
THE RESTRUCTURING REVIEW

EDITOR
CHRISTOPHER MALLON

LAW BUSINESS RESEARCH

THE RESTRUCTURING REVIEW

Reproduced with permission from Law Business Research.

This article was first published in The Restructuring Review, (published in November 2008 – contributing editor Christopher Mallon).

For further information please email Adam.Sargent@lbresearch.com

ACKNOWLEDGEMENTS

The publisher acknowledges and thanks the following law firms for their learned assistance throughout the preparation of this book:

ADVOKATFIRMAET HAAVIND VISLIE AS

ANDREAS NEOCLEOUS & CO LLC

BAKER & MCKENZIE

BAIÃO, CASTRO & ASSOCIADOS –
SOCIEDADE DE ADVOGADOS, RI

CHIOMENTI STUDIO LEGALE

COLLAS DAY

DREW & NAPIER LLC

DUNDAS & WILSON LLP

FORBES HARE

GARRIGUES

GÖRG LAWYERS

GÜR LAW FIRM

HAMILTON ADVOKATBYRÅ

KYRIAKIDES GEORGOPOULOS & DANIOLOS ISSAIAS LAW FIRM

MCMILLAN LLP

SCHELLENBERG WITTMER

SCHÖNHERR RECHTSANWÄLTE GMBH

SERGIO BERMUDEZ LAW OFFICE

SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP

SOLOMON HARRIS

VAN MENS & WISSELINK NV

WEIL, GOTSHAL AND MANGES LLP

WHITE & CASE LLP

WILLIAM FRY

CONTENTS

Prefacevii
	<i>Christopher Mallon</i>
Chapter 1	AUSTRIA 1
	<i>Wolfgang Höller</i>
Chapter 2	BRAZIL 10
	<i>Ricardo Tepedino and Marcelo Lamego Carpenter</i>
Chapter 3	BRITISH VIRGIN ISLANDS 20
	<i>William Hare</i>
Chapter 4	CANADA 29
	<i>Paul Macdonald, Jeff Gollob, Nicholas Scheib and Lisa Kerbel Caplan</i>
Chapter 5	CAYMAN ISLANDS 41
	<i>Laura Hatfield and Sam Dawson</i>
Chapter 6	CYPRUS 49
	<i>Maria Kyriacou</i>
Chapter 7	ENGLAND & WALES 60
	<i>Christopher Mallon and Christian Pilkington</i>
Chapter 8	FRANCE 78
	<i>Jean-Dominique Daudier de Cassini and Lionel Spizzichino</i>
Chapter 9	GERMANY 88
	<i>Christian Bärenz and Carsten Müller-Seils</i>
Chapter 10	GREECE 99
	<i>Leonidas C Georgopoulos and Christina C Papanikolopoulou</i>

Chapter 5

CAYMAN ISLANDS

*Laura Hatfield and Sam Dawson**

I OVERVIEW OF 2007/2008 RESTRUCTURING AND INSOLVENCY ACTIVITY

The ‘credit crunch’ and liquidity crisis that was heralded by the collapse of the Bear Stearns funds in summer 2007 had limited impact on the Cayman Islands. Statistics from the Cayman Islands Monetary Authority show that at the end of September 2008, there were just under 1,000 more registered mutual funds than at the same time in 2007. Registered mutual funds are the vehicle of choice of most hedge funds. There were a number of high-profile hedge-fund liquidations in 2007, including the Master Feeder fund structure set up by Bear Stearns, which invested in collateralised debt obligations that were very badly affected by the downturn in the US housing market, losing the majority of their value, and which some people blame for starting the credit crunch. In addition to court-ordered liquidations, there were some voluntary liquidations and many informal restructurings of hedge funds through late 2007 and the first half of 2008.

However, the post-September 2008 events in the financial markets have had a much bigger impact on liquidity for Cayman-based hedge funds. The crisis of confidence and ripple effect of bank liquidity issues mean that droves of investors can be seen seeking redemptions of their hedge-fund investments. Even hedge funds with investment strategies unaffected by the market turmoil face large numbers of redemptions because their investors have their own liquidity issues and simply need the cash. The directors and investment managers of the hedge funds are mostly having recourse to ‘restructuring’ techniques such as imposing limits on the amount of redemptions that will be paid in cash, placing their own illiquid investments in side pockets and issuing special share classes for these asset pools by way of in-kind redemptions, as well as simply suspending redemptions. All this is designed to give the hedge fund a breathing space to either

* Laura Hatfield is a partner and Sam Dawson is a senior associate at Solomon Harris.

liquidate assets in an orderly fashion to pay redemptions, or try to generate enough new subscriptions to pay redemptions. Inevitably, for some hedge funds this simply won't work, and the Cayman Islands is anticipating a significant number of hedge-fund liquidations through the last quarter of 2008 and into 2009. A lot of these liquidations will be run as voluntary winding-ups but inevitably either the fund's directors or its investors will seek the added protection or scrutiny of a court-ordered winding-up.

Apart from hedge funds, Cayman has seen, as have all other jurisdictions, the death of virtually all structured investment vehicle structures and, as is the case globally, financing transactions have diminished considerably.

In the retail, tourism and service industry sectors of the Cayman Islands' economy, some downturn has been experienced because of the impact of the global, and particularly US, economy difficulties and there is a slowdown of expansion and new projects; however, no significant insolvency or restructuring situations have yet resulted.

II GENERAL INTRODUCTION TO THE RESTRUCTURING AND INSOLVENCY LEGAL FRAMEWORK

i Formal insolvency and restructuring procedures

The formal insolvency and restructuring procedures available under Cayman law are: court-ordered winding-up; voluntary winding-up; voluntary winding-up subject to court supervision; and court-approved schemes of arrangement. There is no equivalent of a UK administration or company voluntary arrangement or a US Chapter 11.

Corporate insolvency law in the Cayman Islands is governed by the Companies Law (2007 Revision) ('the Companies Law'), which provides for both compulsory and voluntary winding-up of Cayman registered companies and companies incorporated outside the Cayman Islands that are registered and carry on business within the Cayman Islands. The Companies Law is supplemented by the 1986 UK Insolvency Rules, which are deemed to be applicable in the Cayman Islands to the extent they are not inconsistent with the provisions of the Companies Law.

Compulsory liquidation is the process by which a Cayman registered company is wound up by order of the court upon the petition of a creditor, a contributory, or the company itself. The court may order the winding-up of a company on the ground that the company is unable to pay its debts as and when they fall due. There is presently no balance-sheet test for insolvency. Another ground for winding-up a company is that the court is satisfied that it is just and equitable to do so, and this is frequently the ground for petitions for compulsory liquidation of investment funds brought by contributories.

Upon an order for winding-up being made, the court will appoint an official liquidator or, usually, joint official liquidators whose duties are to take control of all of the assets of the company. The assets of a company being wound up do not include any assets over which a third party has security and there is nothing to prevent a secured creditor from enforcing its security after a winding-up order has been granted and a liquidator appointed. The granting of an order winding up a company will, however, stay all proceedings against that company without leave of the court.

Upon the making of a winding-up order for a company the date of the winding-up is deemed to have commenced on the date upon which the petition for winding-up was issued. The winding-up order will specify the powers of the official liquidators.

There is an ability to seek appointment of provisional liquidators to take charge of the company's affairs between issue of the petition for winding-up and the appointment of any official liquidator and also an ability to seek a stay of proceedings against the company pending the making of a winding-up order.

Voluntary liquidation is commenced by a special resolution of the company. Typically the voluntary liquidation procedure will be invoked where the company is solvent, but has come to end of the purpose for which it was set up, but there is, at present, no requirement that the company be solvent before the voluntary liquidation process is used. A voluntary liquidation will not stay proceedings against the company but the Companies Law provides for a process by which a voluntary liquidation can be brought under the supervision of the court, thereby obtaining the same protections that are provided to a company that is wound up compulsorily, including a stay of proceedings against the company. Voluntary liquidators will also be appointed by resolution of the company and the powers and duties of voluntary liquidators are set out in the Companies Law and the UK Insolvency Rules. A voluntary liquidator may also seek the directions of the court where it is considered necessary.

The Companies Law also provides a procedure for the formal restructuring of a company by way of scheme of arrangement or compromise with its creditors or shareholders. Where any proposed scheme of arrangement, or compromise, has the support of 75 per cent of the company's creditors or shareholders by value and 50 per cent by number, it may be placed before the court for sanction. Once such a scheme of arrangement or compromise has been sanctioned by the court it is binding on all creditors or shareholders. A company is also free to enter into an informal arrangement with its creditors or shareholders for the compromise of its debts; however, any informal scheme will only be binding on those creditors or shareholders who agree to be bound.

ii Enforcement of security

The Cayman Islands recognises fixed and floating charges and enforcement through the appointment of a receiver whose powers are derived from the charge documents. The assets over which a fixed charge exists are not considered assets of the company and so the holder of the fixed charge can realise them to satisfy the company's indebtedness to it without regard to any other creditors whether or not the company is in liquidation. There are a few preferential debts that rank ahead of a floating-charge holder's security but these are limited to sums due to government and wages and are not usually significant sums.

iii Role of directors

All powers of the directors of a company cease upon the appointment of official liquidators by the court pursuant to a compulsory winding-up order. Although the same is generally true for voluntary liquidations, the special resolution for winding-up of the company may specify certain powers that may still be exercised by the directors after winding-up commences.

Under Cayman law, directors at all times owe statutory, common law and fiduciary duties to the companies over which they are appointed. A liquidator appointed over a company (whether compulsorily or otherwise) is entitled to commence proceedings in the company's name against directors personally to recover any loss suffered by the company as a result of the directors breach of duty. Directors' duties to the company include an obligation to have regard to the interests of creditors in circumstances where the company is either insolvent, or of doubtful solvency.

iv Claw-back actions

There is legislation in the Cayman Islands that (i) prevents the transfer of property and shares of a company in the twilight period between issue of a petition and any winding-up order being granted and (ii) allows for the claw-back of other transactions. Section 156 of the Companies Law provides that all transfers of property and shares of a company in the period between the filing of a petition to compulsorily wind up a company and the granting of a winding-up order will be void unless the court orders otherwise. Therefore, after the filing of a petition to compulsorily wind up the company, no steps can be taken by a company against which a petition for winding-up has been issued to change either the creditor or shareholder position without first seeking the court's approval.

A liquidator also has the power to claw back certain dispositions of property of the company made to creditors which took place in the six months prior to the commencement of any winding-up where that payment has resulted in that creditor obtaining a preference over other creditors. It is worth noting that the court will only void a preferential payment where the liquidator can show that the dominant intention of the company in making the payment was to give that creditor a preference. In practice this has proved to be a high threshold to reach.

There is also legislation to ensure that no creditor is prejudiced by any sale of the assets of a company at undervalue made at any stage during company's life. Any transaction involving the disposal of a company's property will be voidable where the consideration for the disposition is either non-existent or at an undervalue and the disposition was made with the intent to defraud a creditor. Such an action can be brought up to six years after the disposition.

III RECENT LEGAL DEVELOPMENTS

There have been few recent significant legislative developments in the Cayman Islands, although there are going to be significant changes to the legislative framework for insolvency and restructuring either later in 2008 or early in 2009, with the introduction of a revised Companies Law and a set of Rules that will oust the application of the UK Insolvency Rules 1986. Instead, the main developments have occurred as a result of local and foreign case law.

One of the most important recent developments impacting on the practice of insolvency law in the Cayman Islands has come from the decisions of the United States Bankruptcy Court, Southern District Of New York in *Bear Stearns High-Grade*

*Structured Credit Strategies Master Fund, Ltd*¹ and *Bear Stearns High-Grade Structured Credit Strategies Enhanced Leverage Master Fund, Ltd*.² These cases have had wide-ranging impact on the options available to Cayman liquidators appointed over Cayman registered companies who seek recognition of their appointments in the United States. In these cases, the New York court refused recognition of the Cayman-appointed liquidators under Chapter 15 of the US Bankruptcy Code on the basis that the structure of these funds prevented them from reaching the evidential threshold needed to show that they had either their ‘centre of main interest’ (‘COMI’) or an ‘establishment’ in the Cayman Islands, which would enable the liquidations to be granted ‘foreign main’ or ‘foreign non-main’ recognition. The New York court said that the Chapter 15 presumption that the COMI was the location of the registered office ‘in the absence of evidence to the contrary’ meant that the court should consider factors, and ask for evidence in support of those factors if necessary, relevant to establishing where in fact was the COMI of a company even if there was no-one suggesting it was anywhere else other than the location of the registered office. The New York court also stated that in order to show that a company had an ‘establishment’ in a jurisdiction, that company must show ‘non-transitory economic activity’ in the jurisdiction, but declined to specify what might constitute qualifying activity. Instead, the New York court determined that the proper course was for these liquidators to commence parallel insolvency proceedings in the United States. For Cayman liquidators, such a course raises considerable issues of duplicated cost, delay and loss of control. In the Cayman Islands, this is generally considered to be a backward step from the old Section 304 United States Bankruptcy Code procedure for recognition. For this reason, liquidators of Cayman companies with significant connections in the US have considered a number of alternatives to seeking Chapter 15 recognition in the New York courts that will enable them to control assets of the Cayman Islands registered companies in regard to which they are appointed.

The Grand Court’s decisions *In Re Beacon Hill Master Ltd (in Official Liquidation)* and *In Re Bristol Fund Ltd (in official liquidation)* (‘the Funds’) (as yet unreported) has provided some guidance to liquidators in relation to the extent to which claims for indemnity are debts capable of proof in a winding-up and how liquidators should provide for them. The Funds were related investment funds that had contractually agreed to indemnify their auditor for loss suffered by that auditor as a result of its appointments. The auditor sought to prove in the liquidation pursuant to the terms of the indemnity for, *inter alia*, all current and future losses that it suffered as result of claims that had been, or may be, brought against it related to the collapse of the Funds. The court determined that the auditors were officers of the Funds and that they had fiduciary duties to the Funds but that the auditors could be indemnified for anything other than their own dishonesty and bad faith. The court also considered the extent to which all contingent claims, including future rights to indemnity, were provable in the liquidation, no matter how remote the contingency was. The court concluded that such claims were provable and required the liquidators to quantify such claims and set aside funds to provide for

1 Case No. 07-12383 (BRL).

2 Case No. 07-12384 (BRL).

such contingencies prior to any distribution of surplus assets to the shareholders of the Funds. The court noted that where the contingent nature of the claim made it difficult to value, the liquidators were entitled to seek the assistance of the court. The existence of indemnities from a company to directors, auditors, investment advisers and other service providers are common. Claims by the liquidator of a company or shareholders against such service providers may fail to realise any recovery for the company or the shareholders if the claims are such that the service provider can rely on an indemnity from the company. Each indemnity will have to be interpreted on its own wording to see to what extent this create a difficulty for a liquidator seeking to collect assets which are the proceeds of claims against parties liable for causing loss to the company.

IV SIGNIFICANT TRANSACTIONS AND HOT INDUSTRIES

The hedge-fund sector of the Cayman Islands' financial industry has, over the last year, been the source of all major transactions and key developments and is going to be the hot industry for the foreseeable future. The litigation commenced by the liquidators of the various Bear Stearns funds will raise a host of jurisdictional questions as well as involving examination of the role of the independent fund directors, the holders of voting shares and investment managers.

Corporate governance issues particularly with reference to the role of independent directors of hedge funds has already been the subject of litigation and is scheduled to be high on the litigation agenda again. There have been no recorded decisions relevant to directors' duties, other than the principle derived from the *Beacon Hill* decision that officers of a company cannot exclude liability for dishonesty or bad faith. Accordingly, the standard of involvement in a hedge fund expected of an independent director remains to be determined. Some judicial scepticism of the ability of directors who are appointed for a large number of companies to be physically able to carry out their fiduciary duties has been tangentially expressed and there are a number of cases in the litigation pipe line where claims are based on conduct by directors alleged to fall short of the appropriate standard.

The Chapter 15 recognition debate has absorbed and concerned all insolvency practitioners in the jurisdiction since summer 2007 and there are bound to be cases arising that will test what can and cannot constitute a COMI or 'establishment'.

V INTERNATIONAL

Although the Cayman Islands has not adopted the UNCITRAL model, the Cayman courts are committed to the principles of international comity in insolvency proceedings and there are well established procedures, stemming from both legislation and case precedent, whereby the Cayman courts will recognise and give assistance to foreign insolvency practitioners and proceedings.

The Cayman courts will recognise a foreign appointed liquidator or receiver for the purpose of pursuing assets located in the Cayman Islands provided that: (i) the appointment of that practitioner was pursuant to a final order of a court of competent jurisdiction (the appointment cannot be conditional or provisional); (ii) the appointee

was not appointed to enforce a penal statute of a foreign jurisdiction; and (iii) the appointment is recognised in the jurisdiction where the insolvent entity is incorporated. Once recognition is granted, the foreign practitioner will be able to exercise all of the powers granted to him in his original appointment provided they are not inconsistent with the laws of the Cayman Islands.

The Cayman courts will also give assistance to foreign liquidators and receivers who seek to gather evidence from this jurisdiction to support a claim being pursued by them in their home jurisdictions. Although the Cayman Islands is not a signatory to the Hague Convention on Taking Evidence Abroad in Civil and Commercial Matters, the principles of the Convention have been extended to the Cayman Islands through the Evidence (Proceedings in Other Jurisdiction) (Cayman Islands) Order 1975. Through this statutory instrument, a foreign court may request that the Cayman court obtain evidence on the foreign court's behalf from entities in the Cayman Islands. The evidence sought can be either documentary or pursuant to oral examination. However, the Cayman court will only accede to such a request where the evidence is necessary for the prosecution of a particular proceeding in the requesting court's jurisdiction and the evidence sought is specifically identified. The Cayman court will not allow the mechanism to be used to conduct a roving inquiry in this jurisdiction, nor can it be used for general discovery purposes. Historically, the courts have not allowed this procedure to be used by a foreign liquidator who seeks to obtain general information from persons and entities in the Cayman Islands in order to assist his investigations into the entity over which he is appointed. However, the Cayman court has recently recognised an inherent jurisdiction to seek the assistance of foreign courts to recognise Cayman-appointed liquidators and grant them wide investigatory powers in that jurisdiction. It seems likely that the Cayman court will also consider itself to have an equivalent jurisdiction if similar assistance is sought from it by foreign liquidators in the future.

VI OUTLOOK

The most significant development anticipated for the Cayman Islands in regard to insolvency and restructuring is the coming into force of a revised Companies Law and a set of Rules for the conduct of insolvency and restructuring. The revisions to the Companies Law (2007 Revision) are simply waiting Royal Assent and will be passed as soon as the drafting of new rules to govern the conduct of liquidations have been completed. The revisions to the Companies Law include most significantly such provisions as:

- a* the requirement for a declaration of solvency for a voluntary liquidation where there is no supervision by the court;
- b* enhanced powers of obtaining information from officers and former officers of the company by liquidators;
- c* enhanced powers of investigation by liquidators;
- d* assumptions in the case of connected persons of the necessary intention in regard to preferential payments; and

- e* the ability to recover personally from any person found to have conducted fraudulent trading and international cooperation and criteria for appointment of provisional liquidators.

In regard to informal restructuring, the development of tactics adopted by shareholders in investment funds frustrated by the directors and investment managers imposing gates, suspending redemptions and making in-kind redemptions will be interesting. Investor's shares in hedge funds do not usually have voting rights, so the only real weapon of such shareholders is the just and equitable winding-up petition. It can be anticipated that petitions on this ground that embody challenges to the commonly adopted techniques of hedge funds attempting to survive a wave of redemption requests will be presented and the courts will have to consider the merits of ordering a winding-up of the company in such circumstances.