010] 1 CILR 83, in effect confining its reasoning to open-ended mutual funds. Whether this marks the start of a change in that particular context as well, remains to be seen. For a more detailed review of the case, see our eAlert which is available here.

The Cayman Islands Court of Appeal has confirmed, in *Re Rhone Holdings LP*, (19 November 2015, unreported) that provisions in investment agreements contracting out of the right to present winding up petitions are enforceable and not contrary to public policy. This was unsurprising given that Section 95(2) of the Companies Law (2013 Revision), which was originally enacted as part of a suite of reforms and modifications in 2009, specifically requires the court to dismiss a petition brought in breach of such an obligation. The Grand Court in this case had duly done so, and on the hearing of an application for leave to appeal, the Court of Appeal found that an appeal based on a submission that section 95(2) was contrary to public policy had no reasonable prospect of success. It found similarly in relation to the petitioner's submission that, despite the fact that the legislation governing them imports the winding-up provisions in Part V of the Companies Law (in which section 95 appears), the section did not apply in the case of limited partnerships. The case is also an encouraging indication of turnaround time at the Court of Appeal level: the Grand Court decision was given in August, with reasons handed down on 29 September, and the matter came before the Court of Appeal (albeit only for leave to appeal) on 19 November, with a decision rendered immediately.

In what we believe to be the first offshore case of its kind, the High Court in the Isle of Man has considered the application of the 'just and equitable' ground to the winding-up of foundations. In *Cavendish Trust Company Limited v. The Shared Success Foundation* (CHP 2015/40, 13 July 2015, unreported), the applicant, Cavendish, was the registered agent of the Shared Success Foundation. Following a breakdown in the operating relationship, Cavendish gave notice of its intention to resign from the registered agent role. Pursuant to section 28(2) of the Foundations Act 2011 a foundation must have a registered agent. However the foundation refused to appoint a replacement, forcing Cavendish to remain in place. Against this background Cavendish applied on the just and equitable ground for a winding up order, which the Isle of Man's Chief Justice, Deemster Doyle,

granted. The case may have relevance to other jurisdictions where foundations have been introduced and potentially, by analogy, to registered agents or directors of companies wishing to resign but, due to statutory requirements, unable to do so for want of a replacement.

Staying and dismissing winding-up proceedings and rescinding winding-up orders

Every year, we find that a particular topic has occupied the attention of the courts of several jurisdictions. In 2015, it was the interplay between insolvency proceedings and arbitration. Three cases have addressed the question of whether insolvency proceedings should be stayed, or orders set aside, on the basis of an arbitration clause. The Bermuda Court of Appeal has also grappled with the question of whether an arbitral award that has been stayed can constitute the debt on which a petition is founded.

In the BVI, the Court of Appeal delivered judgment on 15 September in *C-Mobile Services v. Huawei Technologies Co Ltd* (BVIHCMAP 2014/0006 and BVIHCMAP 2014/0017, unreported) on appeals following an application to set aside a statutory demand and stay proceedings. The appellant argued in the Court of Appeal (but not before the Judge) that the statutory demand should be set aside under the court's discretionary powers in section 157(2) of the Insolvency Act and section 6(2) of the Arbitration Ordinance 1976. The Court rejected that argument: it had not been raised before and the fact that the arbitral proceedings had been withdrawn was also a powerful factor against exercising the court's discretionary power. The Court of Appeal also upheld the trial court's finding that winding up proceedings fell outside the scope of the arbitration clause. The winding up proceedings were not proceedings commenced 'in respect of any matter agreed to be referred' and were therefore not caught within the ambit of the mandatory stay provisions of the Arbitration Ordinance.

In *Jinpeng Group Limited v. Peak Hotels & Resorts Limited* (BVIHCMAP 2014/0025 and BVIHCMAP 2015/0003, 8 December 2015, unreported), the Court of Appeal set aside an order striking out an application for the appointment of liquidators, on the basis that the judge had misapplied the legal test which was whether or not the dispute raised by the Company was raised on genuine and substantial grounds. Having reached this conclusion, it was necessary to consider the effect of the arbitration clauses in the underlying documents upon which the debt was founded. Applying the English decision in *Salford Estates v. Altomart* [2015] 3 WLR 491 the Court of Appeal concluded that as winding up proceedings are not an 'action' covered by arbitration clauses in agreements or section 18(1) if the Arbitration Act 2013, the court should not grant an automatic stay. Under BVI Law, the court's statutory jurisdiction to wind up a company is based on the latter's inability to pay its debts as they fall due unless the debt is disputed on genuine and substantial grounds. A creditor does not have to prove exceptional circumstances to invite the court to exercise its discretion to make a winding up order.

In the Jersey case of *Consolidated Resources Armenia v. Global Gold* [2015] JCA 061, 27 March 2015, unreported, the Jersey Court of Appeal granted a stay of proceedings including a claim for relief on the grounds of unfairly prejudicial conduct under Article 141 of the Companies Law 1991, or in the alternative a winding-up order. Several of the pleaded instances of unfairly prejudicial conduct involved breaches of or failures to comply with an agreement that contained a binding arbitration clause. The case provides useful guidance on aspects of Jersey's arbitration legislation and their interaction with unfair prejudice and winding-up proceedings: in particular, the Court confirmed (relying on the reasoning of the English Court of Appeal in *Fulham Football Club v. Richards and Another* [2012] 1 All ER 414) that there is no reason of public policy for declaring that an unfair prejudice claim or a claim for the winding up of a company on just and equitable grounds are incapable of arbitration.

The Court also considered the scope of Article 27 of the Arbitration (Jersey) Law 1998, which permits the Court to order that an arbitration agreement will cease to have effect insofar as this is necessary to allow the Court to determine any allegation of fraud which arises in the proceedings. It held that the discretion to stay must be exercised with regard to the substance or otherwise of the connection between the dispute and Jersey. Where Jersey is not the seat of the arbitration in question, there is an almost overwhelming presumption against the exercise of the power under Article 27; any other interpretation would not be compliant with Jersey's international obligations.

Here the seat of the intended arbitration was New York, and the Court held that although allegations of fraud had been raised, there was nothing exceptional about the case which meant that those allegations could not be determined within the scope of the arbitration.

In a further case with an arbitration angle, Appleby acted for the respondent in the Bermuda case of *LAEP Investments Ltd v. Emerging Markets Special Situations 3 Ltd* [2015] CA (BDA) 10 Civ, 9 April 2015, unreported. This was an appeal against the High Court's refusal to stay an enforcement order made 22 March 2013 and to set aside a winding-up order dated 4 April 2014 and certain ancillary orders. The dispute ultimately giving rise to the appeal goes back to a reference to arbitration submitted by the appellant company in Brazil in October 2010 in a dispute arising out of a debt restructuring transaction. In the arbitration, an award had been made on 18 March 2013 in the respondent's favour, but there were various challenges proceeding in Brazil. An interim stay order was granted on 19 December 2013 by the Saõ Paulo State Court of Appeals.

In a ruling dated 1 April 2014 the judge at first instance dismissed the Appellant's application for a stay of the Bermuda Enforcement order issued in respect of the arbitration award. At the time of the application the arbitration award stood as valid, albeit subject to attack from an annulment application and subject to the 19 December interim stay order. The application was refused on the ground that the trial judge did not believe there was any material before him to outweigh the bias towards enforcement. An order winding up the Company was granted on 4 April 2014.

On review, the Court of Appeal found that the trial judge had erred in his application of the test under Order 45 Rule 11 and thus his refusal to grant a stay, in that in his reasoning he took into account the prospects of success of the Brazilian annulment application, which was a matter for the Brazilian Courts to assess and for the Bermuda Courts to await the outcome. The Court of Appeal therefore granted the stay as requested.

As regards the winding up and ancillary orders, the Court of Appeal agreed that these should be set aside on the grounds that, had the stay been granted as it should have been, there would have been no debt leading to the statutory demand that formed the basis of the petition to wind up the Appellant.

A further case involving the early termination of winding up proceedings comes from the Cayman Islands and does not (unlike the above cases) have anything to do with arbitration. *In the matter of Brookemil Ltd* (Grand Court, FSD 80/2014, 12 June 2015, unreported) was an unusual case, in that it involved a company *resisting* the withdrawal of a creditor's winding-up petition against it.

Faced with a petition based on failure to pay on a promissory note, defended by the company on the grounds that the note and various related documents were forged, the court adjourned the petition and directed the trial of an issue as to the validity of the note. As the date for that trial drew near, the petitioning creditor attempted to withdraw the petition and vacate the trial. On hearing the company's submission as to the injustice of

allowing the creditor to deny it the benefit of judicial findings on the issues, the Court refused to allow the creditor to do so. The preliminary issue was duly tried and Brookemil successfully established that the note and four supporting documents were forgeries. Accordingly, the Court dismissed the petition and ordered the petitioner to pay the company's costs on the indemnity basis.

The above cases address the stay or dismissal of proceedings before a winding-up order has been made. *The Spirit of Montpelier and others v. Lombard Manx Ltd* (Isle of Man Staff of Government Division, 2DS 2014/9, 2015/01, 18 June 2015, unreported) concerned the jurisdiction of the Isle of Man Court to rescind a winding-up order after it has been issued. There had been no Manx authority on this point. Neither the Rules of the High Court nor the Companies (Winding-Up) Rules 1934 give express jurisdiction to rescind a winding-up order. At first instance, Deemster Doyle held (albeit with 'considerable reluctance') that he had no inherent jurisdiction and that it was a matter for legislation or for higher court authority. On appeal, the Island's Court of Appeal disagreed, holding that there was an inherent jurisdiction at Manx common law to review, rescind or vary a winding-up order, where such an order is necessary in the interests of justice. In doing so the Court noted that in the absence of a power to rescind, the company could only seek a stay of a winding-up order, which could be wholly unsatisfactory and prejudicial to the ongoing operation of the company. The Court cautioned that the jurisdiction is limited to cases where there has been a material change in circumstances since the making of the winding up order, or if the facts on which the original order had been made were mistaken, innocently or otherwise, or if there had been a manifest mistake on the part of the judge in formulating the order.

International Co-operation

A paradigm case of cross-border insolvency co-operation, and a locally ground-breaking one, arose out of the collapse of Channel Islands-based shipping and transport business Huelin Renouf. The business had operated through two Jersey and Guernsey companies, but the affairs of both were inextricably intertwined, so that on their insolvency it was clearly going to be an impractical exercise, or at least extremely expensive one, to attempt to separately unravel the affairs of the two companies. The liquidators therefore applied to the Royal Courts of Jersey and Guernsey for orders pooling their assets and liabilities, to be effected by the transfer of the assets of the Guernsey company to the Jersey company and the payment from that entity of any dividend to the creditors of both companies. In *In the matter of Huelin-Renouf Shipping (Guernsey) Limited (in liquidation)* (Judgment 46/2015, 4 September 2015, unreported) and *Representation of Huelin-Renouf Shipping (Liquidation)* [2015] JRC 206, 7 October 2015, unreported, the Royal Courts of Guernsey and Jersey respectively granted the applications. This was the first time pooling had been done in Guernsey and is a notable illustration of cross-border co-operation between the Guernsey and Jersey Courts. In Jersey, there had been previous examples where the Court had ordered pooling of assets and the court noted the very wide powers the Court enjoyed pursuant to Art. 155(4) of the Companies (Jersey) Law 1991.

Again in Jersey, and following the theme of the Royal Court seeking to find the most practical and sensible solution to an insolvency problem, the case of *In the matter of the Representation of Deutschepfandbriefbank AG* [2015] JRC 137, 24 June 2015, unreported (also more pronounceably known as *Re Alard*) confirmed the Royal Court's willingness to look at the appropriateness of insolvency regimes in other jurisdictions where such regimes would better serve the creditors of a Jersey company. This was the first occasion since *HSBC Bank plc re Tambrook* [2013] JRC 046, 28 February 2013, unreported when the Royal Court has issued a letter of request to the High Court of England and Wales seeking an administration order over a Jersey company under the assistance provision of s.426(4) of the Insolvency Act 1986. By way of reminder, in *Tambrook*, the High Court's initial refusal to accept the application for assistance (on the basis that it was not being requested to

assist the Royal Court in any insolvency proceedings, but rather to provide a substitute remedy where Jersey insolvency regimes were lacking) was overturned on appeal (*Re Tambrook Jersey Limited [2013] 2 WLR 1249*). That decision confirmed the availability of English administration for a creditor of a Jersey company. *Re Alard* accordingly serves to restate and confirm the established practice that a creditor is able to petition the Royal Court to issue a letter of request to the High Court seeking the appointment of English administrators and place the company into English administration, if appropriate to do so. The reasoning in *Alard* has been followed in *The matter of Siena SARL* [2015] JRC 260, 16 December 2015, unreported.

In another case involving a letter of request to a foreign court in insolvency proceedings, the Grand Court of the Cayman Islands considered the operation of particular sections of the Companies Law requiring persons to assist liquidators. *In the Matter of China Milk Products Group (in liquidation)* (Grand Court, FSD 83/2011, 20 May 2015, unreported) was a case where liquidators were facing difficulty getting the company's books and records from its former management, and therefore sought to compel others, in particular the Hong Kong-based former auditors and solicitors, to produce them. Whereas s. 103 of the Companies Law compelled 'insiders' of the company such as directors to provide any information or documents regarding the company in their possession, it was accepted that this could not be used against the auditors and solicitors. They were, however, within the ambit of s. 138, which applies to any person, but under that section they could only be compelled to produce documents and information to which the company 'appears to be entitled'. The solicitors did not appear, but the auditors, while agreeing to produce certain categories of documents requested by the liquidators, resisted in respect of their audit work papers on the basis that they were (under the Hong Kong law-governed terms of engagement) the property of the auditors and the company was not entitled to them.

The Court accepted that this was the position regarding ownership of the working papers, but drew a distinction between the papers and the information contained in them. It relied on evidence of Hong Kong law as to the company's ownership of information and the ability of the Hong Kong court to compel production. A letter of request was accordingly issued asking the Hong Kong court to order production insofar as the work papers contained information that 'belonged' to the company.

Last year, we discussed the combined decisions of the Privy Council in *Saad* and *Singularis*, and their revised approach to the concept of 'modified universalism' in cross-border insolvency. This topic was examined in Guernsey in *In the matter of X (a bankrupt)* (Judgment 36/2015, 6 July 2015, unreported). The Trustee in Bankruptcy of an English bankrupt appointed by order of the English Court and whose appointment had been recognised by the Guernsey Court, applied for an order that a third party based in Guernsey deliver up information and documents concerning the affairs of the bankrupt. There is no statutory power under Guernsey law which empowers the Court to make such an order in aid of a foreign bankruptcy proceeding. The Royal Court explored a number of different propositions as to how this might be achieved under Guernsey law, including by analogy with the powers conferred by statute in respect of the corporate insolvency regime. The decision is particularly notable insofar as it focussed on the decision of the Privy Council in *Singularis*, specifically whether there exists an inherent jurisdiction to treat a power conferred by statute as being available in a case which is not within the statute, 'relying on some combination of usefulness, a generous assessment of analogy, and resort to a supposed beneficial principle of "modified universalism" of insolvency law, of indefinite and necessarily presupposed extent.' The Royal Court held it was not bound by the majority decision in *Singularis* and sided with the minority view that there was no such power. In the light of this decision, it appears that the position of insolvency office-holders in foreign jurisdictions, in the context of personal insolvency at least and possibly corporate insolvency by analogy, is that, unless such persons are able to rely

on a 'letters of request' route, they will not be able to obtain an order of the Royal Court compelling the provision of documents or information from third parties in Guernsey.

Determining entitlements

Our final two cases, both from the Cayman Islands, address questions relating to working out who gets what in a liquidation.

Primeo Fund (in liquidation) v. Herald Fund SPC (in liquidation) (Grand Court, FSD 27/2013, 12 June 2015, unreported) was one of many cases arising out of the Madoff frauds, Herald being a direct investor in Mr Madoff's company and Primeo an indirect one, by reason of investments in Herald. In his decision, Jones, J. of the Grand Court of the Cayman Islands addresses not only the vexed question of the status of redeeming hedge fund investors (in relation to which we review the case in our separate fund disputes update) but also the ability of a Cayman liquidator to rectify the register so as to undo the effect of redemptions that occurred at false net asset value figures, and thereby resolve the issue of 'false profits' arising from a Ponzi scheme.

Section 112 of the Companies Law empowers liquidators in certain circumstances to rectify the company's register of members, and Order 12, rule 2 of the Companies Winding Up Rules *requires* them to do so where shares have been issued and/or redeemed at prices based upon mis-stated NAVs which are not binding upon the company and its members by reason of fraud or default. Although by reason of the Madoff fraud, Herald's NAVs were wrong, the Court held that the requirement that the NAVs not be binding between the company and its members means that there must be some conduct on the part of the company itself or conduct on the part of an agent which can properly be imputed to the company which has the effect of vitiating the contract with its members. In the absence of such conduct by Herald, the liquidators were under no duty to rectify. They did, however, have the power to do so, the object being to create a 'true' register removing the effects of the fraud. The Court left the questions of how that should be done and the valuation methodology to be adopted, to a further hearing. For a more detailed commentary, see our article here.

The final case in our selection of the insolvency cases of 2015 is *In the matter of Caledonian Bank* (Grand Court, FSD 27/2015, 23 July 2015, unreported), in which Smellie CJ addressed the treatment of deposits and preferential dividends. The Court also applied various principles of banking law to determine whether or not certain payments had been completed at the time the bank went into liquidation.

In the Cayman Islands there is no statutory depositor protection scheme, but in a liquidation certain bank deposits count as preferred debts and rank ahead of most other creditors. The case concerned the interpretation of the provisions applying that principle, in particular as to the operation of the value limit of CI$20,000. The relevant provision granted preferential status to 'any sum due to eligible depositors … which does not exceed the deposit limit.' The issue was whether this protected the first $20,000 of deposits of whatever size, or only deposits that in total were less than that amount. The Court agreed with the submissions of the liquidation committee that as a matter of interpretation of the specific words used, supported by sound policy reasons, the latter was correct.

Appleby acted for the respondent company in Brookemil, for the Liquidation Committee in Caledonian Bank, for the Respondent in LAEP Investments Ltd v Emerging Markets Special Situations and for the creditor applicant in re Alard.

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