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# Client Memorandum

**Duties of a Director of Insolvent Companies: Company Restructuring: Russia Sanctions**

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In the recent case of *BTI 2014 LLC v Sequana SA [2022] UKSC 25*, the Supreme Court refined the issue of the duty of directors to act in accordance with the interests of the company's creditors where the company in question is approaching insolvency and as established in *West Mercia Safetywear Ltd v Dodd [1988] BCLC 250*. The Supreme Court concluded that where the company was bordering on insolvency or facing probable but not inevitable insolvency the interests of the creditors must be balanced with the interests of the shareholders, which has been described as a "sliding scale" analysis. But, where a company's insolvency is inevitable, the interests of creditors become the paramount consideration. In such circumstances, the Supreme Court held that the directors should manage the company's affairs in a way which takes creditors' interests into account and seeks to avoid prejudicing them. Decisions of the Supreme Court are not per se binding in the Cayman Islands, but English case law, absent distinct statutory difference, is persuasive and followed by the Cayman Islands court and invariably where the common law or statutory basis is the same. In the present case the 'creditor duty' set out in s172 of the English Companies Act 2006 has never been similarly integrated into Cayman Islands statute. However, to the extent that that section codifies the principles of the directors' duty as laid down in *West Mercia,* we conclude that the refinements of the tests for the directors' duty to creditors laid down in *Sequana* would now be regarded as being of persuasive authority in the Cayman Islands Court.

## Introduction of Company Restructuring Officers in the Cayman Islands

With effect from 31 August 2022, an amendment to the Companies Act of the Cayman Islands (the "**Act**") was adopted that introduced the concept of a Company Restructuring Officer ("**CRO**"), whose mandate is to oversee and implement a restructuring of the company's debts under the supervision of the Grand Court of the Cayman Islands (the "**Court**").

The Act provides that a CRO may be appointed where: (a) the company is or is likely to become unable to pay its debts as they fall due, and (b) the company intends to present a compromise or arrangement to its creditors (or classes thereof) either, pursuant the Act, the law of a foreign country, or by way of a consensual restructuring. The changes apply to exempted companies, exempted limited partnerships and any other company, association or partnership that is liable to be wound up under the provisions of Part V of the Act.

The CRO concept significantly improves the law in relation to debt restructuring in the Cayman Islands by separating it (as far as possible) from the formal insolvency process. The previous system relied on provisional liquidators ("**PLs**") being appointed on a "light touch" basis under S.104(3) of the Act whereby a company which needed "breathing space" from hostile creditors could be placed into provisional liquidation with its PLs mandated to work in conjunction with the company's directors to implement a restructuring of the company's liabilities. The previous system had a number of flaws, however, in particular, the rule in *Re Emmadart* provided that directors could not present a petition to wind up their company unless that power was expressly given to them by the members of the company, either in the company's articles or via a members' resolution. Where no such power existed, and could not be given in time, the company would need to rely on the presentation of a winding up petition against the company by a "friendly" creditor followed by an *ex parte* application by the company to the Court for the appointment of PLs.

Another inherent problem with the appointment of PLs was that the automatic stay on all legal proceedings against the company would only arise upon the appointment of PLs potentially putting the company at risk of creditor action during the time between the presentation of the winding up petition and the time such order was made. Consideration also had to be given to the stigma attaching to a company being placed in provisional liquidation causing reputational damage as well as triggering a number of unwanted effects such as contractual events of default or change of control provisions under service provider contracts and/or financing transactions.

The CRO Regime has largely addressed these shortcomings as it permits a company to present a CRO petition without a resolution of its members or an express power in its articles. Furthermore, the rule in *Re Emmadart* has been softened by an amendment to S.94 of the Act which allows directors of a company incorporated after 31 August 2022 to petition the Court to wind up the company on the grounds that it is unable to pay its debts, or where a winding up petition has been presented to apply for the appointment of PLs.

Unlike the old provisional liquidation regime, there is no need for a winding up petition to be presented against the company in order to appoint a CRO so there is far less stigma and potential commercial risk. Of course, further consideration may still need to be given to what constitutes an "event of default" and/or "cross default" under any financing transactions the company is a party to when considering appointing a CRO.

Last, the stay on legal proceedings arises immediately upon the presentation of the CRO petition, rather than the making of a PL order, thereby affording the company additional protection from the risk of creditor action.

### General Licence to Deal with Frozen Assets (Russia sanctions)

In relation to the Russia sanctions introduced by the United Kingdom this year in connection with Russia's military assault on Ukraine, the Governor of the Cayman Islands, with the consent of the UK Secretary of State, issued a General Licence (the "**Licence**") on 4 October 2022 pursuant to which, investment funds (and managers of such funds) (the "**Permitted Parties**") whose assets are frozen due to the investment fund being owned or controlled directly or indirectly by a "Designated Person" may redeem, withdraw or otherwise deal with investment interests and make payments for basic needs of the fund. Such needs include the payment of: insurance premiums; audit and accounting fees; corporate and regulatory fees; corporate services and registered office fees; director fees; professional service provider fees; reasonable fees or reasonable service charges arising from the routine holding and maintenance of the investment fund's frozen funds or economic resources; legal fees; and any other reasonable routine expenses. Additionally, Permitted Parties may also redeem, withdraw or otherwise deal with investment interests of a person that is not a "Designated Person" (or owned or controlled directly or indirectly by a Designated Person), provided that the relevant redemption, withdrawal or other dealing is in accordance with the Licence and the relevant investment fund's constitutional and contractual documents (together, the foregoing actions, the "**Permitted Actions**").

A "Designated Person" is a person designated from time to time by the UK Secretary of State pursuant to The Russia (Sanctions) (EU Exit) Regulations 2019 (the "**Russia Regulations**") (as extended to the Cayman Islands (with minor modifications) by the Russia (Sanctions) (Overseas Territories) Order 2020) for the purposes of Regulations 11-15 of the Russia Regulations.

In order for Permitted Parties to avail themselves of the Permitted Actions granted under the Licence, such Permitted Parties must report to the Governor (which may be provided by email to GovernorsOffice.Cayman@fcdo.gov.uk) as soon as practicable the first time the Licence is relied upon and must subsequently report to the Governor on the 16th of every month setting out any activities carried out in the preceding month in accordance with the above Permitted Actions. Furthermore, in respect of a fund that is regulated by the Cayman Islands Monetary Authority ("**CIMA**"), the relevant Permitted Party must notify CIMA of its employing the Permitted Actions granted under the Licence within three (3) business days of using it.

Any Permitted Party conducting activities or making payments in accordance with the Permitted Actions, is required to keep accurate, complete and readable records, on paper or electronically, of any activity purporting to have been permitted under Licence for a minimum of six (6) years. The Licence is set to expire on 4 April 2023.

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