The Cayman Islands – emerging trends in vessel finance

by Richard Munden, Walkers

Our article in the 2013/14 edition of the Shipping Finance Review explored some of the initiatives by the Cayman Islands government to support the growth of the maritime sector in the Cayman Islands and explained how Cayman Islands structures are used for vessel finance, securitisation of charter receivables and for insuring maritime risks. We also outlined several features of Cayman Islands law that make the jurisdiction attractive for the incorporation of special-purpose vehicles for investing in and owning commercial vessels, large private yachts, offshore equipment and other maritime assets. In this article we examine certain trends we have seen over the last year for financing and investing in such assets.

Private equity fund investments

The Cayman Islands is a popular jurisdiction of domicile for private equity funds and we have seen several recent examples of investments in commercial vessels being made by funds that have previously had limited or no exposure to this asset class. The financing and ownership structure typically features special-purpose vehicles at one or more levels with only the ultimate vessel-owning (or vessel-operating) entity required to be incorporated in a specific jurisdiction (in order that the vessel may be registered under the flag chosen by the operator, for example, the Marshall Islands). Cayman Islands entities are a popular choice for the special-purpose vehicles that participate elsewhere in the structure and this mirrors the widespread use of Cayman Islands entities for “downstream” investments by private equity funds across a range of sectors. Key advantages of the jurisdiction for these purposes include that there is no tax on the income, profit or gains of a Cayman Islands entity and no withholding tax is imposed in the Cayman Islands on any cash flows.

A key consideration is the analysis by the investor of whether it may be liable for claims related to the operation of the vessel or other maritime asset. Of particular concern is the risk that an investor who does not participate in the management of the vessel might face claims solely on the basis that the investor has or is considered to have an ownership or other interest in the vessel. These concerns are frequently forward-looking in the sense that whilst the current liability position is understood and factored into the investment, changes in legislation during the life of the transaction could significantly alter the position. Steps adopted at day one may mitigate such an impact.

There are a number of features that can be introduced into a vessel financing structure with a view to clarifying that the investor does not have any role in the operation and management of the vessel. In addition, the method of investment can be tailored with a view to mitigating concerns that the investor may face liability solely on account of having an ownership or other interest in the vessel. The risk is not only that the investor could be liable for the substantive damages which result from an incident but also the costs that would be incurred in any successful defence of a claim.

In structuring a vessel investment one option available to reinforce that a mere investor does not have nor could claim to have an ownership or other interest in the vessel is for the investment to be made through a Cayman Islands trust. Where a Cayman Islands discretionary trust (in respect of which the investor can be – but does not necessarily have to be – a beneficiary) holds shares or equivalent interests in an entity that participates in the title/charter chain then as a matter of Cayman Islands trust law the legal owner of such shares will be the trustee of the trust. A discretionary beneficiary of such a trust would not be recognised as having a fixed proprietary ownership interest in those shares. In addition in structures where the trust invests in a company incorporated in the Cayman Islands then as a matter of Cayman Islands trust law the legal owner of such shares will be the trustee of the trust. A discretionary beneficiary of such a trust would not be recognised as having a fixed proprietary ownership interest in those shares. In addition in structures where the trust invests in a company incorporated in the Cayman Islands then as a matter of Cayman Islands law the trustee in its capacity as shareholder of such a company would not itself be considered to have any interest by way of ownership in a vessel (or any other asset) owned by that company except in very restricted circumstances, for example, where the incorporation of such company was for a fraudulent purpose).
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Walkers advises as to the laws of the Cayman Islands, the British Virgin Islands, Ireland and Jersey with respect to the financing of commercial and private vessels (including semi-submersible rigs, platform supply vessels, LNG carriers, VLCCs, tugs, passenger vessels and super yachts), vessel ownership structures and the registration of vessels.

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Capital markets financing with ECA support
Cayman Islands companies are frequently used as the issuer of debt instruments for capital market transactions across a diverse range of sectors. The long history of Cayman Islands companies in the capital markets means that the bankruptcy remoteness characteristics and other concepts of Cayman Islands law that are instrumental both to analysis by investors and by the rating agencies are widely understood. The use of such companies as the special-purpose borrower for export credit-supported finance structures is also widespread covering a range of equipment produced by several leading economies such as Brazil, Canada, China, France, Germany, Spain and the UK. In recent years there has been a convergence of these two types of financing in the commercial aircraft sector whereby capital markets financing has been combined with export-credit agency support for which investors have shown a strong appetite.

We do not see any reason that an equivalent form of finance could not be used for new vessel deliveries.

A capital markets structure for the financing of equipment will rely on the revenue stream generated by the equipment to fund the payments to the noteholders. There are no taxes imposed in the Cayman Islands with respect to the income received by the issuer or on payments by the issuer to the noteholders. The recourse of the noteholders to the issuer will be limited to the income received by the issuer and, for secured notes, the proceeds of the collateral that is subject to the security arrangements. An export credit-supported structure introduces a guarantee from the relevant export credit agency/ies. The guarantee will pay out to make the noteholders whole in the event that the issuer fails to make the collateral available (the case of the insolvent party) and (ii) the collateral not having been brought onto the balance sheet of the lender/investor.

Enforcement and work-outs
On a number of occasions since we wrote for the 2013/14 edition of the Shipping Finance Review we have been asked to advise lenders in respect of the enforcement of ship mortgages and other collateral securing loans to finance vessels. In these scenarios we have seen that there is a role for a Cayman Islands bankruptcy remote orphan company to participate in warehousing arrangements. Such arrangements are used to either facilitate liquidation of the collateral or confer on the lender or investor control of the title to the collateral for a period during which the parties seek to restructure the terms of the financing.

From the perspective of the lender/investor the use of a Cayman Islands orphan company to hold the collateral provides comfort that during the term of the sale process or restructuring (as the case may be) neither the company nor its shareholder will take any steps with respect to the business of the company or the title to the collateral that would be contrary to the interests of the financing parties. Depending on the circumstances there are also likely to be other advantages such as (i) mitigating the consequences of the debtor (or third party that has made the collateral available) becoming insolvent (as the collateral will no longer be an asset of the insolvent party) and (ii) the collateral not being brought onto the balance sheet of the lender/investor.

Exempted limited liability companies
In 2014 we expect a new law, the Exempted Limited Liability Companies Law, to be enacted in the Cayman Islands. The law, which at the time of writing exists in a draft form and is under review by the Cayman Islands government, will provide for the incorporation of a new form of Cayman Islands vehicle, the exempted limited liability company (an “ELLC”). The draft law is similar to the Delaware LLC law and an ELLC is therefore expected to be similar to a Delaware LLC, being a body corporate with separate legal personality and will require at least one member. It is hoped that the similarity will encourage investors and lenders that are accustomed to working with Delaware LLCs to consider the ELLC as a viable alternative when structuring transactions.

Pursuant to the draft law there are several differences in the nature and operation of an ELLC compared to a Cayman Islands exempted limited company (the vehicle usually incorporated to participate in a vessel finance structure or as charterer of a Cayman-flagged vessel). These differences include that the arrangements for the
management and administration of an ELLC with more than one member are a matter for agreement between the members and to be set out in an ELLC agreement (which will not have to be filed at the Registrar of Companies of the Cayman Islands). This would enable the members to determine at their discretion matters such as capital commitments, allocations of profits and losses, allocations of distributions, voting methods and classes of interests and should permit greater (or at least a more straightforward) tailoring of an investment vehicle or other participant in a vessel finance or ownership structure than might otherwise be practicable.

Other key distinctions are expected to be that (i) subject to the provisions of the ELLC agreement, a manager or member of an ELLC in whom management of the ELLC is vested shall not owe any duty to the ELLC or any member or any other person except the duty to act in good faith (and that duty may also be expressly eliminated by the ELLC Agreement); and (ii) subject to the ELLC agreement a person serving on any board or committee of an ELLC shall not owe any duty to the ELLC or to any member and may, if expressly permitted by the ELLC agreement, act in a manner which the person believes to be in the best interests of a particular member or members (even though it may not be in the best interests of all members together or the ELLC itself).

We anticipate that the introduction of the ELLC vehicle will be a useful addition to the tools already available for structuring transactions through the Cayman Islands.

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