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## 2022 Caribbean Insolvency Symposium

# It Is a Legal Entity, Jim, but Not as We Know It: SPACs, SPCs and More

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# CARIBBEAN INSOLVENCY SYMPOSIUM



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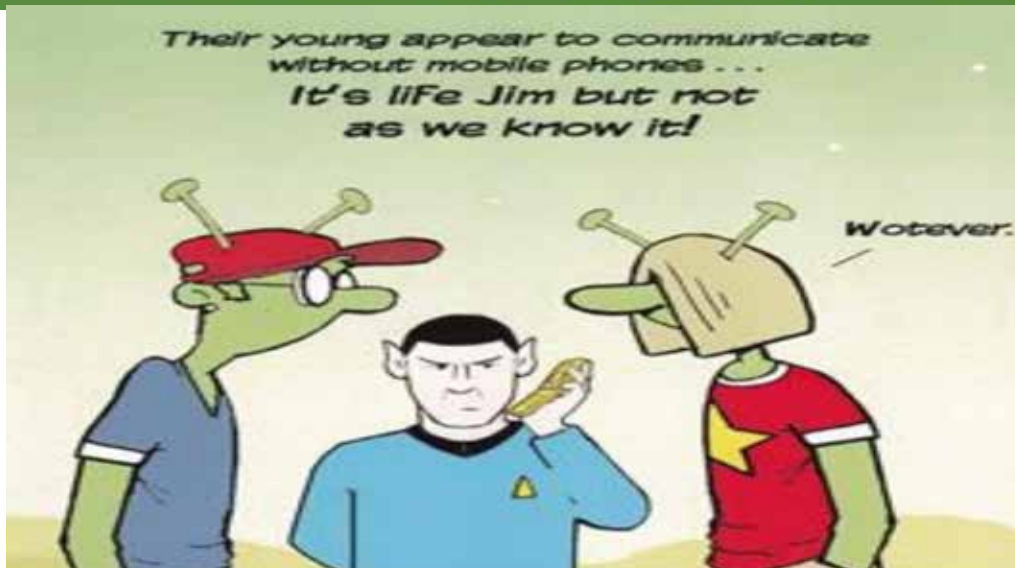
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**FEBRUARY 7-9, 2022**



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## CARIBBEAN INSOLVENCY SYMPOSIUM

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# It Is a Legal Entity, Jim, but Not as We Know It: SPACs, SPCs and More



## SPEAKERS



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## Foundation Companies



Foundation Companies – what are they?

- A Cayman Islands company
- Corporate alternative to a trust
- Distributions are permitted to beneficiaries, rather than members
- Typically 'ownerless' – no members



## Foundation Companies – who’s involved

- Founder – may or may not have any powers or rights
- Beneficiaries – can be 0 or more
- Board of Directors – day to day management
- Supervisor – ‘supervise’ the directors
- Secretary – a Cayman Islands licensed company manager



## Foundation Companies – use cases

- Private trust company
- Asset holding vehicle/estate planning
- Charitable purposes
- Investment Foundation for an undefined group of beneficiaries
- Crypto/Blockchain applications



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### Foundation Companies – Insolvency considerations

- Same insolvency rules apply as to regular Cayman companies
- Same considerations for directors
- Who can make claims – Supervisors and third parties
- Cayman Court involvement
  - Foundation Company can apply for directions
  - Various Interested Parties can make an application to the court when 'difficulties' arise
- Court has wide ranging powers



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### Cayman Limited Liability Companies





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### Cayman LLCs – what are they

- Introduced in Cayman in 2016
- Similar to a Delaware LLC as the law was loosely based on the Limited Liability Company Act in the State of Delaware
- However Cayman LLC law has preserved legal principles applicable to Cayman companies
- A corporate entity which has legal personality separate from that of its members.
- Liability of members is limited



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### Cayman LLCs – who's involved

- Must have at least one member
- It can be member managed by some or all of its members
- LLC agreement can also provide for the appointment of non-member managers
- Profits and losses are allocated among its members, and among classes of LLC interests or groups of members, in accordance with the terms of the LLC agreement.
- Distributions of cash or in kind are similarly allocated



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### Cayman LLCs – like an Exempted Limited Company

- a body corporate with legal personality separate from that of its members
- perpetual succession
- the capacity to sue and to be sued, and to defend legal proceedings in its name
- the power to acquire, hold and dispose of property (unlike an ELP where assets held on trust by the general partner)



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### Cayman LLCs – not like an Exempted Limited Company

- Partnership like treatment of profits and losses
- Pass-through treatment of profits and losses for tax purposes
- Increased flexibility to specify the extent of duties of board members
- The ability to stipulate that a person appointed to a board or committee by a particular member may act in the best interests of that member rather than the LLC





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### Cayman LLCs – features and use cases

- A Cayman LLC may be formed for any lawful business, purpose or activity
- Members can have capital accounts and can agree how the profits and losses are to be allocated
- An LLC agreement may:
  - Provide for classes or groups of managers with relative rights, powers and duties
  - Provide for the taking of an action
  - Grant various voting rights to managers, classes or groups



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### Cayman LLCs – features and use cases

- Investment feeder fund
  - As flexible as an ELP, but only 1 entity instead of two (ELP and GP)
- General Partner
- Management Companies
- JV entities
- SPVs



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### Cayman LLCs – insolvency considerations

- Provisions of Companies Act are imported so similar procedures for voluntary winding up, compulsory winding up or winding up under the supervision of the court
- Bankruptcy/insolvency of a member does not cause membership to cease (unlike a Delaware LLC)
- No time limitation on clawbacks where a member receives a distribution where the LLC was insolvent and the member knew



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### Exempted Limited Partnerships



## Exempted Limited Partnerships – what are they?

- Exempted Limited Partnership Act (2021 Revision)
- Prohibited from trading in the Cayman Islands
- Not a separate legal personality
- A contractual arrangement created by a Limited Partnership Agreement
- Limited partners are not liable for the debts or obligations of their exempted limited partnership



## Exempted Limited Partnerships – who's involved

- Passive limited partners and one or more managing general partners
- All management responsibility is conducted by the general partner(s)
- Property is held by its general partner on trust
- Unlimited liability for the general partner if assets < liabilities



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### Exempted Limited Partnerships – use cases

- Typically used as a closed-ended investment vehicle permitting investment during a limited capital raising period



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### Exempted Limited Partnerships - Termination

- LPA typically contains wording to provide for automatic termination on some specific event
- Or by resolution of all the general partners and a two-thirds' majority of limited partners
- Typically wound up by the general partner unless someone else is designated in the LPA or an order of the court
- Winding up procedure similar to that for Companies
- Any surplus remaining after satisfaction of all ELP liabilities is distributed to the partners in accordance with the LPA



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### Exempted Limited Partnerships – insolvency considerations

- 6 month clawback period if a limited partner receives a distribution when the ELP is insolvent, and that limited partner has actual knowledge of the insolvency
- A creditor who has security over the assets of the ELP is entitled to enforce their security without the leave of the court and without reference to the general partner or any liquidator appointed to wind up the exempted limited partnership.



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### Exempted Limited Partnerships – insolvency considerations

- Section 33(1) of the ELP Act states that subject to subsection (3), legal proceedings by or against an ELP may be instituted by or against **the general partners only**
- This was tested in the recent Padma Fund LP case, where the Cayman court held that there is no provision within the ELP Act or the Partnership Act which provides that legal proceedings may be instituted against an ELP in the name of the ELP.
- The court dismissed a petition to wind up the ELP brought by a creditor of the ELP on the basis that the court didn't have jurisdiction to wind up an ELP



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### Exempted Limited Partnerships – insolvency considerations

- Another recent case on ELPs and section 33(1) was Port Fund, LP in respect of derivative actions
- As per last slide, 33(1) says only GP can bring claims, subject to 33(3), which provides that:
  - “[a] limited partner may bring an action on behalf of an exempted limited partnership if any one or more of the general partners with authority to do so have, without cause, failed or refused to institute proceedings.”
- Judgement held the test under section 33(3) did not require a limited partner to specifically request that the general partner bring certain claims, and for the general partner to refuse for section 33(3) of the ELPA to be capable of being relied upon. It was enough that the general partner had failed to bring the claims.



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## Segregated Portfolio Companies



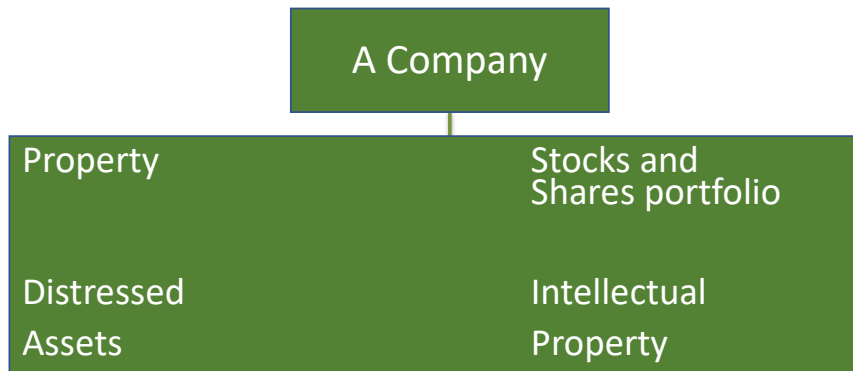


## What is an SPC

- Exempted Company which created segregated portfolios to legally separate the assets and liabilities from each other and from the general assets of the fund.
- Who predominantly uses SPCs
  - Insurance vehicles
  - Offshore fund structures
- Can a standard exempted company become an SPC?



## Typical Ordinary Company Structure

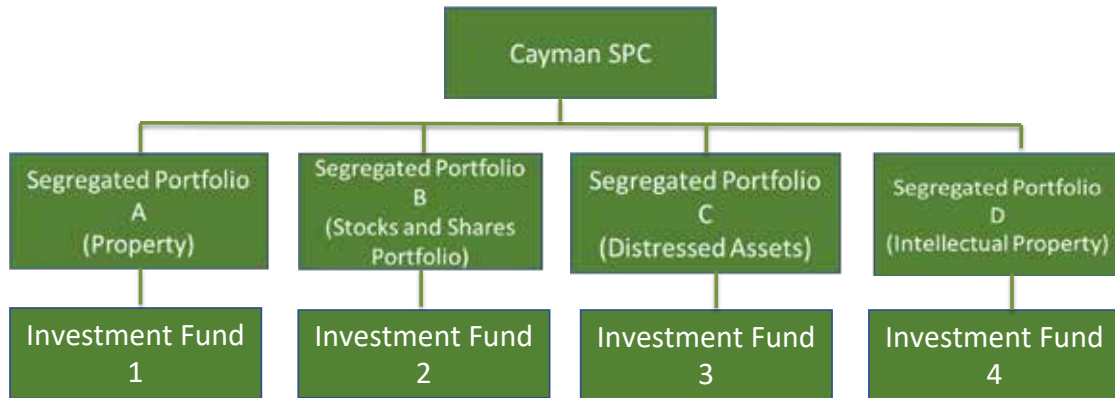




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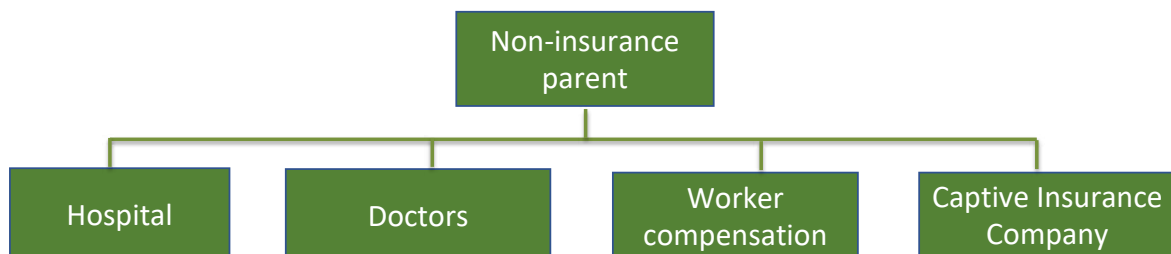
## Typical Fund SPC Structure



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## Typical Captive Insurance Structure



- Captive insurer self-insures the risk of the parent and associated companies.
- Premiums are paid by the parent and associated companies.
- As owners of the captive insurance company, the parent and associated companies are entitled to receive distributions from the profits of that entity



## Principal Benefits of an SPC

- The assets of each segregated portfolio are segregated from the assets of the other portfolios and from the SPC's general assets
- Protects against cross liability issues between the segregated portfolios
- Stability: Receivership
- Termination of individual portfolios
- No exchange control restrictions
- Lower annual fees



## Insolvency of SPCs

- Solvent Liquidation of the SPC
- Insolvent Liquidation of the SPC
- Termination of segregated portfolios
- Appointment of Receivers over segregated portfolios
- Cross –border recognition



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### Notable Cases

- ABC Company (SPC) v J & Company Limited
- Obelisk Fund SPC and Obelisk Global Gold Focus Fund
- JP SPC1 and JPC SPC4
- Centaur Litigation SPC



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### What is a SPAC?

- A SPAC is a publicly traded company that issues shares through an initial public offering, but conducts no business of its own.
- Its purpose is to merge with a private company so that that company may become publicly traded.



## What is a SPAC?

- SPACs provide an alternative and faster method for private companies to become publicly traded, as compared to filing a registration statement and prospectus with the Securities and Exchange Commission before going public.



## How Does a SPAC Work?

- A sponsor forms a SPAC to pursue an acquisition.
- SPAC shares typically are valued at \$10.
- The funds SPACs raise in an IPO are placed in an interest-bearing trust account. These funds cannot be disbursed except to complete an acquisition.



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### How Does a SPAC Work?

- If an acquisition is not completed within two years, the SPAC is liquidated and money returned to investors.
- After an acquisition, a SPAC is usually listed on one of the major stock exchanges.



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### How Does a SPAC Work?

- After SPAC shareholders approve an acquisition and the deal is completed, the SPAC's investors have the choice to either swap their shares for shares of the merged company or redeem their SPAC shares to get back their original investment, plus the interest accrued while that money was in trust.
- SPAC sponsors normally get a 20% stake in the final, merged company, plus warrants.





## Risks with a SPAC

- Investors have no idea what target company will be
- Sponsors are incented to complete an acquisition before 2 years, leading to possibility of riskier acquisitions
- There is less oversight and disclosure in a SPAC IPO as compared with a conventional IPO



## Trends in SPACs

- In 2014, 5% of US IPOs were SPACS (<http://www.spacanalytics.com>)
- In 2021, that number was 63%
- Currently, there are approximately 600 SPACs seeking acquisitions, with aggregate funding of almost \$160 billion
- Recent SPACs rarely exceed the \$10 share price



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### Trends in SPACs

- There is evidence that SPAC acquisitions underperform the market. See “Months after the SPAC boom, returns have been ‘weak,’ says Goldman Sachs” (last accessed on Jan. 6, 2022 at <https://fortune.com/2021/09/16/spac-returns-ipos-goldman-sachs/>)
- Current top performing SPAC is DWAC – Digital World/Trump Media – over \$55



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### SPACs and Restructuring

- Certain SPACs explicitly target restructured companies
- In 2015, Hycroft Mining Corp. completed reorganization
- In 2020, acquired by SPAC Mudrick Capital Acquisition Corp. (MUDS)
- On January 10, 2022, trading for just under \$10 over past six months



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### SPACs and Restructuring

- Skillsoft Corp. completed its reorganization in bankruptcy in August 2020 with well restructured finances
- In October 2020, SPAC acquisition by Churchill Capital II was announced
- Acquisition closed in June 2021
- Trades under SKIL – trading at \$8.30 on January 10, 2022



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### SPACs and Restructuring

- Some SPACs state that they are looking for acquisitions in distress
- View S-1 prospectuses, 8-Ks, and 10-Ks for such information
- Failures of such acquisitions resulting in bankruptcy could lead to litigation brought by trustees, committees, etc.



THANK YOU FOR LISTENING

QUESTIONS ?



## Contact

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# Faculty

**Laura S. Hatfield** is a partner with Bedell Cristin in Grand Cayman, Cayman Islands, and heads its Litigation and Insolvency & Restructuring groups in the Cayman Islands. She focuses on bankruptcy, restructuring, investor rights, fiduciary duties in corporate governance and professional negligence. Ms. Hatfield has advised bankruptcy and restructuring professionals, lenders, investors and professional services providers in the Cayman Islands, USA and Europe, and has been involved in most of the significant cases of the last decade in the Cayman Islands, including Bear Stearns, Weaving and the precedent-setting cases establishing the basis for corporate liquidation based on the just and equitable grounds for failure of a company's purpose when a fund is in run-off. As well as litigation up to Privy Council level, she has used alternative dispute resolution methods to conclude disputes and has been involved in several mediated settlements. She was qualified as a solicitor of the Supreme Court of England and Wales in 1989 and was admitted as a Cayman Islands attorney-at-law in 2001. A member of the Law Society of England and Wales, Cayman Islands Law Society, ABI, IWIRC and INSOL, Ms. Hatfield has significant experience in cross-border and multi-jurisdictional cases, including regulatory regimes, and often works closely with U.S. attorneys and insolvency professionals. She received her B.Sc. from the University of Exeter in England.

**Thomas M. Horan** is a member of Cozen O'Connor in Wilmington, Del., where he focuses his practice on financial restructuring and bankruptcy litigation, representing debtors and official unsecured creditors' committees in complex chapter 11 proceedings; counseling secured creditors, trustees, unsecured creditors, and debtor-in-possession lenders; and representing clients in preference and fraudulent transfer proceedings. He is ABI's Vice President - Communications & Information Technology and serves on the advisory boards of ABI's Georgetown Views from the Bench, Delaware Views from the Bench Conference and Mid-Atlantic Bankruptcy Workshop. Mr. Horan was named a "Rising Star" by *Super Lawyers* and holds an AV rating by Martindale-Hubbe. He received his B.A. in 1989 and his M.A. in 1992 from Fordham University, and his J.D. *cum laude* from St. John's University School of Law in 2002, where he was executive notes and comments editor for the *ABI Law Review*.

**Casey McDonald** independent director at Calderwood in Grand Cayman, Cayman Islands, where he accepts appointments on the boards of investment funds and related structures, advising on corporate governance and regulatory compliance. He also leads Calderwood's Special Situations practice, which includes out-of-court solutions in distressed and other circumstances. Prior to joining Calderwood, Mr. McDonald was the managing director of the Cayman Islands office of a boutique insolvency and fraud-investigation firm. Previous to that, he spent 15 years with KPMG in Canada, the Cayman Islands, London and most recently in the British Virgin Islands, where he led KPMG's advisory practice there, as well as co-managed the office. Over the course of his career, Mr. McDonald has acted as a shareholder or court-appointed fiduciary with respect to hedge funds, banks, insurers, property-development companies, shipping companies and manufacturing groups. His appointments have been throughout the Caribbean and have extended into North America, Europe, Hong Kong and China. Mr. McDonald is a member of the Canadian Institute of Chartered Accountants, the Cayman Islands Institute of Professional Accountants, INSOL, the Cayman Islands Restructuring and Insolvency Specialists Association and ABI. He is an accredited director of the Institute of

Chartered Secretaries and Administrators of Canada, and he is a registered professional director with the Cayman Islands Monetary Authority and a member of the Cayman Islands Directors Association. Mr. McDonald holds a B.B.A.

**Paula Richmond** is a director at Kalo Advisors in Grand Cayman, Cayman Islands, where her expertise includes formal appointments relating to construction, retail, hospitality and leisure, and the solvent winding up of solvent group entities as part of wider restructurings. Prior to her move to the Cayman Islands, she spent more than 20 years working in the U.K. on a wide range of formal U.K. and cross-border appointments. Ms. Richmond was previously with a Big Four firm, where she worked on trading and nontrading restructuring assignments and performed investigations into the conduct of directors. Prior to that, she was with an international law firm specializing in debt-recovery, winding-up and bankruptcy petitions for a number of clients, including major construction suppliers and HMRC. Ms. Richmond is a U.K. qualified insolvency practitioner, a Fellow of the Insolvency Practitioners Association, a Fellow of the Association of Business Recovery Professionals in the U.K. and a Cayman Islands appointment-taker. She previously held positions at AlixPartners LLP, Zolfo Cooper and PwC.