CAYMAN ISLANDS

COURT OF APPEAL

Weavering Macro Fixed Income Fund Limited (in liquidation) (Unreported, 18 November 2016)

SECTION 93 COMPANIES LAW (2013 REVISION) – CROSS BORDER INSOLVENCY – COMPULSORY WINDING UP – VOIDABLE PREFERENCES – CLAW BACK OF REDEMPTION PAYMENTS

A fundamental principle of insolvency law is that, subject to statutory priorities given to certain creditors, an insolvent's assets should be distributed equally between its creditors on a *pari passu* basis so that each creditor recovers the same proportional amount (and, therefore, suffers the same proportional loss). This principle may be contravened when an insolvent entity makes a distribution to a creditor, leaving insufficient funds to pay its remaining creditors. To remedy such mischief, the Grand Court of the Cayman Islands has powers under the *Cayman Islands Companies Law (as revised)* to claw back such preferential distributions, and the proper exercise of these powers was recently the subject of a decision of the Cayman Islands Court of Appeal in *Re Weavering Macro Fixed Income Fund Limited (in liquidation)* (unreported, 18 November 2016).

Weavering Macro Fixed Income Fund Limited (the "Fund") was an open-ended investment fund, in which investors were able to subscribe for redeemable participating shares. The Appellant, Skandinaviska Enskilda Banken AB (Publ) ("SEB"), was one such subscriber. From around October 2008, the Fund began receiving large volumes of redemption requests from investors, which included two requests by SEB that would result in the redemption of its entire shareholding. What the investors did not know at the time was that the Fund's NAV was hugely inflated, and the Fund had entered into a number of sham transactions significantly impacting on the true value of the Fund. Despite these perilous circumstances, the Fund had paid SEB under its first redemption notice in full, and under its second notice in two tranches. While some other investors were also paid out pursuant to their redemption requests, others were never paid out at all. Ultimately, the Fund ran out of cash and entered liquidation, leaving many investors severely out of pocket.

PwC and Grand Thornton were appointed as the Joint Official Liquidators ("JOLs") of the Fund and brought claims against a number of the investors who had been paid out in full, including SEB. The JOLs' claims were based on Section 145(1) of the *Cayman Islands Companies Law (2013 Revision)* (the "Law") which states:

"Every conveyance or transfer of property, or charge thereon, and every payment obligation and judicial proceeding, made, incurred, taken or suffered by any company in favour of any creditor at a time when the company is unable to pay its debts within the meaning of section 93 with a view to giving such a creditor a preference over the other creditors shall be invalid if made, incurred, taken, or suffered within six months immediately preceding the commencement of a liquidation".

At first instance, the Grand Court considered that the evidence showed the Fund was unable to pay its due debts at all material times, and that the payments had been made with a view to giving SEB a preference over the other creditors. It found that SEB had received certain payments that were invalid as preferences over the other creditors of the Fund, and ordered that SEB repay over US$8 million in redemption proceeds to the Fund.

Appeal

SEB appealed to the Cayman Islands Court of Appeal, which was asked to consider the following issues:

- Whether the Fund was unable to pay its due debts at the time of the payments within the meaning of Section 93 of the Law (the "Solvency Issue");

- Whether the payments made with a view to giving SEB a preference over the other creditors (the "Preference Issue") and

- Whether there were any other factors that supported SEB's position that it should not repay the claimed amounts (the "Repayment Issue").

The Court of Appeal

In relation to the Solvency Issue, the Court of Appeal was satisfied that the material before it showed that the Fund was unable to pay its debts on the date it made the first of its redemption payments to SEB. The Court of Appeal agreed with the Grand Court that the Fund was therefore insolvent within the meaning of Section 93 at all material times. In making this finding, and effectively introducing a "forward-looking element" into the Cayman test for insolvency, the Court of Appeal also noted that the cash flow test in the Cayman Islands "is not confined to consideration of debts that are immediately due and payable. It permits consideration also of debts that will become due in the reasonably near future". However, what will amount to the "reasonably near future" will likely differ from case to case.

In relation to the Preference Issue, the Court of Appeal also agreed with the Grand Court that the redemption payments were made with a view to giving SEB a preference over the other creditors. In doing so, the Court of Appeal confirmed that Section 145(1) of the Law contains no implied requirement of dishonesty on the part of the Fund in order for a payment to be considered preferential. In this case, the Court of Appeal found that it could be inferred that payments were made to SEB with a view to prefer SEB over the other creditors for the following reasons:

- before making those two payments the Fund knew it was cash flow insolvent;

- the Fund nevertheless adopted a policy to allow investors who submitted redemption requests earlier (including SEB) to be paid ahead of later redeemers (instead of taking the proper course to suspend redemptions) and

- the two payments to SEB were made pursuant to that policy.

On the basis of the above, the Court of Appeal concluded that SEB therefore received an advantage over the later redeemers who the Fund knew would not be paid and that the Company had shown a "specific intention" to prefer. This appears to be a departure from earlier authority, including long established English authority. More specifically, in *RMF Market Neutral Strategies (Master) Ltd -v- DD Growth Premium 2X Fund*, Smellie CJ stated: [1]

"The mere fact of a preference – that is, the consequence that one creditor gets paid ahead of others – is not on its own enough, for that approach would give no effect to the requirement that the payment is made with a view of giving a preference. The requirement is that the ***dominant intention*** *is to prefer the creditor who receives payment".* (emphasis added)

In relation to the Repayment Issue, SEB argued that the Law does not explicitly direct that preferential payments are to be repaid to the insolvent company and argued that liquidators must rely on a restitutionary remedy or a common law claim in order to have the money repaid to the company. The Court of Appeal rejected this argument, finding that it is implicit in Section 145(1) of the Law that preferential payments are to be returned to the company and common law defences are therefore unavailable in Section 145 claims.

The Court of Appeal's decision in *Weavering* indicates a greater willingness of the Court to claw back transactions, and a rebalancing of principles in the Cayman Islands in favour of the *pari passu* principle. However, as the Privy Council is yet to weigh in, it remains to be seen whether this is a permanent shift and whether the expansion of the Law provided for in the Judgment will remain. In the meantime, insolvency professionals, investors and custodians will find the Court's guidance in the *Weavering* judgment informative should similar circumstances arise in the future.

[1] [2014] 2 CILR 316.