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Insolvency analysis: The Grand Court of the Cayman Islands has

Restructuring & Insolvency analysis: The Grand Court of the Cayman Islands has recently considered for the first time in In the Matter of Obelisk Fund SPC and In the Matter of Obelisk Global Focus Fund (Unreported, Grand Court, 21 August 2021) the appropriate insolvency test to be applied in respect of Cayman Islands segregated portfolio companies (SPCs). Written by Jessica Williams and Niall Dodd at Harneys.

SPCs were first introduced in the Cayman Islands in May 1998, by an amendment to the Companies Act (Revised) (the Companies Act). An SPC is a type of exempted company, which remains a single legal entity, and which may create segregated portfolios (Portfolios) whereby the assets and liabilities of each Portfolio are legally distinct from the assets and liabilities of any other Portfolio. The assets of a particular Portfolio are also separate from the SPC's general assets and liabilities. SPCs were originally introduced as a structuring vehicle for the insurance industry but their use has become very popular in the context of investment funds and they are often used for multi-class or multi-strategy collective investment schemes and fund platforms. The principal benefits include statutory protection against cross liability issues in respect of separate Portfolios and speed of formation for multiple portfolios.

It is important to note that a Portfolio cannot be formally liquidated or dissolved on its own without liquidating and terminating the whole SPC because it is not a separate legal entity, but a receivership order provides a similar remedy for closing down a Portfolio.

What was the background?

Obelisk Capital Management Ltd (in official liquidation) (the Petitioner) is a Cayman Islands exempted company involved in operating and financing gold doré, an alloy of gold and silver, usually created at the site of a mine for further transport and refinement. Obelisk Global Gold Focus Fund (the Fund) is a segregated portfolio of Obelisk Global Fund SPC (Obelisk SPC), a Cayman Islands SPC, which is described on its website as providing investment opportunities in a variety of markets and jurisdictions via preferred shares in a segregated portfolio structure.

Under a loan agreement dated 6 May 2019, the Fund was indebted to the Petitioner in the sum of US$55,000. The Joint Official Liquidators of the Petitioner (JOLs) made demand for repayment of the debt. Receipt of the demand was acknowledged by the Fund and the amount was not disputed. The JOLs served a statutory demand on the Fund on 10 February 2021, which was not paid. Thereafter a petition was brought (the Petition) seeking the appointment of receivers over the Fund's assets on the basis of the Fund's insolvency. Counsel on behalf of the JOLs submitted that this

was a classic case of a company seeking to raise ‘a cloud of objections’ to stave off the making of the order sought in the face of an unpaid debt which was clearly due and owing (see *Re Claybridge Shipping Co S.A.* [1997] 1 BCLC 572, per Lord Justice of Appeal Oliver at p.579). The Fund resisted the making of the order, submitting that it had not been shown that the Fund had failed to satisfy the statutory requirement for the appointment of receivers and that, even if the court concluded otherwise, it should not exercise its discretion to make the order sought.

At the time judgment was handed down, the Petition debt had been settled and so the judgment of the Grand Court was concerned only with its jurisdiction to appoint receivers.

The law

Section 224 of the Companies Act sets out the grounds for the appointment of receivers, providing as follows:

- Subject to subsections (2) to (5), if in relation to a segregated portfolio company, the court is satisfied—
  - that the segregated portfolio assets attributable to a particular segregated portfolio of the company (when account is taken of the company’s general assets, unless there are no creditors in respect of that segregated portfolio entitled to have recourse to the company’s general assets) are or are likely to be insufficient to discharge the claims of creditors in respect of that segregated portfolio, and
  - that the making of an order under this section would achieve the purposes set out in subsection (3)

  the court may make a receivership order under this section in respect of that segregated portfolio

The purposes set out in section 224(3) are the orderly closing down of the business of or attributable to the Portfolio and the distribution of Portfolio assets attributable to the Portfolio to those entitled to have recourse to them.

The Cayman Islands courts have previously considered the application of section 224 of the Companies Act, in the context of the nature of the powers that would be exercisable by a receiver appointed under the section (see *In the matter of JP SPC1 and JP SPC 4*, unreported, Grand Court, 15 April 2013 and *ABC Company and J Company* [2012 (1) CILR 300]), but not in the context of the applicable insolvency test. Note that, in *Re JP SPC1 and JP SPC 4*, it was held that joint receivers of a segregated portfolio, in relation to that portfolio, would be granted the same powers as would be granted to liquidators in relation to companies, though the extent of the powers of the receiver, if appointed in this case, was not discussed.

The parties agreed that the court was being invited to interpret the section in the context of the applicable test for insolvency of a Portfolio.

The arguments

The Fund took the position that the Petitioner's unsatisfied demand for repayment of a liquidated sum did not bring it within section 224(1)(a) and accordingly, it was for the court to determine the applicable test for insolvency.

The test for insolvency of a company in the Cayman Islands is well known. Section 93 of the Companies Act provides that a company is deemed to be insolvent if it has failed to pay a demand served on it exceeding KYD$100 or it is proved to the satisfaction of the court that the company is unable to pay its debts. It is also not contentious that, where the insolvency of a company is concerned, the fundamental question is whether the debt is bona fide disputed on substantial grounds and that the burden lies with the company to show that the debt is bona fide disputed on substantial grounds.

The fund did not dispute that the debt owed was in excess of the mandatory statutory minimum, nor that it was immediately due and payable. It argued that, on the wording of section 224, the test for appointing receivers over a Portfolio differed from the settled test for the appointment of liquidators to an insolvent company, ie that the test for appointing liquidators over a Portfolio was entirely different from the test for the appointment of liquidators to an insolvent company and was a balance sheet test.

The Petitioner contended that the wording of section 224 does not support an analysis that it provides for a balance sheet test at all, drawing a comparison with section 123(2) of UK Insolvency Act 1986 (the *IA*), which provides for an alternative balance sheet test in different terms from section 224, as follows:

> '*A company is also deemed unable to pay its debts if it is proved to the satisfaction of the court that the value of the company's assets is less than the amount of its liabilities, taking into account its contingent and prospective liabilities.*'

The court was invited to conclude that the language of section 224, in particular the words 'discharge the claims of creditors' may be used analogously with the language of the cash-flow test in section 92(d) of the Companies Act.

The Petitioner also cited passages from McPherson (The Law of Company Liquidation 4th Ed. At [94], [111] and [116]) in support of the argument that a stand-alone balance sheet test would be problematic, in circumstances where:

- it is not easy, in terms of both time and costs, to establish that the value of the company's assets is outweighed by its liabilities
- the balance sheet test is employed significantly less frequently by creditors seeking to establish that a company is unable to pay its debts, because unless the creditor is a director or a shareholder, a creditor will not be likely to have access to financial statements, the company's books and records, and
- the valuation of assets is not an exact science and it involves many variables, even if a creditor did have access to the relevant information

It was submitted on behalf of the Fund that, on a plain reading of section 224, one does not derive a traditional cash flow test of insolvency with language as to debt and timing of payment and that unlike section 92(d), there is no deeming provision. It was also pointed out by the court that the differences between the deeming provision and the test in section 224 were discussed in *ABC Company v J Company* (at paragraphs 20–21), where it was noted that the legislature had not chosen to adopt a recommendation from the Law Reform Commission in 2006 to repeal those sections of the Companies Act which created an insolvency regime in respect of segregated portfolios which was inconsistent with the statutory regime in respect of companies.

What did the court decide?

The court did not accept the submission on behalf of the Petitioner that section 224 equated to a cash-flow test of insolvency because section 224(1), on a plain reading, clearly provided that the test was whether the assets of the company are or are likely to be sufficient to discharge the claims of creditors. The court also held that the wording of the IA in relation to the definition of inability to pay debts, was similar to the Cayman provision, albeit that the UK section had the words ‘value’ added to assets and ‘amount’ added to liabilities, with the consequence that both sections establish a balance sheet test. The court held that section 224, by including the words ‘the discharge of claims of the creditors’, meant that more than a simple assessment of the relative values of both sides of a balance sheet was required.

The court held that it had jurisdiction to make a receivership order when a Portfolio’s assets are, or are likely to be, insufficient to discharge the claims of a creditor and that in order to do so, it would need to make a determination ‘on the available evidence of whether the assets are sufficient now, or are likely to be in the near future, when assessed against its liabilities (as well as its prospective and contingent liabilities), and are held in a form where they may be used to pay the claims of creditors’.

The court accepted that a stand-alone test, ‘more akin to a traditional balance sheet test’ for Portfolios sets a different bar for creditors, but held that this is what the statute clearly provides.

What are the practical implications?

It is of significance that the Fund accepted that it did not have sufficient assets to pay the Petition debt (at least at the time of the swearing of its evidence). The Petition debt having been settled before the judgment was delivered, the court dealt only with the jurisdictional point of the test to be applied. The court concluded that there was ‘no evidence whatsoever in this case as to the asset position of the segregated portfolio Fund, save for the amounts said to be due from third parties’

On a practical level, it is improbable that in circumstances where a segregated portfolio does not present evidence to the court of its solvency on a balance sheet basis, that it could reasonably expect to avoid an order for the appointment of receivers, pursuant to section 224.

The Cayman SPC provides significant commercial and structural advantages, and although a Portfolio is not amenable to the winding up process, the statutory regime provides a clear remedy for creditors through the appointment of a receiver.

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