



April 2010

Updater

Current developments in Cayman's legal and regulatory environment

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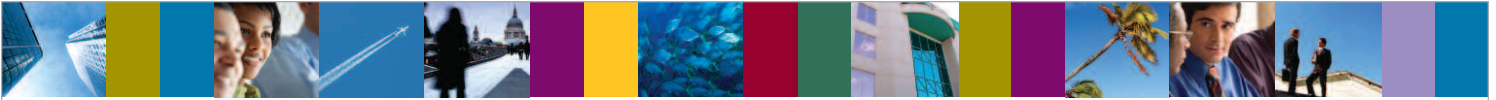
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Cayman Inc. in fine health

Perception shapes behaviour and in recent months many interested service providers and governmental agencies in rival financial centres have sought to attract business away from Cayman by painting a picture that clear-sighted observers would not recognise. Rumours of the demise of Cayman have been exaggerated to the point of fabrication. An analysis of some key metrics of Cayman's financial services industry demonstrates that it is faring well in absolute terms and extremely well relative to its rivals. The following review of Cayman's robust health is provided by Cayman Finance.

Whilst the taxpaying public and corporations in many G20 jurisdictions are battling the effects of increased taxation, international capital is starting to flow once again and hedge fund returns are up ticking. It is useful therefore, to take a hard statistical look at how Cayman's financial services industry has fared through the crisis.

The total number of banks and financial institutions that failed in the Cayman Islands during this latest financial crisis is zero and subsequently there is no statistical basis for the suggestion that instability exists within the Cayman Islands regulatory regime. No doubt, without the power to print money like the UK and US, the Cayman regulatory authorities are simply not in a position to bail out private enterprise, and therefore require a more risk-adverse and prudent set of operating guidelines to be practiced by the Cayman banking sector. Based on facts, not negative PR, the strength of the Cayman banking industry is well evidenced by deposits and inter-bank bookings, now tracking at \$1.795 trillion, slightly behind the peak of \$1.9 trillion recorded in September 2007. This is still a healthy overall figure considering the global climate in which the financial services sector has been operating and considering that there have been zero depositor losses.

Registered investment funds fell from 9,870 as at December 2008 to 9,523 at the end of 2009, but are still

well ahead of the 8,751 funds in 2007. A new growth trend is evidenced by the statistics for January 2010 which show 147 new fund authorisations and only 58 terminations. This compares quite favourably to the 106 authorisations and 39 terminations seen in January 2008 and is on target with the natural attrition trends experienced in the healthier market periods of previous years.

Cayman Islands fund statistics are being used by some rival international financial centres to suggest that major outflows of fund business are occurring from the Cayman Islands. In fact the drop is around 4% and after the worst financial crisis in a century this seems more like a sign of a strong fundamental belief in the jurisdiction. And where did the 4% go? There is no evidence it went anywhere other than into liquidation as a result of poor investment return and certainly not to Dublin where a like-for-like comparison suggests Irish domiciled funds fell from 5,025 to 4,627 over the same period which is more than double the Cayman decrease. Also, the Irish, to boost their numbers, include sub-funds in their calculations, whereas in Cayman, sub-funds are not counted. Interestingly, Irish fund listings fell from 1,605 to 1,270 during this same period, which is a loss of greater than 20%.

In the insurance division, the story is brighter yet, the Cayman Islands Monetary Authority (CIMA) reports the 2009 number of total insurance companies (including both domestic and international insurers) at 815. This is up 10 for the year ending 2008 and 22 over the 2007 total of 793. Captives specifically have experienced gains over this period, rising to 780 at the end of 2009 from 765 in 2007. The assets held in the captive insurance industry have risen from \$36.8 billion in 2008 to \$44.7 billion at the end of 2009, an 18% increase. By contrast, the largest jurisdiction for the captive insurance industry, Bermuda, reports 1,140 captives holding \$84 billion in assets, which is down from their 2007 report of 1,149 captives holding \$88.8 billion in assets. This demonstrates that Cayman, the second largest domicile for captives, continues to gain ground against its major competitor.



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Overall, these numbers are strong and prove the resilience of the Cayman Islands financial services industry and suggest that Cayman structures are essential to the global flow of capital – a key to economic recovery everywhere. The question that has not yet been asked given the strength of capital flows through Cayman is the extent to which the protectionist elements of both the HIRE Act 2010 in the US and the European AIFM Directive will have the unintended consequence of drying up the flow of funds from Cayman to the US and Europe at a time when the funding requirements of both are increasing not decreasing. The more logical consequence of the most recent iteration of the AIFM Directive is that rather than Cayman hedge funds wishing to move to the EU, fund managers who wish to continue to run hedge funds proper must move out of the EU.

The recession has not completely leapfrogged the Cayman Islands as transactional volumes have decreased no doubt as have assets under management (we await the latest CIMA figures). The business community as a whole has had to downsize accordingly. Streamlining into leaner operations is to be expected as part of a normal business cycle and so too the Cayman Islands Government is reducing public sector expenditure. But, in what has hopefully been the most trying financial period of our time, Cayman's financial services industry has shown extraordinary fortitude, exhibiting both strong demand and staying power.

Cayman Islands Court of Appeal Camulos Partners Offshore Limited

In the recent decision of Camulos Partners Offshore Limited ("the Fund"), the Cayman Islands Court of Appeal has re-emphasised that aggrieved investors may not bring winding-up proceedings merely to exert pressure on funds to accede to investor demands, and has confirmed that even under the new Cayman Companies' Law, there is no standalone court remedy for unfair prejudice to investors whereby aggrieved investors may compel the purchase of their shares,

unlike the position in the United Kingdom.

Background facts

The Fund was a Cayman Islands feeder fund in a group which, according to its offering documents, invested in a diverse portfolio of undervalued and distressed assets. The Fund received a high number of redemption requests amidst the global financial crisis of 2008, including a redemption request from Kathrein & Co (the "Investor") for a redemption date of 30 September 2008. The Investor's redemption request was accepted for a redemption price of approximately US\$27 million. Ultimately, in early September 2008, in response to the high number of redemption requests received, the Fund proposed an "exchange offer" restructuring arrangement to investors. The Investor did not accept the exchange offer and instead sought to enforce its redemption. In response, the Fund suspended payment of the redemption price.

The initial legal proceedings

In April 2009, the Investor issued an originating summons against the Fund seeking declarations that the full US\$27 million remained payable (and that at least 15% of that amount had to be paid in cash). In June, the Fund applied to have the Investor's originating summons struck out. In July 2009, after learning that the Fund proposed to make a cash payment to investors who had accepted the exchange offer, the Investor threatened to present a winding-up petition against the Fund on just and equitable grounds.

On 3 August 2009, the Fund filed an injunction seeking orders restraining the presentation of a winding-up petition by the Investor, but a single judge of the Grand Court of the Cayman Islands refused to grant the injunction. The Investor immediately filed a winding up petition and then, once the judge's order was officially sealed a few days later, filed a further winding-up petition on substantially the same grounds.



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Given the presentation of the winding-up petitions, the Fund was forced to obtain validation orders to enable it to carry on its business and to make distributions to other investors. In return, the Fund deposited a sum equivalent to the full US\$27 million redemption price into court as security for the Investor's claim.

The appeal

The Fund appealed to the Cayman Islands Court of Appeal and obtained orders staying the winding-up petitions until the determination of the appeal. The appeal was concerned with the circumstances in which a shareholder may bring winding-up proceedings against a fund on just and equitable grounds. The Fund contended that the petitions should be struck out as an abuse of process as there was an alternative, more suitable remedy, in the form of ordinary civil litigation - that is a writ.

Counsel for the Investor relied extensively on the Cayman Islands Court of Appeal decision in Strategic Turnaround as a complete answer to the Fund's case. Further, the Investor contended that new amendments to the Cayman Companies Law had broadened the scope of the Court's powers, so as to enable it to make share buy-out or sale orders as a remedy in circumstances which constitute "unfair prejudice" to the interests of shareholders (as was the position under s.459 of the United Kingdom Companies Act 1985 now section 994 of the Companies Act 2006). On this point, the Court of Appeal held that the judge at first instance had been wrong in believing that there had been an expansion of the Court's powers on the ground of unfair prejudice. The new s.95(3) does not provide a freestanding unfair prejudice remedy, but rather, certain alternative forms of relief to a winding-up order, the grounds for which must first be established.

The Court of Appeal held that filing a contributory's winding-up petition, in circumstances where the petitioner has an alternative remedy, will amount to an abuse of process and will render the petition liable to be struck out if the petitioner is acting unreasonably in not

pursuing that alternative remedy. **The two key questions**

The Court of Appeal identified two key questions:

1. whether there is an alternative remedy available to the petitioner; and
2. whether the petitioner is acting unreasonably in not pursuing that remedy.

The Court of Appeal distinguished the decision in Strategic Turnaround on the basis that, in that case, there was no alternative remedy available to the petitioner in respect of the particular circumstances alleged. Given there was no alternative remedy available, the petitioner could not be said to be acting unreasonably in pursuing the only remedy which was available.

A key point of distinction between the facts in Strategic Turnaround and the Camulos case was the deposit into court of the US\$27 million by the Fund. In view of the deposit, the Court of Appeal could not accept the Investor's assertion that by paying other redeeming investors (who had accepted the exchange offer), the Fund had preferred those investors. The Court found that the relief sought by the Investor (principally payment of the US\$27 million and orders restraining other investors from receiving further payment) would be available in ordinary civil litigation and accordingly, the first question was answered in the affirmative.

The Court of Appeal next considered the second question - was the investor acting unreasonably in not pursuing the alternative remedy? The Court considered the Investor's conduct as a whole since filing the original writ action in April 2009 and concluded that the Investor's objective was to put maximum pressure on the Fund to accede to its demands which, the Court found, is clearly not a proper reason for electing to proceed by way of a winding-up petition. Consequently, the second question was also answered in the affirmative.

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The outcome

Accordingly, the Court of Appeal struck out the petition as an abuse of process and awarded costs to the Fund on the indemnity basis (enabling the Fund to recover most of its legal costs).

The decision is important in two respects; First, it confirms that there is no separate standalone remedy in the form of share purchase or sale orders analogous to an 'unfair prejudice' petition in the United Kingdom - a petitioner must demonstrate that the company should be wound up on just and equitable grounds and only then will the alternative forms of relief in the new s.95(3) of the Companies Law become available. Secondly, the decision makes clear that disputes between investors and funds should be litigated in ordinary civil proceedings, except in the (potentially rare) circumstances where the investor has no real choice but to seek the winding up of the Fund. If the principal objective in bringing a winding-up petition is to apply pressure to a fund to accede to an investor's demands, the petition will almost certainly be struck out.

The SIPC Trustee of Bernard L. Madoff Investment Securities LLC is formally recognised in the Cayman Islands

In the recent decision of Bernard L. Madoff Investment Securities LLC (in Securities Investor Protection Act Liquidation) ("BLMIS"), the Grand Court of the Cayman Islands recognised the right of Irvin H. Picard in his capacity as Securities Investor Protection Corporation Trustee of BLMIS (the "SIPC Trustee") to act on behalf of or in the name of BLMIS in the Cayman Islands.

Background

The SIPC Trustee was appointed to BLMIS pursuant to the United States Securities Investor Protection Act of 1970 on 15 December 2008. As a matter of United States law, the Trustee's appointment resulted in the

termination of the powers of BLMIS' directors and managers and thereafter the SIPC Trustee was the only person entitled to act on behalf of the company. The SIPC Trustee subsequently sought orders from the Grand Court of the Cayman Islands recognising his exclusive right to represent BLMIS in that jurisdiction pursuant to s.241(1)(a) of the Cayman Islands Companies Law (2009 Revision).

Section 241(1)(a) provides that upon the application of a foreign representative, the Court may make an order recognising the right of the foreign representative to act in the Cayman Islands on behalf of or in the name of a "debtor" (that is, a foreign corporation subject to a foreign bankruptcy proceeding).

The recognition hearing

The matter first came before the Court on 21 January 2010. At the hearing, the judge noted that once made, an order recognising the SIPC Trustee would have universal effect upon all persons present within the Cayman Islands without the need for the SIPC Trustee to establish his right to represent BLMIS again in the future. The Court took the view that numerous Cayman Islands persons and entities could potentially have a legitimate interest in the recognition or non-recognition of the SIPC Trustee and as a result, the hearing was adjourned to allow for advertisement locally and internationally (in a Cayman Islands newspaper and the Wall Street Journal).

Following the advertisement, a second hearing was held on 5 February 2010. The Court held that s.241(1)(a), which came into force with effect from 1 March 2009, did not change the pre-existing conflict-of-laws rules governing the recognition of representatives of foreign corporations. Rather, the purpose of the section was to provide foreign representatives with a convenient and expeditious method of establishing their credentials and right to act on behalf of foreign debtors without the need to re-establish such right separately against individual counterparties on an on-going basis.



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The Court held that as a matter of Cayman Islands law, the place of incorporation of a company determines those persons who are recognised to act on its behalf. A liquidator appointed under the law of the place of a company's incorporation will be so recognised in the Cayman Islands. Accordingly, the Court recognised the SIPC Trustee as the sole person having the right to act on behalf of or in the name of BLMIS in the Cayman Islands.

Implications of the decision

Recognition of the SIPC Trustee in the Cayman Islands will have a relatively limited impact upon persons and entities within the Cayman Islands. The SIPC Trustee's rights and powers will remain limited to those which exist under the general law of the Cayman Islands, and the enforcement of any judgment obtained in the United States against a Cayman Islands person or entity will be enforceable in the Cayman Islands only, to the extent allowed by the Court applying established conflict-of-laws principles.

This having been said, the SIPC Trustee may now (for example) commence legal proceedings in the Cayman Islands without first having to establish his authority to represent BLMIS. Further, he may apply to the Court for certain "ancillary orders" under sub-sections (b) to (e) inclusive of s.241(1) - which would include orders staying proceedings or judgments against BLMIS and orders requiring the turnover of property belonging to BLMIS to the SIPC Trustee - albeit, an application for ancillary orders will also be determined having regard to relevant conflict-of-laws principles (as modified by s.242 of the Companies Law).

The Cayman Islands continue to demonstrate transparency

The Cayman Islands Government announced on 25 March 2010 that it will conclude a further 16 tax information exchange agreements (TIEAs) with several G20 jurisdictions of economic significance, in addition to the

15 TIEAs already in place.

The Cayman Islands Government has also advanced its work with the Organisation for Economic Development and Cooperation (OECD) Global Forum Steering Group, particularly in reference to the recently announced peer review evaluation programme.

A breakdown of the identified 15 pending TIEAs is as follows:

- Agreements have been reached with 6 countries: Aruba, Canada, Germany, Italy, Mexico and South Africa. These agreements, which have been finalised from the Cayman Islands, are with the signatory countries for their authorisation process and confirmation of a signing date.
- Negotiations are in various stages with 9 additional OECD/G20 countries.

For the OECD Global Forum Steering Group, the Cayman delegation was able to provide input, guidance and direction on the methodology and terms of reference for the peer review programme. The Cayman Islands will also be an assessor for the peer review programme.

In addition to having input on OECD's peer review process, Cayman has been identified in the first cohort of countries to undergo a peer review evaluation. This phase of the peer review involves providing comprehensive information on the implementation of Cayman's tax transparency regimes to OECD assessors, including relevant laws, regulations and guidance notes.

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