The Appleby 2012 Offshore Round-Up: Insolvency and Restructuring

Welcome to Appleby's review of the key insolvency and restructuring decisions handed down in the leading offshore jurisdictions during 2012, compiled by members of our Litigation & Insolvency Practice Group in Bermuda, the British Virgin Islands, the Cayman Islands, Jersey, Guernsey and the Isle of Man. Equivalent updates are available in the areas of fund disputes (several of the cases in which also concern insolvency issues), company law, civil procedure and trust litigation. Copies may be obtained from our website or from your usual Appleby contact.

During the year we have seen several decisions involving who can petition to wind up a company and when, as well as a groundbreaking approach to class votes in schemes of arrangement.

Winding-Up Petitions

The Royal Court of Guernsey dealt with a number of issues arising out of a winding up petition of a Guernsey company *In The Matter of Synergy Capital Limited* 28/2012. Two applicants, a Mr Markovic and UBS AG Bank made a joint application to wind up the company concerned on the grounds that Mr Markovic was a creditor and/or that both applicants were 'interested parties'. In relation to the latter ground, there exists a somewhat unusual provision of Guernsey law, not present under similar statutory regimes such as in England, which allows a petition to be presented not only by the company, any director, member or creditor thereof, but also 'by any other interested party'. Mr Markovic had invested significant sums from his UBS account into another company (that he owned beneficially) which had then invested as a partner in the Synergy structure. The company challenged the standing of both parties to make the application.

On the first issue, as to whether Mr Makovic was a creditor, the Court found that, in the absence of any definition within the Companies (Guernsey) Law 2008 a 'creditor' could "be given its ordinary meaning as being a person to whom a debt is payable". The Court found that Mr Markovic was not a creditor on the basis that his investment had been made to a company (which he owned beneficially), which then invested the sums in the Synergy structure as a partner of that structure. In effect, Mr Markovic was a creditor of the company he owned beneficially and not of Synergy Capital. He did not therefore have standing as a creditor to wind up the company.

In relation to the 'any other interested party' issue, the Court reviewed a range of authorities and found that the words 'by any other interested party' should not be construed extremely broadly as this could have the effect of expanding to an undesirable extent the range of persons able to petition for the winding up of a company. It concluded that Mr Makovic was an interested party for the specific purpose of winding up Synergy Capital as that entity was able to carry on business using monies that ultimately came from him and only him. Although he was not a director, member or creditor "his interest in [Synergy Capital] is as close as anybody else could get". The Court however declined to allow UBS to be an interested party on the basis in had no direct interest in Synergy Capital and was at best "one step removed".

In the same decision, the Court also considered the approach to be taken where an application to wind up a company where the debt owed is disputed. Applying *Baker Hughes Ltd v CCG Contracting International Ltd* [2005] SC 65 the Court held that "…if the debt claimed is disputed in good faith and on real and substantial grounds, then the petitioners cannot satisfy the statutory requirement that they are a creditor so as to have title to sue in a petition for winding up, whatever their lack of alternative remedy".

Also related to the issue of standing, in *Re Kingate Management Ltd* [2012] SC (Bda) 14 Com (6 March 2012) the Court in Bermuda was faced with an extraordinary application which required it to consider whether JPLs have the power to seek a winding-up order on the company's own petition. The company was devoid of assets and was defendant to claims for recovery of Madoff related performance and management fees said to exceed $300 million. The JPLs were seeking winding-up because they wished to demit office in favour of the Official Receiver, apparently due to a dispute over funding with the petitioning members. The Court considered the JPLs lack of standing to take over a stagnant members petition "obvious" but made the winding up order in any event on the basis that where a matter concerning the company is before the Court and the conditions in section 161 of the Companies Act 1981 were made out, the Court itself had a discretionary power to make a winding-up order of its own motion.

In *Gerova Financial Group* [2012] SC (Bda) 18 Com (19 March 2012), the Bermuda Court considered the legal principles applicable to the costs of withdrawing a winding-up petition. The Court decided that as a matter of Bermuda law a petition is brought for an improper collateral purpose if the petitioner genuinely seeks a winding-up order but also hopes to achieve some personal benefit which will not accrue ratably to other creditors of his class. In addition, the Court decided that in most cases where a petitioning creditor has a comparatively modest presently due debt and the debtor company is not already involved in winding-up proceedings, failure to demand payment prior to presentation of the winding up petition could be found to be unreasonable because of the potentially draconian consequences of winding-up proceedings.

Liquidators' Release

In the Matter of *Amazing Global Technologies Ltd and Kingston Management (Guernsey) Ltd* 29/2012, the Guernsey Court considered an application made by the liquidator of the two companies whereby, as part of the dissolution of the companies, the liquidator be granted an order by the Court releasing him from all liability in relation to his conduct as liquidator of the companies, save to the extent that he had been fraudulent, reckless, grossly negligent or had acted in bad faith.

The application was made under section 426 of the Companies (Guernsey) Law 2008 which permits a liquidator to "seek the Court's directions in relation to any matter arising to the winding up of the company and upon such an application the Court may make such order as it thinks fit." The Court found that there are no provisions under the Guernsey Companies Law dealing specifically with the discharge and release of liability of a liquidator.

The Court also found that the English and Guernsey regimes regarding matters of corporate insolvency in this respect were different and Guernsey did not have the statutory provisions present under the English framework, nor was there scope for the judicial 'development' of Guernsey Law in order to permit such a release under the present legislative provisions. The Court ultimately found that the release being sought was not available under the general power to give directions in section 426 of the Companies (Guernsey) Law 2008.

Automatic Stay of Proceedings

In the second instalment in the Kingate saga (mentioned above) for 2012, *Kingate Management Ltd* [2012] SC (Bda) 52 Com (3 October 2012), the Bermuda Court considered whether an ordinary writ action issued against the company prior to winding-up ought to be continued, or advanced instead through the proof of debt process in the company's liquidation. The Court set out important principles applicable to lifting the automatic stay of proceedings against a company in liquidation. The Court accepted that although case law is informative and illustrative of the various circumstances in which the discretion has been exercised one way or another, much depends on the facts and circumstances of each particular case. Notwithstanding the broad discretion, the Court agreed that the stay will normally be lifted to pursue proceedings involving questions which cannot be determined in the liquidation or where the company is a necessary party to proceedings against others, provided the claims are not obviously unsustainable. This ruling can be regarded as a considerable win for parties attempting to make post-Madoff recoveries against managers and other advisors that have no direct contractual nexus with spurned investors.

Assistance in Foreign Insolvency Proceedings

The Isle of Man Courts had ample opportunity during 2012 to consider the burgeoning principles of universality and mutual assistance in respect of global insolvency proceedings. One such case was *US Securities and Exchange Commission v. Samuel E. Wyly and Others* ORD 2012/24 heard by the Staff of Government Division in April 2012. This case concerned a Letter of Request from the US Securities and Exchange Commission to the Isle of Man seeking assistance for obtaining evidence for use in a civil case in America. The SEC alleged that Mr Wyly and others had engaged in a 13 year fraudulent scheme concerning millions of dollars of securities. It was alleged that the apparatus of this fraud was an elaborate system of trust and subsidiary companies located in the Isle of Man and the Cayman Islands. The SEC sought to obtain evidence in support of their case from the Isle of Man.

In this case, the Court considered the Evidence (Proceedings in Other Jurisdictions) Act 1975 of the United Kingdom as it had been extended to the Isle of Man and also considered the Isle of Man's developing jurisprudence of assisting where possible courts exercising jurisdiction outside of the Isle of Man. Deemster Doyle found that in this case the Court would grant the requested assistance to the SEC, that the US procedures for taking the depositions would apply and that US lawyers could take the depositions. A request that a special mode or procedure should be followed should be complied with unless it was incompatible with the law of the state of execution. If a request is made as to the particular manner for taking depositions, that manner should be employed unless the manner proposed is so contrary to Manx established procedures that it should not be permitted. It would not be a breach of the Advocates Act 1976 for the US attorney to take the deposition because the examination is entirely separate from the civil proceedings before the Court.

Deemster Doyle emphasised that the Manx Court has assisted (and therefore presumably will continue to assist) "Courts, insolvency officers and others from countries outside the Isle of Man when they have requested assistance in obtaining information and evidence in the Isle of Man especially in cases of alleged wrongdoing or insolvency."

This topic reared its head again, albeit raising a slightly different issue, in the case of *Interdevelco Limited v. Waste2Energy Group Holdings PLC* CHP 2012/56. Here, Chapter 11 bankruptcy proceedings had been commenced in America in relation to the defendant (an Isle of Man company) and other companies in its group (W2E) which were closely connected with the USA. The claimant sought to issue fresh winding up proceedings in the Isle of Man. There was no question that the Isle of Man Court had jurisdiction to hear the claimant's claim should it consider it right to do so, but the defendant successfully persuaded the Court not to exercise this jurisdiction. The Court considered issues of *forum non conveniens* and the principle of universalism and decided that the Isle of Man should recognise the American proceedings, on the basis that the W2E companies had a more real and substantial connection with America than with the Isle of Man. The presumption would often be that the place of a company's incorporation would be the appropriate forum for it to be wound up, but this could be rebutted by the facts of the particular case. Although the Isle of Man has not formally adopted the UNCITRAL Model Law on Cross-Border Insolvency, its courts can thus be seen to be following its underlying principles in many respects.

This case relied heavily on *Cambridge Gas Transportation v. Navigator Holdings plc* [2006] UKPC 26 which the English Supreme Court has stated was wrongly decided in *Rubin v Eurofinance* [2012] UKSC 46. It will be interesting to see whether the increasing willingness of the courts to assist in foreign bankruptcy proceedings will be at all curtailed by this decision.

Set-Off

Another interesting development in the area of insolvency in 2012 was that Elle Macpherson was granted permission by the Privy Council to appeal the 2011 Isle of Man Staff of Government decision in *Simpson & Others v. Light House Living & Other* 2DS 2010/29.

That case arose out of the collapse of Icelandic bank Kaupthing. Elle Macpherson bought a London property via a nominee company called Light House Living Limited and the company took out a mortgage of £7.8 million with the now-insolvent bank KSF (IOM). Upon its insolvency, the liquidators insisted that the company repay the mortgage loan in full. Elle Macpherson argued that she should have been able to set off her £2.54 million deposit against her nominee company's mortgage of £7.8 million. Although successful at first instance, the Isle of Man Staff of Government Division overruled the previous decision, holding that no set-off should take place because the borrower was a nominee company, whereas the deposit was held in Elle Macpherson's personal capacity. This case has important ramifications for the Isle of Man and beyond, and we eagerly await the outcome of the Privy Council appeal.

Schemes of Arrangement

Finally in the area of insolvency and restructuring, there have also been developments relating to schemes of arrangement which are frequently adopted in offshore jurisdictions.

On 20 April 2012, the decision of Jones J in the Cayman Islands in *Re Little Sheep Group* (Unreported, 20 January 2012) was considered by Cresswell J in a further scheme of arrangement involving the owner of the online auction site Alibaba.com. The Court was invited to reconsider Jones J's departure from the traditional approach of the courts in relation to the "head-count" test where a custodian is involved (namely that the custodian is treated as one vote for and one vote against the scheme). In the *Little Sheep* case, Jones J stated that for the purposes of the "head-count" test (the requirement that a scheme be approved by a majority in number

of each relevant class), it was appropriate where shares were held by a custodian to count the parties from whom the custodian received voting instructions both for and against the scheme. Cresswell J declined to rule on the efficacy of the *Little Sheep* approach, preferring instead to wait until the outcome of the vote to see whether the "head-count" test was an issue. In the event, the scheme was passed under both the traditional approach and the *Little Sheep* approach and it was unnecessary for Cresswell J to determine the correct test to be applied). The *Little Sheep* approach to the "head-count" test therefore still stands as good law in Cayman (which is at odds with the rest of the Commonwealth legal world).

In Bermuda, in the case of *Dominion Petroleum Ltd.* [2012] SC (Bda) 8 Com (3 February 2012), the Court summarized and confirmed the principles applicable to schemes of arrangement. The Court reiterated that in addition to being satisfied as to the due convening of the meeting and constitution of the classes, the Court must also conclude that (a) the class was fairly represented at the meeting and acting bona fide in the interests of such class and (b) that the compromise is one which "can, by reasonable people conversant with the subject, be regarded as beneficial to those on both sides who are making it". The Court also held, as it has previously, that the need for separate classes is to be determined by dissimilarity of share rights not dissimilarity of interests. Relying upon its own oft-cited decision in *Re APP China* [2003] Bda LR 50 the Court confirmed that where it is contended that a scheme ought not to be sanctioned because material facts were not disclosed, the non-disclosure complained of must be sufficiently serious to undermine the ability of those voting to make a reasonable decision on the merits of the scheme.

Appleby acted for Alibaba.com in the Cayman Islands, Gerova Financial Group in Bermuda and Samuel E Wyly in the Isle of Man.

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