Recent trends: provisional liquidation in the Cayman Islands

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Introduction

There are two grounds on which provisional liquidators (**PLs**) may be appointed in the Cayman Islands under the Companies Act (2021 Revision) (the **Companies Act**), following the presentation of a winding up petition and before the making of a winding up order. The first is what is commonly referred to as a "full powers" PL appointment under section 104(2) of the Companies Act and the second is known as a "restructuring" or "light touch"[1] PL appointment under section 104(3) of the Companies Act.

In seeking to balance the interests of both creditors and companies, the accessibility of relief under each of these sections has diverged in recent years, with the Grand Court demonstrating an increasing willingness to allow companies an opportunity to restructure their liabilities before making a winding up order under section 104(3), concurrent with an increased reluctance to take the drastic step of ousting management altogether pending determination of a winding up petition under section 104(2). A number of recent cases in the Grand Court have reinforced this trend.

Full powers PL appointments

Pursuant to section 104(2) of the Companies Act, a creditor, contributory or CIMA may make an application for the appointment of a PL on the grounds that: (a) there is a prima facie case for making a winding up order; and (b) the appointment of a provisional liquidator is necessary in order to prevent the dissipation or misuse of the company's assets, prevent the oppression of minority shareholders, or to prevent mismanagement or misconduct on the part of the company's directors.

In order to establish whether a good prima facie case has been made out for a winding up order under the first limb of the section 104(2) test, it is not necessary to demonstrate that a winding up order will be granted. An applicant need only show that the allegations in the winding up petition are supported by evidence and have not been disproved, with conflicts of evidence to be resolved

at a substantive hearing (*Asia Strategic Capital Fund LP* [2015] (1) CILR Note 4).

Even if a prima facie case for winding up can be made out, the satisfaction of the second limb of the test under section 104(2) has been described as a "heavy burden" to discharge (per Parker J in *CW Group Holdings Limited*). In *CW Group*, Parker J emphasised the importance of demonstrating with "clear or strong evidence" that the appointment of PLs was **necessary** to prevent dissipation or misuse of assets and mismanagement or misconduct by the directors. Such evidence might include:

a. that the assets of the company are being or are likely to be dissipated to the detriment of the petitioners (*Re Asia Strategic Capital Fund*, Unreported, Segal J, 30 April 2015);

b. the risk that records may be lost or destroyed (*Re Rochdale Drinks*[2013] BCC 419); or

c. mismanagement amounting to "culpable behaviour involving breach of duty" or "improper behaviour" (*Re Asia Strategic Capital Fund*).

Assuming that the Court is satisfied that the statutory pre-conditions for the appointment of provisional liquidators are established, the Court then has a discretion to "grant the provisional liquidators such powers as the Court considers necessary and appropriate to prevent such dissipation, misuse, mismanagement and misconduct and to ensure the Company's assets are properly protected pending the hearing of the winding up petition". This also includes the discretion to adjust and extend the powers of the provisional liquidators "so as to respond to particular problems and needs identified by the PLs and changing circumstances." (*Natural Dairy (NZ) Holdings Limited*, Unreported, Segal J, 20 December 2016).

The difficulty in satisfying the Court of both limbs of the test under section 104(2) is demonstrated by the recent decisions of the Grand Court in *China Resources and Transportation Group Limited* (Unreported, Doyle J, 23 April 2021) and *Grand State Investments Limited* (Unreported, Parker J, 28 April 2021).

In *Grand State*, Parker J did not consider that the "heavy burden" of establishing a serious risk of dissipation had been discharged, concluding that "the Petitioner's evidence does not establish any serious risk of dissipation of assets and/or mismanagement, nor does it explain why the appointment of joint provisional liquidators is necessary to prevent any alleged dissipation or mismanagement".

In *China Resources*, the Court acknowledged the nature of relief under section 104(2) as "exceptional" but concluded that "there is insufficient evidence before the court to take the serious step of appointing provisional liquidators", instead describing the evidence as "flimsy" and "little more than mere assertion".

Accordingly, while the Grand Court is able to grant PLs extensive powers, and adapt those powers to the circumstances of the case once the statutory thresholds have been met, the two limbed test

under section 104(2) remains a high bar to overcome.

Restructuring light touch PL appointments [2]

While relief under section 104(2) is difficult to secure absent "clear and strong evidence", the Court has demonstrated in recent years an increased willingness to allow companies an opportunity to restructure under section 104(3) of the Companies Act, without needing to evidence at the outset that such a restructuring is bound to succeed.

Pursuant to section 104(3) of the Companies Act, an application for the appointment of a PL may be made by the company ex parte on the grounds that: (a) the company is or is likely to become insolvent; and (b) the company intends to present a compromise or arrangement to its creditors.

This provision gives the Court a broad and flexible discretion to step in and "rescue" a company where it is satisfied that a refinancing would be more beneficial than a winding up, where there is a "real prospect" of the refinancing being effected and where the Court is satisfied that it is in the best interests of the creditors in the circumstances, *Fruit of the Loom* (Unreported, Smellie CJ, 30 October 2000).

The additional factors that the court will consider on an application under section 104(3) include:

a. The viability of any restructuring plan. As the statutory gateway only requires an **intention** to present a compromise or arrangement, it is not necessary for the company to present a formulated plan (*Sun Cheong Creative Development Holdings Ltd*, Unreported, Smellie CJ, 20 October 2020) and the Court has also demonstrated willingness to appoint PLs to explore the viability of a restructuring *(ACL Asean Towers Holdco*, Unreported, Kawaley J, 2 January 2019);

b. The wishes of creditors, although the Court should be cautious to simply "count up the claims of supporting and opposing creditors" (*Grand TG Gold Holdings Limited*, Unreported, Segal J, 21 August 2016);

c. The nature of the creditors supporting or opposing the application, including whether they are secured or unsecured (*G3 Exploration Limited*, Unreported, McMillan J, 24 July 2020); and

d. The considered views of the board as to the best way forward (*CW Group Holdings*).

Notwithstanding the Court's willingness to assist in the rescue of Cayman Islands companies, in the recent decision of *Midway Resources International*, Segal J was cautious to demonstrate the Court's ongoing interest in safeguarding the views of creditors.

He was not satisfied on the first hearing of the application that there was a real prospect of the restructuring proposals in question being approved and also noted that, while an application under section 104(3) may be made ex parte, "it is in my view important where possible for the views of creditors to be ascertained and for creditors to have a proper opportunity to file representations and submissions to the Court if they wish to do so". He therefore adjourned the hearing, ordering

that the company file further evidence as to the viability of the restructuring and notify creditors who may wish to be heard on the application, before he was willing to grant the relief sought.

Conclusion

The development of Cayman Islands law demonstrates the Court's flexibility and ongoing ability to balance the interests of both creditors and companies around the appointment of PLs. Where a creditor can show "strong and clear evidence" that it is **necessary** to appoint PLs to prevent dissipation or mismanagement, the Court may appoint PLs under section 104(2), but is cautious to do so unless this heavy burden is discharged. Similarly, the Court has demonstrated willingness to give companies the necessary breathing space to formulate and present a restructuring plan where appropriate, provided that there is some prospect of a viable plan being presented and that creditors are given sufficient opportunity to consider and be heard on the proposal.

Ogier has appeared on behalf of both petitioners and defendant companies in numerous applications in respect of the appointment of PLs including, but not limited to, CW Group Holdings, Grand State Investments, G3 Exploration Limited and Sun Cheong Creative Development Holdings Ltd.

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[1] The term "soft touch" has historically also been used but Segal J recently pleaded with practitioners to adopt the term "light touch" instead since the former "has always seemed to bring with it associations of someone being duped and defrauded!" (*Midway Resources International*, Unreported, Segal J, 30 March 2021 at [68]).

[2] Amendments have been proposed to the regime under section 104(3) of the Companies Act to provide for the appointment of a restructuring officer in lieu of a provisional liquidatior, although it is anticipated that the existing case law will remain relevant. For details of the proposed amendments, see our article: Cayman Islands publishes reforms to restructuring regime.

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