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# Cayman Islands Insolvency Law

## **Preface**

This publication has been prepared for the assistance of those who are considering issues pertaining to the insolvency of companies in the Cayman Islands. It deals in broad terms with the requirements of Cayman Islands law. It is not intended to be exhaustive but merely to provide brief details and information which we hope will be of use to our clients. We recommend that our clients seek legal advice in the Cayman Islands on their specific issues before taking action.

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## 1. INTRODUCTION

Insolvency law in the Cayman Islands is principally regulated by the Companies Law (2016 Revision), the companies Winding Up Rules, the Insolvency Practitioners' Regulations and the Foreign Bankruptcy Proceedings (International Cooperation Rules). Taken together, they provide a modern and comprehensive regime for Cayman insolvency practice and procedure.

Adopted specifically to address the needs of the Cayman Islands as a major financial center, the Cayman Islands insolvency regime focuses on the rights of creditors of all priorities. There are no formal "corporate rescue" or reorganization provisions outside of the Companies Law. Rather, subject to an automatic stay in the case of liquidation or provisional liquidation, secured creditors retain their rights to enforce their security outside the liquidation process. Contractual setoff and netting provisions remain enforceable against the liquidators of insolvent Cayman Islands companies and the law reaffirms the enforceability of multilateral setoff arrangements.

## 2. MODES OF WINDING UP COMPANIES

The Cayman Islands Companies Law provides that a company may be wound up:

- (1) compulsorily by order of the court;
- (2) voluntarily -
  - (a) by virtue of a special resolution;
  - (b) because the period, if any, fixed for the duration of the company by its articles of association has expired; or
  - (c) because the event, if any, has occurred, on the occurrence of which its articles of association provide that the company shall be wound up; or
- (3) under the supervision of the court.

## 2.1 Compulsory Liquidation

The objective of compulsory liquidation is to wind up the company and distribute its assets to its creditors and shareholders. The court's winding up jurisdiction is extended to a foreign company which (i) has property located in the Cayman Islands; (ii) is carrying on business in Cayman; (iii) is the general partner of a Cayman limited partnership; or (iv) is registered as a foreign company in Cayman.

A company may be wound up by the court if:

- (1) the company has passed a special resolution requiring the company to be wound up by the court;
- (2) the company does not commence its business within a year from its incorporation, or suspends its business for a whole year;
- (3) the period, if any, fixed for the duration of the company by the articles of association expires, or whenever the event, if any, occurs, upon the occurrence of which it is provided by the articles of association that the company is to be wound up;
- (4) the company is unable to pay its debts; or
- (5) the court is of the opinion that it is just and equitable that the company should be wound up.

The company, any creditor (including a contingent or prospective creditor) or any shareholder of the company can present a winding-up petition to the court at any time. The Cayman Islands Monetary Authority may also present a winding-up petition to the court at any time in relation to a company which is carrying on a regulated business in the Cayman Islands.

If the articles of the company specifically permit it, the directors of a company can present a winding up petition on behalf of the company without the sanction of the shareholders.

Although there is no statutory obligation on a company or its directors to commence liquidation proceedings, directors owe common law and fiduciary duties to creditors if the company becomes insolvent (see discussion at section 6 below regarding directors' duties in an insolvency).

The court is also statutorily bound to honour any contractual agreement by any person not to present a petition against company.

Shareholder sanction is not required to commence the winding up of a company which, by the terms of its articles, is supposed to liquidate at a certain date, or upon the happening of an event. The winding up is deemed to have commenced on the date specified or upon the occurrence of the event. Further, the passing of the fixed date or the happening of the event constitutes grounds for a petition to the court by a creditor or contributory if the company did not wind itself up as required.

A company is deemed unable to pay its debts where any of the following apply:

- (1) it neglects to pay (or fails to secure the debt, or come to an arrangement, to the creditor's satisfaction) for more than three weeks a sum in excess of CI\$100 for which a demand has been made and served on it;
- (2) an execution or other process issued in the form of a judgment, decree or order by the court in favour of any creditor is returned unsatisfied in whole or in part;
- (3) it is proved to the satisfaction of the court that the company is unable to pay its debts.

If the debt claimed in the demand is disputed by the company in good faith and on substantial grounds then it cannot form the basis of a winding-up petition. If, however, the debt claimed is a judgment debt, the company cannot legitimately dispute it, unless execution of the judgment has been stayed by the court.

Despite the language of the Companies Law emphasizing a "cash flow" test, in practice, the cash flow test applied by the Courts in the Cayman Islands is not

confined to consideration of debts that are immediately due and payable. It permits consideration also of debts that will become due in the reasonably near future and is more akin to a “balance sheet” test.

Official liquidators are appointed by the court and their authority displaces that of the company's directors. The official liquidators control the company's affairs, subject to the court's supervision. Official liquidators must be qualified insolvency practitioners resident in the Cayman Islands or foreign practitioners appointed jointly with a resident qualified insolvency practitioner.

It is the official liquidator's primary duty to collect, realise and distribute the assets of the company to its creditors and the legislation confers upon the liquidator wide powers to enable him to do so.

Once the affairs of a company in compulsory liquidation have been fully wound up, the court makes an order, on the liquidator's application, that the company is dissolved.

## **2.2 Voluntary Liquidation**

In a voluntary liquidation, the company's affairs are wound up and the assets distributed. Voluntary liquidation can be used by companies incorporated and registered under the Companies Law and can be commenced by shareholder resolution or on the expiry of a period or the occurrence of an event. Upon commencement of the voluntary winding up, the company must cease business activities except so far as necessary for its beneficial winding-up.

A company can be wound up voluntarily in the following cases:

- (1) when the fixed period, if any, for the duration of the company in its memorandum or articles expires;
- (2) if an event occurs which the memorandum or articles provide is to trigger the company's winding-up;

- (3) if the company resolves by special resolution that it be wound up voluntarily;
- (4) if the company resolves by ordinary resolution that it be wound up voluntarily because it is unable to pay its debts as they fall due.

Any person, including a director or officer of the company, may be appointed as a voluntary liquidator; there are no qualification requirements for appointment as a voluntary liquidator. On appointing a voluntary liquidator, the directors' powers cease, except to the extent the company (through a general meeting) or the liquidator sanctions the continuance of those powers.

The voluntary liquidator, however, must apply to court within 28 days of the commencement of the liquidation for an order that the liquidation continue under the supervision of the court unless all of the directors have signed a Declaration of Solvency in the prescribed form. Even where such declaration is provided, the liquidator and any creditor or contributory has the discretion to make an application for supervision, on the ground that the company is or is likely to become insolvent or that the supervision of the court would facilitate a more effective, economic or expeditious liquidation.

A liquidator appointed to conduct a voluntary liquidation does not require the court's authorisation to exercise his powers. The liquidator can apply to the court, however, to determine any question that arises during the winding-up process.

There is nothing in the Companies Law to suggest that protection from the company's creditors is available during a voluntary liquidation.

Once the affairs of a company in voluntary liquidation have been fully wound up, the liquidator must call a general meeting of the company to present the liquidator's account of the liquidation. The liquidator must then file, within seven days of the meeting, a return in the prescribed form with the Registrar of Companies, and the company is deemed to have been dissolved three months after the date of registration of the return.

## 2.3 Court-supervised Liquidation

A voluntary liquidation can be brought under the court's supervision. As noted above, the voluntary liquidator must apply to the court for an order that the liquidation continues under the court's supervision unless, within 28 days of the liquidation commencing, the directors sign a declaration that the company will be able to pay its debts in full (with interest) within a period not exceeding 12 months after the commencement of the liquidation. Even if a declaration is made, the liquidator or any creditor or shareholder can apply to bring the liquidation under the court's supervision on the grounds that either:

- (1) the company is or is likely to become insolvent;
- (2) court supervision will facilitate a more effective, less expensive or quicker liquidation of the company in the interests of the shareholders and creditors.

When making a supervisory order, the court will appoint a qualified insolvency practitioner as liquidator of the company to replace the voluntary liquidator as though it were a court ordered winding up.

## 3. RESCUE PROCEDURES

### 3.1 Provisional Liquidation

The historical practice of Cayman Islands courts to allow the use of provisional liquidation in aid of reconstruction was given a statutory basis. The company may apply for a provisional liquidator where it is or is likely to become, unable to pay its debts and intends to present a compromise or arrangement to its creditors. A creditor, contributory or shareholder can also make an application (usually *ex parte* or without notice to the company) on the ground that there is a *prima facie* case for making a winding-up order and the appointment of a provisional liquidator is necessary to prevent:

- (1) the dissipation or misuse of the company's assets;
- (2) the oppression of minority shareholders; or

- (3) mismanagement or misconduct on the part of the company's directors.

The objective is usually to preserve and protect the company's assets until the hearing of a winding-up petition and the appointment of official liquidators but, as noted above, a company can petition for its own winding-up and apply for the appointment of provisional liquidators to protect itself from creditors and to have time to restructure its business in the same way that an administrative order in England or Chapter 11 proceedings in the United States might be utilised. The appointment of a provisional liquidator in assisting the rescue of a solvent company may be beneficial in circumstances where refinancing or sale as a going concern is a real possibility and is likely to be more advantageous to creditors than realising and distributing the assets in a compulsory liquidation.

An application to appoint provisional liquidators can only be made following the presentation of a winding-up petition. Provisional liquidators are subject to the court's supervision and only carry out the functions that the court confers on them. The court order appointing a provisional liquidator may limit the scope of their powers depending on the reason for appointment. Existing management may be allowed to remain in control of the company subject to the supervision of the court and provisional liquidators in circumstances where a company restructuring is proposed.

No suit, action or other proceeding can be commenced or proceeded with against the company without the court's leave once a provisional liquidator has been appointed. The automatic stay does not prohibit secured creditors from enforcing their security.

Provisional liquidation is brought to an end by court order usually as a result of either:

- (1) the winding-up order being made (in which case the company is dissolved at the conclusion of the liquidation); or
- (2) an order dismissing or withdrawing the winding-up petition (in which case the company continues to exist).

The court can also order earlier termination of the provisional liquidator's appointment either:

- (1) on application by the provisional liquidator, the petitioner, the company, a creditor or a shareholder; or
- (2) if an appeal against the provisional liquidator's appointment succeeds.

### **3.2 Schemes of Arrangement**

The objective of a scheme of arrangement is to allow the company to enter into an agreement with its shareholders and/or creditors (or any class of them) to either:

- (1) restructure its affairs while solvent so that it can continue to trade and avoid liquidation; or
- (2) reach a compromise or arrangement with creditors or shareholders (or any class of them) after liquidation has commenced.

A scheme of arrangement is initiated by the company, any company creditor or shareholders, a company liquidator or provisional liquidator applying to the court for an order convening a meeting of the creditors, shareholders (or class of them) in a manner which the courts direct. There is no statutory obligation on a company or its directors to propose a scheme of arrangement (but see discussion at section 6 below regarding directors' duties in an insolvency).

A scheme of arrangement in the Cayman Islands requires the sanction of the Grand Court in order for it to be binding on the company and its creditors. In every case, the court will consider whether it is appropriate to convene class meetings of creditors and, if so, what the composition of those classes should be. The applicant must satisfy the court that the scheme documentation will provide the creditors with all information reasonably necessary to make an informed decision about the merits of the proposed scheme of arrangement and will have the right to attend and be heard at the hearing of the petition.

Within seven days of the creditor's meeting, the applicant is required to file a supplementary affidavit sworn by the Chairman of the meeting verifying that notice was duly sent in accordance with the court's order for directions, that the meeting was duly held and giving particulars of the result.

If a majority in number representing 75% in value of the creditors present and voting either in person or by proxy at the meeting, agree to the scheme of arrangement, that scheme shall, if sanctioned by the court, be binding on all creditors as well as the company.

If the scheme of arrangement is proposed outside of liquidation, the directors remain in control of the company. If the company is in official or provisional liquidation, then its affairs will be controlled by its official or provisional liquidators, subject to the court's supervision.

If the scheme of arrangement is proposed outside of liquidation, no protection from the company's creditors is available. If the scheme is initiated after the commencement of an official or provisional liquidation, then an automatic stay prohibits the commencement or continuance of any suit, action or other proceeding against the company without the court's leave. The automatic stay does not prohibit secured creditors from enforcing their security.

A scheme of arrangement is binding on the company and all creditors, shareholders and class of them once it receives court sanction. There is no formal conclusion to a scheme of arrangement. The scheme comes to an end once all compromise or arrangement terms to which it relates have been complied with. If the company is not in liquidation, it continues to exist. If the company is being wound up, it is dissolved at the conclusion of the liquidation.

#### 4. CREDITOR PROTECTION

The Cayman Islands Companies Law contains an express provision that secured creditors are entitled to enforce their security without the permission of the court or reference to the liquidator. Creditors are not treated differently based on whether they are based in Cayman or elsewhere. The Law also makes it clear that multilateral set-off is included.

At any time between the presentation of a winding up petition and the making of a winding up order, the company or any creditor or shareholder can apply for an injunction to restrain further proceedings in any action or proceeding pending against the company in a foreign court. On the making of a winding-up order, an automatic stay is imposed prohibiting any suit, action or other proceeding from being proceeded with or commenced against the company without the leave of the Grand Court. As noted above, these stays and injunctions do not prohibit secured creditors from enforcing their security.

The Companies Law also includes provisions dealing with fraud in anticipation of the winding up (including concealing assets, removing property, making false entries in the books, destroying or falsifying documents, etc.). Criminal penalties affix to any officer, service provider, shadow director (the definition of which follows that of the UK legislation), voluntary liquidator or controller who does these types of things with the intention to defraud. Similar prohibitions and penalties apply to those knowingly participating in fraudulent transactions, misconduct in the course of winding up, or those making material omissions from the statement of the company's affairs or making a false declaration of solvency.

The Companies Law confirms the ability of the court to require liquidators to assist in criminal investigations of liquidated companies. The attorney general is required under the new provisions to seek the court's leave to commence a criminal prosecution against the company once a provisional liquidator is appointed or a winding up order is made.

## **5. MEMBER PROTECTION**

The Companies Law includes powers in connection with petitions brought on the ground that it is just and equitable that the company be wound up. This is, effectively, an ‘oppression remedy’. Unlike the English ‘unfair oppression remedy’, however, it does not exist as a freestanding right, but is framed in terms of alternative relief that the court can grant on a just and equitable winding-up petition.

A “just and equitable” petition is commonly presented where there has been some serious mismanagement or breach of fiduciary duties on the part of the company director(s) or loss of substratum where the purpose for which the company was established has fallen away.

On the hearing of such a petition, the court may make the following orders:

- (1) an order regulating the conduct of the company in the future;
- (2) an order requiring the company to refrain from doing or continuing an act complained of by the petitioner;
- (3) an order authorizing civil proceedings to be brought in the name and on behalf of the company by the petitioner on such terms as the court may direct;
- or
- (4) an order providing for the purchase of members’ shares by other members or by the company.

## **6. FIDUCIARY DUTIES OF DIRECTORS IN AN INSOLVENCY**

### **6.1 Generally**

The common law and statute impose various duties and responsibilities on directors of Cayman companies. Directors should always consider these duties and responsibilities when charting a course of conduct with respect to the company and its interests. If there is the least doubt or concern about a particular approach or action, and how it might impinge upon or otherwise interact with the director's duties and obligations, fact-specific legal advice should be obtained without delay.

At common law a director owes two types of duty to the company; a fiduciary duty and a duty of skill and care.

Within the confines of fiduciary duty, an individual director must act in good faith in his or her dealings with or on behalf of the company and exercise the powers and fulfil the duties of the office honestly. This fiduciary duty includes the following aspects:

**A Duty to Act in Good Faith** - A director has a duty to act in good faith in what she or he considers is in the best interests of the company and not for any collateral purpose.

**A Duty to Exercise Powers in the Company's Interests** - Directors must exercise their powers in the company's interests and only for the purpose(s) for which they are given.

**Conflicts of Interest** - A director must not put himself or herself in a position where there is an actual or potential conflict between a personal interest or the duties owed to third parties and his or her duty to the company.

**Secret Profits** - A director's fiduciary position precludes him or her from taking a personal profit from any opportunities that result from the directorship, even if the director is acting honestly and for the good of the company, unless the articles provide otherwise. Subject to such articles, any profit so arising must be paid over to the company.

A director's fiduciary duty imposes a largely negative obligation not to do anything that would conflict with the company's interests. However, when a director is acting in the company's interests she or he is expected to exercise whatever skill she or he possesses with reasonable care. This duty includes the following aspects:

**Degree of Skill** - A director need not exhibit a greater degree of skill than may reasonably be expected from a person of like knowledge and experience. A director is not expected to exercise a level of skill he or she does not have.

**Attention to the Business** - A director must diligently attend to the affairs of the company and in performing directors' duties, they must display the "reasonable care ... that an ordinary man may be expected to take in the same circumstances on his own behalf".

**Reliance on Others** - A director is not liable for the acts of co-directors or other company officers solely by virtue of the position. A director is entitled to rely on his or her co-directors or company officers as well as subordinates who are expressly put in charge of attending to the detail of management, provided such reliance is honest and reasonable (although directors cannot absolve themselves entirely of responsibility by delegation to others). As a general rule, before delegating responsibility to others, the directors in question should satisfy themselves that the delegates have the requisite skills to discharge the functions delegated to them.

## 6.2 To Whom is the Duty Owed?

The fiduciary duties of the directors are owed to the company itself. This duty translates into the directors having regard to the collective interests of the members of the company as long as it is a going concern. The usual justification for this is that the members are the residual claimants to the assets of the company once the claims of all the creditors have been satisfied. Recently, the courts have recognised that when a company becomes insolvent or is nearly so, then the interests to which the directors must have regard when acting in the interests of the company include the interests of the creditors. In some cases, the collective interests of the creditors supersede the collective interests of the members because there will be no residual assets to turn over to the members after all the creditors have been paid in an insolvency.

## 6.3 Timing



In deciding when a company should go into liquidation, this should be done as soon as possible after the directors realise that there is no reasonable prospect that the company will avoid going into an insolvent liquidation. If, on the advice of professional advisers, the directors are of the view that there is a reasonable prospect of turning the company around within a reasonable period of time and of avoiding an insolvent liquidation, then the directors may take whatever action is necessary to avoid or reverse the insolvency or at the very least, to minimise loss to the company's creditors. In any event, the directors should review the company's position on a regular basis and if they come to the view or are advised that there is no realistic prospect of lifting the company out of its financial difficulties, they must put the company into liquidation. To do otherwise, would put them at risk of breaching their fiduciary duties.

## **7. INTERNATIONAL CO-OPERATION**

The Cayman Islands Companies Law contains provisions dealing with co-operation in international bankruptcy and insolvency proceedings. This section defines "foreign bankruptcy proceedings" as including proceedings for the purpose of reorganizing or rehabilitating an insolvent debtor. "Foreign representative" is defined as a trustee, liquidator or other official appointed in respect of a debtor for the purposes of a foreign bankruptcy proceeding.

A foreign representative is empowered to apply to the court for the purposes of:

- (1) recognizing the right of the foreign representative to act on behalf of or in the name of the debtor locally;
- (2) enjoining the commencement or staying the continuation of legal proceedings against a debtor;
- (3) staying the enforcement of any judgment against a debtor;

- (4) requiring a person in possession of information about the business of the debtor to be examined by and produce documents to the foreign representative; and
- (5) ordering the turnover to a foreign representative of any property belonging to a debtor.

In exercising its discretion the court is to be guided by matters which will best assure an economic and expeditious administration of the debtor's estate, consistent with:-

- (1) the just treatment of all holders of claims against or interests in a debtor's estate wherever they may be domiciled;
- (2) the protection of claim holders in the Islands against prejudice and inconvenience in the processing of claims in the foreign bankruptcy proceeding;
- (3) the prevention of preferential or fraudulent dispositions of property comprised in the debtor's estate;
- (4) the distribution of the debtor's estate amongst creditors substantially in accordance with the order prescribed by Part V;
- (5) the recognition and enforcement of security interests created by the debtor;
- (6) the non-enforcement of foreign taxes, fines and penalties; and
- (7) comity.

Where a Cayman company is the subject of foreign bankruptcy proceedings, notice of this fact is now required to be filed by the company's liquidator (or where there is none, its directors) with the Registrar and published in the Gazette.

## **8. CONCLUSION**

Cayman's insolvency regime enables insolvent Cayman companies to be wound up in a transparent, efficient and cost-effective manner to the benefit of their creditors. Sanctions against fraudulent trading and other measures to promote good corporate governance provide further protection to creditors and shareholders.

*This publication should not be construed as legal advice and is not intended to be relied upon in relation to any specific matter. It deals in broad terms only and is intended merely to provide a brief overview and give general information.*

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