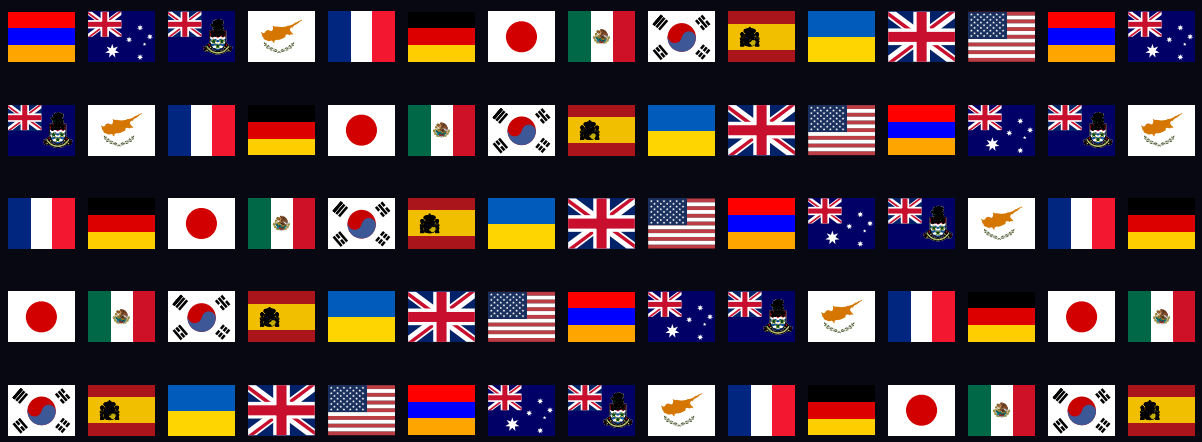
INSOLVENCY LITIGATION

Cayman Islands



LEXOLOGY
Getting The Deal Through

Consulting editor
Latham & Watkins LLP

Insolvency Litigation

Consulting editors

Suzzanne Uhland, George A. Davis, Adam J. Goldberg, Christopher Harris

Latham & Watkins LLP

Quick reference guide enabling side-by-side comparison of local insights, including into pre-litigation considerations; avoidance actions; claims against directors, officers and shareholders; creditor actions and strategic considerations; pre-insolvency debtor claims; other claims against creditors and debtors; cross-border considerations; remedies and enforcement; settlement and mediation; and recent trends.

Generated 14 December 2021

Table of contents

Contributors

COMMENCING PROCEEDINGS

Litigation climate

How would you describe the general climate surrounding insolvency litigation in your jurisdiction? What are the most common sources of dispute? To what extent is litigation used as a pressure or delay tactic?

The general climate surrounding insolvency litigation in the Cayman Islands in 2021 has been reasonably favourable. Although we have not experienced a tidal wave of insolvencies and related litigation as a result of covid-19, the litigation market has been reasonably active in 2020 and 2021, with a noticeable increase in winding-up petitions and other commercial disputes. We anticipate that there will be a further increase in winding-up petitions and avoidance actions, similar to the aftermath of the 2007–2008 financial crisis, as moratoriums and government financial support ends and the full extent of the financial damage is realised.

In recent years, we have seen a number of instances of fraud and misconduct leading to the appointment of joint provisional liquidators and official liquidators, including high-profile cases involving Luckin Coffee Inc, and Abraaj Holdings and Abraaj Investment Management Limited.

Litigation is frequently used as a pressure tactic, especially with the threat or presentation of winding-up petitions to force payment of debts and force opposing parties to the bargaining table.

Law stated - 06 August 2021

Sources of law

What key sources of law form the basis of claims arising from insolvency? How does the insolvency regime interact with other laws?

The Cayman Islands are a British overseas territory and have a legal system based on the English common law system.

The doctrine of stare decisis applies in the Cayman Islands where the courts are bound by judicial precedent. In the absence of Cayman specific authorities, the courts will look to English authorities, which are highly persuasive. Although not binding, case authorities from other Commonwealth jurisdictions will also be considered persuasive.

The Cayman Islands have their own statute law with the principal corporate and insolvency law being the Companies Act (2021 Revision) . Insolvency-related claims are based on the Companies Act (ie, winding-up petitions, restructurings and avoidance actions), the Fraudulent Dispositions Law (1996 Revision) (avoidance claims brought by creditors outside insolvency proceedings) and the principles of contract law, tort law and equity (negligence, breaches of directors duties, unjust enrichment, etc).

In many of the liquidation proceedings, the court-appointed official liquidators may pursue various targets and types of claims, especially if the insolvency was brought on by fraud, misconduct or misappropriation of assets. This often includes the pursuit of claims of negligence or breach of contract against auditors and other service providers, statutory and breach of directors' duties claims against directors, and avoidance actions against the recipients of dispositions at under value or voidable preferences.

Law stated - 06 August 2021

Procedure

What procedural rules govern insolvency litigation in your jurisdiction? What common procedural hurdles arise in practice?

Civil procedure in the Cayman Islands is governed by the Grand Court Rules 1995 , which apply generally to insolvency proceedings. Insolvency litigation is also governed by the Companies Act, the Companies Winding Up Rules 2018 , the Foreign Bankruptcy Proceedings (International Co-operation) Rules 2018 , Insolvency Practitioners' Regulations 2018 and the Grand Court Practice Directions (2021 Consolidation) .

Certain entity-specific legislation, such as the Exempted Limited Partnership Act (2021 Revision) , the Limited Liability Partnership Act (2021 Revision) and the Limited Liability Companies Act (2021 Revision) , provide further guidance on the winding up and liquidation of those entities.

One procedural hurdle is that directors are unable to independently commence winding-up proceedings to proceed with the appointment of a 'light touch' provisional liquidator for the purpose of restructuring a company without a shareholder resolution approving those actions or the company's articles explicitly authorising the directors to do so. The workaround to this is to have a 'friendly' creditor present a winding-up petition. The directors can then make a cross-application for the appointment of the 'light touch' provisional liquidator.

Law stated - 06 August 2021

Courts

Which courts hear insolvency claims? How experienced are they with insolvency litigation?

The Financial Services Division of the Grand Court of the Cayman Islands (FSD) was created in 2009 as a specialist court to deal with more complex proceedings arising out of the financial services sector, and in particular hears insolvency-related claims. The FSD is well experienced in handling routine and complex multi-jurisdictional insolvency proceedings given the global nature of the financial services industry in the Cayman Islands.

Any insolvency-related appeals follow the same path as other civil appeals from the Grand Court, first to the Cayman Islands Court of Appeal, and then on further appeal to the Judicial Committee of the Privy Council in London, England.

Law stated - 06 August 2021

Jurisdiction

Through what law do the relevant courts have jurisdiction to hear insolvency claims? Does jurisdiction differ for domestic and cross-border matters?

The Grand Court of the Cayman Islands derives its jurisdiction to hear insolvency claims from section 11 of the Grand Court Law (2015 Revision) .

Order 72, Rule 1(2) of the Grand Court Rules sets out the particular types of proceedings, both domestic and cross-border, heard in the FSD including but not limited to any action or application made:

- in a winding-up proceeding (to which the Companies Winding Up Rules apply);
- under the Companies Act to which Order 102 of the Grand Court Rules applies (including schemes of arrangement);
- under the Grand Court (Bankruptcy) Rules (2021 Revision);
- under the Foreign Bankruptcy Proceedings (International Co-Operation) Rules 2018;

- for the enforcement of foreign judgments (whether under common law or pursuant to the Foreign Judgments Reciprocal Enforcement Law (1996 Revision)); or
- for the enforcement of a foreign arbitral award under the Foreign Arbitral Awards Enforcement Law (1997 Revision).

The Court also has jurisdiction to hear cross-border insolvency proceedings through the common law principles of comity and modified universalism. In the Matter of LATAM Finance Limited et al (unreported, 24 August 2020), Kawaley J held that that the Court has a common law duty to 'assist foreign insolvency courts' and to 'promote the most economically efficient administration of transnational insolvency estates'.

Law stated - 06 August 2021

Limitation periods

What limitation periods apply to bringing insolvency-related claims? Are there any notable exceptions?

The relevant insolvency-related limitation periods are set out in the Companies Act and in the Limitation Law (1996 Revision) .

The avoidance provisions under the Companies Act provide the following limitations.

- Under section 145, dispositions made at an undervalue are voidable on the application of a liquidator within six years of the date of the disposition.
- Under section 145, a liquidator can apply to the court no later than six years from the commencement of a liquidation to void a preference made by a company within the six-month period immediately preceding the commencement of the liquidation.

The relevant limitation periods under the Limitation Act are as follows.

- Claims founded on tort can be brought up to six years after the cause of action accrued.
- Claims made for a breach of contract have a limitation period of six years from the date of the breach.
- Judgments can be enforced up to six years from the date judgment became enforceable.
- Arrears of interest on a judgment cannot be recovered beyond six years from the date the interest became due.

A creditor may make an application outside an insolvency proceeding under the Fraudulent Dispositions Law to set aside a disposition of property made with the intent to defraud and at an undervalue within six years of the relevant disposition.

In circumstances involving fraud, deliberate concealment of a fact relevant to a plaintiff's right of action, or where the action is for relief from the consequences of a mistake, the relevant limitation period does not begin until the plaintiff has either discovered or could have discovered with reasonable diligence the fraud, concealment or mistake.

Parties are permitted to enter into tolling or standstill agreements to pause limitation periods, which can be useful if parties are attempting to negotiate settlements or to allow proceedings to progress (ie, criminal proceedings), including in other jurisdictions.

Law stated - 06 August 2021

Interim remedies

What interim remedies are generally available and commonly deployed in insolvency proceedings? How are these used as part of claimants' overall litigation strategy?

There are a number of interim remedies that can be deployed as a precursor to or within insolvency proceedings, including:

- domestic and worldwide freezing orders;
- Anton Piller search-and-seizure orders;
- discovery orders such as Norwich Pharmacal or Bankers Trust orders;
- anti-suit injunctions; and
- appointment of provisional liquidators.

These remedies are often part of the pre-litigation strategy to gather information and documentation, identify litigation targets and restrain foreign proceedings and to prevent the dissipation of assets prior to commencing litigation and obtaining a judgment.

If creditors, contributories or the Cayman Islands Monetary Authority suspect wrongdoing by a company, they can use the powerful tool of applying to the Grand Court for the appointment of a provisional liquidator provided that:

- there is a prima facie case for making a winding-up order; and
- the appointment of a provisional liquidator is necessary to prevent:

The provisional liquidator derives their powers from the appointment order.

Within official liquidation proceedings, a creditor or contributory can apply to the court under section 114 of the Companies Act for an order, provided the court thinks it fit to do so, to inspect a company's documents and for the preparation of reports by the liquidators to be delivered to the company's creditors and contributories.

Law stated - 06 August 2021

Evidence

What rules and procedures govern the collection and admissibility of evidence in insolvency litigation? To what extent is expert witness testimony allowed? What common evidential issues should claimants be aware of?

The admissibility of evidence in civil proceedings (including insolvency-related proceedings generally) is governed by the Evidence Act (2021 Revision) , in particular sections 42 to 56.

The Companies Winding Up Rules and the FSD User Guide set out the requirements for the filing of evidence in winding-up and liquidation proceedings.

The FSD User Guide and Grand Court Rules outline the specific rules related to expert witness testimony, which is only permitted in insolvency-related and other FSD proceedings with leave of the Grand Court.

The Grand Court Rules govern the procedural aspects of evidence within civil proceedings.

Within civil proceedings, parties are obligated to provide discovery of documents (including electronic documents) that

are in their possession, custody and power that are relevant to the matters in dispute. Parties can demand and seek orders for further and better disclosure.

Although uncommon, parties in actions commenced by writ can apply to the court for an order for the oral discovery (depositions) of a party. Litigants are also able to provide a list of written questions (interrogatories) to be answered by opposing parties.

Parties must be cognisant of the Confidential Information Disclosure Law 2016 and the Data Protection Act (2021 Revision) , which govern the collection, use and disclosure of confidential and private information and documentation.

Law stated - 06 August 2021

Time frame

What is the typical time frame for insolvency claims?

The time frame for the adjudication of insolvency claims is difficult to assess and is dependent on the nature of proceedings, the complexity of the issues, the degree of opposition and the availability of the court. It can be a matter of days or months for the hearing of shorter applications while full trials can take a number of years from pre-action protocols to final judgment.

One of the largest and most significant cases litigated to date in the Cayman Islands, AHAB v Saad , was commenced in 2009 and the trial (which took place over the course of one year) resulted in the handing down of a 1,300-page judgment in early 2018. The judgment was appealed in 2018 and the appeal was heard in spring 2019. The judgment from the Cayman Islands Court of Appeal has not been handed down as at 1 August 2021.

Law stated - 06 August 2021

Appeals

What are the requirements to appeal insolvency-related judgments? What is the typical time frame for appeals?

Appeals of insolvency-related judgments have the same requirements as civil proceedings. Parties can appeal matters of law and fact, as well as the exercise of judicial discretion.

Final judgments can be appealed as of right, but parties are required to seek leave in most circumstances in respect of interlocutory rulings. Winding-up orders are considered final judgments, while orders made in the course or regulation of liquidation proceedings and orders made ancillary to or following a winding-up order are considered interlocutory.

The time frame for an appeal varies depending on a number of factors, including the Court of Appeal's schedule – which sits three times per year. It can typically take six months to two-plus years from the commencement of the appeal to judgment. However, parties may request a special sitting if the appeal is urgent.

Parties have 14 days from the date of the decision or date of the registration of the resulting order, or from the granting of leave (if required) to file their notice of appeal. The procedural rules for appeals are set out in the Court of Appeal Law (2011 Revision) .

Law stated - 06 August 2021

Costs and litigation funding

How are costs handled and how are claims funded? Can claimants obtain third-party funding to finance the prosecution of claims?

Parties in civil proceedings (including insolvency-related claims) typically fund their own litigation. Within liquidation proceedings, the liquidator's actions (including the prosecution or defence of claims) are funded out of the assets of the debtor.

Prior to the Private Funding of Legal Services Act 2020 coming into force on 1 May 2021, third-party litigation funding and contingency and conditional fee arrangements were illegal (outside the liquidation context) in contested litigation proceedings due to the doctrines of maintenance and champerty. With the passing of the new legislation, litigants now have the ability to seek third-party funding to finance the prosecution of claims.

Within the liquidation context, prior to 1 May 2021, official liquidators had (and continue to have) statutory authority to obtain third-party funding (subject to the sanction of the court) because the Companies Act permits liquidators to sell a company's property (ie, fruits of the litigation) and to raise or borrow money.

Costs awards are governed generally by Order 62 of the Grand Court Rules and the overriding objective is that the successful party should be entitled to recover their reasonable costs from the opposing party.

Order 24, Part II of the Companies Winding Up Rules sets out the entitlement of the liquidator and various stakeholders to costs awards in liquidation proceedings. Order 62 of the Grand Court Rules is applicable to the taxation of costs of a liquidation proceeding.

Law stated - 06 August 2021

AVOIDANCE ACTIONS

Fraudulent transfers and undervalue transactions

What are the essential elements of avoidance actions seeking to claw back fraudulent conveyances and transfers? Can actions be brought for transfers without fraudulent intent based on undervalue of the transfer?

Any disposition of property where the disposition was made by or on behalf of a debtor company can be set aside on the application of an official liquidator under section 146 of the Companies Act if the disposition was made:

- at an undervalue (for no consideration or where consideration of money or monies worth is significantly less than the value of the property); and
- with the intent to defraud its creditors.

'Intent to defraud' is defined as an intention to wilfully defeat an obligation owed to a creditor.

The liquidator has:

- six years from the date of the disposition to commence an action or proceedings to set aside the disposition; and
- the burden of establishing the company's intent to defraud a creditor.

If the court sets aside the disposition and is satisfied that the transferee of the property did not act in bad faith:

- the transferee is entitled to a first charge over the property for its entire costs properly incurred defending against the liquidator's actions to set aside the disposition; and
- the disposition is set aside subject to the transferee's proper fees, costs, pre-existing rights, claims and interests.

These types of avoidance actions under the Companies Act and Fraudulent Dispositions Law require both the element of an undervalue disposition and fraudulent intent.

Law stated - 06 August 2021

Preference and improvement of position

What are the essential elements of avoidance actions seeking to claw back transactions and payments based on preference and improvement of position shortly before insolvency proceedings?

Under section 145 of the Companies Act, every conveyance or transfer of property by a company in favour of any creditor while the company is unable to pay its debts, with the view to give such creditor a preference over other creditors, shall be invalid if made within a six-month period immediately preceding the commencement of a liquidation. A liquidator has standing to apply to the court for an order to set aside the transaction and seek restitution of the payment or the return of property or title.

The dominant intention of the company (by its directors) must be to give a creditor a preference over other creditors, which can be inferred.

If the debtor company makes a payment to a related party (ie, has control of or exercises significant authority over the company in making financial and operating decisions), the payment shall be deemed to have been made with the view of giving that creditor a preference.

The defence of change of position and other common law defences are not available where the elements of section 145 are established.

Upon repayment or transfer of property to the liquidator, the creditor (receiving the preference) will then have its corresponding right to rank as a creditor within the liquidation.

Law stated - 06 August 2021

Liens and floating charges

What are the essential elements of actions for the avoidance of liens and floating charges on subsequently acquired property?

Despite the requirement for companies to maintain and update a register of mortgages and charges for any security interests they have granted, the failure to adhere to this requirement does not automatically invalidate security interests. However, security interests can be set aside in the following situations and manners.

- If a security interest is granted that is not in the best interests of a company (eg, the company did not derive a benefit from the transaction), a court application can be made by an interested party (ie, the liquidator, the creditor or the shareholder) to set aside the security on the basis that this action constituted a breach of a director’s fiduciary duties owed to the company;
- If the granting of the security constitutes as voidable preference under section 145 of the Companies Act as a

conveyance or transfer of property in favour of a creditor while the company is unable to pay its debts, with the view to giving the creditor a preference, the court on application from a liquidator, can set aside the preference;

- If the disposition of property is made at an undervalue and with the intent to defraud creditors under section 146 of the Companies Act, a liquidator can apply to the court to set aside a fraudulent or undervalue transaction; and
- If a security interest is granted after the presentation of a winding-up petition but before the granting of a winding-up order, the granting of the security is void unless the court grants a validation order under section 99 of the Companies Act.

Law stated - 06 August 2021

Process and resolution of avoidance actions

Through what process are avoidance actions litigated? What procedural issues often arise and how are avoidance actions usually resolved?

Avoidance actions under the Companies Act and Fraudulent Dispositions Law are litigated through the commencement of new proceedings by way of writ and follow the procedures for litigation as set out in the Grand Court Rules 1995. These types of proceedings have been some of the most hotly contested matters in the Cayman Islands, often leading to appeals to the Court of Appeal and Privy Council.

Law stated - 06 August 2021

CLAIMS AGAINST DIRECTORS, OFFICERS AND SHAREHOLDERS

Breach of fiduciary duty

What are the essential elements of a claim for breach of fiduciary duty against directors and officers in the context of corporate insolvency?

There is no statutory codification of directors' duties in the Cayman Islands. However, liabilities and duties are derived from English common law, with the two main categories of duties being fiduciary duties and the duty of care, skill and diligence.

Directors and officers ordinarily owe their duties to the company and not to creditors or shareholders. The duty to act in the best interests of a company is implicated when a company is insolvent or nearing insolvency as a director must then have regard to the interests of creditors. It is in a company's interests for creditors to be paid and to avoid the inability of paying debts as they come due. Directors can be held personally liable to the company for breaches of their fiduciary duties and duty of care. To succeed in a common law claim against a director, the claimant must establish (1) that a duty was owed, (2) that the duty was breached and (3) the damage caused by the breach.

Law stated - 06 August 2021

Protection from liability

To what extent does the law in your jurisdiction protect directors and officers from liability for decisions made in connection with the restructuring or insolvency?

While there is no formal business judgement rule or similar, directors and officers benefit from the court considering their subjective belief as to whether they honestly believed their actions were in the best interests of the company, without regard to the objective reasonableness of the actions. If no evidence is presented of a director's subjective belief, the court will move on to consider the objective reasonableness of a director's actions.

Directors and officers also benefit from the robust practice in the Cayman Islands of providing exculpation and indemnity clauses in a company's memorandum and articles of association. Directors and officers insurance can be an attractive option to pursue for claims. However, the nature of the types of claims that would ordinarily fall outside the scope of the indemnity clauses may lead to those claims being excluded under directors and officers insurance.

For public policy reasons, exculpation and indemnity clauses typically do not cover breaches of core fiduciary duties and fraud, and commonly exclude from indemnity acts of wilful neglect and misconduct, dishonesty and gross negligence.

Provided that all material facts have been disclosed, shareholders are able to pass resolutions to ratify the actions of directors, including those made in breach of their duties, except for actions involving fraud, misappropriation and illegality.

Law stated - 06 August 2021

Converting credit to equity

Can credit extended by an insider or shareholder be recharacterised as equity? If so, what is the mechanism by which such an action is brought, and what elements are required to prevail?

It is possible to swap debt for equity, which can be achieved through a scheme of arrangement.

Law stated - 06 August 2021

Illegal dividends

Can dividends received by shareholders be prosecuted as illegal?

Dividends paid to shareholders out of a company's share premium account can be clawed back if the company is insolvent at the time of the dividend payment or made to be insolvent as a result of the dividend payment. A company, and any director or manager, can be subjected to imprisonment for up to five years and a fine of CI$15,000 if they permit or authorise such a dividend payment to be made. The director may also be liable at common law to repay the illegal dividend.

Law stated - 06 August 2021

Trading while insolvent

How is trading while insolvent treated in your jurisdiction? If actionable, what mechanisms apply and what are the elements of a successful claim?

There is no obligation for a company to commence insolvency proceedings. A company can continue to trade while insolvent without attracting civil or criminal liability.

Criminal and civil liability can be incurred if a company's business was carried on with the intent to defraud creditors of the company. Section 147 of the Companies Act (fraudulent trading) permits a liquidator to apply to the Grand Court for a declaration that any persons who were knowingly parties to the carrying on of the business of a company with the intent to defraud creditors of the company or creditors of any other person or for any fraudulent purposes, are liable to make contributions to the company's assets in an amount the Court thinks proper.

Directors can also be found civilly liable if they continue to trade while a company is insolvent or likely to become insolvent, which is considered a breach of their fiduciary duties.

Law stated - 06 August 2021

Equitable subordination

Is equitable subordination of shareholder claims allowed? If so, what requirements and mechanisms apply?

All bona fide claims can be made in insolvency proceedings by filing a proof of debt, regardless of whether the claimant is a shareholder or some form of insider or non-arm's length creditor. The liquidator will review and adjudicate the proof of debt in the ordinary course and consider any potential set-off claims the company may have against the shareholder.

Law stated - 06 August 2021

Other claims

Are any other claims commonly brought against shareholders, directors and officers in your jurisdiction? If so, what mechanisms are used to raise these claims and what elements are required to prevail?

Constructive trust claims may pre-exist the commencement of insolvency proceedings and may be brought where a company (at the direction of its directors or officers) illegally transfers assets out of the company in breach of trust and fiduciary duties. The recipient of the property may be implicated and be held liable if they knew that they received the property as a result of a breach of trust and fiduciary duties.

These claims can be brought as derivative claims by shareholders prior to insolvency proceedings. Once a liquidation is commenced, the liquidator may pursue these claims.

Directors may also face liability for deceit and negligent misstatements. Creditors are unable to bring claims directly against directors unless a director has voluntarily assumed a direct duty or liability to the creditor.

Shareholders are not subjected to liabilities of debtor companies in their capacities as shareholders. However, they can be held liable as shareholders for the unpaid portion of their shares.

In certain limited circumstances, the court may be able to pierce the corporate veil and impose personal liability on a shareholder if the shareholder is found to have treated the company as their alter ego.

There are a number of statutory offences under the Companies Act in which directors, officers and professional services providers can face liability, including:

- fraud in anticipation of winding up (section 134);
- transactions in fraud of creditors (section 135);
- misconduct in the course of winding up (section 136);
- material omissions from statements relating to the company's affairs (section 137);
- where a director, manager, secretary or other officer wilfully misrepresents the nature or amount of a debt or claim of any creditor (section 19); and
- illegal redemption and repurchase of shares paid out of a company's capital while the company is unable to pay its debts or becomes insolvent as a result of the payment (section 37(6)).

Law stated - 06 August 2021

Risk mitigation

How can shareholders and sponsors mitigate the risk that claims against them will be successful, and minimise the accompanying financial burden?

If a company is run for proper purposes, has appropriate corporate governance and the shareholders' shares are paid in full, shareholders face little to no risk of successful claims being made against them. Matters such as thorough internal investigations, mediation and early settlement may have an impact on reducing the amount of claims made against a company, which may leave the shareholder in a better position to recover their investment on a solvent liquidation.

Law stated - 06 August 2021

CREDITOR ACTIONS AND STRATEGIC CONSIDERATIONS

Contesting restructuring plans

Can creditors bring actions contesting the restructuring plan? If so, what law governs such actions? What must the creditor show to succeed and what must the debtor show to successfully defend? How are these actions usually resolved?

A formal court-driven restructuring is implemented through the use of a scheme of arrangement under section 86 of the Companies Act. The Grand Court can sanction a proposed scheme provided that the majority in number representing 75 per cent of the value of the creditors or class of creditors, or members or class of members, votes to approve the scheme. The scheme will fail if a class of creditors or members rejects it.

A creditor can prevent a scheme from being sanctioned if they hold more than 25 per cent of the value of the debt or shares, or a class of debt or shares.

At the first (convening) hearing a creditor can object to the jurisdiction of the Grand Court to sanction the scheme and can seek to persuade the Court on any issue that would unquestionably lead the Court to refuse to sanction the scheme as it would be reluctant to spend the time and money to go through the process if the scheme were to fundamentally fail.

A creditor (despite being outvoted in a class meeting approving a scheme) can object at the Court sanction hearing on the following grounds, including:

- the class composition was not properly constituted;
- notice requirements and other procedural matters were not complied with; and
- stakeholders were treated unfairly by the debtor or other stakeholders.

Law stated - 06 August 2021

Winding-up petitions

Do creditors apply for winding-up orders? If so, what law governs these actions? What must the creditor show to succeed and what must the debtor show to successfully defend? How are these actions usually resolved?

Creditors have standing to apply for a winding-up order under the Companies Act. To succeed in presenting a winding-up petition, a creditor must establish that the debtor is unable to pay its debts or that it is just and equitable that the

company should be wound up.

To successfully defend a winding-up petition on the basis of a debt, the debtor must demonstrate that there is a bona fide dispute on substantial grounds as to the validity of the petitioner's purported debt. If the debtor establishes a bona fide dispute, the court may dismiss or stay the petition pending the resolution of the dispute.

If the court is satisfied that there is no bona fide dispute on substantial grounds, it will proceed with making a winding-up order and appoint a liquidator.

Creditor petitions for winding-up orders based on legitimate indisputable debts typically result in official liquidations.

Law stated - 06 August 2021

Stays of proceedings – scope and exceptions

Does the insolvency regime stay any creditor collection actions? If so, what are the parameters of such a stay? Are there any notable or commonly used exceptions?

Section 97 of the Companies Act grants a stay of proceedings against the company upon the making of a winding-up order or the appointment of a provisional liquidator. This prevents suits, actions or other proceedings from being commenced or continued against the company and voids any attachments, distress or execution against the company made after the commencement of the winding-up.

At any point after the presentation of a winding-up petition but before the granting of a winding-up order, the company, a creditor or a contributory can apply to the court to stay or restrain proceedings in the Cayman Islands or in a foreign jurisdiction.

Restructuring under a scheme of arrangement does not come with an automatic stay of proceedings. A 'light touch' restructuring provisional liquidator will have to be appointed to obtain a stay to provide the debtor breathing space to negotiate a restructuring with other stakeholders.

Law stated - 06 August 2021

Stays of proceedings – strategy

How do creditors navigate stays in practice? How do stays generally affect their litigation strategy?

Creditors can apply to the Grand Court for leave to commence or to continue proceedings against a debtor on such terms that the Court may impose. The Court applies the following two-pronged test when considering whether to grant leave.

- The Court looks at the threshold question of whether the creditor has a claim 'worth entertaining' (an 'arguable case').
- If the Court finds an arguable case, it has broad discretion to grant leave and will consider whether it would be fair, in the context of the liquidation as a whole, for the liquidators to have to deal with the burden of the litigation if leave is granted.

While there is no presumption for or against granting leave and each case turns on its own facts, the Court will likely refuse leave if a claim can be dealt with in a convenient manner within the liquidation.

Law stated - 06 August 2021

Stays of proceedings – effect on emergence from insolvency

How do stays affect the debtor's emergence from insolvency?

Within official liquidations, the stay remains in place until the proceedings come to an end when the company is dissolved.

As for companies subject to the appointment of a provisional liquidator, the provisional liquidator's appointment comes to an end by an order of the court, which coincides with the court making a winding-up order placing the company into official liquidation or by dismissing the winding-up petition. In the latter circumstances, the company will continue to exist and the stay is lifted.

As for 'light touch' provisional liquidator restructurings, if the court sanctions the scheme of arrangement, the provisional liquidator will no longer be required and will be discharged. The scheme will be binding on creditors and contributories, and the stay will come to an end. If a scheme is not sanctioned or fails after it is sanctioned, a company may be placed into official liquidation and the stay will continue.

Law stated - 06 August 2021

Subordination and disallowance of creditor claims

Are the courts in your jurisdiction empowered to punish creditors' bad acts or inequitable conduct by pushing their claims down the priority waterfall? Can they void the claims altogether?

The priority waterfall is set out in the legislation and the courts are unable to alter the rank of a creditor's claim.

Law stated - 06 August 2021

Vote designation

Can creditors be disenfranchised based on bad-faith conduct?

Yes, based on common law authorities, the votes of creditors can be disregarded in certain situations including where the creditor: (1) has a separate interest in the debtor company as a shareholder or an affiliated company; or (2) received an inducement to vote in favour where other class members did not receive such an inducement.

Law stated - 06 August 2021

PRE-INSOLVENCY DEBTOR CLAIMS

Available claims

To what extent can claims existing before insolvency be pursued against shareholders and their affiliates and agents during an insolvency proceeding – including any contractual, tort and misfeasance claims and claims for the recovery of company property?

Company claims that existed before insolvency can be pursued by the company through the court-appointed liquidators or receivers. Liquidators will require sanction from the Grand Court under Part I of Schedule 3 of the Companies Act to pursue litigation on behalf of the company.

As for receivership, the appointment order should set out the receiver's ability to conduct the litigation on behalf of the

company.

Law stated - 06 August 2021

Procedure and resolution

What procedural mechanisms and issues should be considered when bringing pre-existing claims? How are they usually resolved?

Pre-existing debtor claims can be pursued by the liquidator upon sanction of the Grand Court pursuant to Part 1 of Schedule 3 of the Companies Act. Once sanction is granted, the liquidator may commence proceedings in the Grand Court and follow the procedural mechanisms set out in the Grand Court Rules and the Financial Services Division User Guide.

It will be important to consider whether there are sufficient assets within the liquidation estate to pursue the liquidation or whether litigation funding will be required – which will necessitate an application for the Court to sanction litigation funding.

As with all other civil proceedings, these pre-existing claims are resolved through informal settlement negotiations, mediations or after trial (including any appeals).

Law stated - 06 August 2021

Standing and assignment of claims

Who controls the pursuit of pre-insolvency debtor claims? Can creditors or other stakeholders pursue them derivatively if the debtor or trustee refuses to do so?

The court-appointed office holder is entitled to pursue the pre-insolvency debtor claims on behalf of the company.

Shareholders can be permitted to pursue claims on behalf of the debtor if the liquidator refuses to do so. In the Matter of The Sphinx Group of Companies , 2014 (2) CILR 131, the Grand Court reviewed a line of cases from the United Kingdom and Australia and held, in obiter, that 'it would appear that even a substantive issue of standing to sue by shareholders could be accommodated by the court in a suitable case where a liquidator refuses to take action'.

A liquidator may seek court sanction to sell a claim to a third party (ie, a creditor) who could then pursue the claim independently of the liquidation proceedings for their own benefit.

Law stated - 06 August 2021

Risk mitigation for creditors

How can creditors mitigate the risk that pre-insolvency debtor claims and remedies will be successful?

Besides operating in a diligent manner and adhering to contractual terms, creditors can mitigate risk by:

- taking security at an early stage and avoiding entering into transactions and accepting security from a company that is insolvent or in a distressed situation; and
- obtaining guarantees from other parties.

In the case of custodian investors, the custodians should ensure that they have indemnity agreements or hold-back provisions in their agreements with their client investors in case clawback claims are made.

Law stated - 06 August 2021

Minimising costs for creditors

How can creditors reduce the costs of litigation associated with these claims? What procedures are commonly used?

Litigating in the Cayman Islands can be a lengthy and expensive endeavour. As such, early-stage mediation and settlement are always encouraged to avoid incurring the significant costs associated with litigation.

Law stated - 06 August 2021

OTHER CLAIMS

Other claims against creditors

Are there any other major categories of claims that may be pursued against creditors during insolvency proceedings in your jurisdiction? If so, what are the essential elements of such claims?

A company in liquidation can set off any amounts the company is owed by a creditor against the amount claimed by the creditor.

Law stated - 06 August 2021

Other claims against debtors

Are there any other major categories of claims that may be pursued against debtors during insolvency proceedings in your jurisdiction? If so, what are the essential elements of such claims?

Subject to the Grand Court granting leave under section 97 of the Companies Act, parties may pursue valid claims against a debtor subject to insolvency proceedings. Otherwise, all claims must be made within the liquidation by submitting proof of debt to the liquidator.

Law stated - 06 August 2021

CROSS-BORDER PROCEEDINGS

Parallel proceedings and international judgments

Are parallel proceedings and international judgments recognised in your jurisdiction? What are the requirements for recognition? Can recognition be challenged? On what grounds?

Given the global nature of the financial services industry in the Cayman Islands, the Grand Court is frequently asked to recognise and grant assistance to foreign insolvency proceedings as well as international judgments.

Although the Cayman Islands have not adopted the UNCITRAL Model Law on Cross-Border Insolvency, there is a robust legislative and common law regime to recognise foreign and parallel insolvency proceedings.

Under section 241 of the Companies Act, the Grand Court has the authority to make orders ancillary to foreign insolvency proceedings to:

- recognise the right of a foreign representative to act in the Cayman Islands on behalf of or in the name of a debtor;
- stay the commencement or continuation of legal proceedings and the enforcement of judgments against a debtor;
- require the examination of individuals with information relating to the business or affairs of a debtor by the debtor's foreign representative and produce documents to the representative; and
- order individuals to turn over to the foreign representative any relevant documents or property belonging to a debtor.

In cases where the recognition of a foreign representative or foreign proceedings does not fall within the statutory recognition provisions of the Companies Act, recognition may be sought pursuant to common law principles (eg, the recognition of receivers appointed by foreign courts).

International judgments can be enforced in the Cayman Islands under the Foreign Judgments Reciprocal Enforcement Law (1996 Revision) (FJRE) or as a matter of common law.

The FJRE presently extends reciprocity only to Australia and its external territories. A foreign judgment may be enforced under the FJRE if:

- it is final and conclusive;
- it is for the payment of a sum of money;
- the registration is sought within the six-year limitation period; and
- it has not been satisfied.

Foreign judgments registered under the FJRE can be set aside on the following non-exhaustive grounds:

- if the court that issued the original judgment had no jurisdiction;
- the judgment was obtained by fraud;
- the judgment debtor, being a defendant in the proceedings in the original court, did not receive proper notice of the proceedings in sufficient time to enable them to defend the proceedings, and did not appear;
- the enforcement of the judgment would be contrary to Cayman Islands public policy; and
- the rights under the judgment are not vested in the person making the application for registration.

Under the common law, a foreign money judgment can be enforced in the Cayman Islands if the judgment was:

- made by a court that has personal jurisdiction over the defendant;
- for a debt or definite sum of money;
- final and conclusive; and
- not obtained by fraud, and not contrary to the principles of natural justice or public policy.

Foreign non-monetary judgments can be enforced if:

- the judgment is final and conclusive;
- the principles of comity require enforcement; and
- the integrity of the Cayman Islands is not impugned.

Parties seeking to challenge the recognition of foreign monetary and non-monetary judgments can do so by alleging the above requirements have not been complied with.

The Grand Court will not enforce foreign judgments related to taxes, fines, penalties and other similar charges on the basis of the relevant legislation and public policy.

Foreign arbitral awards can be enforced in the Cayman Islands under the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958 (for signatories) and the Arbitration Law 2012 (for convention and non-convention jurisdictions).

The enforcement of foreign arbitral awards (both convention and non-convention) can be challenged under the Foreign Arbitral Awards Enforcement Law (1997 Revision) where:

- a party to the arbitration agreement was under some incapacity;
- the arbitration agreement was not valid;
- the party challenging the enforcement was not given proper notice of the appointment of the arbitrator or of the arbitration proceedings, or was unable to present its case;
- the award deals with a difference not contemplated by or not falling within the terms of the submission to arbitration or contains decisions on matters beyond the scope of the submission to arbitration (the parts of the arbitral award that contain decisions on matters submitted to arbitration can be enforced);
- the composition of the arbitral authority or the arbitral procedure was not in accordance with the agreement of the parties or with the law of the country where the arbitration took place; or
- the award has not yet become binding on the parties, has been set aside or suspended by a competent authority of the country in which, or under the law of which, it was made.

Law stated - 06 August 2021

Judicial cooperation

To what extent if any will there be judicial cooperation with other courts in relation to insolvency proceedings?

Given that many of the insolvency proceedings in the Cayman Islands involve cross-border or parallel proceedings in other jurisdictions, the Grand Court frequently cooperates and communicates with courts in other jurisdictions.

The Cayman Islands judiciary has bolstered its commitment to international cooperation by adopting the Judicial Insolvency Network (JIN) Guidelines for Communication and Cooperation between Courts in Cross-Border Insolvency Matters (the Guidelines), the American Law Institute – International Insolvency Institute Guidelines via the implementation of Practice Direction No. 1 of 2018 and the JIN Modalities of Court-to-Court Communications via the implementation of Practice Direction No. 2 of 2019.

It is common for international protocols to be entered into between Cayman Islands officeholders and foreign officeholders. In fact, the Companies Winding Up Rules require official liquidators to consider whether or not it is appropriate to enter into an international protocol with a foreign officeholder. Practice Direction No. 1 of 2018 stipulates that officeholders appointed in the Cayman Islands in respect of restructuring proceedings supervised by the Grand Court and other interested parties involved in cross-border insolvency cases should consider, at the earliest opportunity, whether to incorporate some or all of the Guidelines into an international protocol or an order by the Grand Court adopting the Guidelines.

Law stated - 06 August 2021

REMEDIES AND ENFORCEMENT

Remedies for debtors

What legal remedies are broadly available to successful debtor-claimants? Have the courts awarded any notable remedies recently?

The courts can order a suite of remedies for successful debtor-claimants in the Cayman Islands including:

- compensatory damages;
- injunctive relief;
- declaratory relief;
- specific performance;
- accounting of profits;
- constructive trust;
- recission;
- restitution;
- proprietary (tracing);
- rectification;
- costs;
- interest;
- aggravated damages; and
- punitive or exemplary damages.

One recent notable ruling is the Privy Council's July 2020 ruling in Skandinaviska Enskilda Banken AB v Conway and another [2019] UKPC 26 clarifying the law on the pursuit of voidable preferences under section 145 of the Companies Act in a claim for restitution of shareholder redemption payments made to a custodian, which were subsequently passed along to investors. The Privy Council also clarified the position on the inability to rely on the change of position defence.

Law stated - 06 August 2021

Remedies for creditors

What legal remedies are available to successful creditor-claimants? Have the courts awarded any notable remedies recently?

The courts can order a suite of remedies for successful creditor-claimants in the Cayman Islands including:

- compensatory damages;
- injunctive relief;
- declaratory relief;
- specific performance;
- accounting of profits;
- constructive trust;
- recission;
- restitution;
- proprietary (tracing);

- rectification;
- costs;
- interest;
- aggravated damages; and
- punitive or exemplary damages.

Law stated - 06 August 2021

Court enforcement mechanisms

What tools are available to the court to enforce its rulings? Are there any jurisdictional limits to the court's enforcement powers?

There are a number of domestic enforcement tools to enforce judgments, including foreign judgments and arbitral awards registered in the Cayman Islands, including:

- charging orders (charging or securing shares or other company or personal assets);
- stop notices (to temporarily prevent dissipation of assets including the transfer of shares);
- attachments of earnings (usually applied to working individuals);
- garnishee orders (judgment debtor is owed monies from a third party – the court can compel the third party to pay the creditor directly);
- writs of fieri facias (the court bailiff can seize and sell assets or goods);
- bankruptcy or winding-up petitions made on the basis of an unpaid judgment (bankruptcy petition against an individual or winding-up petition against a company);
- receivership by equitable execution (application to appoint a receiver of a debtor through equitable execution); and
- committal proceedings (contempt of court), including for failure to abide by injunctive relief or disclosure orders.

Law stated - 06 August 2021

SETTLEMENT AND MEDIATION

General court approach

Are the courts in your jurisdiction generally amenable to settlements?

Although the courts in the Cayman Islands cannot mandate settlements, they generally welcome settlement between parties, not least because it reduces the time and financial burden on the court system.

Law stated - 06 August 2021

Timing

When in the course of litigation are settlements most likely to be sought out?

Litigation in the Cayman Islands can be settled at various stages and has, on a number of occasions, been settled after a hard-fought hearing, trial or appeal but before a judgment has been handed down. In those instances, the court reserves its right to hand down a written judgment despite the settlement of the proceedings.

Law stated - 06 August 2021

Court review and approval

How do courts review settlements? What is the legal standard for entry into and approval of a settlement?

Parties are generally free to enter into a settlement and the court will not be required to review and approve a settlement.

Within liquidation proceedings, a liquidators' powers are derived from the appointment order and the legislation – where they can exercise powers with the sanction of the Grand Court under Part I of Schedule 3 of the Companies Act and powers with or without sanction of the Court under Part II of Schedule 3 of the Companies Act. If the necessary power to make such settlements or compromise is not included in the appointment order, the liquidator will have to seek sanction from the Court.

The Grand Court will generally accept the commercial judgment of the liquidator when considering such a sanction application, unless it views the proposed actions by the liquidator as so unreasonable or untenable that no reasonable liquidator would take it.

In its review, the Court will:

- consider all relevant evidence;
- consider whether the proposed transaction is in the commercial best interests of the company;
- give considerable weight to the liquidator's views unless there is evidence revealing reasons for not doing so, because the liquidator is generally in the best position to take an informed and objective view; and
- consider the correctness or otherwise of the liquidator's decision having regard to the following:

Law stated - 06 August 2021

Mediation clauses

Will courts enforce mandatory or voluntary mediation clauses in pre-existing contracts?

The courts in the Cayman Islands will generally enforce mediation and arbitration clauses in pre-existing contracts.

However, the Grand Court maintains exclusive statutory jurisdiction in respect of winding-up petitions that supersedes any arbitration agreement inconsistent with this course. Winding-up petitions can be stayed in favour of arbitration if there is a bona fide dispute on substantial grounds. The winding-up petition may be resumed once the dispute is resolved.

Law stated - 06 August 2021

UPDATE AND TRENDS

Recent developments

What have been the most notable recent developments in insolvency litigation in your jurisdiction, including any key cases and legislative changes?

The law and procedure in respect of litigation funding within and outside liquidation proceedings have continued to develop. On 1 May 2021, the Private Funding of Legal Services Act came into force. We may see a significant increase in insolvency-related claims outside the liquidation context as parties will be able to seek third-party litigation funding

or enter into contingency fee agreements with law firms.

In addition, a consultative approach was undertaken in 2020 and draft revisions have been made to the Companies Act to introduce a more defined restructuring regime that will, among other things, permit directors to commence restructurings without shareholder approval and permission in the articles. The draft revisions also provide for the appointment of a chief restructuring officer as the court-appointed officer, which will be used instead of the current regime of the appointment of a 'light touch' provisional liquidator.

Law stated - 06 August 2021

Jurisdictions

Armenia	Concern Dialog Law Firm
Australia	Blackwattle Legal
Cayman Islands	HSM Chambers
Cyprus	Patrikios Pavlou & Associates LLC
France	Latham & Watkins LLP
Germany	Latham & Watkins LLP
Japan	Mori Hamada & Matsumoto
Mexico	Mañón Quintana Abogados
South Korea	Bae, Kim & Lee LLC
Spain	Latham & Watkins LLP
Ukraine	GOLAW
United Kingdom	Latham & Watkins LLP
USA	Latham & Watkins LLP