
# Cayman Islands Court provides further guidance on the insolvency considerations for Segregated Portfolio Companies

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## Introduction

The Grand Court of the Cayman Islands has recently offered additional, useful guidance in the growing jurisprudence on the insolvency of Segregated Portfolio Companies ("**SPCs**"). We have previously discussed the applicable test of insolvency that applies to the appointment of a receiver in respect of a segregated portfolio ("**SP**") of an SPC here.

In this article, we will consider the recently handed down judgment in ***In the Matter of Performance Insurance Company SPC (in official liquidation)***[1] and the implications of this for SPCs and SPs as well as the impact that the new Restructuring Officer regime might have in cases of insolvent SPCs and SPs.

## SPC and SPs – fundamental principles

An SPC is a legal entity incorporated pursuant to Part XIV of the Cayman Islands Companies Act (2022 Revision) (the "**Act**"). SPCs can create one or more SPs but crucially, whilst an SPC has its own legal personality, SPs do not.[2] However, the assets and liabilities of an SP benefit from a statutory "ring-fence" from the assets and liabilities of any other SPs of the SPC and from the general assets and liabilities of the SPC.[3] Therefore, a creditor of one SP, does not have any recourse to the assets of other SPs or, subject

[1] FSD No. 70 of 2021 (RPJ).
[2] s.216(2) of the Act.
[3] s.216(1) of the Act.

to any contrary terms in the SPC's Memorandum and Articles of Association, the general assets of the SPC (and vice versa).[4]

To reinforce this principle, s.219(6) of the Act states that:
"*It shall be the duty of the directors of a segregated portfolio company to establish and maintain (or cause to be established and maintained) procedures –*

a) *to segregate, and keep segregated, portfolio assets separate and separately identifiable from general assets;*
b) *to segregate, and keep segregated, portfolio assets of each segregated portfolio separate and separately identifiable from segregated portfolio assets of any other segregated portfolio; and*
c) *to ensure that assets and liabilities are not transferred between segregated portfolios or between a segregated portfolio and the general assets otherwise than at full value.*"

In the Cayman Islands, SPC structures are commonly used to establish investment funds, given their inherent flexibility to, among other things, facilitate the pursuance of multiple strategies and/or hybrid funds. For example, a single SPC could establish separate SPs to pursue multiple investment strategies or to invest in different asset classes (e.g. public securities, private equity and cryptocurrency).
However, this structure is not without its complexities, particularly in the event of insolvency. For example, if an SPC and some, but not all, of its SPs are insolvent, what is to become of those that are solvent and should their assets be available to affected creditors to make good any shortfall in the insolvent SPs? These issues were recently considered by the Grand Court in the matter of Performance Insurance Company SPC (in official liquidation).

## In the matter of Performance Insurance Company SPC (in official liquidation)

The case relates to Performance Insurance Company SPC (the "**Company**") and certain of its SPs, in particular Bottini SP ("**Bottini**") and SSS SP ("**SSS**"). The Company was placed into voluntary liquidation in February 2021 after the Company and certain of its SPs (but not Bottini or SSS which both remained solvent and continued to operate as usual) were the victims of an alleged fraud.

The Joint Official Liquidators ("**JOLs**") of the Company intended to wind up the Company and the insolvent SPs. It was further intended that the solvent SPs (including Bottini and SSS) would be novated to new structures which they would themselves select. However, the JOLs would not permit such novation to take place unless and until the solvent SPs agreed to be responsible for a pro rata share of the costs and expenses of the liquidation, which amounted to hundreds of thousands of dollars.

[4] s.220 of the Act.

The shareholders of Bottini and SSS therefore sought the appointment of an additional joint official liquidator ("**AJOL**") as they considered the JOLs to be conflicted and which was prejudicial to the interests of the solvent SPs. It was submitted that the nature of the conflict arose from the fundamental feature of SPCs that segregates assets and liabilities of each SP from other SPs, as the JOLs were effectively attempting to prioritize the funding of the costs of the liquidation over the interests and entitlement of the stakeholders in the solvent SPs.

In their submissions, the shareholders of Bottini and SSS cited s.223(1) of the Act which requires liquidators to "*deal with the company's assets only in accordance with the procedures set out in section 219(6)*", which is quoted above. It therefore follows, they argued, that a liquidator's ability to pay an insolvent company's liabilities and expenses (including the liquidator's remuneration) does not automatically extend to the SPs of the company in question. They argued that to find otherwise would undermine this part of the Act and would render s.219(6) in particular, meaningless.

The Grand Court accepted the submissions of the shareholders of Bottini and SSS and ordered the appointment of the AJOL with their powers and those of the JOLs to be limited such that: (1) the JOLs were no longer empowered to act in respect of either Bottini and/or SSS; (2) the AJOL has sole and exclusive responsibility for Bottini and SSS; and (3) the fees and expenses of the JOLs are not the responsibility of Bottini and/or SSS, whose sole responsibility for costs is those of the AJOL.

Further, the Grand Court affirmed that the principles set out in s.219(6) of the Act (whereby the assets of SPs are not available to guarantee or 'back stop' the general liabilities and expenses of the SPC) apply equally where the SPC in question is in liquidation.

Commenting on the appointment of the AJOL, the Grand Court considered that it would be "*necessary and appropriate*" to make such an order in other cases where the joint official liquidators in question are "*reasonably perceived to be conflicted*" and where such conflict causes difficulties "*in respect of the allocation of their fees and expenses as between the insolvent SPs and solvent SPs*".

In our view, the Grand Court reached the only logical conclusion based on the Act as it is currently drafted. This judgment is certainly welcome in casting light on the issue of conflicted joint official liquidators and illuminating the remedies that stakeholders in solvent SPs have available to them, should they consider that the liquidators in question are over-stepping.

## Restructuring Officer Regime

We have previously considered the full implications of the proposed amendments to Part V of the Act here. The Restructuring Officer Regime will of course apply equally to SPCs and it will be interesting to observe how practice develops in this space, especially in circumstances similar to those described in Performance Insurance Company SPC (in official liquidation).

For example, if an SPC and certain (but not all) of its SPs are insolvent, what role will any solvent SPs be able to play in a restructuring? It would seem to be illogical to exclude them as this would be tantamount to splitting the SPC and its SPs up; but one can foresee that it will be easy for the waters to be muddied further between the solvent and insolvent SPs whilst the restructuring is negotiated and implemented.
Whilst in the context of joint official liquidators, it is, as we saw in Performance Insurance Company SPC (in official liquidation), sometimes 'necessary and appropriate' for an additional joint official liquidator to be appointed to address actual or perceived conflicts of interest, will it also be appropriate for an interim restructuring officer to be appointed in respect of solvent SPs for similar reasons where it is in the interests of the relevant SP to do so?[5]

## Conclusion

The clarity provided by Performance Insurance Company SPC (in official liquidation) and the procedural efficiencies which it is hoped and expected will be delivered by the Restructuring Officer Regime are welcome and possibly very timely.

***This publication is not intended to be a substitute for specific legal advice or a legal opinion. For specific advice on insolvency of Segregated Portfolio Companies, please contact your usual Loeb Smith attorney or :***


***Gary Smith***

*E: gary.smith@loebsmith.com*

*T: +1 345 749 7590*

***Robert Farrell***

*E: robert.farrell@loebsmith.com*

*T: +1 345 749 7499*



[5] Per s.91C of the Companies (Amendment Bill), 2021, Supplement No.1 published with Legislation Gazette No.58 dated 21 October 2021

## About Loeb Smith Attorneys

Loeb Smith is an offshore corporate law firm, with offices in the British Virgin Islands, the Cayman Islands, and Hong Kong, whose Attorneys have an outstanding record of advising on the Cayman Islands' law aspects and BVI law aspects of international corporate, investment, and finance transactions. Our team delivers high quality Partner-led professional legal services at competitive rates and has an excellent track record of advising investment fund managers, in-house counsels, financial institutions, onshore counsels, banks, companies, and private clients to find successful outcomes and solutions to their day-to-day issues and complex, strategic matters