

Article

Statutory Demands in the Cayman Islands

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The statutory demand process is widely used by creditors seeking to secure payment of their debts. This article discusses the options for bringing or challenging a statutory demand under Cayman Islands law.

Introduction

When creditors are owed CI\$100 or more by a Cayman Islands company and have attempted to collect their money without success, they may resort to sending a statutory demand for payment. This does not require the Court's involvement and is often used as a leverage tool by creditors in an effort to collect their debt quickly. It operates as a form of caution that if a creditor is not paid within 21 days of the date upon which it is served on the company, the company will be deemed to be unable to pay its debts and a winding up petition may be presented against it in accordance with sections 92(d) and 93(a) of the Companies Law (2020 Revision) (as amended).

Benefits of issuing a statutory demand

If a creditor is confident as to the validity of its debt¹, a statutory demand can be a cost effective and useful method to obtain prompt payment, or to invite settlement proposals, given the consequences that follow if the statutory demand is left unsatisfied.

How to serve a statutory demand

The Companies Winding Up Rules 2018 ("CWR") provide guidance as to the form and content of a statutory demand and the service requirements. A failure to follow these rules is likely to render a statutory demand invalid². A statutory demand must be presented on a statutory demand form (CWR Form 1) and

the original hard copy delivered to the company's registered office by hand. A statutory demand must also be signed and dated by the creditor or someone authorised to make the demand on the creditor's behalf (CWR Order 2 (2)).

Under the current law, transmission of a copy by facsimile or email shall not, by itself, be sufficient to constitute good service. Given current lockdown conditions in the Cayman Islands, temporarily preventing the presentation and receipt of hard copy originals, it remains to be seen whether the Cayman Islands' Grand Court will be willing to treat electronic transmission as effective, on the facts of any particular case, with or without the recipient's prior agreement.

Challenging a statutory demand

If action is not taken swiftly to challenge a statutory demand for payment, the consequences of events that are likely to follow could result in the compulsory liquidation of the company. In many cases, a statutory demand precedes further legal action against the company if the debt is not settled, as the statutory demand is often used as the foundation for issuing winding up proceedings.

Upon being served with a statutory demand, a debtor company has a number of options;

- To satisfy, secure or compound the debt;
- To reduce the debt below the minimum statutory requirement (CI\$100);
- To apply for an injunction, or request an undertaking, within 21 days from the date of service of the

¹ If the debt is governed by a foreign law, it may be prudent to take both Cayman Islands and foreign legal advice on the validity of the debt. If the creditor is aware that the debt is disputed prior to service of the statutory demand, it may be penalised in costs in the event that the statutory demand is met with an injunction application: see *Re A Company* [1996] 1 WLR 491. See also *Aramid Entertainment Fund Ltd v KBC Investments V Limited* [2014] 1 CILR 455, Cayman Islands Court of Appeal.

² See, however, *In the Matter of Pinnacle Global Partners Fund I Ltd* (unreported, 4 February 2019), in which the Grand Court confirmed that the Court has the power to cure irregularities in relation to the commencement of winding up proceedings. It remains to be seen whether this approach will extend to technical defects in statutory demands. In *Re A Debtor No 1 of 1987*

[1989] 1 WLR 271, the English Court of Appeal refused to set aside a statutory demand on the basis of technical defects which caused no substantial injustice.

statutory demand to seek to prevent the presentation of a winding up petition.

If the debtor pays the debt in its entirety, secures or compounds the debt to the satisfaction of the creditor or reduces the debt below the statutory minimum requirements the matter is usually resolved.

The primary basis upon which a debtor seeks to challenge the validity of a statutory demand is on the basis that the underlying debt is genuinely disputed on substantial grounds or that the company has a genuine cross claim against the creditor (*Re Bayoil SA* [1998] EWCA Civ 1364). Substantial, in this context, means that the dispute must be real as opposed to frivolous (see *Arena Corporation Ltd v Customs & Excise* [2004] EWCA Civ 371 and *Vendort Traders Inc v Evrostroy Grupp LLC* (British Virgin Islands) [2016] UKPC 15). A debtor on whom a statutory demand has been served should therefore investigate, and take advice upon, the alleged debt as soon as possible and where the validity of the debt is disputed, should provide the creditor with such details in an effort to have the statutory demand withdrawn.

A statutory demand can be withdrawn by the creditor voluntarily, although if it is only withdrawn after an application has been made to the Court, there are likely to be cost consequences for the creditor. If the debtor is seeking to dispute the debt, it is not sufficient for the company to have a “mere honest belief that the payments are not due” (*Re a Company* [1991] BCLC 464). In circumstances where only part of the debt is disputed the Court has discretion to allow a winding up petition to proceed on the basis that the failure by the debtor to pay the undisputed part of the debt is sufficient evidence of the company’s inability to pay its debts (*Re Javelin Promotions Ltd* [2003] EWHC 1932 (Ch).

Restraining the presentation of a petition

There is no statutory procedure under Cayman law for a company to apply to the Grand Court for an order setting aside a statutory demand served on it. However, there have been cases in which a company has applied to the Grand Court for a declaration that a statutory demand is invalid, and should be set aside³.

The primary remedy for a solvent company that wishes to avoid a creditor issuing winding up proceedings on the basis of a statutory demand would be to restrain the presentation of a petition. The presentation (and advertisement) of a winding up petition can cause immediate, and potentially irreparable, damage to a company. It is important that a company acts quickly once faced with a statutory demand and that any application to the Court is made promptly. It is well established that the winding up jurisdiction of the Court should not be invoked by a purported creditor in respect of a debt which is disputed on *bona fide* substantial grounds.

Taking proactive steps to restructure the company’s debt and to pre-empt a creditor’s winding up petition

If the statutory demand is well-founded, and the company is in fact insolvent, it may be open to the company to take the initiative by making its own application to the Court, for the appointment of soft-touch provisional liquidators and for the imposition of a moratorium or stay, with a view to promoting a scheme of arrangement or a consensual restructuring with its creditors, under the supervision of the Cayman Islands Grand Court.

Some examples of Cayman Islands’ Court Decisions

In the Grand Court decision in *Re Duet Real Estate Partners 1 LP* (Unreported, 7 June 2011), an originating summons was issued by Duet Real Estate Partners 1 LP (“**Duet Cayman**”) seeking a declaration that there was a genuine and substantial dispute about the existence of two debts of approximately \$22 million or \$50 million said to be owing to ESO Capital Lux Holdings II Sarl (“**ESO**”). Duet Cayman sought an injunction to restrain ESO from presenting a winding petition based on the statutory demands that had been served. Duet Cayman also sought an injunction restraining ESO from presenting any winding up petition until such time as the dispute about the existence of the debts was resolved by arbitration before the London Court of International Arbitrators. The issue to be decided by the Grand Court was whether there was a genuine and substantial dispute about the existence (as opposed to the amount) of any debt owing by Duet Cayman, such that the presentation of any creditor’s winding up petition by ESO should be restrained as constituting an abuse of process. In refusing to grant the declaration and the injunction sought, Jones J determined that there was no genuine and substantial dispute.

In the subsequent case of *Re Ebullio Commodity Master Fund LP* (Unreported, 24 May 2013) Jones J took a similar approach noting that the existence of an arbitration agreement and/or pending arbitration would only come into play as being relevant if the Cayman Court determined that the debt relied upon was subject to a *bona fide* dispute on substantial grounds.

Against this background, the Grand Court is only likely to grant an injunction preventing the presentation of a winding up petition if it appears that the company is solvent and that;

- The debt is genuinely disputed on substantial grounds; or
- The company has a cross claim or right of set off against the creditor that exceeds the amount claimed in the statutory demand⁴ or has reduced the

³ See *Mnc Media Investment Limited* [2015] CIGC J0804-1, in which Jones J declined to grant a debtor’s application for a declaration that a statutory demand was invalid. Jones J’s judgment was upheld by the Cayman Islands Court of Appeal: [2015] CICA J1113-1

⁴ When a cross-claim or set-off is relied upon, the question of whether the set-off is a serious one applies in the same way as when one is considering whether the existence of a debt is disputed: see *Quarry Products Limited -v- Austin International Incorporated* [2000] CILR 265 (Sanderson J) and *ACL Asean Tower Holdco Ltd* [2019] CIGC J0102-1 (Kawaley J).

undisputed amount of the debt to less than the statutory minimum amount of CI\$100; or

- If the company has a reasonable excuse for not paying the debt.

In other words, the company needs to show that the presentation of the petition would be an abuse of process, before an injunction will be granted.

Potential reforms to Insolvency laws

As part of a stimulus package to support and protect businesses, jurisdictions such as the United Kingdom, Singapore and Australia have announced a number of temporary changes to insolvency laws.

In Australia, for example, one of the reliefs provided by government has been to increase the threshold for a statutory demand from \$2k to \$20k and to increase the timeframe for companies to respond to a statutory demand from 21 days to 6 months. The higher threshold and longer timeframe for compliance will provide some breathing space for companies facing disgruntled creditors with low value claims.

As of yet, no such changes have been introduced in the Cayman Islands. Directors of Cayman Islands companies still need to be mindful of the need to engage on a timely basis with all creditors (big and small) in an effort to avoid hostile winding up petitions, while any rescue or restructuring plan is designed and implemented.

Conclusion

A statutory demand is an inexpensive and useful tool for frustrated creditors when a valid debt is due and owing. However, it is important for debtor companies to be aware that it is not a *fait accompli* that a winding up order will be made, merely by virtue of a statutory demand, and that there are useful strategies and practical steps that can be deployed in response to a statutory demand. The most unhelpful action when served with a statutory demand is inaction.

For more information or strategic advice on serving, or responding to, a statutory demand or a winding up petition, please reach out to your usual Conyers contact, or one of those listed below.

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