COLLAS CRILL

Court sanctions: distribution of funds from a liquidation estate

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Introduction

The Grand Court of the Cayman Islands (**Court**) has recently handed down two decisions permitting the distribution of funds from a liquidation estate, notwithstanding a competing proprietary interest to the entirety of the assets comprising that estate. In the first application, the Court sanctioned a settlement agreement with a significant proven creditor of the estate (**Settlement Application**); and, in the second, the Court sanctioned the payment of an interim distribution to the unsecured creditors of the debtor, whose proofs of debt had been admitted and who had elected to participate in the proposed distribution, (**Distribution Application** and together with the Settlement Application, the **Applications**).

In determining whether to sanction the course of conduct proposed by the Joint Official Liquidators (**JOLs**), the Grand Court balanced the proven interests of the unsecured creditors of SAAD Investment Company Limited (**SICL**), against the speculative and unestablished interests of a party asserting a proprietary interest to the entirety of the estate's assets. While the circumstances in which the need for the Applications arose are unique, the Court's reasons for its decisions provide useful guidance to officeholders who find themselves having to manage competing interests to assets which fall within their possession and under their control.

Factual background

SICL was a holding company within the Saad group (**Group**) of companies which had been formed in 1980 by Mann Al Sanea, who was the Chairman of the Group. Mr Al Sanea was also a member of the Ahmad Hamad Algosabi family which itself operated a network of companies, referred to as **AHAB**.

In July 2009 AHAB filed proceedings against SICL and 42 other defendants of the Group, asserting that Al Sanea had defrauded AHAB of approximately US$9.2 billion (**AHAB Claim**).[1] The AHAB Claim asserted a right to all of the assets of SICL. Shortly after the AHAB Claim was issued, three lending banks issued a winding up petition against SICL and the company was placed into official liquidation. The main liquidation of SICL was conducted in the Cayman Islands, and an ancillary bankruptcy proceeding remains ongoing against SICL in respect of assets held by SICL in Switzerland.

In mid-2018, the AHAB Claim was rejected in its entirety by the Court. AHAB subsequently appealed as of right to the Cayman Islands Court of Appeal. At the time that the Applications were made, the appeal of the AHAB

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Claim remained to be determined. However, when appealing the first instance decision, AHAB did not seek a stay of the winding up of SICL, nor of the effect of the first instance decision.

The Applications were made ten years after SICL had been placed into liquidation. During the course of that liquidation, the joint official liquidators of SICL had not made a single distribution to the established creditors of the company. This was due to the unresolved AHAB Claim. Notably, in 2010 the Court had made an interim order prohibiting the JOLs from distributing any of the proceeds of sale that were realised during the course of the liquidation until the earliest of, either: (i) judgment in the AHAB Claim; (ii) an order of the Court in respect of the proceeds of sale; or, (iii) the consent of both AHAB and any third party asserting beneficial ownership of the assets of the companies in liquidation[2] (**2010 Order**).

In the normal course, the JOLs would have had the power to declare and make an interim distribution to creditors without seeking sanction of the Court. However, the 2010 Order effectively prohibited them from exercising their power to make such a distribution. Therefore it was necessary to seek the sanction of the Court before doing so. Hence, the Distribution Application was brought by the JOLs of SICL. The Applications and their import are discussed in turn below.

Settlement Application

By the Settlement Application, the JOLs sought the sanction of the exercise of their power to enter into a settlement with a significant creditor of the SICL estate; a power which, under the provisions of the Companies Law, may only be exercised with the sanction of the Court.

The creditor with whom the JOLs had reached a compromise had been admitted to the estate for a claim in the aggregate amount of US$23 million (**Creditor Claim**). The Creditor Claim arose under the terms of a guarantee agreement governed by the laws of New York (**Guarantee**). The Guarantee had been given by both SICL and its wholly-owned subsidiary, in favour of AB Ltd. By the terms of that Guarantee, SICL and its wholly-owned subsidiary had both agreed to act as co-guarantors for all past, present and future indebtedness of the Saad Trading and Contract Company (**STCC**) to AB Ltd accruing under a Promissory Note (**Note**) between STCC and AB Ltd. By the terms of the Note, interest was payable by STCC to AB Ltd at a rate of 12 per cent per annum, and, consequently, the Creditor Claim was comprised of US$12 million in principal, and US$11 million in accrued interest.

The compromise agreed with AB Ltd provided that SICL's liability under the Guarantee would be discharged by a payment of US$17 million (Settlement Amount), and preserved SICL's right to recoup that payment from STCC, by way of subrogation.

The Court sanctioned the JOLs' exercise of their power to enter into the compromise of the Creditor Claim, notwithstanding that the AHAB Claim remained unresolved by reason of the outstanding appeal. In doing so, the Court reasoned that the AHAB Claim "[remained] *at best a contingent proprietary* [claim]*; no trust has been declared to exist in favour of AHAB*"[3] and found that in the absence of the AHAB Claim being established, the JOLs were not yet under any fiduciary obligations to AHAB. The Court went on to find that in the absence of

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having established fiduciary obligations to AHAB, the JOLs were required to carry out their duties as liquidators for "*the benefit of the proven creditors of SICL's liquidation estate*".[4]

Having clarified the contingent nature of the AHAB Claim, the Court turned to consider the impact that the proposed settlement would have on the SICL estate. The Court was persuaded that seen in the round the proposed settlement with AB Ltd was in the best interests of SICL's estate as it would:

- result in a diminution in the liabilities asserted against the estate (for the reason that AB Ltd would be paid US$17 million but had been accepted to proof for US$23 million resulting in a benefit of US$6 million to the remaining creditors);
- avoid the costs that would necessarily be incurred by SICL and its wholly-owned subsidiary in verifying the liabilities of each of SICL and its subsidiary to AB Ltd under the Guarantee; and
- further, avoid expenses from being incurred in relation to the Creditor Claim in the ancillary liquidation of SICL in Switzerland (in which AB Ltd had also filed a proof pursuant to the Guarantee).

Distribution Application

By the Distribution Application, the JOLs sought sanction from the Court to make an interim distribution to the proven creditors of SICL. At the time of making the application, the JOLs had not yet determined the amount of the interim distribution to be paid to each of the proven creditors of SICL. Despite the fact that the members of the liquidation committee of SICL (**LC**) did not unanimously agree that an interim distribution should be made by the JOLs, the Court determined the Distribution Application on the papers and dispensed with the need for a hearing of the application.[5]

As noted above, the 2010 Order prevented the JOLs from making distributions from the SICL estate unless and until the occurrence of certain specified events. The Court agreed with the JOLs' view that the terms of the 2010 Order prevented the JOLs' from making an interim distribution out of the estate and that it was necessary to make the Distribution Application in order to overcome that limitation. In noting the scope of the AHAB Claim and the possible consequences for the JOLs, as trustees, if that claim were established, the Court considered that there was established authority for the JOLs' approach in seeking the protection of the Court through a sanction application when taking a "*momentous decision*",[6] such as the making of the proposed interim distribution.[7]

The JOLs did not intend to make any provision for the unproven AHAB Claim and, upon legal advice, considered the AHAB Claim to lack any merit. However, cognisant of the need to provide adequate safeguards to ensure that the AHAB Claim could be satisfied if it was ultimately successful, the JOLs proposed that creditors wishing to participate in the interim dividend would be required to enter into a Deed of Indemnity (**DoI**) in favour of the JOLs.

The DoI obligated the recipient of distributions to: (i) repay the money to the estate should the AHAB Claim be established; and (ii) provide security for its obligation to do so, by way of a surety bond from an institution with

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a credit rating of at least A-. These terms provided a mechanism whereby the AHAB Claim could be satisfied in the event that the AHAB Claim prevailed on appeal.

The Court agreed with the JOLs' contention that the terms of the DoI adequately protected AHAB from potential prejudice that might result from the interim distribution. The Court acknowledged the *"massive nature"*[8] of the AHAB Claim, but recognised that if sanction was not granted, the proven creditors of SICL would continue to suffer prejudice as a result of funds being withheld, due to the unproven AHAB Claim which the JOLs considered to lack merit. Furthermore, that state of affairs would potentially continue until the AHAB Claim was finally determined at the level of the Privy Council. It was held that the interests of the estate and its creditors were best served by the JOLs being authorised to make the proposed distributions.

A balancing act: proprietary claimants versus unsecured creditors

In allowing the Settlement Application the Court stated that *"it must now be regarded as settled principle that the Court can sanction the payment out of funds that are subject to a proprietary claim which claim, if eventually proven, would mean that the funds were held on trust for the claimant".*[9]That dictum acknowledged the principle set down by the Privy Council in *Guardian Trust*,[10] namely, that a fiduciary who has notice of a third party proprietary claim to assets in his possession, may be exposed to liability to that third party if the fiduciary deals with those assets without having regard to the competing claim.

The Chief Justice further noted that whether or not the Court would grant sanction for the payment to creditors of a liquidation estate out of the assets which are subject to a proprietary claim, *"depends on the particular requirements of justice in the circumstances of the case"*[11]. In each of the Applications the Chief Justice endorsed the principle arising from the *Finers v Miro*[12] and *Re MF Global UK Ltd*[13] line of authority; namely, that the Court has an inherent jurisdiction to make an order permitting the JOLs to distribute proceeds from the estate's assets on a particular basis, where the court is satisfied that it is just and convenient to do so.

In granting each of the Applications, the Court took into account the benefits to the creditors of SICL in granting the Applications, and compared those to the prejudice that would be suffered by them by denying the JOLs sanction. On balance, the Court was of the view that the greater prejudice would be caused to the proven creditors of SICL if the Applications were denied, than if the Applications were granted and the AHAB Claim was then positively established thereafter.

Discussion

The outcome of the Applications confirms that it is a principle of the laws of the Cayman Islands that assets in the possession of a liquidator, which may be subject to a contingent proprietary claim, may be applied to the benefit of proven creditors of the estate, in circumstances where the Court considers that it is just and convenient to do so. In each case it will be a matter for the discretion of the Court to determine whether the

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circumstances favour a scenario where the liquidator should apply funds from the liquidation estate, notwithstanding the possibility that those funds might also be subject to a proprietary interest.

The fact that the proprietary claims remained contingent, led the Court to find that the JOLs did not yet stand in any fiduciary capacity vis-a-vis AHAB. As a result, the proven claims of SICL's creditors could not be convincingly regarded as competing with the unproven proprietary claim of AHAB. Accordingly, it was the obligation of the JOLs to continue to discharge their functions in the best interests of the creditors of SICL. The JOLs considered that those interests would be best served by their entering into a commercially advantageous settlement with a proven creditor, and making an interim distribution to the remaining proven creditors.

In granting sanction in both of the Applications the Court placed weight on the evidence of the JOLs that the appeal of the AHAB Claim was not likely to be successful. That reasoning seems to suggest that the strength and veracity of the proprietary claim asserted over the assets of an estate is a key factor which will be taken into account by the Court when considering if it is just and convenient to make a distribution of proceeds to creditors in the course of a liquidation, where those proceeds are also subject to a potential and unresolved proprietary claim.

The decisions confirm that the liquidation process should not necessarily be stymied by the mere assertion of a proprietary interest over the assets of a liquidation estate. Practically speaking, the decisions give Cayman liquidators guidance as to three questions which to ask themselves when a proprietary claim to the assets of the liquidation estate is asserted, namely:

1. Can the contingent proprietary claim which has been asserted properly be dismissed or disregarded by the liquidators?
2. If no, what are the prospects of that contingent claim being successfully established against the assets of the estate? And,
3. Where, in all the circumstances of the case, does the balance of convenience lie between the interests of the proven unsecured creditors and the party asserting to have a beneficial interest in the assets comprising the liquidation estate?

[1] Notably, a claim that was parasitic to the AHAB Claim was a proprietary claim asserted by Barclays to the entirety of the assets of SICL. The Barclays claim has been held in the background, pending the outcome of the AHAB Claim. It is only if the AHAB Claim is successful that Barclays could successfully assert a proprietary claim to the assets comprising the assets of SICL's estate.

[2] This is a reference to Barclays and its potential proprietary claim to the same assets.

[3] Settlement Application ruling, paragraph 38

[4] Settlement Application ruling, paragraph 40

[5] One of the three members of the LC objected to the JOLs making an interim distribution.

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[6] Distribution Application ruling, paragraph 36, referring by example to *Re Nortel Networks UK Ltd and other companies* [2016] EWHC 2769 (Ch)

[7] Distribution Application ruling, paragraphs 21 and 22 referring at 22 to *Guardian Trust and Executors of New Zealand v Public Trustee of New Zealand* [1942] AC 115

[8] Distribution Application ruling, paragraph 89

[9] Settlement Application ruling, paragraph 44

[10] [1942] AC 115

[11] Settlement Application ruling, paragraph 44

[12] [1991] 1 W.L.R. 35 (CA)

[13] (No 3) [2013] 1 W.L.R. 3874

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