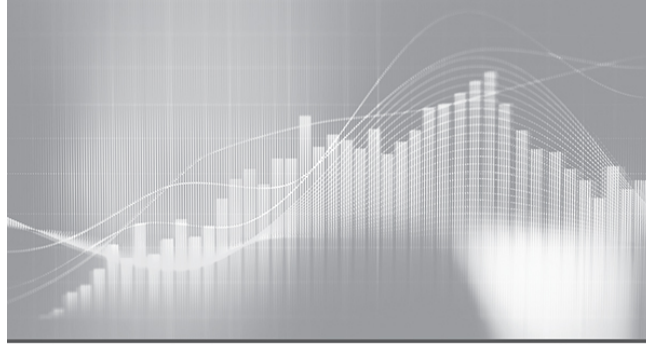




Global Financial Collateral

**A Guide to Security Interests in Securities,
Securities Accounts and Deposit Accounts
in International Transactions**

Penelope L. Christophorou
Celeste Boeri Pozo
Editors



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Cover design by Catherine Zaccarine.

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Printed in the United States of America.

25 24 23 22 21 5 4 3 2 1

ISBN: 978-1-64105-993-0

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Cayman Islands



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Highlights

- Cayman Islands law does not lay out a specific regime for taking security interests in securities, securities accounts, or deposit accounts and does not recognize a concept of “perfection” of security interests per se.
- In financing transactions involving debt securities that are governed by Cayman Islands law or equity securities issued by a Cayman Islands entity (whether an exempted company, a limited liability company, or an exempted limited partnership), the parties will often choose Cayman Islands law to govern the relevant security agreement. That is not mandatory, and in some transactions the parties may choose another law to govern the transaction documents (for example, in the case of collateralized loan obligations (CLO) and other securitization structures the indenture is typically governed by New York law).
- Cayman Islands courts apply common law conflict-of-law rules, which means that, in general, choice-of-law provisions in security agreements will be upheld. That said, if the pledgor or, in the case of equity securities, the issuer, is incorporated, formed, or registered in the

Cayman Islands then there are advantages to ensuring that the documentation for that security interest is governed by Cayman Islands law.

- In interpreting a security arrangement, a Cayman Islands court will first characterize the issues as either contractual, proprietary, or procedural and will then apply the appropriate conflict-of-law rules for each issue. A Cayman Islands court will generally apply the law chosen by the parties in the contract to govern the contractual relationship to determine any contractual issues. No matter which law is chosen by the parties to govern the contractual relationship, the Cayman Islands courts will in most cases apply the “*lex situs*” to any “proprietary” issues. The *lex situs* is the law of the place where the collateral is (or is deemed to be) located. Any issues of procedure relating to a security interest (no matter the governing law) will usually be governed by Cayman Islands law, if enforcement is being sought in the Cayman Islands (the so-called *lex fori* or law of the forum). It is worth noting, however, that the determination and interpretation of contractual and proprietary issues will ultimately be a question of the applicable conflict-of-law provisions, which are highly complex and will depend on the facts and circumstances of a particular transaction.
- It is also worth noting that securities issued by a Cayman Islands entity, or governed by Cayman Islands law, generally take a registered form, and therefore, given that these securities are intangible assets, the security certificate itself (if any) would not constitute the asset, but merely evidence the existence of the same. It is no longer possible for Cayman Islands companies to issue bearer shares. Other negotiable instruments, such as debt securities, would not generally be governed by Cayman Islands law, but may be registered securities, bearer securities, or other negotiable instruments.

P. Preliminary: Securities as Collateral

P.1 What constitutes a “security” under the law of the Cayman Islands for purposes of creating and perfecting a security interest?

There is no concept of perfection as a matter of Cayman Islands law, and the Cayman Islands has no general system of registration of security

interests in order to perfect or obtain priority in respect of a security interest (although registration systems are in place for certain asset classes including ships and aircraft registered in the Cayman Islands, and “personal chattels” transferred under a bill of sale and land located in the Cayman Islands).

As Cayman Islands law does not recognize any consolidated law of creation or perfection of security interests, consequently there is no uniform definition of “securities” that would apply for the purposes of creating and perfecting a security interest. Although not directly relevant to the creation of a security interest, the Securities Investment Business Act (2020 Revision) of the Cayman Islands does contain a definition of “securities,” which may provide some guidance as to what a Cayman Islands court may consider to be “securities” for the purpose of the creation of a security interest.¹ These include shares (including shares and stock of any kind in the share capital of a company and interests in a limited partnership or an exempted limited partnership), instruments creating or acknowledging indebtedness, warrants and other instruments giving entitlements to securities, certificates representing certain securities, options, futures, and contracts for differences.

The key question from a Cayman Islands law perspective in determining whether a particular asset or class of assets is able to form collateral is whether the rights conferred on the pledgor in respect of the relevant asset are transferable and commercially valuable. Many types of securities are commonly provided as collateral, including shares and debt securities, commercial paper, notes, and certificates of deposit (both bearer and registered forms).

Save where it relates to land in the Cayman Islands, or aircraft or vessels registered in the Cayman Islands, a security interest does not need to be registered in any register kept by, or filed with, any governmental authority or regulatory body in the Cayman Islands to ensure the enforceability of the security interest in the Cayman Islands. However, to the extent that the security interest constitutes a charge over assets of the pledgor, the pledgor and its directors are under an obligation to enter such charge in the Register of Mortgages and Charges of the pledgor (which is

an internal, private register) in accordance with the Companies Act of the Cayman Islands (the Companies Act),² but failure to make the appropriate entries does not, of itself, affect the creation of the security interest or its perfection or priority. In addition, where security has been granted over limited partnership interests of a Cayman Islands exempted limited partnership (ELP) or a membership interest in a Cayman Islands Limited Liability Company (LLC), details of these security interests will need to be recorded in the ELP's or, as the case may be, LLC's register of security interests in order to secure priority.

While there is no exhaustive definition of what constitutes a charge under Cayman law, a charge normally has the following characteristics:

- it is a proprietary interest granted by way of security, which entitles the secured party to resort to the charged property only for the purposes of satisfying some liability due to the secured party (whether from the pledgor or a third party); and
- the pledgor retains an equity of redemption to have the property restored to him when the liability has been discharged.

It is possible to create a security interest over certain rights in a partnership or limited partnership interest, as well as over the shares in a Cayman Islands exempted company and the membership interests in a Cayman Islands LLC (which is a body corporate and has the capacity in its own name to enter into secured transactions). Loan participations may be provided as collateral under Cayman Islands law and would be treated as a form of asset over which a security interest is taken.

P.2 Are debt securities treated differently from equity securities under the law of the Cayman Islands for purposes of creating and perfecting a security interest in such securities?

Equity Securities

As a general matter, it is not possible to take a “pledge” of shares of a Cayman Islands company, as they are in registered form and are not therefore negotiable instruments. This means that the right to the shares in the Cayman Islands company cannot be transferred by delivery of the

instrument and cannot be “pledged” as title does not pass on delivery. A security interest over the shares of a Cayman Islands company will instead be taken either by an equitable charge of the shares (where the pledgor retains legal title to the shares until default) or by a legal mortgage of the shares (where legal title to the shares is transferred to the secured party when the security is created).

Although, from a secured creditor’s point of view, an equitable charge is less satisfactory than a legal mortgage in that it will rank behind any subsequent legal mortgage granted by a third party without notice of the equitable mortgage and will generally rank behind any prior equities, in practice it is very unusual for a legal mortgage to be taken over the shares in a Cayman Islands company initially, as this can lead to potentially adverse tax and regulatory consequences and accounting complications for the secured party. Instead the instrument creating the security interest over the shares in the Cayman Islands company will typically contain certain mechanisms intended to mitigate the risk for the secured party and facilitate the process of converting the equitable charge into a legal mortgage on enforcement.

There are some additional considerations that need to be taken in connection with certain types of equity securities. For example, where security is taken over any partnership interest relating to a Cayman Islands ELP, written notice of the grant of any such security interest in the partnership interest will need to be served at the registered office of the ELP, and details of the security interest will need to be entered into the partnership’s register of security interests, and where security is taken over any LLC interest relating to a Cayman Islands LLC, written notice of the grant of any such security interest in the LLC interest will need to be served at the registered office of the LLC, and details of the security interest will need to be entered into the LLC’s register of security interests. Priority in relation to any such security interest over a partnership interest in the ELP or, as the case may be, an LLC interest in an LLC will be determined according to the time that the written notice is validly served at the ELP’s or (as the case may be) LLC’s registered office.

Debt Securities

Debt securities can be subject to the same range of security interests as equity securities, save that certain of the issues noted above in relation to equity securities (for example, the requirement for notice of the grant of a security interest to be served at the registered office of any Cayman Islands ELP or LLC), would not be relevant.

Typically, debt securities issued by a Cayman Islands company would not be governed by Cayman Islands law, and so the steps required for the creation and perfection of a security interest in those debt securities would need to be determined by reference to the governing law of those instruments, and the exact steps required to create and perfect any such security interest will depend on the nature of the underlying securities.

P.3 Under what circumstances is intercompany debt a “security” under the law of the Cayman Islands?

As explained in section P.1 above, there is no uniform definition of “security” under Cayman Islands law that would apply for the purposes of creating and perfecting a security interest. There is, however, no reason why as a matter of Cayman Islands law the interest in an intercompany debt could not be provided as collateral under Cayman Islands law and would be treated as a form of asset over which a security interest is taken.

1. Collateral Consisting of Directly Held Certificated Securities

1.1 Choice of law: What law would a court in the Cayman Islands apply to (i) the creation and perfection of a security interest, (ii) the effect of perfection, and (iii) the exercise of remedies against collateral securing such interest, in the following circumstances?

a. The issuer is organized under the law of the Cayman Islands and the certificates are located in the Cayman Islands

It is important to note that securities (including, in particular, shares issued in respect of a Cayman Islands company) issued in respect of a Cayman Islands entity, or governed by Cayman Islands law, generally take a registered rather than a certificated or bearer form, and therefore (given

that these securities are intangible assets) the security certificate itself would not constitute the asset, but merely evidences the existence of the same. On this basis, from a Cayman Islands law standpoint, the existence of a certificate to represent shares of a Cayman Islands company would be irrelevant to the analysis, as a certificate is merely evidentiary in relation to possession of shares in a Cayman Islands company. It is the entry of a member or holder in the register, which constitutes de facto evidence of title to those shares.

Conflict-of-law issues are complex and highly dependent on the facts of each particular case, and there is not, as a matter of common law, a unified or fully settled position in respect of the interpretation of conflict-of-law issues. The information set out below is therefore a summary of the key issues, but each particular security interest will need to be considered separately in light of the facts arising in that particular case.

Most security agreements that are analyzed by the Cayman court or Cayman legal practitioners will include (i) a choice-of-law provision (i.e., the parties agree to the laws of a particular country as governing the agreement itself) and (ii) a choice-of-forum provision (i.e., the parties agree to the courts of a particular country in which any disputes between them will be determined). Typically, both provisions nominate the same country, but that is not always the case.

Cayman Islands law will apply different choice-of-law rules to different issues. A Cayman Islands court will first characterize the issues and then apply the relevant choice-of-law rules for each issue. The issues will be categorized as contractual, proprietary, or procedural. In this case, the key components to determine the applicable law in the transaction would be (i) the contractual element (i.e., the agreement between the parties relating to their respective contractual rights and obligations in respect of the security interest being created in the underlying securities) and (ii) the proprietary element dealing with the rights and interests in the property of the underlying securities.

Creation

In order for the security interest to attach to the securities, the conditions for creation and attachment specified in the underlying security agreement will first need to be satisfied. This is a contractual question. Cayman Islands law provides that the parties are free to choose the applicable law to govern a contractual arrangement.

The parties' choice of law would generally be recognized and given effect to in any action brought before a Cayman Islands court, unless it is a law:

- which such court considers to be procedural in nature;
- which is a revenue or penal law; or
- the application of which would be inconsistent with public policy, as such term is interpreted under the laws of the Cayman Islands.

Subject to the above, the Cayman Islands court would therefore apply the governing law of the security agreement under which the security interest arises (granting leave to adduce expert evidence on interpreting the applicable law of the security agreement, as required) to determine whether the security interest has been validly created as a matter of the governing law of the security agreement. Provided that all steps required as a matter of the applicable governing law of the security agreement have been taken to create a valid and binding agreement, then the courts of the Cayman Islands would recognize the security interest created by the security agreement.

Assuming that the conditions for the creation of a valid security interest over the securities have been satisfied as a contractual matter under the relevant security instrument, then (following the attachment of the security interest to the underlying securities) the effect of the security interest will become a proprietary question.

Perfection and Priority

As discussed above, there is, in general terms, no concept of perfection under Cayman Islands law. Issues concerning the priority of a security interest will typically be characterized as proprietary and so will generally be determined in accordance with the *lex situs* of the collateral in question. This is generally held to be the jurisdiction of incorporation of the issuer of the securities, although in certain circumstances it may, in the case of

registered securities, be the place where the register is kept,³ or if the securities are bearer securities or represented by negotiable instruments, the place where those securities or instruments are situated at the time of transfer.⁴

It will be a question of the law of the issuer's jurisdiction of incorporation to determine the manner in which any underlying securities should be transferred and whether they should be characterized as registered or bearer securities or negotiable instruments.

In the scenario outlined above, a Cayman Islands court would probably apply Cayman Islands law to determine the priority of a security interest where a Cayman Islands issuer has issued bearer securities or other negotiable instruments⁵ that are held in the Cayman Islands, although contractual issues arising in relation to the underlying security instrument would be a question to be determined by reference to the applicable governing law of the contract.

Assuming that no further steps are required as a matter of all relevant laws (other than the laws of the Cayman Islands) or, if other steps are required (other than by the laws of the Cayman Islands), they are or have been taken, then the courts of the Cayman Islands would generally recognize the security interests created in connection with the securities.

As previously noted, all Cayman Islands limited companies are required to keep a register of mortgages and charges pursuant to section 54 of the Companies Act. An exempted company is required to enter in such register in respect of each mortgage or charge a short description of the property mortgaged or charged, the amount of such charge created and the names of the mortgagees or persons entitled to such charge.

This is an internal register, and failure to update the register of mortgages and charges in this manner will not affect the enforceability of the security interest in question, although the order of entries in the register of mortgages and charges can be evidentiary of the order of priority of security interests.

Remedies

Generally, a Cayman Islands court will only enforce security interests in collateral that is located in the Cayman Islands. Therefore, the claimant must either (a) be able to enforce its secured claim over assets located in the Cayman Islands or (b) be able to enforce a foreign law judgment for the secured debt by recognition in the state where the assets are located.

If the collateral is located in the Cayman Islands, the available remedies for the secured party should, in principle, be a matter determined under the governing law of the security agreement. Nevertheless, enforcement remedies are often treated as procedural and therefore decided by the law of the court where the action is brought. In practice, a Cayman Islands court would not normally grant remedies that are not available locally.

b. The issuer is organized under the law of the Cayman Islands and the certificates are located in an Other Jurisdiction The same principles as outlined in section 1.1(a) above will apply.

The contractual issues, including those relating to creation of the security interest, will be determined in accordance with the applicable governing law of the security agreement.

Proprietary aspects, such as the priority of the security interest and exercise of remedies, will be determined in accordance with the “*lex situs*” of the property in question. As before, it will generally be a question of the law of the issuer’s jurisdiction of incorporation (i.e., in this example Cayman Islands law) to determine the manner in which any underlying securities should be transferred and whether they should be characterized as registered securities or bearer securities or some other form of negotiable instrument. Assuming, however, that they are determined to be bearer securities or other negotiable instruments, applying the same analysis as set out in section 1.1(a) above, it is likely that the place where those securities or negotiable instruments are situated at the time the security interest is taken over the collateral will be a determining factor in establishing the *lex situs* to be applied, although in certain cases the jurisdiction of incorporation of the issuer may also be relevant.⁶

c. The issuer is organized under the law of an Other Jurisdiction and the certificates are located in the Cayman Islands The same principles as outlined in section 1.1(a) above will apply.

The contractual issues, including those relating to creation of the security interest, will be determined in accordance with the applicable governing law of the security agreement.

Proprietary aspects, such as the priority of the security interest and exercise of remedies, will be determined in accordance with the “*lex situs*” of the property in question. It will be a question of the law of the issuer’s jurisdiction of incorporation (which in this case would be that of an Other Jurisdiction) to determine the manner in which any underlying securities should be transferred and whether they should be characterized as registered securities, bearer securities, or some other form of negotiable instrument.

As explained in section 1.1(a) above, if the certificated securities are determined to be bearer securities or other negotiable instruments, it is likely that the place where those certificated securities are situated at the time the security interest is taken over such collateral will be a determining factor in establishing the *lex situs* to be applied. Ultimately, however, the question of the applicable *lex situs* will need to be determined with regard to the applicable conflict-of-law provisions of the issuer’s jurisdiction of incorporation.

1.2 Choice of law: Other instances where Cayman Islands’ law may apply

There are none.

1.3 Perfection and required steps to enforce a security interest against third parties under the law of the Cayman Islands

There is, in general terms, no concept of perfection under Cayman Islands law. As noted in section 1.1 above, in the event that Cayman Islands law was established as the relevant *lex situs*, the courts of the Cayman Islands should recognize the security interests created in connection with the securities, and (save as set out in section 1.4 below) no further action

would be required to be taken under the laws of the Cayman Islands in order to render such security interest enforceable against third parties.

All Cayman Islands limited companies are required to keep a register of mortgages and charges pursuant to section 54 of the Companies Act, which is a private register and does not determine perfection or priority of a security interest, although the order of entries in the register can be evidentiary in determining the order of priority of competing security interests. A security interest does not need to be registered in any register kept by or filed with any governmental authority or regulatory body in the Cayman Islands to ensure the enforceability of the security interest, unless it relates to land or certain other asset classes including ships and aircraft registered in the Cayman Islands, and “personal chattels” transferred under a bill of sale.

1.4 Effect of an enforceable security interest against third parties and priority under the law of the Cayman Islands

Assuming that the security interests in respect of the securities have the priorities specified in the underlying security agreement as a matter of all relevant laws (other than the laws of the Cayman Islands), then the courts of the Cayman Islands would generally recognize such priorities subject to the following limitations:

- The security interest will rank after any prior legal or equitable interest in the securities and any later legal interest in the securities created in favor of a bona fide purchaser or mortgagee for value without notice of the security interests created pursuant to relevant security agreement.⁷
- In the case of a winding up of the issuer in a jurisdiction other than the Cayman Islands, priorities may be subject to any provision of the laws of that jurisdiction as to the priority of claims in a winding up.
- Certain claims that are statutorily preferred by Cayman Islands law will rank ahead of floating charges (but behind fixed charges).
- It will ultimately be a matter for the Cayman Islands courts to determine whether a particular charge is a fixed or floating charge irrespective of the designation by the parties.

It is prudent for notice to be given to the issuer, debtor, or obligor in relation to any securities constituting debts or other intangible collateral to avoid any risk of a third-party bona fide purchaser for value without notice of the underlying collateral from obtaining an equitable interest in the securities, which may rank prior to the security interests created over those securities under the relevant security document.⁸

In addition, where the pledgor is a Cayman Islands company, then the register of mortgages and charges of that company should be updated to reflect the security interest granted in respect of the underlying securities in accordance with the Companies Act.

2. Collateral Consisting of Directly Held Uncertificated Securities

2.1 Choice of law: What law would a court in the Cayman Islands apply to (i) the creation and perfection of a security interest, (ii) the effect of perfection, and (iii) the exercise of remedies against collateral securing such interest, where the issuer is organized under the law of the Cayman Islands?

Creation

As noted in section 1.1 above, the applicable choice of law will need to be determined in relation to the contractual element of the security interest and to the proprietary and procedural elements.

In order for the security interest to attach to the securities, the conditions for creation and attachment specified in the underlying security agreement will first need to be satisfied. This is a contractual question, and as a matter of Cayman Islands law the parties are free to choose the law that governs the underlying contract. The parties' choice of law would generally be recognized and given effect to in any action brought before a Cayman Islands court, unless it is a law

- which such court considers to be procedural in nature;
- which is a revenue or penal law; or

- the application of which would be inconsistent with public policy, as such term is interpreted under the laws of the Cayman Islands.

The most common form of securities that arise in relation to a Cayman Islands issuer would be shares in a Cayman Islands company, membership interests in a Cayman Islands LLC, or partnership interests in a Cayman Islands ELP. As a matter of Cayman Islands law, shares in a Cayman Islands company are registered rather than certificated securities, meaning that it is the entry of a member as the holder of shares in the company in the register of members of the company, rather than the issue or possession of a share certificate, which constitutes de facto evidence of title to those shares. Although Cayman Islands companies may (but are not required to) issue certificates in respect of any shares issued by the Company, these certificates are evidentiary only and do not themselves constitute title to the shares and would not therefore be “securities” for the purpose of this analysis.

For interests in securities other than shares or membership interests in Cayman Islands companies, LLCs or ELPs, the security agreement would not typically be governed by Cayman Islands law (and this is not strictly required as a matter of Cayman Islands law). Where, however, the uncertificated securities relate to an interest in a Cayman Islands company, LLC or ELP (e.g., a charge over the shares in a Cayman Islands company), and the register reflecting those securities (e.g., the register of members) is maintained in the Cayman Islands, then it would be usual for the security document creating the security interest over those securities to also be governed by Cayman Islands law in order to avoid or minimize some of the conflict-of-law issues that may otherwise arise.

Perfection and Priority

As discussed above, there is, in general terms, no concept of perfection under Cayman Islands law and nor is it possible to take a “pledge” of shares of a Cayman Islands company in registered form. Issues concerning the priority of a security interest will be characterized as proprietary and so will generally be determined in accordance with the *lex situs* of the collateral in question.

Assuming Cayman Islands law would be the applicable *lex situs* (on the basis that the issuer is incorporated in the Cayman Islands and the registers reflecting any uncertificated securities are in fact maintained in the Cayman Islands), then issues relating to priority in respect of the security interest would be a question of Cayman Islands law.

Where the uncertificated securities are shares in a Cayman Islands company, any security interest over those shares will either take the form of a legal mortgage or an equitable charge. The difference between these is that in a legal mortgage, title is transferred to the secured party when the mortgage is created, and the secured party will be entered directly as the shareholder in the register of members of the company, whereas in an equitable charge the pledgor will retain title to the shares until such time as there is an event of default leading to an acceleration and enforcement of the security.

Where the underlying securities are shares in a Cayman Islands company, then (other than to effect a legal mortgage over the shares in a Cayman Islands company by registration of such shares in the name of the secured party as a matter of Cayman Islands law) no further action is required to be taken to ensure the priority ranking of the security interest created by any Cayman Islands law-governed share charge.

Remedies

Generally, a Cayman Islands court will only enforce security interests in collateral that is located in the Cayman Islands. So the plaintiff must either (a) be able to enforce its secured claim over assets located in the Cayman Islands or (b) be able to enforce a foreign law judgment for the secured debt by recognition in the state where the assets are located.

If the collateral is located in the Cayman Islands, the available remedies for the secured party should, in principle, be a matter determined under the governing law of the security agreement. Nevertheless, enforcement remedies are often treated as procedural and therefore decided by the law of the court where the action is brought. In practice, a Cayman Islands court would not normally grant remedies that are not available locally.

2.2 Choice of law: Other instances where Cayman Islands law may apply

As described in section 2.1 above, the application of Cayman Islands law will depend on the interpretation of the applicable conflict-of-law considerations of each relevant jurisdiction, which would not themselves necessarily be a Cayman Islands law question.

2.3 Perfection and required steps to enforce a security interest against third parties under the law of the Cayman Islands

As noted above, there is, in general terms, no concept of perfection under Cayman Islands law.

Assuming that no further steps are required as a matter of all relevant laws (other than the laws of the Cayman Islands) or, if other steps are required (other than by the laws of the Cayman Islands), they are taken, then the courts of the Cayman Islands would likely recognize the security interests created in connection with the securities, and no further action would be required to be taken under the laws of the Cayman Islands in order to render such security interest enforceable against third parties save in the case of a security interest granted over partnership interests in an ELP or a membership interest in an LLC. In that case, there must be service of a written notice of the grant of any such security interest in the ELP or LLC interest at the registered office of the ELP or, as the case may be, the LLC, and the entry of details of the security interest in the ELP's or LLC's register of security interests. Priority in relation to such security interest will be determined according to the time that the written notice is validly served at the ELP's or LLC's registered office.

Where the underlying securities are shares in a Cayman Islands company, generally it is advisable that any security interest in the shares of an exempted company be recorded on the register of members of the company. While this recording does not necessarily establish priority pursuant to any statutory provision, the recording of the security interest in the register of members helps to prevent any third party from obtaining higher priority over the secured party's security interest pursuant to the common law and equitable principles that, while as between competing equitable interests the first in time prevails, if the holder of the second-in-time security interest, having advanced his money without notice of the

first-in-time security interest, gets legal title, such second-in-time secured party obtains priority over the first-in-time secured party.⁹

In addition, it is common for the underlying issuer company in question to be put on notice that the secured party has taken a security interest in the shares in the company. Notice to the underlying issuer company ordinarily constitutes a deliverable under the share charge and may give the secured party's security interest priority over other liens on the underlying issuer company's shares in respect of any subsequent distributions made by the issuer company to the pledgor.

It should be noted, however, that such security interests may suffer from certain technical weaknesses or defects including the following:

- The registered holder of the charged shares in a Cayman Islands company will continue to be vested with legal title to such charged shares and will remain entitled to receive any dividends as may be payable, exercise voting rights, and enjoy rights and benefits of legal ownership.
- An equitable security interest in any such charged shares may be defeated by a third party acquiring legal title to such charged shares in good faith, for value and without notice of the preexisting interest.
- An earlier equitable interest will take priority over a subsequent equitable interest.

2.4 Effect of an enforceable security interest against third parties and priority under the law of the Cayman Islands

Assuming that the security interests in respect of the securities have the priorities specified in the underlying security agreement as a matter of all relevant laws (other than the laws of the Cayman Islands), then the courts of the Cayman Islands would recognize such priorities subject to the following limitations:

- The security interest will rank after any prior legal or perfected equitable interest in the securities and any later legal interest in the securities created in favor of a bona fide purchaser or mortgagee for

value without notice of the security interests created pursuant to relevant security agreement.¹⁰

- In the case of a winding up of the issuer in a jurisdiction other than the Cayman Islands, priorities may be subject to any provision of the laws of that jurisdiction as to the priority of claims in a winding up.
- Certain claims that are statutorily preferred by Cayman Islands law will rank ahead of floating charges (but behind fixed charges).
- It will ultimately be a matter for the Cayman Islands courts to determine whether a particular charge is a fixed or floating charge irrespective of the designation by the parties.

As previously noted, all Cayman Islands limited companies are required to keep a register of mortgages and charges pursuant to section 54 of the Companies Act. An exempted company is required to enter in such register in respect of each mortgage or charge a short description of the property mortgaged or charged, the amount of such charge created and the names of the mortgagees or persons entitled to such charge. Generally it is also advisable that any security interest taken over the shares of a Cayman Islands exempted company be recorded on the register of members of that company.

As noted in section P. 2 above, from a security point of view, an equitable charge is less satisfactory than a legal mortgage in that it will rank behind any subsequent legal mortgage granted by a third party without notice of the equitable mortgage and will generally rank behind any prior equities. The main disadvantage of a legal mortgage, however, is that it may operate to group the secured party and the issuer together, with potential adverse tax and regulatory consequences and accounting complications arising as a result. Typically, therefore, any security taken over the shares in a Cayman Islands company will take the form of an equitable charge rather than a legal mortgage.

With respect to the security over the charged shares, the priority among competing equitable interests would be determined according to the time of the creation of the equitable interests. Accordingly, to the extent only an equitable interest is created, the security over the charged shares would rank behind any preexisting equitable interests in the charged shares. Such

security may also rank behind any security interest granted over the charged shares in the nature of legal mortgage. Further, a bona fide purchaser for value of the charged shares without notice of the security could obtain good title to the charged shares.¹¹

3. Collateral Consisting of Assets Credited to a Securities Account

3.1 Securities account as collateral: Under the law of the Cayman Islands, (i) would a securities account to which securities are credited constitute a category of collateral separate from the underlying securities themselves and (ii) can assets other than securities be credited to a securities account (e.g., cash)?

As noted in section 1.1 above, there is no uniform definition under Cayman Islands law of “securities,” and therefore no definitive concept of what would constitute a “securities account,” or whether it would constitute a “security” for these purposes. It is highly unlikely that any securities account to which any securities are credited would be either located in, or otherwise governed by, the laws of the Cayman Islands, and this is not something that would generally be relevant for the purposes of Cayman Islands law.

The common law position around intermediated securities is far from clear, and will be dependent on applicable conflict-of-law rules. Given that neither the intermediaries nor the relevant accounts or securities would be located in or otherwise subject to the laws of the Cayman Islands, this is not something that is likely to be directly a question of Cayman Islands law.

In general, it would be possible as a matter of Cayman Islands law for a secured party to take a security interest in an account into which securities are credited. An account holder’s rights against the account provider can be the subject of a security interest separate from the securities themselves, but usually in practice one security document would deal with both. There is a question as to who the relevant account holder will be for these purposes, which will depend on the nature of the underlying

securities and also the intention of the parties. Where the account is a custodial account or the securities are held through an intermediary and the securities are intangible securities registered in the name of the custodian or intermediary, then it is expected that the securities would be treated as being held on trust by the intermediary for the benefit of the account holder, with the effect that legal title would vest with the registered holder (i.e., the custodian/ intermediary) while the account holder will have a beneficial equitable interest in the collateral.

The types of assets that can be credited to a securities account will depend on the terms of the securities account prescribed by the particular provider. Although it would not in the author's experience be common to do so, in principle assets other than securities could possibly be credited to a "securities account" as a matter of Cayman Islands law.

3.2 Choice of law: What law would a court in the Cayman Islands apply to (i) the creation and perfection of a security interest, (ii) the effect of perfection, and (iii) the exercise of remedies against collateral securing such interest, in the following circumstances?

a. The securities account is located in, or is maintained by a broker/intermediary located in, the Cayman Islands (or where Cayman Islands law governs the account, if relevant)

As noted in sections 1.1 and 2.1 above, the conflict-of-law issues surrounding intangible securities are complex and will be highly dependent on the facts. For example, it will depend on whether the securities are held directly through some intermediary or depository arrangement or through a clearing system. As previously noted, the common law position in this area is far from settled.

As outlined above, there will be both contractual and proprietary issues to consider, although what constitutes a contractual issue and what constitutes a proprietary issue, and their interpretation, will depend on the applicable conflict-of-laws position, which itself will be dependent on the specific facts of each case. Regard would need to be had to the contractual arrangements between the parties governing the operation of the securities account and any agreements made in that document as to choice of law in

relation to the location and operation of the securities account. The choice of law made by the parties to the securities account agreement would, in general, be respected by the Cayman Islands courts in respect of contractual matters.

The question of establishing the *lex situs* of a proprietary right in a securities account for the purposes of determining issues of enforceability against third parties, priority, and exercise of remedies is less clear. Although not entirely free from doubt, it is generally accepted that it is the account between the account holder and the intermediary that forms the basis of any proprietary rights arising in respect of the account, and therefore the “location” of the account for determining the appropriate *lex situs* would be the jurisdiction in which the relevant intermediary is located. It is worth noting, however, that in certain circumstances (depending, in particular, on the relevant governing law of the underlying securities credited to the securities account), a court may need to “look through” to the underlying securities to determine the appropriate *lex situs* to apply. This is not necessarily a Cayman Islands law question and will depend on the facts of the particular case.

b. The securities account is located in, or is maintained by a broker/intermediary located in, the Cayman Islands, and an Other Jurisdiction’s law governs the account agreement

As provided in section 3.2(a) above, the account agreement itself is a contractual arrangement, so the courts of the Cayman Islands would look to the terms of the contract itself to determine the appropriate governing law to apply, and choice of law made by the parties to the securities account agreement would be respected by the Cayman Islands courts. Where the account agreement stipulates a law other than that of the Cayman Islands as the governing law, then issues of creation of the security interest itself, perfection of the security interest, and priority would need to be determined by reference to the selected governing law of that account agreement and considered in the context of the applicable conflict-of-law rules.

3.3 Choice of law: Other instances where the law of the Cayman Islands may apply

a. For example, if the securities account is not maintained by a broker/intermediary located in Cayman Islands, but the issuer of securities credited to the securities account is organized under the law of the Cayman Islands, would Cayman Islands law apply?

As provided in section 3.2 above, a Cayman Islands court would likely look to the jurisdiction of the intermediary/broker to determine the relevant *lex situs* to apply, and the jurisdiction of incorporation of the issuer of the securities would be immaterial.

b. Similarly, if the securities account is not maintained by a broker/intermediary located in the Cayman Islands, but if there exists an intermediary in the holding system between the issuer and the pledgor's own direct intermediary who is located in the Cayman Islands, would Cayman Islands law apply, and if so, to what extent?

On the same basis, it should not matter if there is an intermediary between the issuer and the pledgor's broker that is located in the Cayman Islands, as it is the location of the intermediary, which ultimately holds the securities for the pledgor that should be relevant in determining the appropriate *lex situs* to apply. (This is subject, as noted above, to the fact that in certain circumstances depending, in particular, on the relevant governing law of the underlying securities credited to the securities account, a court may need to "look through" to the underlying securities to determine the appropriate *lex situs* to apply.)

3.4 Perfection and required steps to enforce a security interest against third parties under the law of Cayman Islands

There is, in general terms, no concept of perfection under Cayman Islands law. As noted in section 1.1 above, in the event that Cayman Islands law was established as the relevant *lex situs*, the courts of the Cayman Islands should recognize the security interests created in connection with the securities account, and (save as set out in section 3.5 below) no further action would be required to be taken under the laws of the Cayman Islands in order to render such security interest enforceable against third parties.

3.5 Effect of an enforceable security interest against third parties and priority under the law of the Cayman Islands

Assuming that the security interests in respect of the securities have the priorities specified in the underlying security agreement as a matter of all relevant laws (other than the laws of the Cayman Islands), then the courts of the Cayman Islands would recognize such priorities subject to the following limitations:

- The security interest will rank after any prior legal or perfected equitable interest in the securities and any later legal interest in the securities created in favor of a bona fide purchaser or mortgagee for value without notice of the security interests created pursuant to relevant security agreement.¹²
- In the case of a winding up of the issuer in a jurisdiction other than the Cayman Islands, priorities may be subject to any provision of the laws of that jurisdiction as to the priority of claims in a winding up.
- Certain claims that are statutorily preferred by Cayman Islands law will rank ahead of floating charges (but behind fixed charges).
- It will ultimately be a matter for the Cayman Islands courts to determine whether a particular charge is a fixed or floating charge irrespective of the designation by the parties.

As previously noted, it is prudent for notice to be given to the issuer, debtor, or obligor in relation to any securities constituting debts or other intangible collateral to avoid any risk of a third-party bona fide purchaser for value without notice of the underlying collateral from obtaining an equitable interest in the securities, which may rank prior to the security interests created over those securities under the relevant security document.¹³

4. Collateral Consisting of a Deposit Account

4.1 Deposit account as collateral: Under the law of the Cayman Islands, does a deposit account constitute a separate category of collateral and, if so, what kinds of assets can be credited to a deposit account?

Cayman Islands law does not distinguish separate categories of collateral, although real estate located in the Cayman Islands and aircraft and vessels registered under Cayman Islands law are subject to some specific rules,

and as a matter of Cayman Islands law there is no reason why assets other than cash could be held in a deposit account, although ultimately it will depend on what is permissible under the governing law of that deposit account and of the governing law of the collateral itself. To create a security interest in a deposit account, such deposit account is usually subject to a mortgage or a charge, coupled with an assignment of rights in respect of the deposit account.

4.2 Choice of law: What law would a court in the Cayman Islands apply to (i) the creation and perfection of a security interest, (ii) the effect of perfection, and (iii) the exercise of remedies against collateral securing such interest, in the following circumstances?

a. The deposit account is located in, or is maintained by a bank located in, the Cayman Islands (or where Cayman Islands law governs the account, if relevant)

As explained in section 2.2 above, a Cayman Islands court will need to consider contractual, proprietary, and procedural issues in determining the appropriate conflict-of-law rules to apply.

The account agreement itself is a contractual arrangement, so the courts of the Cayman Islands would look to the terms of the contract itself to determine the appropriate governing law to apply to any contractual issues arising under the contract, and choice of law made by the parties to the deposit account agreement would be respected by the Cayman Islands courts. Where the account agreement stipulates a law other than that of the Cayman Islands as the governing law, then issues of creation of the security interest itself, perfection of the security interest, and priority would need to be determined by reference to the selected governing law of that account agreement and considered in the context of the applicable conflict-of-law rules.

Proprietary issues relating to the pledge of a deposit account will be determined in accordance with the applicable *lex situs*, which will be a matter for the application of the appropriate conflict-of-law rules. Depending on the nature of the underlying asset forming the deposit held in the deposit account, and the jurisdiction in which the deposit collateral

arises, this may be the law governing the deposit itself or the *lex situs* of the debt as constituted by the deposit. As a general rule, under common law principles, a debt will be deemed situated in the country where the account debtor resides (or in the case of a company, is incorporated), on the basis this is where the payment can be enforced. In the case of bank accounts, however, it is generally accepted that under the applicable law of the contract between the bank and the customer the bank's obligation to repay is performable primarily at the branch where the account is kept, and accordingly the *lex situs* of the account would be deemed to be in the jurisdiction in which the branch at which that account is registered and maintained.

b. The deposit account is located in, or is maintained by a bank located in, the Cayman Islands, and an Other Jurisdiction's law governs the account agreement:

As provided in section 4.2 (a) above, the account agreement is a contractual arrangement, so the courts of the Cayman Islands would look to the terms of the account agreement itself to determine the appropriate governing law to apply to any issues arising under the contract. The choice of a law made by the parties to the deposit account agreement would be respected by the Cayman Islands courts. Where the account agreement stipulates a law other than that of the Cayman Islands as the governing law, then issues of creation of the security interest itself, perfection of the security interest, and priority would need to be determined by reference to the selected governing law of that account agreement and considered in the context of the applicable conflict-of-law rules.

As noted in section 4.2(a) above, it is generally accepted that the *lex situs* of a bank account would be deemed to be in the jurisdiction in which the branch at which that account is registered is situated, which in this case would be the Cayman Islands, but the position would still need to be considered with reference to the applicable conflict-of-law rules arising as a result of the governing law of the account agreement.

4.3 Choice of law: Other instances where the law of the Cayman Islands may apply

There are none.

4.4 Perfection and required steps to enforce a security interest against third parties under the law of the Cayman Islands

There is, in general terms, no concept of perfection under Cayman Islands law. As noted in section 1.1 above, in the event that Cayman Islands law was established as the relevant *lex situs*, the courts of the Cayman Islands should recognize the security interests created in connection with a deposit account, and (subject to section 4.5 below) no further action would be required to be taken under the laws of the Cayman Islands in order to render such security interest enforceable against third parties.

4.5 Effect of an enforceable security interest against third parties and priority under the law of the Cayman Islands

Assuming that the security interests in respect of the deposit account have the priorities specified in the underlying security agreement as a matter of all relevant laws (other than the laws of the Cayman Islands), then the courts of the Cayman Islands would recognize such priorities subject to the following limitations:

- The security interest will rank after any prior legal or perfected equitable interest in the securities and any later legal interest in the securities created in favor of a bona fide purchaser or mortgagee for value without notice of the security interests created pursuant to relevant security agreement.¹⁴
- In the case of a winding up of the issuer in a jurisdiction other than the Cayman Islands, priorities may be subject to any provision of the laws of that jurisdiction as to the priority of claims in a winding up.
- Certain claims that are statutorily preferred by Cayman Islands law will rank ahead of floating charges (but behind fixed charges).
- It will ultimately be a matter for the Cayman Islands courts to determine whether a particular charge is a fixed or floating charge irrespective of the designation by the parties.

As previously noted, it is prudent for notice to be given to the issuer, account debtor, or obligor, as well as to the account bank, in relation to any securities constituting debts or other intangible collateral to avoid any

risk of a third-party bona fide purchaser for value without notice of the underlying collateral from obtaining an equitable interest in the securities, which may rank prior to the security interests created over those securities under the relevant security document.¹⁵

G. General Issues

G.1 Corporate authority issues for the pledgor that may arise under the law of the Cayman Islands

The constitutional documents of a Cayman Islands pledgor (which, in the case of a Cayman Islands exempted company, will be its memorandum and articles of association, and in the case of an LLC will be its limited liability company agreement) will set out the terms on which the company's affairs are to be regulated, and any restrictions on the powers of the company, its directors (or, in the case of an LLC, the managers), or the members.

The objects of a Cayman Islands company are generally unrestricted, and the directors (or, in the case of an LLC, its managers) are generally free to manage the affairs of the company in such manner as they see fit, unless the constitutional documents set out any specific restrictions to the contrary. It would therefore be prudent to review the constitutional documents of the pledgor to ensure there are no restrictions or limitations, which may impact the pledgor's ability to enter into the proposed transactions or impose any additional requirements or qualifications.

Although not strictly required (unless the constitutional documents provide to the contrary), it is usual practice that, as a matter of good corporate governance and in order to evidence clear authority for their actions, the directors (or, in the case of an LLC, the managers) pass resolutions approving the entry into any proposed transactions.

It would therefore be prudent, and considered good practice, when dealing with a pledgor that is a Cayman Islands company or LLC to examine the constitutional documents of the pledgor and to request board resolutions specifically authorizing the transaction in question to ensure that what is

being proposed is within the pledgor's powers and has been properly authorized. There is no requirement as a matter of Cayman Islands law for a separate power of attorney to be granted by a Cayman Islands pledgor in connection with a transaction, but where powers of attorney are granted then these should also be examined.

The doctrine of ultra vires does not apply to a Cayman Islands company, and a Cayman Islands pledgor's capacity to contract is unrestricted unless any restrictions are specifically set out in the company's constitutional documents. In addition, in favor of a person dealing with a company in good faith, the power of the directors to bind the company, or authorize others to do so, is deemed to be free of any limitation under the company's constitution.

Counterparties to transactions involving Cayman Islands companies should satisfy themselves that the directors have fulfilled their statutory and fiduciary duties under the Companies Act and common law. It is generally accepted that it will be sufficient for board minutes to state that the directors have taken the relevant factors into account in carrying out their duties. However, more detailed records may be required for significant or unusual transactions.

Cayman Islands ELPs are not bodies corporate and instead act through their general partners. As with a Cayman Islands company, it would be prudent, and considered good practice, when dealing with a pledgor that is a Cayman Islands ELP to examine the partnership agreement of the pledgor to ensure that the partnership has the necessary power and authority to grant security or to determine what consents may be required. It will, however, be a question of the applicable governing law of the general partner of the ELP as to what consents or other authorizations may need to be put in place by the general partner to enter into the proposed transactions in its capacity as general partner of the ELP.

G.2 Jurisdiction of pledgor: Do any of your answers to sections 1–4 above change if the pledgor is organized under the law of the Cayman Islands or any particular Other Jurisdiction, or if the pledgor's chief executive office is located in the Cayman Islands?

There are no changes.

G.3 Circumstances requiring an additional security agreement or additional provisions: Under what circumstances would you recommend either (i) executing an additional security agreement stated to be governed by the law of the Cayman Islands, the jurisdiction of formation of the issuer, or in the case of certificated securities, the jurisdiction where the certificates are located, or (ii) incorporating specific provisions in a security agreement governed by the law of the applicable U.S. State?

The answer turns on the particular facts and issues arising and would be determined by the particular transaction. There is no Cayman Islands legislation that addresses this point.

As noted previously, where the *lex situs* of the securities in question is determined to be the Cayman Islands, it would be prudent for notice to be given to the issuer, debtor, or obligor in relation to any securities constituting debts or other intangible collateral to avoid any risk of a third-party bona fide purchaser for value without notice of the underlying collateral from obtaining an equitable interest in the securities, which may rank prior to the security interests created over those securities under the relevant security document.

In addition, where the securities are shares in a Cayman Islands company or membership interests in a Cayman Islands LLC or ELP, it would be prudent for the security agreement to incorporate the relevant provisions for the giving of notice and provision of ancillary documents that would typically be included in any Cayman Islands law-governed agreement and which, in the case of an ELP or LLC, would be required in order to ensure that the security interest is enforceable against the ELP or LLC (as the case may be).

As previously explained, Cayman Islands law provides that the parties are free to choose the applicable law to govern a contractual arrangement and this would be recognized and given effect to in any action brought before a court of competent jurisdiction in the Cayman Islands, unless it is a law:

- which such court considers to be procedural in nature;

- which is a revenue or penal law; or
- the application of which would be inconsistent with public policy, as such term is interpreted under the laws of the Cayman Islands.

There is therefore no requirement per se for a separate Cayman Islands law– governed security agreement.

It would, however, be common practice where the uncertificated securities relate to an interest in a Cayman Islands company, LLC or ELP (e.g., a charge over the shares in a Cayman Islands company), and the register reflecting those securities (e.g., the register of members) is maintained in the Cayman Islands, for the security document creating the security interest over those securities to also be governed by Cayman Islands law in order to avoid or minimize some of the conflict-of-law issues that may otherwise arise. It is still possible for these security interests to be created under a security agreement governed by the laws other than those of the Cayman Islands, but in that case it would be advisable to require that provisions relating to applicable notice requirements and deliverables be incorporated into the non-Cayman Islands law–governed security agreement.

G.4 Creation, perfection, and priority of a security interest in proceeds under the law of the Cayman Islands

The treatment of proceeds of a disposal or disposition of collateral will depend in part on the nature of the security interest taken and also of the underlying collateral, as well as any terms agreed between the parties.

Where the collateral is disposed of with the consent of the secured party, then the secured party would typically either agree to discharge the security interest in connection with the disposal, or otherwise the pledgor, the secured party and the party acquiring the collateral will agree that the collateral is to be transferred subject to the security interest. Whether or not the proceeds of disposal of the collateral will continue to be subject to the security interest will depend, to some extent, on the terms agreed between the parties, but where the collateral is transferred subject to the security interest the secured party will not have any claim to the proceeds of the sale, because they will retain their security interest in, and right to

claim against, the original collateral and therefore the secured party will continue to be able to enforce this interest against the recipient of the collateral in place of the original pledgor.

Where the collateral constitutes receivables, then, where the receivables are disposed of, a security interest in those receivables will generally attach to any proceeds received in exchange for them, save for where the security interest has been granted as a floating charge (in which case the pledgor will typically be free to deal with the receivables until such time as the charge crystallizes).

Where the pledgor disposes of the collateral without the consent of the secured party, then the security interest will generally attach to the proceeds of such unauthorized disposition. The secured party is treated as the holder of a beneficial interest in the collateral and will, in its capacity as beneficiary of a trust over the collateral, be entitled to a continuing beneficial interest not merely in the trust property but in its traceable proceeds as well. This interest will bind everyone who takes the property or its proceeds except a bona fide purchaser for value without notice.¹⁶

If the collateral is transferred to a third-party bona fide purchaser for value without notice of the security interest, that purchaser may obtain an equitable interest in the collateral, which ranks prior to the security interests created over those securities under the relevant security document. As noted previously, it is prudent for notice to be given to the issuer, debtor, or obligor in relation to the collateral to minimize the risk of a third-party bona fide purchaser for value without notice of the underlying collateral from obtaining any such equitable interest in the collateral in priority to the secured interest of the secured party.

G.5 Rehypothecation of collateral under the law of the Cayman Islands

A right to sell, pledge, or rehypothecate is uncommon in Cayman Islands security agreements because it implies that a full title transfer has occurred. Usually a pledgor will create a security interest in favor of the secured party but retain ownership and possession of the collateral (i.e., as noted in section 2.1. above, typically the security would be constituted by way of an equitable mortgage or charge, as legal mortgages that require a

transfer of legal title which can be problematic for the reasons previously outlined are rare).

G.6 Exercise of remedies under the law of the Cayman Islands

The main methods of enforcing a security interest in the Cayman Islands are the following:

(1) Taking Possession

If the secured party has a legal mortgage (where legal or beneficial title but not possession has been transferred to it), it is entitled to take possession as a means of protecting the security interest (i.e., to prevent the pledgor from dealing with it).

(2) Selling the Collateral

A secured party will be permitted to sell the collateral if it has a power of sale either under express provisions in the security document or under a statute or in common law. There is no statutory power of sale that would arise under Cayman Islands law unless the collateral is real estate located in the Cayman Islands. The security holder's rights in respect of any sale will be regulated by the contractual terms of the security agreement under which the power arises. The sale may be conducted privately or by public auction and there is no need to apply to a court as under Cayman Islands law a court order is not required to exercise a power of sale. Unless required as a matter of contract, no notice is required to be given to the pledgor regarding the sale itself, although in practice it will have notice.

In relation to a pledge, there is an implied power of sale when the pledgor is in default. The power of sale is subject to reasonable notice having been given to the pledgor.

A secured party exercising the power of sale is subject to various duties, including the duty to:

- act in good faith;
- take reasonable steps to obtain a proper price for the asset;
- obtain the best price reasonably obtainable;
- act with reasonable skill and care; and

- act fairly toward the pledgor.

As long as the secured party complies with these duties, a court will not interfere in the sale merely because the pledgor objects. As a result of the duties, the secured party cannot sell the assets to itself without permission of the court. Additionally, if the secured party were to sell the collateral to a company in which it held shares, both the secured party and the purchasing company would need to show that the sale was made in good faith and reasonable precautions were taken to obtain the best price reasonably obtainable at the time of the sale.

(3) Appointing a Receiver, Who then Sells the Collateral

A receiver would take charge of the assets, realize them (by selling), and apply the money in repayment of the secured debt. A secured party would need to have either an express power to appoint a receiver in the security document or a statutory power.

A receiver's primary duty is to the secured party that appointed him, but he must act in good faith and deal fairly and equitably with the pledgor. A receiver is subject to the same duties in selling the collateral as described above.

(4) Foreclosure and Appropriation

If the secured party wants to retain the collateral (perhaps because it is worth more than the secured debt) there are two options:

- (a) Foreclosure: Where a mortgage is granted over an asset, the pledgor retains the right to recover the asset on full repayment of the secured debt. If the secured party wishes to retain the collateral, the secured party will need to extinguish this right (called the "equity of redemption") using a court procedure called foreclosure. It is a two-stage process, and the pledgor must be given time to pay after the first stage. The court can order that the collateral be sold in any foreclosure action. In the event that there are excess proceeds available from the sale following the settlement of the secured debt (and any associated costs that are properly recoverable by the pledgor), the pledgor would be required to pay the balance of those proceeds after application in accordance with the terms of the

financing documents back to the pledgor. The right to foreclose arises once the secured debt has become due. In practice, foreclosure proceedings are extremely rare.

- (b) Appropriation and Right of Use: If the document establishing the security interest provides the secured party with a right to appropriate the collateral, this power may be exercised without a court order. Similarly, if the collateral arrangement so provides, the secured party has the right to use and dispose of the collateral. The secured party must value the collateral in accordance with the relevant provisions agreed between the parties to the security document and in any event in a commercially reasonable manner. If the collateral is worth more than the secured obligations, the secured party must account to the pledgor for any difference.

Pending exercise of one of the powers described above, there may also be some ancillary steps that are necessary or desirable, including (i) giving notice to the issuer of the securities that future payments/dividends are to be paid to the secured party and (ii) applying to a Cayman Islands court for a “stop notice,” which is an order given by the Grand Court¹⁷ to the issuer of the securities that the person serving the notice has an interest in the securities and preventing the securities from being dealt with before the person has an opportunity to assert his claim.

1 Securities Investment Business Act (No. 44 of 2001) (Revised) sched. 1.

2 The Companies Act (No. 3 of 1961) (Revised) § 54.

3 Shares of all Cayman Islands companies are issued in registered form (i.e., they are evidenced by an entry on the register of members of the company) and are not therefore negotiable instruments regardless of whether certificates are issued.

4 *See* *Macmillan v Bishopsgate Investment Trust plc* (No. 3) [1995] 3 All ER 747.

5 *See* note 4 for further discussion of securities registration.

6 Conflict-of-law issues such as this are complex and highly fact dependent, and there is not, as a matter of common law, a unified or fully settled position, so while both the jurisdiction of incorporation of the issuer and the jurisdiction in which the certificates are located will be considered, it will depend on the facts as to whether a Cayman Islands court would consider the Cayman Islands to be the *lex situs* in this instance.

7 The priority as between successive assignees or chargees of intangible collateral will be determined, based on the English decision in *Dearle v Hall*, subject to exceptions, according

to the order in which notice is given to the debtor or obligor in respect of the debt or other chose in action. *Dearle v Hall* (1828) 38 Eng. Rep. 475; 3 Russ. 1.

- 8 *See* section 1.1 above. This is intended to deal with the position established under the English decision in *Dearle v Hall* that the priority as between successive assignees or chargees of intangible collateral will be determined based on, subject to exceptions, the order in which notice is given to the debtor or obligor in respect of the debt or other chose in action. *Dearle v Hall* (1828) 38 Eng. Rep. 475; 3 Russ. 1.
- 9 *See* *Dearle v Hall* (1828) 38 Eng. Rep. 475; 3 Russ. 1.
- 10 *Id.*
- 11 *Id.*
- 12 *Id.*
- 13 *Id.*
- 14 *Id.*
- 15 *Id.*
- 16 *See* Lord Millett in *Foskett v McKeown* [2000] UKHL 29.
- 17 The Grand Court is the first instance division of the Cayman Islands courts (i.e., equivalent to the High Court in England and Wales). There is a specialist Financial Services Division of the Grand Court (the FSD), which was created in 2009 in recognition of the need for special procedures and skills for dealing with complex civil cases that arise out of the financial sector in the Cayman Islands. Most commercial disputes involving the analysis of security instruments and enforceability will be heard by the FSD.