RECOGNITION AND COOPERATION

In

CROSS-BORDER INSOLVENCY MATTERS

REPORT

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1. Terms of Reference

1.1 We have been asked to review the *Model Law on Cross-Border Insolvency* published in 1997 by the United Nations Commission on International Trade Law ("Uncitral"). It seeks to promote co-operation in international insolvency matters by facilitating the adoption by individual countries of model, but nevertheless flexible, legislation designed to achieve certain minimum recognition and assistance benchmarks.

1.2 We have been asked to analyse the existing Cayman Islands law and practice in relation to cross-border insolvency matters and advise Government to what extent it meets the benchmarks contained in the *Model Law*.

1.3 Even if these benchmarks are met (which is in fact substantially the case), we have been asked to advise Government whether any other legislative changes would be desirable having regard to the fact that corporate reconstruction and liquidation business is an important part of this country's financial services industry.

2. Executive Summary

2.1 Cayman Islands law and practice does meet the benchmarks contained in the *Model Law* in all material respects. (A detailed analysis is contained in Sections 4 – 7 below).

2.2 This law and practice is contained in a substantial body of case law built upon Part V of the Companies Law and the application of the UK Insolvency Rules 1986.

2.3 This limited statutory framework has had the advantage of permitting a highly flexible (and successful) approach on the part of the judiciary. However, we consider that a greater degree of codification would now be advantageous, provided that it is not done in a way which eliminates all flexibility on the part of the judiciary and the insolvency practitioners.

2.4 We therefore recommend that it would be desirable for Government to update Part V of the Companies Law and to expand its scope so as to codify certain matters currently to be found only in the case law (including those matters dealt with in the *Model Law*).

2.5 We recommend against attempting to enact standalone legislation on the basis of the *Model Law* because it would be a technically very difficult exercise and it would serve no useful purpose because the existing law and practice clearly meets the benchmarks.

2.6 We also recommend that it would be desirable for the Grand Court Rules Committee to publish a comprehensive set of insolvency rules with a view to eliminating the complications and uncertainties which tend to arise from the current practice of applying English rules "to the extent that it is practical to do so" without at the same time unduly diminishing the flexibility currently permitted. This, along with the update of Part V of

the Companies Law, would address certain of the issues raised in Section 9 of the KPMG *Review of Financial Regulation in the Caribbean Overseas Territories and Bermuda*.

3. Factual Background

3.1 The nature of this country's economy is such that purely domestic insolvency proceedings are practically unknown. Personal bankruptcy proceedings are also practically unknown. The typical scenario involves a foreign owned company which is incorporated in this jurisdiction and has substantial assets and business activities located elsewhere. It is therefore inevitable that cross-border corporate insolvencies are the *only* kind of insolvencies which our courts and practitioners are called upon to deal with in practice.

3.2 As this country's financial services industry has expanded and matured, the relative importance of corporate reconstruction and insolvency business has grown. Today, we estimate that there are as many as 100 professional insolvency practitioners and support staff engaged in this business on a fulltime basis. In addition, the reconstruction and insolvency business generates a high proportion of the legal work done by the litigation departments of the major law firms, all of whom employ specialist insolvency lawyers.

3.3 A significant volume of cross-border corporate insolvency proceedings have been handled by the Grand Court over the past 20 years, much of which has been very high profile. As a result there is a large body of case law and our judiciary have far more experience than their counterparts overseas. Recognition and co-operation of the kind contemplated by the *Model Law* has been afforded by the Grand Court on scores of occasions. Conversely, the courts of many English speaking countries, in particular the United States, United Kingdom and Hong Kong, have recognised Cayman appointed official liquidators and entered into protocols with the Grand Court on many occasions since the mid 1980's. With the notable exception of Luxembourg little, if any, co-operation is forthcoming from most European and South American countries which still tend to adopt a nationalistic and discriminatory approach in insolvency matters.

4. Access of Foreign Representatives and Creditors to the Grand Court

4.1 Articles 9 – 12 of the *Model Law* seek to ensure that foreign representatives have direct access to a country's courts without the need to rely upon cumbersome and time-consuming letters rogatory or other forms of diplomatic or consular communications as is the case in many South American countries. This benchmark is clearly met as no such impediment exists under Cayman Islands law. Foreign representatives have commenced and participated in proceedings in the Grand Court without any difficulty on many occasions.

4.2 Article 13 embodies the principle that foreign creditors who seek to commence insolvency proceedings or make claims in such proceedings shall be treated the same as local creditors. It has always been a fundamental principle of Cayman Islands law that all creditors are treated equally. For example, creditors of all the ring fenced branches of BCCI (in France and many Third World countries) have been able to claim in the

Cayman liquidation proceedings and have received dividend payments from the Cayman liquidation estate to give them parity with the 60% global dividend rate which has been paid to date. In practice a high proportion of insolvency proceedings are commenced by foreign creditors.

4.3 It should be noted that the *Model Law* would not prevent Government from continuing to be a preferred creditor in respect of fees and taxes. Nor would it prevent Cayman Islands law from refusing to recognise and enforce claims made by foreign Governments for payment of tax.

4.4 Article 14 seeks to ensure that foreign creditors receive notification of insolvency proceedings and have the same opportunity to make claims as local creditors. Many countries discriminate against foreign creditors by requiring that notices be published only in official gazettes, imposing unrealistically short deadlines for filing, and insisting that claims be filed in the local language. In contrast, Cayman Islands practice assumes that most, if not all, creditors will be foreign. The Grand Court may require publication of multi-language reports and notices; require publication of notices in foreign newspapers; permit foreign creditors to file claims and proxy forms by fax; and permit them to participate in creditor meetings by telephone. It is the norm to hold creditor meetings outside the Cayman Islands.

4.5 Cayman Islands law and practice clearly meets, and arguably goes beyond, the requirements of Articles 13 and 14.

5. Recognition of Foreign Proceedings

5.1 Articles 15 – 17 deal with the circumstances in which foreign insolvency proceedings should be recognised and sets out certain formalities in respect of recognition (or exequatur) proceedings. Under the common law rules applicable in the Cayman Islands, a representative of a company appointed by a court in its country of incorporation (ie someone equivalent to an official liquidator or trustee in bankruptcy) is entitled to recognition automatically. There are no specific formalities at all. Indeed, the rules are so well established and known, that foreign representatives are commonly recognised by local banks without having to commence any proceedings at all.

5.2 The only area of uncertainty which would inevitably necessitate an application to court is the circumstance in which the only foreign representative seeking recognition was appointed by the courts of a country other than the company's country of domicile. This situation is highly unlikely to occur in practice.

5.3 The consequence of recognition is that the foreign representative is able to collect the assets and generally act on behalf of the company in the Cayman Islands. However, in the case of foreign companies carrying on businesses of a kind which are not subject to regulation by the Monetary Authority through branch operations (as opposed to subsidiaries), there are limitations upon the assistance which can be given to foreign representatives for reasons which are explained in Section 7 below.

6. Co-Operation with Foreign Courts and Representatives

6.1 We believe that the Grand Court has adopted a uniquely flexible and cooperative approach in cross-border insolvency matters. The following paragraphs give examples of the way in which the Grand Court has co-operated with foreign courts in the manner contemplated by Articles 25 – 27.

6.2 Article 25 contemplates "direct" communication between the Grand Court and foreign courts and representatives. A dramatic example of such "direct" communication occurred in February 1995 when the Chief Justice and an English High Court judge held a joint sitting of their respective courts on a Sunday afternoon by means of an open telephone line for the purposes of making concurrent winding up and administration orders in respect of Baring Securities Limited which had been made insolvent by the activities of Nick Leeson in Singapore. Communication can be no more "direct" than a teleconference between the judges of two different countries.

6.3 The Grand Court routinely appoints foreign insolvency practitioners (including government or quasi-government officials) as joint official liquidators of Cayman Islands companies as contemplated by Article 27(a). In practice this is a highly effective method of ensuring that a co-operative and unified approach is adopted in multi-jurisdictional insolvencies. For example, the Grand Court recently appointed a nominee of the SEC jointly with a local insolvency practitioner. Very few countries permit this to be done on a routine basis. It is permitted in Bermuda and it was permitted by Luxembourg in the case of BCCI SA. It is not now permitted and nor do we think it likely to be permitted in the United States or United Kingdom.

6.4 The Grand Court enters into "protocols" of various kinds with foreign courts for a variety of purposes. The best known is the BCCI pooling agreement which was approved by the courts of the United Kingdom, Luxembourg and the Cayman Islands. It may be noted that French law apparently dictates that the liquidation of BCCI Overseas Ltd's French branches be ringfenced and their liquidator has refused to co-operate or pool its assets with the Cayman Islands Estate. This has not stopped the Cayman Islands liquidators from admitting creditors of the French branches in the Cayman Islands liquidation proceedings and paying any top up dividends (to achieve global parity of all creditors) once the final payout from the French liquidation has been determined. More recent examples are the Peregrene Group in which the Grand Court entered into a protocol with the High Court of Hong Kong and the Inverworld Group in respect of which it entered into a protocol with the US Bankruptcy Court in Texas. Many such protocols are intended to allocate responsibilities for liquidating companies between the insolvency practitioners and courts of two or more countries.

6.5 Another form of protocol concerns the reconstruction as opposed to liquidation of groups of companies. The Grand Court has put companies into provisional liquidation on the basis that its liquidators will promote a scheme of arrangement in parallel with a reorganisation plan under Chapter 11 of the US Bankruptcy Code. This has recently

been done in connection with Fruit of the Loom Inc, a major clothing manufacturer in the United States which had a head office operation in the Cayman Islands. Similar proceedings have been commenced in respect of certain Enron subsidiaries which are ancillary to the Chapter 11 proceedings in the United States.

6.6 Official liquidators appointed by the Grand Court have sought and obtained assistance from foreign courts, in particular in the United States, on numerous occasions. In this respect the landmark decision was Universal Casualty & Surety Company (1985) in which the US Bankruptcy Court for the Southern District of New York analysed Cayman Islands law and practice and concluded that it did meet the criteria (under Section 304 of the Bankruptcy Code) necessary to enable it to provide assistance to an official liquidator appointed by the Grand Court. Such assistance has been rendered on numerous subsequent occasions.

6.7 In our view Cayman Islands law and practice clearly meets the benchmarks for cross-border co-operation contained in Articles 25-27 of the *Model Law*.

7. Concurrent Proceedings

7.1 Article 28 contemplates the possibility of both recognising foreign proceedings and entertaining concurrent ancillary proceedings in the Cayman Islands based solely on the fact that the foreign company has assets in this jurisdiction. As we have already explained, the foreign representative has direct access to the Grand Court and can commence whatever proceeding may be necessary to collect a foreign company's assets or otherwise enforce its rights in the Cayman Islands. To this extent Cayman Islands law and practice meets the benchmarks laid down in the *Model Law*.

7.2 Article 28 also contemplates the commencement of concurrent *insolvency* proceedings in respect of operations conducted in the Cayman Islands through a branch as opposed to a subsidiary. There is no doubt that the foreign representative could himself commence an insolvency proceeding in the Grand Court in respect of a locally incorporated subsidiary. In the case of a branch of a licensed bank or insurance company, the foreign representative could ask the Monetary Authority to commence a concurrent proceeding. However, there is probably no generally applicable right for creditors or foreign representatives to commence concurrent proceedings in respect of the branch operations of foreign companies. In this one respect Cayman Islands law and practice probably does not meet the benchmark contained in the *Model Law*, at least in theory. So far as we are aware, the point has never in fact arisen. This is no doubt a reflection of the fact that very few companies, apart from banks, have branches as opposed to subsidiaries in the Cayman Islands. The only notable exceptions are the foreign airlines which operate flights to Grand Cayman.

8. Conclusion

In conclusion, it can be seen that the principles espoused by the *Model Law* are, to a very large extent, already incorporated in Cayman Islands law and practice. In fact the

Cayman Islands is one of the most progressive jurisdictions in the world as far as adoption of these principles are concerned. Undoubtedly, Part V of the Companies Law does require to be updated as it relates to insolvency matters and the legal and accounting professions are committed to achieving this in a manner that ensures that the Cayman Islands continues to be a jurisdiction of choice for international business.

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