



Cayman Islands: Restructuring & Insolvency

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This country-specific Q&A provides an overview of the legal framework and key issues surrounding restructuring and insolvency in [Cayman Islands](#).

This Q&A is part of the global guide to Restructuring & Insolvency.

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1. **What forms of security can be granted over immovable and movable property? What formalities are required and what is the impact if such formalities are not complied with?**

The following security rights may be granted over immovable and movable property in the Cayman Islands:

- Mortgage. A mortgage arises when a creditor lends money at interest in exchange for a transfer of an interest in the debtor's property. The conveyance of title will become void upon the payment of the debt. An equitable mortgage will be created where the property subject to the mortgage is not transferred to the lender. An equitable mortgage is capable of being defeated by a third party buyer with no notice of the lender's interest.
- Charge. Unlike a mortgage, title to the property will not be transferred to the lender pursuant to a charge, with the chargee merely being granted rights over the property as security for a debt. A charge may be fixed or floating, with a fixed charge attaching to specific assets which cannot then be sold by the borrower. Under a floating charge, a borrower is free to deal with the various assets subject to the charge until such time as a default occurs. Upon an event of default, the charge will crystallise over the property held by the borrower at the time of default. The charge then becomes a fixed charge, with the lender having the power to sell the assets in order to satisfy the outstanding debt.
- Lien. A lien arises by operation of law based on lawful possession and may be used when a creditor is in possession of an asset and monies are due to it for services provided. A lien will not create any rights in the property in the creditor's favour and a creditor has no power to sell the property to allow payment of the debt.
- Pledge. Under a contract to pledge, the property is deposited as security for a debt. The right to the property vests in the creditor to the extent necessary to secure the debt. The creditor has the power to sell the property in the event of a default by the borrower.

The relevant to be observed in circumstances in which a borrower entity incorporated in the Cayman Islands

grants security over its assets will largely be prescribed by the relevant entity's articles of association. However, it is likely that a directors' resolution will be required prior to the granting of any security interest over the company's assets.

The Cayman Islands has centrally maintained ownership registers for land, ships, aircraft and motor vehicles on which creditors' mortgages or charges can be registered. Any third-party purchaser will be deemed to have notice any interest registered at the time of the purchase of the relevant encumbered asset and will acquire the asset subject to a creditor's interest as the holder of a registered mortgage or charge.

Although a Cayman Islands incorporated company is required to maintain an internal register of mortgages and charges, no central register exists for other types of immovable property. A creditor must therefore take adequate steps to ensure that it has sufficient control over an asset to prevent a third party from purchasing it. Any creditor should review a company's register of mortgages and charges prior to making a loan, in addition to ensuring that the register is updated following the date upon which the loan is made.

Failure to comply with the relevant formalities will not automatically render the security void, although there is a risk that the security will not be binding on the debtor company. In addition, a third party purchaser could acquire the asset free of the creditor's security interest or acquire a higher ranking security interest over the asset.

2. What practical issues do secured creditors face in enforcing their security (e.g. timing issues, requirement for court involvement)?

A debtor company may seek to frustrate a secured creditor's attempts to secure the repayment of its debts by dissipating assets prior to enforcement. In such circumstances, a creditor may be required to issue proceedings to recover the debt, whilst at the same time issuing an application for an injunction for the purpose of freezing a company's assets pending the outcome of such proceedings. In order to obtain such relief, a secured creditor would be required to demonstrate to the Grand Court of the Cayman Islands (the "Court") that there was a substantial risk of dissipation of assets on the part of the company.

The legal rights of a secured creditor will be unaffected by the commencement of winding up proceedings in respect of a debtor company. Accordingly, a secured creditor will retain the ability to enforce its security and sell the charged property to obtain payment of the debt. If the sale proceeds of the charged asset are insufficient to discharge the debt, a secured creditor can rank as an unsecured creditor in the liquidation in respect of the balance of the debt.

A secured creditor may appoint a receiver over a charged asset for the purpose of enforcing their security rights under the relevant security document. A receiver is not subject to supervision by the Court and their primary duty will be to the secured creditor, as opposed to the general body of creditors.

3. What is the test for insolvency? Is there any obligation on directors or officers of the debtor to open insolvency procedures upon the debtor becoming distressed or insolvent? Are there any consequences for failure to do so?

A company may be wound up on the ground of insolvency if it is unable to pay its debts as they fall due (i.e. the cash flow insolvency test). A company will be deemed to be unable to pay its debts if:

1. It fails to satisfy a statutory demand (provided that the debt claimed in the demand is not disputed by the debtor company in good faith and on substantial grounds);
2. Execution of a judgment is returned wholly or partly unsatisfied; or

3. It is proved to the satisfaction of the Court that the company is unable to pay its debts.

There is no statutory obligation on a company's directors to commence liquidation proceedings. However, in circumstances in which the company is insolvent or of doubtful solvency, the directors' duty to act in the best interests of the company requires them to have regard to the interests of its creditors. Directors may incur personal liability to the company for any losses which they cause to the company if they act in breach of that duty, for example, by causing the company to incur further obligations when they knew or should have known that there was no reasonable prospect of the company avoiding an insolvent liquidation.

4. What insolvency procedures are available in the jurisdiction? Does management continue to operate the business and / or is the debtor subject to supervision? What roles do the court and other stakeholders play? How long does the process usually take to complete?

Insolvency proceedings in the Cayman Islands are generally subject to the supervision of the Court. The main processes are as follows:

1. Liquidation (Official and Voluntary);
2. Provisional Liquidation (discussed at section 7 below); or
3. Scheme of arrangement (discussed at section 7 below). (Although not an insolvency proceeding per se, schemes may be used within or outside an insolvency proceeding for the purpose of achieving a compromise with creditors or shareholders.)

Official Liquidation

A company is placed into official liquidation upon the making of a court order for the appointment of liquidators. Official liquidators will act as officers of the Court and their primary duty will be to collect in the company's assets and distribute them pari passu to the company's creditors in accordance with the statutory waterfall of payments, with any surplus assets available for distribution to the company's shareholders.

The powers of directors will cease upon the appointment of official liquidators, who will control the company's affairs, subject to the court's supervision.

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 Court and any rights of action against the company are converted into claims in the liquidation proceedings. Notwithstanding the making of a winding up order, a secured creditor is not prohibited from enforcing any valid security interest.

The length of the liquidation process varies on a case by case basis and will largely depend on the nature and complexity of the company's business and the issues required to be dealt with in order to allow a liquidator to wind up a company's affairs. There is no timeframe within in which a liquidation must be completed.

Voluntary Liquidation

Although not technically an insolvency procedure, the Companies Law also provides a mechanism by which a company incorporated in the Cayman Islands may be wound up voluntarily by an ordinary resolution of its members if it is unable to pay its debts as they fall due.

The voluntary liquidator must apply to the Court for an order bringing the voluntary liquidation under the Court's supervision unless within 28 days of the commencement of the liquidation, 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. If a supervision order is made, the liquidation will

thereafter proceed in the same manner as an official liquidation.

5. How do creditors and other stakeholders rank on an insolvency of a debtor? Do any stakeholders enjoy particular priority (e.g. employees, pension liabilities)? Could the claims of any class of creditor be subordinated (e.g. equitable subordination)?

The legal rights of secured creditors are unaffected by the liquidation of a company and will be permitted to enforce their security by, for example, selling any charged asset in order to secure repayment of the sum owed. However, whilst secured creditors rarely participate in the liquidation process, in the event that the sale proceeds realised for a charged asset are insufficient to discharge the outstanding debt, a secured creditor may rank as an unsecured creditor in the liquidation for the balance of the debt.

Cayman law provides for a very limited class of preferential creditors. Such preferred debts include wages accrued during the four months immediately preceding the commencement of the liquidation, payments due in respect of any medical health insurance premium and any taxes due to the Cayman Islands Government. Under the Companies Law, preferred creditors rank ahead of both unsecured and secured creditors, where the secured creditor's security is in the form of a floating charge but behind the liquidation expenses (including the liquidator's remuneration and legal expenses).

The general body of unsecured creditors will rank *pari passu* in respect of their claims in the liquidation and the quantum of any distribution made to such creditors will be determined by the value of any realisations achieved by a liquidator in the liquidation.

Rights of set off and subordination are recognised under Cayman Islands law, although a creditor which extended credit to a company at a time when it had notice of a winding-up petition cannot offset such a debt against the debtor company. Netting agreements relating to financial contracts (including multilateral netting) will prevail over the statutory set-off provisions.

6. What restructuring and rescue procedures are available in the jurisdiction, what are the entry requirements and how is a restructuring plan approved and implemented? Does management continue to operate the business and/or is the debtor subject to supervision? What roles do the court and other stakeholders play?

There are two main statutory proceedings allowing for a rescue / restructuring of a company's operations and debts:

1. Scheme of Arrangement

A scheme will allow a debtor company to enter into an agreement with its shareholders / or creditors (or any class of them) pursuant to section 86 of the Companies Law for the purpose of either:

1. Restructuring its affairs to allow the company to continue to trade and avoid a winding up; or
2. Reaching a compromise or arrangement with creditors (or any class) following the commencement of liquidation proceedings.
3. A scheme will be subject to the supervision of the Grand Court and can be implemented by the company, any creditor or shareholder or a provisional liquidator applying to the Court for an order convening a meeting of creditors, shareholders or any class of them as directed by the Court.

In order for a scheme to be implemented, a majority constituting at least 50% in number and 75% in value of the creditors, shareholders or each class of them present and voting at the meeting must agree to the compromise or arrangement. Subject to obtaining the requisite approvals, the party proposing the scheme must then apply to the Court for an order approving the scheme.

In the event that a scheme is proposed outside of liquidation, the directors will maintain control of the company's affairs. If the scheme is implemented in a provisional liquidation scenario, the provisional liquidator will control the company's affairs, subject to the supervision of the Grand Court.

2. Provisional Liquidation

The purpose of a provisional liquidation is usually to preserve and protect a company's assets pending the hearing of a winding-up petition in respect of the company.

However, the 'soft touch' provisional liquidation regime may be implemented by a company for the purpose of appointing court appointed provisional liquidators to protect itself from creditors and restructure its business whilst effecting a compromise or scheme of arrangement with a company's stakeholders. The use of this procedure is comparable to the UK administration procedure and the Chapter 11 process in the United States.

Any creditor, shareholder or the company itself can apply for the appointment of provisional liquidators in the period following the presentation of a winding up petition and prior to the hearing of the petition.

Upon appointment, the provisional liquidators will be subject to the court's supervision and may only carry out the functions set out in the order appointing them. In the event that a company restructuring is proposed, existing management may be permitted to retain control of the company subject to the supervision of the Court and the provisional liquidators.

The issue of whether a company's directors have the power to present a winding up petition in the absence of a resolution of its shareholders has been the subject of judicial debate in the jurisdiction, with the recent decision of Justice Mangatal in *Re China Shanshui Cement Group Limited* (Grand Court, Mangatal J, 25 November 2015), laying down a restrictive interpretation of directors' powers to present a winding up petition in the name of the company without the approval of the company in general meeting or the power to present such a petition in the company's articles of association.

However, in a recent first instance decision in *Re CHC Group Ltd* (Grand Court, McMillan J, 17 January 2017), Justice McMillan held that in circumstances in which a creditor's petition has been presented against a company, its directors could seek the appointment of provisional liquidators, notwithstanding the absence of an express power in the company's articles of association or a resolution of the company's shareholders.

As discussed at section 19 below, it is anticipated that this area of the law will be subject to legislative reform in the near future, thereby bringing section 94 of the Companies Law in line with section 124 of the UK Insolvency Act, in addition to introducing a new statutory regime allowing a company to petition for the appointment of restructuring officers to obtain a stand-alone restructuring moratorium.

7. Can a debtor in restructuring proceedings obtain new financing and are any special priorities afforded to such financing (if available)?

Both official liquidators and provisional liquidators may obtain third party financing and grant security over the company's assets, subject to obtaining the prior approval of the Court.

In the absence of any security interest being granted to a lender, such lending will rank as an expense of the liquidation, with the lender enjoying a statutory priority over the company's unsecured creditors.

8. How are existing contracts treated in restructuring and insolvency processes? Are the parties obliged to continue to perform their obligations? Will termination, retention of title and set-off provisions in these contracts remain enforceable? Is there any an ability for either party to disclaim the contract?

A liquidator has no right to disclaim either onerous property or unprofitable contracts, which will therefore continue to bind a company in liquidation, although the commencement of insolvency proceedings may constitute an event of default allowing a counter-party to terminate an existing contract.

Under common law, a winding-up order serves to terminate all employment contracts of the company in official liquidation.

Employees' rights will only be affected by a scheme of arrangement in the event that the scheme purports to compromise their rights as creditors under their employment agreement. Similarly, the impact of a scheme on existing contracts and the parties ongoing obligations under those contracts will depend on the terms of the scheme (in particular, the extent to which the scheme purports to compromise rights under the contracts) and the terms of the contracts.

The commencement of a voluntary or provisional liquidation will have no legal effect on employees' rights, except as for provided for in the relevant employment agreement.

Termination, retention of title and set-off provisions contained in the contracts to which the company was party prior to its winding up will remain enforceable by the contracting counter-party on any winding-up. In the absence of any set-off provision, account must be taken of what is due from each party to the other in respect of their mutual dealings, and a set-off is applied in relation to those amounts.

9. What conditions apply to the sale of assets/the entire business in a restructuring or insolvency process? Does the purchaser acquire the assets “free and clear” of claims and liabilities? Can security be released without creditor consent? Is credit bidding permitted?

The principal of caveat emptor will apply to any purchaser of a company's assets / business by a liquidator (whether a provisional liquidator or official liquidator). Only very limited representations and warranties will be given by the liquidators, who will act as agents of the company without personal liability. The purchaser will therefore take the assets subject to existing claims and security interests, although the company will remain liable for any existing creditor claims.

Liquidators have no power to release security without creditor consent. Whilst rarely seen in practice, there is no prohibition on credit bidding pursuant to Cayman Islands law.

10. What duties and liabilities should directors and officers be mindful of when managing a distressed debtor? What are the consequences of breach of duty?

See 3 above.

11. Is there any scope for other parties (e.g. director, partner, parent entity, lender) to incur liability for the debts of an insolvent debtor?

If a director or third party has provided a guarantee to a creditor in respect of a company's debts, that guarantee may be capable of enforcement against such director or third party guarantor personally.

Directors may also be personally liable for the company's debts if they breach their fiduciary duties in certain circumstances. In addition, if it appears that any person has been carrying on the business of the company to defraud creditors or for any fraudulent purpose, a liquidator may apply to the Court for an order that such persons make a contribution to the company's assets.

As a separate legal entity, a parent company will not usually be liable for its subsidiary's debts. However, in certain circumstances, the Court may lift the corporate veil to make a parent company liable if it can be demonstrated that:

1. Some impropriety has occurred and the incorporation of the subsidiary company is a façade designed to conceal or avoid liability on the part of the parent company; or
2. The parent company is exercising control over the subsidiary, such that the subsidiary is effectively acting as its agent.

12. **Do restructuring or insolvency proceedings have the effect of releasing directors and other stakeholders from liability for previous actions and decisions?**

No, to the extent they exist, such liabilities will continue until the date of dissolution of the company.

13. **Will a local court recognise concurrent foreign restructuring or insolvency proceedings over a local debtor? What is the process and test for achieving such recognition?**

The Companies Winding Up Rules 2008 (as amended) provide for a Cayman Islands appointed liquidator to enter into protocols with foreign officeholders appointed by a foreign court for the purpose of promoting the orderly winding up of the company's affairs and avoiding conflicts between the competing winding up proceedings in the Cayman Islands and the foreign jurisdiction.

Section 241 of the Companies Law also allows a foreign representative (defined as a trustee, liquidator or other official appointed for the purposes of a foreign bankruptcy proceeding) to apply to the Court to make orders ancillary to the foreign bankruptcy proceeding. Such orders include:

- An order recognising the foreign representative's right to act in the Cayman Islands on behalf of or in the name of the debtor;
- An order granting a stay of proceedings or the enforcement of a judgment against the debtor;
- An order requiring certain persons with information regarding the debtor's business or affairs to be examined and/or to produce documents to the foreign representative; or
- An order requiring the debtor to turn over property to the foreign representative.

14. **Can debtors incorporated elsewhere enter into restructuring or insolvency proceedings in the jurisdiction?**

Yes. A foreign company may be the subject of a scheme of arrangement in the Cayman Islands or be wound up here in the event that it has property located in, or has been carrying on business in, the jurisdiction, acts as a general partner of an ordinary or exempted Cayman Islands limited partnership, or is registered as a foreign company under the Companies Law.

15. **How are groups of companies treated on the restructuring or insolvency of one of more members of that group? Is there scope for cooperation between office holders?**

This will largely depend on where the insolvent company sits within the group. However, generally speaking, liquidators of a holding company will have the ability to take control of and sell the company's subsidiaries.

Consolidated proceedings are not recognised by Cayman Islands law and the Court will generally recognise the separate legal personality of each company within the group. However, if multiple companies within the group are the subject of winding up proceedings, the Court may appoint the same or common liquidators if it is satisfied that it is appropriate to do so (and having regard to the facts of the case and the risk of any conflicts of interest arising).

No statutory provisions exist in order to govern co-operation between liquidators of different group companies, although liquidators appointed over different group companies may co-operate informally if it is in the best interests of both estates. In exceptional circumstances, the Court may also permit to allow the pooling of assets and liabilities between members of the same corporate group, for example, to allow the liquidators to achieve a compromise in relation to cross-claims between the group entities.

16. **Is it a debtor or creditor friendly jurisdiction?**

The Cayman Islands has traditionally been, and continues to be, regarded as a creditor friendly jurisdiction, with creditors being treated equally irrespective of the jurisdiction in which they are domiciled.

17. **Do sociopolitical factors give additional influence to certain stakeholders in restructurings or insolvencies in the jurisdiction (e.g. pressure around employees or pensions)? What role does the state play in relation to a distressed business (e.g. availability of state support)?**

There is no state support available to distressed businesses in the Cayman Islands. As noted above, given the importance of the funds industry in the jurisdiction, the Cayman Islands have been careful to maintain their reputation as a creditor friendly jurisdiction.

18. **What are the greatest barriers to efficient and effective restructurings and insolvencies in the jurisdiction? Are there any proposals for reform to counter any such barriers?**

As noted in section 7 above, the present uncertainty regarding the ability of the directors of a Cayman Islands company to access the provisional liquidation regime for the purpose of effecting a restructuring without has been the subject of criticism from practitioners.

However, it is anticipated that section 94 of the Companies Law will shortly be amended, such that directors of a Cayman Islands incorporated company will have the ability petition for the company's winding up and apply for the appointment of provisional liquidators without the sanction of a resolution passed at a general meeting. This legislative reform will increase the ability of a company to restructure its debts under the supervision of provisional liquidators with the benefit of a moratorium on creditor action.