VOISIN LAW

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One of the consequences of the current financial climate caused by the recent pandemic is that the question of solvency will become a more frequent consideration when examining the viability of a business going forward.

For the purposes of the Bankruptcy (Désastre) (Jersey) Law 1990 (the "**Bankruptcy Law**") and the Companies (Jersey) Law 1991 (the "**Companies Law**"), a company is insolvent if it is unable to pay its debts as they fall due. This test is often referred to as the "cash flow" solvency test, with Jersey law placing more emphasis on the cash flow basis of insolvency rather than a balance sheet basis of insolvency, which requires a company to show that the value of its assets is greater than the value of its liabilities.

For example, the applicable test on an application for a désastre under the Bankruptcy Law is the cash flow test. Under the Companies Law, insolvency on a cash flow basis is also relevant when considering matters such as whether a company is eligible to migrate into Jersey or whether a transaction can be set aside as a transaction at an undervalue or preference.

However, although the cash flow solvency test is mentioned in a number of Jersey cases, the courts of Jersey have yet to consider the precise meaning of cash flow insolvency and there is an element of uncertainty to this area of law.

For example, when considering cash flow insolvency, it is at present unclear the extent to which future debts should be taken into account in determining whether a Jersey company is unable to pay its debts as they fall due.

In trying to ascertain the precise meaning of cash flow insolvency, the Jersey courts may well consider the position under the English case law, and the case of *Re Cheyne Finance Plc* provides helpful guidance on the meaning of cash flow insolvency.

In this case, the court was asked to consider the meaning of being "*unable to pay its debts as they fall due*."

When analysing the meaning of this phrase, the court rejected the argument that only those debts which are presently due may be considered and were of the view that the cash flow test has an element of futurity as the words "*as they fall due*" are synonymous with "*become due.*"

The judgment goes on to set out the rationale behind this argument where it states that:

"*cash flow or commercial insolvency is not to be ascertained by a slavish focus only on debts as at the relevant date as such a blinkered review will, in some cases, fail to see that a momentary inability to pay is only the result of a temporary lack of liquidity soon to be remedied and in other cases fail to see that due to an endemic shortage of working capital a company is, on any commercial view, insolvent, even though it may continue to pay its debts for the next few days, weeks or even months before an inevitable failure*."

The court further held that in relation to how far into the future enquiries as to solvency need to be made was:

"*a fact sensitive question depending upon the nature of the company's business and, if known, of its future liabilities*."

The issue of course with this approach is that, as acknowledged by the court at the time, looking at future financial positions could cause a high degree of uncertainty. Unlike in other jurisdictions, under Jersey law there is no fixed timeframe as to how far into the future a company must look with regards to when debts become due.

The case of *Re Cheyne Finance Plc* has been subsequently approved by the Supreme Court case of *BNY Corporate Trustee Services Ld v Eurosail-UK 2007-3 BL plc*.

In this case, the Supreme Court described the judgement in *Re Cheyne Finance Plc* as being perceptive and consistent with the approach taken in cases such as *Bond Jewellers [1986] BCLC 261 and Byblos Bank SAL v Al-Khudhairy [1987] BCLC 232*. The Supreme Court further held that:

"the "cash flow" test is concerned, not simply with the petitioner's own presently due debt, nor only with other presently due debt owed by the company, but also with debts falling due from time to time in the reasonably near future. What is the reasonably near future, for this purpose, will depend on all the circumstances, but especially on the nature of the company's business".

When considering the cash flow test, the nature of the company's business in particular can be important. By way of example, in the hospitality sector, assessing the insolvency of a trading company based on its inability to pay its future debts (for example paying staff wages, suppliers, and other bills on time) could be more difficult because trading receipts would fluctuate from time to time.

On the other hand, in relation to a fairly typical scenario in Jersey where a special purpose vehicle holds real estate investments with financing in place, future debts may be more easy to ascertain (for example, scheduled principal repayments under a loan agreement) and rental streams from tenants may be easier to assess and would be taken fully into account in determining whether a company is able to pay its debts as they fall due.

Importantly, the Supreme Court further held that if you have to move beyond the reasonably near future (the length of which depends, again, on all the circumstances, but which is likely to involve looking ahead to a period of months, rather than years) any attempt to apply a cash-flow test will become completely speculative and that the 'balance sheet' test becomes the only sensible test.

Under English law, any uncertainty caused by the cash flow insolvency test can therefore be overcome by applying a balance sheet insolvency test instead which is expressly set out in the Insolvency Act 1986.

However, in contrast with the English law position, Jersey statutes do not have a balance sheet insolvency test. As a result, the uncertainties expressed in the English law cases as to the extent to which future debts should be taken into account cannot therefore be overcome by relying on an alternative balance sheet test.

One of the consequences of this uncertainty is that a Viscount or liquidator may face an uphill struggle in demonstrating that a company was insolvent on a cash flow basis when seeking to set aside a questionable transaction as a transaction at an undervalue or a preference, given the uncertainties surrounding how far into the future enquiries as to solvency need to be made.

In light of these uncertainties, consideration should perhaps be given as to whether it is time to update the definition of "*Insolvent*" and "*Insolvency*" in the relevant Jersey statutes to introduce both a cash flow solvency and balance sheet solvency test, as is found in other jurisdictions such as the UK and Guernsey. This would enable any uncertainty caused by the cash flow insolvency test to be overcome by applying a balance sheet insolvency test instead and would provide a more workable and certain approach in ascertaining solvency.