

UPDATE

Independence of liquidators: perception of the fair minded stakeholder

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The Grand Court of the Cayman Islands (the **Court**) recently endorsed the test articulated in the matter of *Hadar Funds Ltd (in Voluntary Liquidation)* in relation to the independence or otherwise of proposed joint official liquidators, confirming that the test to be applied in assessing the independence of liquidators is whether or not the Court considers that fair minded stakeholders are justified in being reasonably concerned that the liquidators operate under a conflict of interest.

Facts

The Joint Voluntary Liquidators (**JVLs**) of Bay Capital Asia Fund, LP (in Voluntary Liquidation) (the **Fund**) filed a petition seeking an order for voluntary liquidation to continue under the supervision of the Court and to remain in office as official liquidators of the Fund.

Two creditors of the Fund, the former General Partner Bay Capital Asia Fund GP (**Bay Capital**) and a secured creditor (together, the **Opposing Creditors**), objected to the appointment of the JVLs on the basis of a perceived conflict of interest. The Opposing Creditors were represented by Mourant Ozannes.

The Fund is a Cayman Islands registered exempted limited partnership. The Fund made only one investment, in bonds issued by Fung Choi Media Group (**FCMG**), incorporated in China (the **Bonds**). The Fund held the Bonds indirectly through its wholly owned subsidiary, BCA Best Business Service Limited (**BBS**). As a result, the Fund had a direct economic interest in FCMG.

In August 2014, FCMG defaulted on its obligations under the Bonds. Bay Capital (through BBS) then commenced enforcement action against FCMG to recover the value of its investment in the Bonds. That recovery action was the Fund's only realisable asset.

The Fund was placed into voluntary liquidation following resolutions passed by its directors and current General Partner, Military Mutual Aid Association (**MMAA**). MMAA had previously instructed the JVLs' firm to advise them on their position, and the scope of that advice had included the removal of Bay Capital from its position as the Fund's General Partner and its replacement with MMAA. MMAA considered that the JVLs were best placed to act as official liquidators on the basis that their prior involvement would lead to cost efficiencies and their firm's global reach would assist with recoveries in China.

The Opposing Creditors asserted that they had reasonable concerns that the JVLs were conflicted. These concerns arose from two matters, although only one of those matters was relied on at the hearing. First, stock exchange announcements and FCMG's financial reports confirmed that the JVLs' firm had been engaged to perform an internal audit for FCMG. This matter had only come to light shortly before the hearing. Second, as noted above, the JVLs' firm had previously advised MMAA, including in relation to the removal of Bay Capital as the Fund's General Partner. This matter had been identified several months before the hearing and raised in correspondence with the JVLs. The Opposing Creditors took the position that no satisfactory response had ever been provided to their correspondence.

The JVLs requested an adjournment of the petition hearing to gather evidence to respond to the first matter. The Opposing Creditors took the position that they were content to rely on the second matter for the purposes of the hearing.

Decision

The Opposing Creditors focused on the resolution passed by MMAA appointing the JVLs which stated that:

'The advisory work undertaken by [the JVLs] to date to protect the interests of MMAA is valuable in terms of allowing a subsequent appointed liquidator to best protect the interests of the Fund.'

The removal of Bay Capital as the Fund's General Partner had been a contentious issue and the Court accepted that, prima facie, a conflict of interest existed. Although the JVLs submitted that they could adduce evidence to explain their relationship with MMAA, the Court considered that it would be hardly likely that any explanation the JVLs might put forward would be enough to remove the reasonable concerns of the Opposing Creditors.

The Court also noted that the Opposing Creditors had requested information in relation to the perceived conflict, in clear terms, several months prior to the hearing. The Court noted that the issue had not been addressed and commented that any further delay in resolving it would be inconsistent with the principle that creditors are entitled to know the identity of the liquidator as soon as possible.

Finally, the Court reiterated that the best interests of creditors are of paramount importance. The Court emphasised that it would not be guided by what is in the best interests of prospective liquidators.

For each of the above reasons, the Court decided that the Opposing Creditors were justified in having reasonable concerns that the JVLs were conflicted. Importantly, the Court noted that it is not a question of whether or not the Court itself is satisfied that there is a conflict. The perception of conflict by fair minded stakeholders, provided that the perception is reasonable, is sufficient to satisfy the test.

On that basis, the adjournment was refused and the Court appointed the alternative official liquidators put forward by the Opposing Creditors.

Conclusion

The decision in Bay Capital shows that prospective liquidators must view their conflicts position, including the prior involvement of colleagues in other jurisdictions, through the lens of other interested parties and that it is not enough to simply satisfy internal checks. It is clear that the Court will prioritise the views of those with the real economic interest in the company or fund in liquidation. If a pre liquidation relationship could 'impair the appearance of independence', prospective liquidators must be very careful in explaining matters so as to dispel any reasonable concerns held by stakeholders.

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