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UPDATE

The Grand Court declines to sanction the sale of a company's assets where the creditors' evidence gives substantial reason to interfere with a liquidator's commercial judgment

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In the recent decision of *In the matter of Pacific Harbor Asia Fund 1, Ltd (in official liquidation)* (unreported, 6 May 2020), the Grand Court of the Cayman Islands considered the principles applicable to a liquidator's application for leave to exercise a power of sale of the company's property. The decision of Justice McMillan confirmed the settled position that, on a sanction application, it is ultimately a question for the court as to whether leave for the sale should be granted however, in coming to that decision, the court will afford the commercial judgment of the liquidator due weight but will also take into consideration the wishes of the creditors, being the persons with a real interest in the liquidation. Mourant acted for one of the creditors in successfully opposing the sanction application.

Background

Pacific Harbor Asia Fund 1, Ltd (the **Company**) was one of two feeder funds of Pacific Harbor Asia Master Fund (Cayman) L. P. (**Master Fund**) and was placed into voluntary liquidation on 8 June 2017, with the liquidation coming under the supervision of the court on 29 August 2017. Joint official liquidators were appointed and their responsibilities were divided by the terms of the supervision order (the **JOLs**).[1]

The application before the court was the JOLs' application for leave to exercise their power of sale of the Company's assets which were said to comprise its limited partnership interest in the Master Fund, its redemption claims against the Master Fund, and claims for liquidation expenses and other claims owned by the Company against its service providers and third parties. By November 2019, the JOLs had determined that it was in the best commercial interests of the Company that its assets be sold and they entered into negotiations with one of the Company's creditors ('**B**') with a view to settling the fees and expenses of the liquidation and bringing the liquidation to an end.

While the JOLs were in negotiations with B, the affiliate of a contributory of the Company ('**S**') submitted a competing bid for the Company's assets.[2] A competitive bidding process had therefore commenced without B being aware that such a process was ongoing whereas S was aware that an earlier bid had been submitted to the JOLs. The JOLs invited best and final bids from all of the creditors on 31 January 2020 and invited those bids to be tendered by 5 February 2020, i.e. within three business days. B and S both tendered bids within the stipulated timeline. S's bid was higher in value than B's bid, and was ultimately accepted by the JOLs, notwithstanding the objections of the liquidation committee, particularly as to the transparency of the JOLs' bidding process.

The JOLs then entered into a sale and purchase agreement with the Company's contributory (S's affiliate) ('**SPA**') which required court sanction as a condition precedent. The JOLs brought the contested sanction application which was opposed by five separate creditors on the basis that, amongst other things, they did

[1] One liquidator was tasked with realising the assets of the Master Fund while the other was tasked with all other matters relating to the liquidation of the Company.

[2] The Company's contributory, '**M**', later acquired a debt interest in the Company and became a creditor.

not consider the sale to be in the commercial best interests of the Company because its effect would be to pay the JOLs' remuneration and expenses and effectively extinguish the creditors' claims (i.e. there would be insufficient to give the creditors any return after the JOLs' remuneration and expenses were paid out of the Company's estate). Moreover, a further bid was submitted by B prior to the sanction application, which was on better commercial terms than S's bid, however the JOLs rejected that bid in favour of S's bid and went ahead with the sanction application.

The Law

Section 110(2)(a) and Schedule 3, Part 1 of the Companies Law (2020 Revision) provides that an official liquidator may only exercise a power of sale of the company's property by public auction or private contract with sanction of the court.

The principles to which the court must have regard on a sanction application are settled (*Re Greenhaven Motors Ltd* [1999] 1 BCLC 635; *Re Edennote Ltd* (No 2) [1992] 2 BCLC 89). Justice McMillan referred to a recent Cayman Islands decision by the Chief Justice in *In the Matter of SAAD Investments Company Limited* (In Official Liquidation) (Unreported, 1 October 2019, Smellie CJ) which set out those principles:

1. the decision whether to sanction the exercise of a liquidator's power falling in Schedule 3, Part 1 is a decision of the court;
2. in exercising its discretion to grant sanction, the court must consider all of the relevant evidence;
3. the court must consider whether the proposed transaction is in the commercial best interests of the company, reflected *prima facie* by the commercial judgment of the liquidator;
4. the court should give the liquidators' views considerable weight unless the evidence reveals substantial reasons for not doing so;
5. the liquidator is usually in the best position to take an informed and objective view; and
6. unless the Court is satisfied that, if the company is not permitted to enter the compromise in question, there will be better terms or some other deal on offer, the choice is between the proposed deal and no deal at all.

Justice McMillan also made reference to the comments of by Cresswell J in *Re Trident Microsystems (Far East) Ltd* [2012] (1) CILR 424 which held that a decision to sanction the exercise of a power under Schedule 3, Part 1 of the Companies Law was a matter for the court, which must consider the correctness or otherwise of the liquidator's decision having regard to all of the evidence, in particular:

1. the financial consequences of the decision for stakeholders;
2. the wishes of the stakeholders; and
3. whether the interests of stakeholders are best served by permitting the company to enter into a particular transaction.

Cresswell J continued that, taken together, these decisions demonstrate that the court should ordinarily respect the commercial judgment of the liquidators and grant sanction unless the course of action proposed by the liquidator is so untenable that no reasonable liquidator should take it.

The case law also confirms however that creditors will be good judges of where their interests lie, if they can be said to be uninfluenced by extraneous considerations (*Re Greenhaven Motors*).

The court's decision

The court had voluminous evidence before it which it was required, as a matter of law, to consider in weighing the respective issues. Justice McMillan did not consider the matter to be an ordinary sanction application in the sense that it raised such unusual features. Given the principles set out above, his Lordship was required to determine whether the voluminous evidence showed any substantial reason why sanction should not be granted, independent of the JOLs' views.

The JOLs' argued that notwithstanding B's second bid, S's bid should be preferred and that the SPA should be sanctioned. They argued, amongst other things, that the deal with S, having been documented, provided certainty whereas B's second bid constituted merely non-binding heads of terms and may leave the estate in a worse position if terms could not ultimately be agreed with B. The JOLs also relied upon the non-payment of their liquidation fees and expenses as a factor militating in favour of granting sanction.

B argued that its second bid provided better commercial terms for the Company and its creditors (it was greater in value than S's bid and gave the creditors a participation right in any realisations of the assets). B also argued that the bidding process was unfair because it was not aware that a competitive bidding process had begun before best and final bids were sought on 31 January 2020 and questioned the JOLs' contact with S during the bidding process at a time when B was not aware that a competitive bidding process was underway. The other opposing creditors supported B's position.

The court considered it very difficult to resolve the various issues as to fact and inference on affidavit evidence but held that, when viewed in hindsight, the creditors' evidence provided the court with concerns as to the clarity and transparency of the bidding process. The court went on to find that the JOLs were right to bring the sanction application on the basis of their professional judgment that it was the best deal available, and they did so properly and in good faith. However, the court could not lightly disregard the creditors' procedural complaints as to the bidding process and the fact the B's second bid was of greater commercial value to the Company and its creditors. As such, and while giving considerable weight to the JOLs' views, the court must also give the views of the creditors weight even though some of those creditors may have been influenced by extraneous considerations.[3]

On the JOLs' fees and expenses, the creditors argued that the deal with S may extinguish their claims altogether (the JOLs' fees and expenses were just under US$ 4.1 million immediately prior to the sanction application and S's bid for the Company's assets was UD$ 4.5 million). The JOLs and the creditors put forward two contrasting cases dealing with unpaid liquidation fees and expenses. One sanctioned the liquidator's settlement of a claim where the liquidator's remuneration and expenses would be paid out of the settlement amount but the creditors would get no return (*Universal and Surety Company Limited* 1992-93 CILR 149). The other provided that where a settlement agreement would effectively pay the JOLs' remuneration and expenses but would provide nothing for the creditors while also waiving the Company's strong litigation claims, the creditors views were of greater weight than those of the liquidators and sanction was refused (*PAC Ltd (In Official Liquidation)* (Justice Foster, Unreported, 11 December 2015). Justice McMillan was clear that each case turned on its facts and that unpaid liquidation fees and expenses are not, of themselves, dispositive of the merits of a sanction application. Rather, Justice McMillan found that fees clearly have a larger role where further respective recoveries are unpromising as opposed to good, however where there are other concerns (even of a procedural nature as on this application), those concerns are not minimised by the fact that the sanction in question would provide the liquidators with full recovery of their fees.

Comment

The circumstances surrounding this sanction application were, as the court noted, highly unusual. While sanction of a liquidator's powers is a matter for the court, it will ordinarily give significant weight to a liquidator's views given that a liquidator will usually be best placed to provide an informed and objective view of the transaction. However, in exercising its discretion to sanction a liquidator's powers, the court must also take into account the wishes of the creditors who, if uninfluenced by extraneous matters, will be the best judges of where their interests lie. Justice McMillan's decision provides a helpful overview of the relevant case law and underscores that the cases are highly fact-specific and will turn upon the particular facts of the case. That all creditors are treated fairly, and that one is not treated more favourably than another, will be a relevant consideration when the court is determining what weight should be given to a liquidator's views. Similarly, that the liquidators' remuneration and expenses will be met in full is not, of itself, sufficient to warrant sanction being granted.

[3] By way of example, both B and S could be said to have dual interests being both creditors and bidders.

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