IN THE GRAND COURT OF THE CAYMAN ISLANDS
FINANCIAL SERVICES DIVISION

The Hon Mr Justice Andrew J. Jones QC
In Chambers, Monday 26th March 2012

FSD No. 91 of 2011 (AJJ)

IN THE MATTER OF THE COMPANIES LAW (2010 REVISION)

IN THE MATTER OF HURLSTON HOLDINGS LTD

Appearances: Ms. Rebecca Hume, Charles Adams Richie & Duckworth, for the Official Liquidators

Mrs Harriet Lott, a creditor of the Company, acting in person

In Attendance: Messrs Michel Pearson and Andrew Childe of Deloitte & Touche

Mr. Rolan Heeralal of CIBC FirstCaribbean Bank

RULING

Introduction

1. This is a sanction application made by Messrs Sybersma and Pearson of Deloitte & Touche in their capacity as joint official liquidators of Hurlstone Holdings Ltd ("the Liquidators" and "the Company" respectively). By their summons dated 19th March 2012 the Liquidators seek an order of the Court authorizing them to sell the Company's principal asset, which is the property in George Town from which it carried on its business known as the *Caymania Building*, for a price of US$2.7 million.

2. The general factual background leading to the liquidation of the Company is set out in my Ruling made on 24th May 2011 and does not need to be repeated. In order to put this application in context it is sufficient to say that in July 2008 the Company bought the

Caymania Building for a price of about US$4.9 million in a highly leveraged transaction financed by CIBC FirstCaribbean Bank ("CIBC"). [1] The timing of this transaction could not have been worse. It coincided with the height of the property market. The credit crunch of September and October 2008 occurred within months and triggered a significant recession in the local economy, resulting in a sharp decline in property values. There was also a decline in sales to tourists, with the result that the Company was unable to pay its debts (including the sum of US$36,000 per month required to service the CIBC loan) as they fell due. Notwithstanding that the Company was clearly insolvent, applying both a cash flow test and a balance sheet test, I nevertheless made a provisional winding up order on the basis that the Liquidators would carry on the business for a limited period; investigate its financial position; and ascertain whether or not there was any prospect of implementing the Sale and Purchase Agreement made on 11th November 2010, by which Mrs Harriet Lott ("Mrs Lott") had agreed to sell the Company to Penha Image Duty Free Ltd ("Penha") for a nominal sum of US$100. In the event Penha was not prepared to buy the Company and a final winding up order was made on 1st September 2011.

3. On any view, it is unfortunately clear that the dividend payable to the ordinary unsecured creditors is bound to be nil. The only person having a direct interest in the Company's assets is CIBC which has a fixed charge over the *Caymania Buiilding* and a floating charge over its other assets. Mrs Lott has an indirect interest because she has personally guaranteed the Company's obligations to CIBC and has secured her guarantee with a charge over her personal assets. In order to be released from her guarantee, I think that *Caymania Building* would need to be sold for a gross price (before costs of sale) of nearly US$5 million. In recognition of the fact that it is wholly unrealistic to contemplate a price anywhere close to this amount, Mrs Lott has already paid US$1.7 million to CIBC pursuant to her guarantee (for which she now has a claim against the Company). If the *Caymania Building* is sold for US$2.7 million, she will still be left with an additional personal liability to CIBC in the region of US$450,000.

4. CIBC would be entitled to exercise its power of sale. However, at the original hearing on the petition, an undertaking was given to the Court that it would not take any steps towards exercising its power of sale for a period of three months and it was on this basis that I made the provisional winding up order. The undertaking has now expired and CIBC is in fact entitled to exercise its power of sale but took the decision not to do so and has instead relied upon the Liquidators to realize its security. It is this unusual sequence of events which explains why CIBC has not appointed a receiver and is serving as a member of the liquidation committee.

[1] The Bank was at that time known as First Caribbean International Bank Ltd.

5. The Liquidators' summons is opposed by Mrs Lott whose position is that the manner in which the *Caymania Building* has been marketed is inadequate and that it should be re-offered for a price of US$3.2 million, with a reserve of not less than US$3 million. The summons was served on Penha and CIBC. Penha has a substantial claim as an ordinary unsecured creditor. Having regard to the fact that it has no prospect of receiving any dividend, even if the *Caymania Building* were to be sold for the higher price of US$3.2 million, it is unsurprising that it chose not to participate in the hearing. Having notified the Liquidators that it agrees with the proposed sale at a price of US$2.7 million, CIBC also chose not to participate in the hearing although one of its senior executives was present as an observer.

The Official Liquidators' Power to Sell the Company's Property

6. The function of official liquidators, as set out in section 110 of the Companies Law (2011 Revision), is "to collect, realize and distribute the assets of the Company" and "to report to the company's creditors and contributories upon the affairs of the company and the manner in which it has been wound up." Official liquidators must have the powers necessary to perform these functions, including the power to sell the company's assets. The Third Schedule to the Companies Law identifies whether particular powers are exercisable with or without the sanction of the Court. By Part I, paragraph 3 of the Third Schedule, the official liquidators' power "to dispose of any property of the company to a person who is or was related to the company" is exercisable only with the sanction of the Court. Section 110(5) of the Law defines who shall be treated as a related party for these purposes. It includes both insiders (directors, shareholders and professional service providers) and those who are creditors or debtors of the company. I think that there is a clear policy reason why the Court's sanction should be required before the assets of a company in liquidation are sold to an insider or someone who has an interest in the outcome of the liquidation. The fact that Part I, paragraph 3 of the Third Schedule expressly requires official liquidators to obtain the sanction of the Court sanction to dispose of any property (which must include disposal by means of sale) to a related party is therefore perfectly understandable.

7. It follows, or at least should follow, that official liquidators have power to dispose of any of a company's property to someone who is *not* a related party without the sanction of the Court. It is therefore surprising, to say the least, to find that paragraph 8 of Part I of the Third Schedule states that the power "to sell any of the company's property by public auction or private contract with power to transfer the whole of it to any person or to sell the same in parcels" is exercisable only with the sanction of the Court. In my judgment it is inconsistent for both paragraph 3 and paragraph 8 to be included in Part I of the Third Schedule. Logically, its seems to me that paragraph 8 belongs in Part II, as it was in

earlier drafts of the Companies (Amendment) Bill prepared by the Law Reform Commission. The purpose of section 110(5) and paragraph 3 of Part I of the Third Schedule is to distinguish between transactions with related parties and those with unrelated parties. It seems to me that the true intention of the legislature was to empower official liquidators to sell a company's property without the sanction of the Court unless the purchaser is a related party, in which case sanction would be required. I find it difficult to think of any good policy reason why the legislature should have required official liquidators to seek the sanction of the Court before selling any property, no matter what the circumstances. If it was the legislature's intention to require sanction in every case, then paragraph 3 serves no purpose. It adds nothing to paragraph 8. On any view, the present formulation of Part I of the Third Schedule is confusing and the application of paragraph 8 is impractical. Official liquidators should be empowered to sell a company's assets without the sanction to the Court, with the result that sanction applications would only be made if the realization of the asset in question is particularly significant to the outcome of the liquidation or its sale involves some particular difficulty or there is an objection on the part of the stakeholders. Even if the Liquidators had power to sell *Caymania Building* without the sanction of the Court, this would be an appropriate case in which to make a sanction application because the asset is highly significant and its sale at the price proposed by the Liquidators is challenged by Mrs Lott.

The Court's Approach on Sanction Applications

8. The Court's approach to a sanction application depends on whether the power in question falls within Part I or Part II of the Third Schedule. The decision whether or not to sanction the exercise of a power which falls within Part I is a decision for the Court. It is not a decision which can be taken by the official liquidator in the absence of the Court's sanction. In deciding whether or not to sanction a proposed transaction or intended decision of this sort, the Court must consider whether the interests of the creditors or contributories (as the case may be) are likely to be best served by permitting it or not permitting it. If the Court declines to sanction the proposed transaction or decision, it will probably need to make consequential directions that some different course of action be pursued by the official liquidator. In cases falling within Part II the Court is asked to control the exercise of a power for which the official liquidator does not require the sanction of the Court. If the official liquidator has taken a decision which he is entitled to take without its sanction, the Court should only interfere if the official liquidator is not acting *bona fide* or his decision is one which no reasonable liquidator could take in the circumstances of the case. This is the approach adopted by the English Court of Appeal in *Re Greenhaven Motors Ltd (In Liquidation)* [1999] 1 BCLC 635. Although there are material differences between the insolvency legislation applicable in the United Kingdom and Part V of the Cayman Islands Companies Law, I think that the reasoning of

Chadwick LJ (who is now president of the Cayman Islands Court of Appeal) in that case can and should be followed in this jurisdiction.

9. A possible reason for adopting a different approach in this jurisdiction is the Court's former practice of granting a blanket authority to the official liquidator at the time of his appointment to the effect that he may exercise all or any of the Part I powers without any further reference to the Court. Such orders were granted, at least in part, because it was recognized that it really serves no useful purpose to require official liquidators to seek the sanction of the Court to enter into routine transactions or make routine decisions, particularly those referred to in paragraphs 3, 8, 10 and 11 of Part I. However, I think that it is now recognized that it is wrong in principle to grant a blanket authority, as part of the original winding up order, without reference to any factual circumstances which may or may not justify the Court's sanction. In this case, I did not grant any blanket authority when making the winding up order and so the issue does not arise. However, if I had done so, I still think that the proper approach would have been to treat this case as one falling within Part I. Therefore, the question I have to decide is whether the interests of the creditors would be best served by allowing *Caymania Building* to be sold for a price of US$2.7 million.

Marketing of the *Caymania Building*

10. On 31st August 2011 the Liquidators sought a marketing proposal from International Realty Group Ltd ("IRG"), a well known and respected real estate agency which has extensive experience of marketing commercial properties, including sales arising out of insolvency situations. Mrs Lott accepts that the Liquidators' decision to instruct IRG was appropriate. IRG's marketing campaign could have been launched in September but it was agreed that it would be delayed for 30 days to enable Mrs Lott to conduct negotiations with a potential purchaser who had indicated to her an interest in purchasing the *Caymania Building* for US$3.5 million. In the event, no offer was received and IRG's marketing campaign was launched in November. Its proprietor, Mr Jeremy Hurst ("Mr. Hurst"), has sworn an affidavit which sets out a detailed explanation of the way in which the *Caymania Building* was marketed. I can summarize his evidence as follows –

- a prominent 4'x4' for sale sign was erected on the property
- it was listed on CIREBA's multiple listing service, giving access to its 30 member companies and their 200+ sales agents
- it was featured on CIREBA's public website which is ranked on the front page of Google's search engine under all relevant keywords and receives over a million hits each year
- it was featured on IRG's own website, both on the front page and with a detailed listing

- a half page colour advertisement was published in CIREBA's large *Winter 2011/12* magazine and colour advertisements were also published in CIREBA's small monthly magazines in January and February
- sixteen quarter page colour advertisements were published in the *Caymanian Compass* on a regular weekly or twice-weekly basis during December, January and February.

Mrs Lott does not criticize this advertising campaign. Her point is that it should have been continued for at least a few more weeks.

11. In addition to conducting this advertising campaign, IRG developed an information sheet. This was sent to all those who made enquiries in response to the advertisements. More importantly perhaps, Mr Hurst sent the information sheet to all those commercial property investors and developers on IRG's own database whom he thought might be interested in buying this property. Mrs Lott carried out a similar exercise and the information sheet was sent to additional people whom she identified as potential purchasers.

12. The marketing was organized on the basis that it would be a sale by tender. During the run up to the date fixed for receiving sealed bids, a large (8'x3') red banner was slung between the trees in front of the *Caymania Building.* The package of bid documentation was sent by e-mail to all those who had shown any degree of interest and this was followed up with phone calls and e-mails. Eventually, five parties expressed an intention to submit sealed bids. In the event bids were received from only three of them at prices of US$1.785 million, US$1.9 million and US$2.7 million. Acting on the advice of IRG, the Liquidators resolved to accept the highest bid, subject to obtaining the sanction of the Court.

13. Mrs Lott has sworn an affidavit in which she makes the point that the Liquidators have not paid any or any sufficient regard to the valuation which she obtained from DDL Studio Ltd ("DDL"), a firm of quantity surveyors having expertise and experience in the valuation of commercial properties. She rightly emphasizes that the DDL valuation is dated 1st August 2011 and therefore reflects the current recessed market conditions. It uses two alternative valuation techniques. The "sales comparison/market data approach" involves a comparative analysis of 9 transactions in the period between January 2006 and May 2011 and leads to a valuation of US$4.342 million. In addition to the comparable transactions, DDL makes the important point that the *Caymania Building* was sold twice during this period. In July 2006 it was sold for US$3.24 million. Just two years later, Mrs Lott paid US$4.915 million for it, which was actually the highest price per square foot ever paid for any of the properties which DDL identified as comparable. Mrs Lott has not sought to explain why she apparently thought that the value of this building had risen by

50% in just two years. With the benefit of hindsight, the evidence tends to suggest that the Company paid far more than it ought to have done. The "investment/comparative rental approach" involves analyzing comparative rental values and capitalizing the estimated net income at the rate of return currently demanded by investors. On this basis DDL valued the property at US$4.47 million, assuming a rent of about US$70 psf gross or US$55 psf net and a 9% rate of return. Mr Hurst agrees that it is appropriate to adopt a 9% rate of return, but he takes a very different view of the current rental value of the *Caymania Building.* Firstly, he makes the point that the rental value of the ground floor retail space is greater than the value of the smaller second floor back office space. Secondly, he relies upon comparable rentals achieved in the immediate area which are bound to be lower than the rates achieved on or near the waterfront relied upon by DDL. Mr Hurst states quite emphatically that a gross rental of US$70+ psf (for the ground floor, let alone for the building as a whole) "is not achievable in the current market in this location nor has it been for some years". He estimated a net rental income in the region of US$183,745 at the lower end of the range and US$212,450 at the upper end. Capitalizing this income stream at the same 9% rate used by DDL results in a projected value in the region of US$2.0 to US$2.4 million. On paper, I found Mr Hurst's analysis more compelling than that of DDL and I think that the Liquidators were right not to attach greater weight to DDL's opinion.

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Conclusions

14. In the final analysis, the best evidence of current market value is the result of the thorough marketing exercise conducted by IRG between November 2011 and February 2012, not the academic valuation exercises done by the two firms in August last year. In my judgment the evidence leads to the conclusion that US$2.7 million is a good price and I am satisfied that the interests of the creditors, including Mrs Lott, will be best served if it is accepted. I therefore make an order that the Liquidators be authorized to sell the *Caymania Building* to Adare Investments Ltd for the price of US$2.7 million.

15. I also recommend that the Insolvency Rules Committee review Parts I and II of the Third Schedule of the Companies Law (2011 Revision) with a view to recommending amendments which will eliminate the current confusion and introduce a more practical list of powers which may be exercised only with the Court's sanction.

DATED this 26th day of March 2012

The Honourable Mr Justice Andrew J. Jones QC

GRAND COURT – CAYMAN ISLANDS