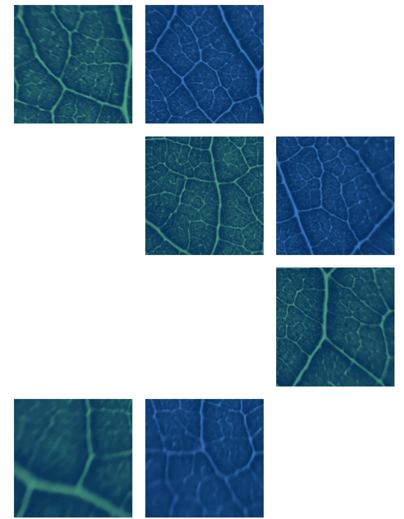

Is it time to dispose of the definition of disposition?

Section 146(2) of the Cayman Islands Companies Act (2023 Revision)

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Summary

We may think we know or understand a person's dispositions. But in the context of section 146(2) of the Cayman Islands Companies Act (2023 Revision)[1] there are a finite number of possible situations, of a finite variety. As a consequence, an understanding of such dispositions will not necessarily render the prospect of recovery of assets by a liquidator, when using this provision, a course of action with a sufficiently certain prospect of success as to warrant pursuit.[2]

Section 146(2) of the Companies Act provides that, "[e]*very disposition of property made at an undervalue by or on behalf of a company with intent to defraud its creditors shall be voidable at the instance of its official liquidator*". No doubt, when drafted and subsequently implemented, this provision was intended to be, and was considered to be, the equivalent in the Cayman Islands of section 238 of the Insolvency Act 1986[3] in England and Wales.[4]

However, section 238 refers to a "*transaction*" at an undervalue as opposed to a "*disposition*" at an undervalue (the latter being the phraseology used in section 146(2)). Moreover – and unlike section 238, in relation to which the word "*transaction*" is not defined – the word "*disposition*" is specifically defined for the purposes of section 146(2).

This briefing explores what we consider to be the unintended consequences (and the failure to appreciate the consequences) of the decision to define "*disposition*"; and specifically the decision to define the word "*disposition*" by reference to the meaning of that word as contained in and used for the purposes of the Cayman Islands Trusts Act (2021 Revision).[5] More specifically, we consider the consequences that follow in circumstances where payments are made by way of electronic bank transfers, with the requisite intent to defraud (as also required by section 146). We advocate that, for the sake of coherence and, more importantly, to make the relevant section far more effective in addressing what was plainly the mischief at which section 146(2) was directed, the Cayman Islands legislature should either remove entirely the definition given to "*disposition*", or refine it (for example) to remove the reference to a "*disposition*" constituting a transaction "*by which any legal or equitable interest in property is created, transferred or extinguished*". Most straightforwardly, perhaps, the wording of section 238 of the Insolvency Act should be adopted in the Cayman Islands – which provision has proved to be effective in reversing antecedent transactions in the context of corporate insolvency and is (unlike, it would seem, section 146) widely invoked by liquidators in England as part of their 'toolkit' to recover assets of the corporate insolvent estate for the benefit of creditors.

1 The 'Companies Act'.

2 Adapted from Karl Popper, 'Objective Knowledge A Realist View of Logic, Physics, and History', ch 1 (pp 1–37) of *Physics, Logic, and History* (1970, eds Wolfgang Yourgrau and Allen D Breck). In this essay Popper was discussing the promulgation and understanding of theories in a scientific and philosophical context. He went on to say that a full understanding of a theory must carry with it an understanding of all of its logical consequences. The genesis of this briefing is that adopting and transposing the word "*disposition*" from a different legal and statutory context for use in section 146 of the Companies Act manifests a failure to understand any or all of the logical consequences of such transposition, and illustrates the dangers of such an approach to statutory draughtsmanship.

3 The 'Insolvency Act'.

4 In 2006, the Cayman Islands Law Reform Commission undertook a review 'of the Corporate Insolvency Law and Recommendation for the Amendment of Part V of the Companies Law'. Regarding 'Avoidance of pre-liquidation transactions', the Law Reform Commission observed at paragraphs [11.1]–[11.2] that the Fraudulent Disposition Act (1996 Revision, 'FDA') "*provides a remedy for the creditors of companies whose assets have been improperly disposed of at an undervalue. However, the effectiveness of the remedy is limited by the fact that the liquidator of a company does not fall within the definition of 'creditor'. The overall effect of sections 147 and 148 of the draft bill is to put the liquidator in the same position as the creditors. In future it will normally be the liquidator, rather than a creditor, who will institute proceedings to set aside transactions made at an undervalue*". Section 146 thereafter appeared in the Memorandum of Objects and Reasons that accompanied the Companies (Amendment) Bill, 2007.

5 The 'Trusts Act'.

Briefing

Introduction to the legislative provisions

Section 146(2) of the Companies Act provides that "[e]very *disposition of property made at an undervalue by or on behalf of a company with intent to defraud its creditors shall be voidable at the instance of its official liquidator*". The word "*disposition*" is specifically defined for the purposes of section 146.[6] Section 146(1)(a) provides that the word has the meaning ascribed to it in Part VI of the Trusts Act.[7] In section 87 of the Trusts Act a "*disposition*", in relation to property, "*connote[s] every form of conveyance, transfer, assignment, lease, mortgage, pledge or other transaction by which any legal or equitable interest in property* ***is created, transferred or extinguished***" (emphasis added). By section 2 of the Trusts Act, "*property*" is defined as including "*real and personal property, and any estate, share and interest in any property, real or personal, and any debt, thing in action and other right or interest, whether in possession or not*".[8] As such, the definition plainly includes a credit balance held in a bank account (*qua* "*debt*" or "*thing in action*").

Bank transfers

When 'money' is paid into a bank account it becomes the property of the bank. The customer ('X') is now the possessor of a chose in action: there exists a debt as between X and the bank, with a right held by X to claim from the bank the amount standing to its credit in its bank account. When X transfers money to a third party ('Y') from its bank account, X issues a payment instruction to its bank. When the bank executes X's payment instruction, the chose in action (as represented by the credit balance in favour of X) is reduced *pro tanto* (or extinguished *in toto*) and a new chose in action is created (or the value of an existing chose in action is increased) in favour of Y, as between Y and its bank.[9] Such a transaction involves no transfer of property or any interest in property directly from X to Y or as between X and Y; there may be one or more book entries evidencing the transfer of value from X to Y, but no asset or property right or interest is transferred by X to Y as part of this process.[10]

"Dispositions" made by bank transfer

As noted above, for the purposes of section 146, a transaction by which an interest in property is extinguished or created constitutes a "*disposition*". This means that a payment executed by way of electronic bank transfer from one bank account to another constitutes (at least) two separate dispositions:

- The first disposition is the transaction by which X's interest in the chose in action represented by the credit balance in favour of X in respect of its bank account (ie, X's property) is extinguished or reduced in value (disposition 1)[11] consequent upon the transfer between X's bank account and Y's bank account.
- The second disposition is that by which a chose in action in favour of Y, as represented by the credit balance held in Y's bank account (ie, Y's property), is created or enlarged (disposition 2).

The specific problem presented by the wording of section 146

When a liquidator advances a claim under section 146, it is the transferee (the recipient of the company's property) that is the obvious 'target' of such a claim.[12] A "*transferee*" is defined for the purposes of section 146 as the "*person to whom a relevant disposition is made and shall include any successor in title*".[13] Insofar as section 146 refers to "*any successor in title*" (and "*any predecessor transferee*")[14] it plainly contemplates that there may be more than one "*disposition*" (as defined) which can form the basis of a claim as against the ultimate recipient of a corporate asset where that ultimate

6 The definition does not apply to other sections of the Companies Act. This is clear from section 146(1) itself, which provides that "[i]n *this section and section 147 – (a) "disposition" has the meaning ascribed in Part VI of the* [Trusts Act]".

7 In fact, the definition is found in Part VII of the Trusts Act. The reference to Part VI seems to be a drafting legacy from the Companies Act (2009 Revision), which referred to the Trusts Act (2009 Revision).

8 There is no definition of "*property*" contained in section 146. However, "*disposition*" in section 87 of the Trusts Act is defined, as being "*in relation to property*". Pursuant to Cayman Islands principles of statutory interpretation, it may be taken that the intention of the legislature was to also import into section 146 the definition of "*property*" as contained in section 2 of the Trusts Act.

9 *R v Preddy* [1996] AC 815.

10 The inherent value in the credit transferred from one bank account to another may be traced: *Foskett v McKeown* [2001] 1 AC 102 at page 128C. However, 'tracing' (in the strict technical sense) is of no real relevance in the context of this specific statutory cause of action; what matters under section 146 is whether property is disposed of to a "*transferee*". True it is that a "*transferee*" may include a "*successor in title*", and to that extent the identification of relevant (and specific) property in the hands of a "*transferee*" may be of importance.

11 For present purposes, we do not consider the difference between the extinguishment of a chose in action and a reduction thereof to be significant. Either way, X's interest in its property (ie, the chose in action) is either extinguished in full or reduced *pro tanto*. The same applies, *mutatis mutandis*, as regards the creation of a new chose in action and any increase in value of an existing chose in action as between Y and its bank.

12 Interestingly, section 146 does not expressly state who may be sued. However, by necessary implication it is the "*transferee*": see for example section 146(5) that grants the "*transferee*" certain protections in the event that they have not acted in bad faith in relation to the receipt of the relevant property.

13 By section 146(1)(d) of the Companies Act.

14 By section 146(5)(b) of the Companies Act.

recipient also constitutes a "*successor in title*".[15] However, as will be apparent, whilst a disposition might include a series of transactions,[16] the availability of any remedy under section 146 is delimited (by reference to its own terms) – that is, consequent upon the definition of "*disposition*" and (to a lesser extent) the definition of "*transferee*". This presents a peculiar problem where the relevant disposition (the transaction that is intended to be challenged) is made electronically by way of a bank transfer.

As analysed above, the relevant banking transaction will comprise (at least) two dispositions (disposition 1 and disposition 2). However, pursuant to disposition 2, Y does not receive X's property, or any right to or interest in X's property (ie, the chose in action as existed between X and its bank). Nor does Y succeed to any title in that item of property. Rather, Y obtains an entirely new chose in action (or there is an increase in value of an existing chose in action), as between Y and its bank. The debt that existed as between X and its bank and the debt as between Y and its bank (whether created or enlarged) are "*two different choses in action, although their monetary value may be equivalent*".[17] As a consequence, there has been no "*disposition*" of property by or from X to Y (within the meaning of section 146), and Y (not being a recipient or a "*successor in title*" to any relevant property of X or any interest in such property) is not and cannot be a "*transferee*" within the meaning of section 146. The only relevant "*disposition*" (as defined by section 146) is as between X and its bank, and the only "*transferee*" (as defined by section 146) is the bank with which X holds its bank account.

The position under section 99 of the Companies Act

Contrast the position under section 99 of the Companies Act (which is the equivalent of section 127 of the Insolvency Act). Insofar as material, section 99 provides that "***any disposition of the company's property** ... made after the commencement of the winding up is, unless the court otherwise orders, void*" (emphasis added). Unlike for the purposes of section 146, the word "*disposition*" is not defined in or for the purposes of section 99. As such, the section does not include an express limitation on the meaning and effect of the word "*disposition*".[18] The same is true for section 127 of the Insolvency Act.

In their analysis of section 127 of the Insolvency Act, the Courts in England and Wales have recognised the potential difficulty presented by the use of the word "*disposition*". However, it is precisely because the word "*disposition*" is not a defined term that allows section 127 of the Insolvency Act to operate with flexibility and as was intended. As a result, under that section, it is "*sufficient that identifiable property by some act having legal consequences (so excluding mere effluxion of time) ceases to be in the ownership of the company, so that it is no longer available to the liquidator of the company for the statutory purposes, and the value accrues to some other person (so excluding consumption or waste), even though that other person cannot necessarily be said to become the owner of the same property*".[19]

As to the intermediate steps contained within the process of making payments through a bank to the ultimate recipient, there is not considered to be any relevant disposition of the company's property to which the section applies.[20] The relevant disposition, under section 127 of the Insolvency Act, is therefore the transfer of value from X to Y – that is, no different from X withdrawing cash from its bank and handing it to Y directly.

We note also that the Courts in England and Wales have alluded to the potential difficulty that arises as regards the proper meaning of the word "*disposition*" in the context of its use in section 127 of Insolvency Act in relation to the equivalent provision that applies to personal insolvency (bankruptcy); observing that any such potential difficulty or potential issue does not arise under section 284 of the Insolvency Act because, unlike section 127, section 284 deals with and refers to both "*dispositions*" and "*payments*".[21]

The position would, we have no doubt, be the same under section 99 of the Companies Act as it is under section 127 of the Insolvency Act.[22] Therefore, the lack of any definition of the word

15 This point was made by Mr Justice Parker in *Raiffeisen International Bank AG v Scully Royalty Ltd* (Unreported, 12 March 2021) at paragraph [136] as regards the equivalent provisions in the FDA. On appeal, the Cayman Islands Court of Appeal agreed, holding that there was nothing in the language of the FDA which compelled the view that only the first transaction in a series of transactions should be identified as the disposition for the purposes of the FDA (see [2022] (1) CILR 497, at paragraph [14]).

16 Analogous with the position under sections 238 and 423 of the Insolvency Act, in relation to which it has been said, in "*some cases it may be appropriate ... to treat a single step in a series of linked dealings as the relevant "transaction"; in others it may not*": *Feakins v Department for Environment, Food and Rural Affairs* [2007] BCC 54, at paragraph [78].

17 *First City Monument Bank Plc v Zumax Nigeria Limited* [2019] EWCA Civ 294, at paragraph [76].

18 And the word "*transferee*" does not appear in this context, let alone is it defined.

19 *Officeserve Technologies Ltd (In Liquidation) v Anthony-Mike* [2017] BCC 574 at paragraph [99] applying *Akers v Samba Financial Group* [2017] AC 424.

20 *Bank of Ireland v Hollicourt (Contractors) Ltd* [2001] Ch 555 at paragraph [23] (deciding that the only dispositions to which section 127 applied were those between the company and the payees of the cheques, and that the debiting of the account did not amount to a disposition in favour of the bank, as the learned judge had thought at first instance); and see *Coutts & Co v Stock* [2000] 1 WLR 906.

21 *Pettit v Novakovic* [2007] BCC 462, at paragraph [15].

22 See eg, *Scotiabank (Cayman Islands) Limited v Treasure Island Resort (Cayman) Limited* [2004–05] CILR 423.

"*disposition*" for the purposes of section 99 of the Companies Act should permit a similar flexibility of interpretation in the context of potentially void transactions as exists in England and Wales. However, because of the strictures of the specific definition of "*disposition*" (and for that matter the definition of "*transferee*") as required for the purposes of section 146, such flexibility of interpretation in that context is not available.

The implications for a liquidator's claim under section 146

Let us assume that X is an insolvent company, making a payment electronically by way of bank transfer to Y with intent to defraud its creditors. A liquidator would no doubt seek to 'claw back' the payment from Y. However, we have concluded above that Y is not a "*transferee*" (as defined by section 146) because there has been no "*disposition*" (as defined by section 146) of X's property made to Y. As such, on the wording of section 146, any claim under that section as against Y ought therefore be bound to fail. A liquidator would instead be faced with the prospect of a claim against X's bank, *qua* the only relevant "*transferee*" consequent upon a "*disposition*". We consider it doubtful that section 146 was intended to have such an effect: ie, that it was intended for X's bank in such circumstances to be liable to restore the value of the transaction to the insolvent company, namely the value of the debt of which it has been absolved as a result of the relevant bank transfer having taken place.

First, it is counterintuitive. In substance, when X pays Y by way of a bank transfer there is a disposition of X's property, but not to Y – although value may be said to have been transferred from X to Y, and the end result is the same as if X had paid Y in cash directly. In such a scenario, X's bank has simply acted as agent for its customer consequent upon (other things being equal) a lawful payment instruction. As a result, a liquidator will invariably pursue Y under section 146 – but, as concluded above, such a claim strictly speaking should (as it seems to us) be bound to fail.

Secondly, we consider that every payment made by electronic bank transfer would inevitably be at an "*undervalue*". For the purposes of section 146, a disposition is made at an undervalue if a company disposes of its property for either no consideration or for consideration the value of which, in money or money's worth, is significantly less than, "*the value of the property which is the subject of the disposition*".[23]

"*Consideration*" is not defined for the purposes of section 146, but Professor Goode suggests that it should be given the "*normal meaning ascribed to it by the law of contract*".[24] As a matter of contract law, consideration is "*to be contrasted with objective value*".[25] However, section 146(1)(e)(ii) expressly requires the value of the consideration provided to the company to be compared with the value of the property which is the subject of the disposition. Even if – which is not clear – the disposition by X to X's bank is for consideration,[26] the value of that consideration in money's worth would inevitably be "*significantly less than the value of the property which is the subject of the disposition*" – that is, the value of the chose in action in X's bank account. If that is right, there will never be any question of such a disposition being for value.

Thirdly, the result (namely the imposition of a liability on a bank in the circumstances under consideration) cannot be supported on policy grounds. Section 146 aims to prohibit the "*improper reduction of a company's net asset value...*",[27] and consequently obtain a restorative remedy as against the party that has correspondingly benefited from that reduction in value. The section is concerned with dispositions of a company's property that reduce the company's net asset position to the detriment of its creditors,[28] and is therefore premised upon the preservation of the *pari passu* principle of distribution to a company's creditors in an insolvent winding-up. This is also the premise for section 99 of the Companies Act and section 127 of the Insolvency Act.[29]

Finally, it has been observed (*viz* section 127 of the Insolvency Act) that, as a result of the debiting of a bank account itself constituting a "*disposition*" of company property, banks would effectively be required to underwrite

23 By section 146(1)(e): "'*Undervalue*' *in relation to a disposition of a company's property means – (i) the provision of no consideration for the disposition; or (ii) a consideration for the disposition the value of which in money or monies worth is significantly less than the value of the property which is the subject of the disposition.*"

24 *Goode on Principles of Corporate Insolvency Law* (5th edn, 2018) at [13–23]. For a contrary view see *McPherson & Keay's Law of Company Liquidation* (5th edn, 2021) at [11–032].

25 *Goode, op cit*, at [13-23].

26 *Goode, op cit*, at [13-23] notes that if a party "*exacts a counter-undertaking or the performance of a designated act, this constitutes consideration for his promise whether or not the counter-presentation has any objective value, for contract law does not concern itself with the adequacy of consideration*". As such, X requires its bank to discharge its liability (*qua* debtor) to X (*qua* creditor), and the bank's performance of this act could be said to constitute consideration.

27 *Goode, op cit*, at [13-03], referring to section 238 of the Insolvency Act.

28 *Goode, op cit*, at [13-11].

29 See *Coutts & Co v Stock, supra* at page 909H, and *Denney v John Hudson & Co Ltd* [1992] BCC 503, at page 504H–505A. The protection of the *pari passu* principle is accomplished by, in effect rendering void the transfer of value, without (unless and to the extent necessary) impinging upon the legal validity of any intermediate steps, such as those involved in the completion of banking transactions (see *Bank of Ireland v Hollicourt (Contractors) Ltd, supra*, at paragraph [23]), and which merely constitute the mechanics by which value is transferred away from the company in question and received by a third party (*Goode, op cit*, at [13-121]–[13-122]). The relevant third party (consequent upon the voidness of the transfer of value) may then be made liable to restore to the company the value the company has lost.

all payments debited from accounts in credit upon a company's insolvency, which could in substance (if not in fact) amount to an extension of the bank's duty of care.[30]

None of these consequences, it is submitted, can possibly be considered as having been intended by the terms in which section 146 has been drafted.

Preferences

The same issue does not arise under section 145 of the Companies Act concerning voidable preferences. The wording of that section is much broader, insofar as it refers to every *"conveyance or transfer of property, or charge thereon,* ***and every payment obligation*** *and judicial proceeding, made ...* ***in favour*** *of any creditor"* (emphasis added). Payment is the process by which money passes from one party to another and *"a payment"* refers to the money or value that is the subject of that process.[31] We have already noted the similar position under section 284 of the Insolvency Act, which refers both to *"dispositions"* and *"payments"* and thereby avoids any potential controversy by the use of the word disposition.

Solution

As section 146 is currently drafted, *"disposition"* encompasses a transaction pursuant to which an interest in property is extinguished or created, meaning that each of the *"intermediate steps"*[32] making up a single 'bank transfer' is itself a *"disposition"*. The consequence is potentially to impose restitutionary liability (referring to the examples given above) on X's bank – which is not merely unattractive but, we consider, plainly unintended for the reasons already stated; simply put, this is not the type of transaction that was intended to be the target of liability under section 146.

Unlike section 127 of the Insolvency Act (and section 99 of the Companies Act), we are not of the view that section 146 can be interpreted in such a way as to include transfers of value. As a matter of Cayman Islands law, while the grammatical meaning of an enactment is not necessarily synonymous with its legal meaning,[33] we take the view that the legislature's decision to specifically define *"disposition"* in unequivocal terms, coupled with the attendant definition of *"transferee"*, means that section 146 is legally capable of only being interpreted in accordance with those definitions, and a more flexible or purposive meaning is not possible or appropriate.

However, there are alternative solutions. The definition of *"disposition"* could be removed. This would mean that, like section 127 of the Insolvency Act (and, by parity of reasoning, section 99 of the Companies Act), flexibility could be applied to the meaning of *"disposition"*, with the result that a payment by way of bank transfer could be treated as a disposition by the company to the ultimate payee / recipient of the value of the transaction.[34]

To dispense with the definition of *"disposition"* would also bring the effect of this provision in line with its counterpart in the Insolvency Act (ie, section 238), which does not define the word *"transaction"*, and which word has: "[a] *very wide meaning. It is not confined to contracts but extends to gifts and other arrangements which are not based on contract, and where there is a contract, "transaction" may cover not only that contract but any linked transaction, even though involving a different party."*[35]

Arguably, a better alternative would be simply to adopt the wording of section 238 of the Insolvency Act (with all necessary changes and amendments for context). This would achieve unequivocally the intended objective of section 146, and have the added benefit of the Cayman Islands Courts being able to consider and apply (as appropriate) the developed jurisprudence of the Courts of England and Wales in the application of section 238. Either way, the decision to define, and the definition given to, *"disposition"* (and *"transferee"*) results in the application of section 146 of the Companies Act in a way that is far too restrictive and which consequently impairs its effectiveness. Accordingly, section 146 requires urgent revisiting by the Cayman Islands legislature.

30 Adrian Walters, *'Void Dispositions in Compulsory Winding-up'* in Armour and Howard Bennett (eds), *Vulnerable Transactions in Corporate Insolvency* (2002) at [8.76].

31 *Pettit v Novakovic, supra*, at paragraph [12].

32 *Bank of Ireland v Hollicourt (Contractors) Ltd, supra*, at paragraph [23].

33 *BDO Cayman Limited v Governor in Cabinet* [2018] (1) CILR 457, at paragraph [125].

34 Walters, *op cit*, at [8.75].

35 Goode, *op cit*, at [13-18].

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