

9-05-11

**IN THE GRAND COURT OF THE CAYMAN ISLANDS**

**FINANCIAL SERVICES DIVISION**

**Hon Mr Justice Andrew J. Jones QC**  
**In Chambers (by telephone) on 9<sup>th</sup> May 2011**

**FSD Cause #59 of 2011 (AJJ)**

**IN THE MATTER OF THE COMPANIES LAW (2010 REVISION)**

**AND IN THE MATTER OF UCF FUND LIMITED (In Liquidation)**

**Appearances :** Ms Rebecca Hume of Charles Adams Ritchie & Duckworth for the Official Liquidator

**RULING**



**Introduction**

1. UCF Fund Limited ("the Fund") was incorporated on 3<sup>rd</sup> August 1999 as a multi-class open ended mutual fund. It is apparent from the very limited evidence presently before the Court that the Fund's investors subscribed for non-voting shares. The voting shares were issued to the Fund's promoter and investment manager, UCF Group LLC. On 3<sup>rd</sup> March 2011 the investment manager signed a written resolution by which the Fund was put into voluntary liquidation and Mr Michael E.G. Saville of Begbies Traynor Cayman Limited was appointed as liquidator. Since the Fund's directors did not sign a declaration of solvency, Mr Saville presented a petition to the Court on 31<sup>st</sup> March 2011 asking for a supervision order to be made in the usual way. Mr Saville is a qualified insolvency practitioner who was able to swear an affidavit complying with the requirements of CWR O.4, r.4(1), with the result that Foster J. made a supervision order on 28<sup>th</sup> April 2011 without the need for any oral hearing.
2. By paragraph 4 of the prayer to his petition, Mr Saville asked for an order that he be authorized to exercise any and all of the powers contained in Part I of the Third Schedule of the Companies Law (2010 Revision) without further sanction or intervention of the Court. At this stage Mr Saville had not prepared any report and no other evidence was

filed in support of the application. Nor did his counsel prepare any written submission or seek to justify an order in these terms in any way whatsoever. Apart from the fact that the Fund is insolvent on balance sheet test and that its investment manager had seen fit to put it into liquidation, Foster J. knew practically nothing about it or the circumstances which led to its demise. The assumption underlying Mr Saville's application was that the Court should give its official liquidator a blanket authority to exercise any and all of the Part I powers without the need to make any sanction applications, irrespective of the circumstances in which the powers might actually be exercised in due course. Foster J. indicated that he would not consider making any such order unless it could be justified by reference to the particular circumstances of this liquidation, for which purpose it would be necessary for Mr Saville to file evidence and a written submission. Since Foster J. is currently unavailable, the application now comes before me, albeit in a modified form. Instead of asking the Court to sanction the exercise of *all* the Part I powers, Mr Saville now asks the Court to make an order sanctioning the exercise of the powers contained in paragraphs 2, 4, 5, 6, 8, 10 and 11 only. The evidence relied upon is the Liquidator's First Report and Accounts (prepared in accordance with CWR O.10, r.2) for the two month period from commencement of the liquidation to 2<sup>nd</sup> May 2011. However, his counsel's written submission makes it clear that the application is still put on the basis that the Court should grant a blanket authority without reference to any specific circumstances or transactions. In my judgment it would be wrong in principle to make an order in this form in the absence of any compelling evidence.

### **The Law**

3. Section 110(2) of the Companies Law provides that an official liquidator may exercise the powers contained in Part I of the Third Schedule only with the sanction of the Court, whereas the general powers contained in Part II may be exercised with or without sanction. The purpose of this provision is to subject official liquidators to the general supervisory jurisdiction of the Court. In respect of the Part I powers, the onus is on the official liquidator to make a sanction application in every case, whether or not the exercise of the power is controversial. In respect of the Part II powers, the onus is on the creditors or contributories to make a sanction application if they disapprove of the way in which the official liquidator has exercised or intends to exercise the powers. In principle, the effect of granting a blanket authority is that the official liquidator is freed from the Court's supervisory jurisdiction and can exercise all of his powers in any way he thinks fit unless the creditors or contributories make a sanction application, acting individually or through the liquidation committee. The purpose and effect of Section 110(2)(a) is that official liquidators should have an obligation to make sanction applications in certain circumstances. In my judgment it would be wrong in principle for the Court to eliminate this obligation by granting a blanket authority in every case, thereby converting an

obligation to make sanction applications into a power to do so if and when the liquidator thinks fit. The following reasons for dismissing each individual aspect of Mr Saville's application illustrate why it is generally wrong in principle to authorize the exercise of an official liquidator's Part I powers in a hypothetical way, without reference to any specific circumstance or transaction.

### **Justification for sanction sought in the Official Liquidator's petition**

#### Paragraph 2 – Power to carry on the Fund's business

4. Mr Saville has determined, for the purposes of Section 110(4) and CWR Orders 8 and 9, that the Fund is insolvent on a balance sheet test. Notwithstanding that a company is insolvent, Paragraph 2 of Part I of the Third Schedule enables the Court to authorize an official liquidator to carry on the whole or part of its business if the circumstances are such that it can be said to be "necessary for its beneficial winding up." In the context of an insolvent company, this provision contemplates the situation in which it has a potentially viable business, whose goodwill has not been destroyed by the making of a winding up order. Exceptionally, the Court can permit an official liquidator to carry on a business if it can be satisfied that the expenses of doing so will be outweighed by the benefits and that there is a realistic prospect that the creditors will receive a higher return if the business can be sold as a going concern.
5. As a practical matter it must be impossible for Mr Saville to carry on the Fund's original business (whatever that was) and counsel's written submission reflects that it is not in fact his intention to do so. The application for sanction to exercise the Paragraph 2 power is put on the basis he needs to "deal with the [Fund's] investments, which may include holding them for a period of time, selling some or all of the investments and/or distributing some or all of the investments in specie to the [Fund's] creditors and/or shareholders." This reflects a misunderstanding of the nature and purpose of the power contained in Paragraph 2. Carrying on a company's business for the benefit of the liquidation is not the same thing as dealing with and realizing its assets. It follows that this application must be dismissed.
6. Even if I were to treat this application as one to sanction a decision to "hold the investments for a period of time" or to "distribute some or all of the investments in specie" (as suggested in the written submission), I would still dismiss it on the basis that it is insufficiently particularized, unsupported by any relevant evidence and premature. The Liquidator's First Report says nothing about the Fund's business or the nature of its remaining assets. The related Accounts reproduce in Appendix A3 the management

accounts as at the commencement of the liquidation which reflect three asset classes, as follows –

Investment in funds	\$1,767,313
Loans and receivables	\$ 47,878
Cash and cash equivalents	\$ 878,665
Total assets	<u>\$2,693,856</u>

There are no explanatory footnotes to these accounts. I assume that the asset class “Investment in funds” means an investment in one or more mutual funds and that \$1,767,313 is the investment manager’s best estimate of the current market value. Mr Saville does not need any specific authority from the Court to “deal with the [Fund’s] investments”. The Court will not grant authority to “hold the investments for a period of time” or “distribute some or all of the investments in specie” on a hypothetical basis, simply because the official liquidator anticipates that it *might* be appropriate to do these things. The Court will not make hypothetical orders which give official liquidators blanket authority to do whatever might appear to them to be appropriate from time to time during the course of a liquidation. Sanction applications should be made in respect of specific decisions or transactions, the nature and purpose of which is described in a report or supporting affidavit.

Paragraph 4 – Power to pay any class of creditors in full

7. The procedures relating to proving debts, payment of dividends and related matters are governed by CWR Orders 16, 17 and 18. If any difficulty arises about the status of any creditor or class of creditors, Mr Saville should then make a sanction application supported by evidence and written submissions addressing the specific matters in issue. It is inappropriate and would serve no useful purpose to make an order authorizing him, in a hypothetical way, to pay an unidentified class of creditors in full.

Paragraphs 5 and 6 – Powers to compromise

8. Mr Saville apparently contemplates that there will be difficulty in connection with the quantification of the amounts owing to trade creditors, but the nature of the debts and reasons for the likely difficulty is not explained in his Report, which is perhaps unsurprising bearing in mind that it was written before he had even invited proofs of debt. He apparently contemplates that there will be difficulty in connection with investors who claim to have redeemed their shares and will submit proofs of debt as creditors. None of these anticipated difficulties are explained in the Report or in counsel’s written submission. It would serve no useful purpose to make a hypothetical order at this stage of

the liquidation by which the liquidator is empowered to compromise potential issues which have not been defined or analysed, let alone negotiated. On any view, this application is premature.

Paragraph 8 – Powers relating to the sale of assets and/or distribution of assets in specie

9. As I pointed out in paragraph 6 above, this application presumably relates to whatever assets are comprised in the class described by management as “Investment in funds”. I infer from the fact that the Liquidator’s Report does not describe these assets or discuss any issues arising in connection with their realization that Mr Saville has not yet had sufficient time in which to investigate the matter, identify the problems and form a view about the best way forward. The series of accounts annexed to Mr Saville’s Report suggest that the Fund has been undergoing a “soft liquidation” over a period of at least three years. It is probably reasonable to infer that what is left of the “Investment in funds” is both illiquid and difficult to value, but none of this is explained and analysed in Mr Saville’s initial report, which is hardly surprising bearing in mind that he has only been in office as voluntary liquidator and official liquidator for about two months in total. When Mr Saville has investigated the matter, discussed it with the liquidation committee (which has not yet been appointed) and formulated a specific proposal for realizing and/or distributing these assets, he should then make a sanction application. The present application must be dismissed on the grounds that it is premature; it is unsupported by any relevant evidence; it is hypothetical; and it therefore serves no useful purpose.

Paragraph 10 – Power to utilize Begbies’ staff and re-engage the Fund’s former service providers

10. The Court appoints individuals as official liquidators, but it does so on the basis that they are partners of firms or directors of companies which carry on business as professional insolvency practitioners and that they have the human and other resources necessary to undertake the job in question. It is rarely, if ever, the case that an official liquidator is appointed on the basis that he will undertake all the work personally. In the typical case, the Court expects that the bulk of the work will be delegated to appropriate grades of staff who will be charged out at hourly rates which are lower than the rate applicable to the official liquidator himself. It is neither necessary nor appropriate for a winding up order or supervision order to include a generalized authorization to do that which the official liquidator is bound to do in any event. Mr Saville’s decision to delegate work to his firm’s staff will be sanctioned retrospectively, by necessary implication if not expressly, as part of the order approving his remuneration agreement.

11. This application is also put on the basis that "It may also be appropriate and cost effective for Mr Saville to engage the services of the [Fund's] administrator or investment manager and/or the [Fund's] auditors...". The Court will not grant a blanket authority based upon speculation about what may or may not be appropriate and cost effective. If an official liquidator of a mutual fund wants to re-engage the services of its former administrator or investment manager, his sanction application must be supported by an affidavit which explains why the engagement is thought to be appropriate and sets out the proposed terms and conditions which have been negotiated and agreed upon. Since Mr Saville has not in fact decided that he should engage the services of either Trinity Fund Administration Limited or UCF Group Ltd, this aspect of his application must be dismissed on the ground that it is premature and unsupported by any relevant evidence.

Paragraph 11 – power to retain lawyers and other professionals

12. This application comprises two elements, namely the retention of (a) lawyers and (b) other professionals. Different considerations apply.
13. The purpose of Paragraph 11 is not for the Court to sanction the threshold decision to engage or not to engage lawyers. CWR Order 25 assumes that all official liquidators will need to retain legal counsel, if only for the purpose of making those applications to Court which must be made in every liquidation. The role of the Court is to ensure the chosen firm or firms are independent and free from conflicts of interest and that the terms of their engagements are appropriate in the circumstances of the case. If an official liquidator of a failed mutual fund wants to retain the same law firm as its investment manager or administrator or auditor, the onus will be on him to persuade the Court that it is not an inappropriate choice. Similarly, if he wants to retain multiple law firms in respect of discrete subjects, the onus will be on him to justify this course. Every application under Paragraph 11 must be supported by evidence upon which the Court can determine that the choice of law firm and the terms of its engagement are appropriate in all the circumstances. An order sanctioning the engagement of a law firm will take effect retrospectively from the date upon which the firm started work.
14. During the course of her oral submission counsel assured me that the appropriate due diligence and conflict checks have been performed and that both her firm and Mr Saville are satisfied that it is appropriate for them to be engaged. I accept this submission and will make an order authorizing Mr Saville to retain Charles Adams Ritchie & Duckworth, but counsel rightly pointed out that the terms of her firm's written engagement letter, prepared in accordance with CWR O.25, r.1(2), need to be reviewed by the Liquidation Committee, which will be not be formed until 24<sup>th</sup> May at the earliest. For this reason it is



premature to make any order sanctioning the engagement of Charles Adams Ritchie & Duckworth.

15. To the extent that this application relates to "other professionally qualified persons", it must be dismissed because it is unsupported by any relevant evidence. If and when Mr Saville decides to employ someone to assist with marketing illiquid assets, he will need to provide the Court with details of the proposed appointee; the qualifications and experience of the firm and individuals involved; the scope of the engagement; the proposed remuneration; and other relevant terms and conditions.

### **Conclusions**

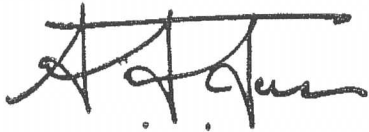
16. This application must be dismissed. At best, it is premature. It would serve no useful purpose to make an order, either in the terms originally sought in the petition or on the slightly narrower basis upon which the application was actually presented by counsel this morning. The effect of such an order would be to relieve Mr Saville from the obligation to make sanction applications in respect of the exercise of all or most of the powers contained in Part I of the Third Schedule. It would serve no useful purpose, because I suspect that Mr Saville would make a duplicative application if and when he is faced with any actual difficulty or controversy. Even though I am sure that Mr Saville is not in fact seeking to eliminate the Court's supervisory role, I also think that it would be wrong in principle to make an order which would have this effect, at least in the absence of some special reason or compelling evidence.
17. The purpose and effect of Section 110(2)(a) of the Companies Law is that official liquidators must obtain the sanction of the Court before implementing decisions and transactions of the kind described in Part I of the Third Schedule. It does not require them to obtain the Court's authority to embark upon the work which might ultimately lead to a decision or transaction, the implementation of which requires the Court's sanction. It follows that, in the ordinary course, sanction applications should be made in accordance with CWR Order 11 and that petitioners should not expect winding up orders and supervision orders to include any provisions to the effect that the official liquidators will be given a blanket authority to exercise any and all of the Part I powers without further reference to the Court.
18. To the extent that Part I relates to the utilization of the official liquidator's own staff, it is taken for granted that it will be done in every case and the Court will be concerned only to satisfy itself that the terms of the remuneration agreement are appropriate and have been approved by the Liquidation Committee in accordance with the Regulations. It is also taken for granted that official liquidators will need to retain lawyers and the Court will be concerned only to satisfy itself that the firm(s) selected by the official liquidator

are independent, free from conflicts of interest and that the terms of their engagement have been reviewed by the Liquidation Committee and recorded in writing in accordance with CWR O.23, r.1(2). It follows that the Court's sanction will be given retrospectively, usually as part of the official liquidator's first application to approve his remuneration.

19. Having reached these conclusions, I am bound by CWR O.24, r.9(2)(a) to consider disallowing Mr Saville's costs of this application. However, by r.9(5) I have a discretion to make some other order if I am satisfied that there are exceptional circumstances and special reasons for doing so. I accept counsel's submission that there is some uncertainty amongst the profession about the practice of including in winding up and supervision petitions a prayer for an order which would give the official liquidation a blanket authority to exercise all the Part I powers without any further reference to the Court. In my judgment, the existence of this uncertainty is a special reason which justifies making an order that Mr Saville's costs of this application be paid out of the assets of the Fund as an expense of the liquidation.

20. Finally, I direct that this Ruling be treated as if it was delivered in open court.

Dated this 9<sup>th</sup> day of May 2011



Hon Mr Justice Andrew J. Jones QC