Cayman Islands antecedent transactions

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Many businesses continue to experience unprecedented pressure on their cash flow given, among other things, the continued fall-out from the global pandemic, the war in Ukraine, the cost of living crisis, rising interest rates, the end of cheap debt and the expected global downturn.

To mitigate their exposure to personal liability, it's important that directors of insolvent companies or companies in the zone of insolvency comply with their duties to act in the best interests of the company as a whole. This includes the interests of creditors as a whole.

For helpful background, read our previous article on the UK Supreme Court's decision in BTI v Sequana which confirmed how directors' duties ought to be applied when a company is in the zone of insolvency.

In addition to a director noting and complying with their duties, they must also be aware that certain transactions entered into by the company prior to its liquidation are likely to be investigated by the official liquidator and may, in certain circumstances, be set aside.

This article sets out a summary of challenges that may be made to antecedent transactions in the Cayman Islands. These may also apply to Limited Liability Companies, Partnerships, Exempted Limited Partnerships and, in certain circumstances, foreign companies, but this article focuses on Cayman companies.

Certain antecedent transactions effected by companies are automatically void whereas others are voidable on the application of (variously)

- an official liquidator appointed by order, or under the supervision, of the Grand Court of the Cayman Islands
- a voluntary liquidator appointed without the intervention of the Court
- a creditor prejudiced by the transaction. Other transactions may give rise to a liability to contribute to the assets of the company

Void ab initio

When a winding up order has been made, any disposition of a company's property and any transfer of shares or alteration in the status of the company's members made after the commencement of the winding up is, unless the Court directs otherwise, void. The deemed commencement date of an official liquidation is either the presentation of the winding up petition or, if preceded by a form of voluntary liquidation, the passing of that resolution. This can give rise to a period of uncertainty for those dealing with a company fending off a winding up petition and care should be taken to seek a validation order prior to entering into any arrangement affecting the property of the company during this period.

Where a company has commenced liquidation voluntarily (which has not come under the supervision of the Court), then any transfer of shares without the sanction of the voluntary liquidator, and any alteration in the status of the company's members, made after the commencement of the voluntary winding up is void. However, unlike a compulsory liquidation, no transfer of the company's property is automatically void. There is not normally the same uncertainty with voluntary liquidations as, on the appointment of a voluntary liquidator, all of the powers of the directors cease and are displaced by the voluntary liquidator (except so far as the company in a general meeting or the voluntary liquidator sanctions their continuance). As such, the transfer of property is not automatically void but care should be taken that any transfer of property effected by the company after the appointment of voluntary liquidators has the requisite authority.

Voidable

- **Voidable preference**

Every conveyance or transfer of property (or charge thereon), or money which is made by the company in favour of a creditor at a time when the company is unable to pay its debts as they fall due (i.e. on the cash flow basis), made with a view to preferring that creditor, is void if made within six months immediately preceding the commencement date. The intention to prefer the creditor has to be the dominant intention of the person effecting the transaction (i.e. the company), although that intention may be inferred, with the intention being to put the recipient in a better position than it would otherwise have been in an insolvent liquidation of the company.

If the preference is made to a 'related party' (defined as having the ability "to control the company or exercise significant influence over the company in making financial and operation decisions") then the payment is deemed to have been made with a view to preferring such creditor or creditors ahead of other creditors.

- **Dispositions at an undervalue or fraudulent dispositions**

Every disposition of property made for no value or for value that is significantly less than the value of the property by, or on behalf of, the company with intent to defraud its creditors is voidable at the request of an official liquidator.

The official liquidator must establish intent to defraud for the purposes of this section, which is defined as an intention to wilfully defeat an obligation owed to a creditor. The intention to defeat a creditor needs only be "a" purpose and not the sole or dominant purpose. This is still a difficult burden for the official liquidator to satisfy and the official liquidator may not commence proceedings more than six years after the transaction in question.

Separately, a creditor prejudiced by a disposition of property may seek an order from the Court that the disposition is void if it was for no value or for value that is significantly less than the value of the property. The creditor must again establish intent to defraud (defined as above and not required to be the dominant purpose) for the purposes of this section, which can be even more difficult without the powers of an official liquidator to investigate the company's books and records. The relevant disposition must have occurred not more than six years prior to the application of the creditor.

Even if such a claim commenced by a creditor succeeds, the disposition is only set aside to the extent necessary to satisfy the creditors prejudiced by the disposition, although recent authority suggests that for an insolvent company, this may go beyond the value of the claim of the creditor seeking the order, to ensure all creditors are made as whole as possible even with a *pari passu* distribution.

Where a transferee is found not to have acted in bad faith in either case, the Court may provide for the proper fees, costs, pre-existing rights, claims and interests of the transferee.

Liability to contribute

Where any business of the company has been carried on with intent to defraud creditors of the company or creditors of any other person, or for any fraudulent purpose, a liquidator (either official or voluntary) may also apply to the Court for a declaration that any persons who were knowingly parties to the carrying on of the business in that manner are liable to make such contributions to the company's assets as the Court thinks proper. Usually, each director will be "knowingly" a party to the ways in which the business of the company is carried on and therefore potentially liable if that business is carried on fraudulently. There is no applicable limitation period for this offence.

Summary

Directors should exercise caution (and obtain legal advice) before entering into transactions when a company is or may be insolvent or on the verge of insolvency, as these transactions will likely be scrutinised by liquidators and potentially unwound while increasing the risk and scope

of director liability. When directors have concerns as to the solvency of a company, they must remain informed of the company's financial position at all times and take into account the interests of the creditors (as a whole), even if an insolvency process is not inevitable, balancing their interests against the interests of the shareholders where they may conflict. There will be circumstances where the creditors' interests are best served by the immediate appointment of an insolvency practitioner to act as a liquidator or a restructuring officer, for more information read our article on Cayman restructuring officers, thereby minimising losses to creditors and reducing the risk of personal liability which might otherwise arise if they delay taking such steps.

For as long as directors continue to manage the business (i.e. until the appointment of a liquidator or a restructuring officer) while a company is of doubtful solvency, all transactions should be considered carefully and well documented with reference to the financials of the company as they will likely be scrutinised. Transactions may be potentially voidable as an unfair preference, undervalue or even a fraudulent disposition.

Ogier has acted for creditors, debtors and officeholders across the spectrum of restructurings, official and voluntary liquidations and contentious insolvencies more generally. Please contact your usual Ogier contact if you require any further information.

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