



TO SELL OR NOT TO SELL: A RECEIVER'S DILEMMA

Nicole Ferreira-Aaron & Keomi Lourenco



'My property was sold at an under value because the Receiver was only concerned to recover for the Bank what was owed to it without regard for the true value of my property. If he had waited longer, if he had advertised more fully, if he had chosen to sell the property individually rather than as a portfolio, my property would have realised its true worth.'

This would be the all too familiar voice of a Borrower licking his wounds on a sale of his property occasioned by a defaulted loan, the object of his tirade being our friendly neighbourhood receiver, appointed by the mortgagee who advanced the loan.

The recent High Court of England decision in the case of **Bell vs. Long and others** delivered in June of this year, to the relief of all receivers in this particularly volatile climate, reaffirms the nature of the duties of a receiver (appointed by a mortgagee) to a mortgagor in the exercise of his power of sale as follows:

1. A receiver appointed by a mortgagee to sell mortgaged property in order to recover or reduce the mortgage debt is effectively in the same position as the mortgagee;
2. He owes a duty to the mortgagor to obtain a proper price for the property, also described as the best price reasonably obtainable;
3. He is not however a trustee of his power of sale for the mortgagor and accordingly can choose the time of sale even if that turns out to be disadvantageous to the debtor who could have recovered more had the property been sold later.

Background

The Claimant was a director and majority shareholder of a property company that had secured financing by creating in favour of a bank a fixed and floating charge over the Company's assets which consisted primarily of four tenanted commercial properties (the 'Properties'). When repayments were not made, Receivers were appointed and they decided to sell the Properties to recover the monies owed.

The Receivers appointed Valuers to market and sell the Properties. Consistent with market practice at that time the Valuers prepared valuations of each of the four Properties on three bases the lowest of which produced a reduced price for a quick sale of 660,000 pounds sterling.

As it turns out, the Properties were sold as a portfolio for 770,000 pounds after a formal marketing period of approximately three weeks. The purchaser subsequently sold the properties individually for a combined amount of 1.13M pounds sterling.

(cont'd on page 3)

<i>In This Issue</i>	<i>Author</i>	<i>Page</i>
<i>To Sell or Not to Sell: A Receiver's Dilemma</i>	<i>Nicole Ferreira-Aaron & Keomi Lourenço</i>	<i>1</i>
<i>Due Diligence—Before You Seal the Deal</i>	<i>Kevin Nurse</i>	<i>2</i>
<i>Cross-Border Transactions: Managing the Risks</i>	<i>Jonathan Walker & Stacy-Lee Daniell</i>	<i>4</i>



DUE DILIGENCE – BEFORE YOU SEAL THE DEAL

By Kevin R. Nurse

You've sealed the deal, money has exchanged hands, and the business is finally yours. Four weeks later all employees walk off the job, major suppliers refuse to do business, and an angry creditor shows up demanding millions of dollars in legal damages. This all could have been avoided had you done the proper due diligence.

Unfortunately, many believe that a cursory review of a business' bottom line is sufficient prior to purchasing a business. This article seeks to explain the due diligence process and its objective, and to assist you in avoiding the purchaser pitfalls before you seal the deal.

Due diligence defined

The due diligence exercise is the process of investigation performed by a purchaser into the affairs of a target business. It is a fact finding process designed to protect the purchaser by ensuring that he is aware of just what he is purchasing, any potential issues which may affect the decision to proceed, and the proper amount of consideration to pay should he choose to proceed.

The types of due diligence

The nature of the exercise will vary according to the type of due diligence being conducted. The three major types are the financial, business and legal due diligence. The financial due diligence examines the true financial state of the business and is performed by Accountants or Auditors. The business due diligence looks into the management and operations of the business being acquired. This article is concerned with the third type – the legal due diligence.

The purchaser's pitfalls

Three pitfalls were identified in the opening scenario: employee matters, commercial agreements, and litigation (potential or pending). Other areas of concern include the business' corporate status and corporate agreements (where the business is a

company), freehold and leasehold title to property and other assets, intellectual property, tax status, pensions, insurance, and regulatory status, to name a few. A proper due diligence exercise will usually require that the seller provide you access to all documents relevant to these issues.

Conducting the due diligence – the data room

Once all relevant documents have been assembled your legal representatives will be required to review them. In the past, this review required that the seller establish a physical Data Room at which the purchaser's representatives would physically attend to conduct the review. Increasingly however, with the move toward greater globalization, the "Virtual Data Room" has gained popularity.

In the case of the virtual data room the documentation is reduced to an electronic format then sent via electronic mail, burned on data CDs or DVDs, or placed onto a secure limited access website, for review by the purchaser's representatives. Once the proper hardware and software is in place the use of the virtual data room can greatly decrease the expense and resources required in reviewing the documents.

The due diligence report

Once all data has been reviewed, and your legal representatives have asked and answered any questions arising out of the review of those documents, a report is generated. This report will contain a comprehensive list of the issues identified and the steps to be taken toward completion of the purchase and beyond. The report will inform the purchaser with regard to:

- any potential exposure to the purchaser in completing the purchase;
- the respective responsibilities of the parties to the business purchase agreement, and the appropriate warranties to be included in such agreement;
- the proper level of consideration;
- the need for indemnities or limitations to liability;
- the approach to negotiation; and

(cont'd on page 5)

TO SELL OR NOT TO SELL: A RECEIVER'S DILEMMA (cont'd)

The Claim

The Claimant, who took an assignment of the Company's rights, claimed that the sale price was significantly lower than the market value of the four Properties at the time of sale, and that if sold for their true market value at the time only 3 of the 4 Properties would have been required to be sold to repay the debt and meet the costs of the receivership.

He sued both the Receivers and the Valuers claiming that the Receivers negligently failed to carry out their duty to obtain the best price reasonably obtainable for the Properties. He also brought against them a claim of fraud which was unsubstantiated at trial and fell away.

The Decision

After considering the nature of duties owed by Receivers to a mortgagor in this situation, the Court concluded that there was no breach of such duty and the claim was therefore dismissed.

The Rationale

The Court made the following observations regarding the duty of a Receiver appointed by a mortgagee to a mortgagor:

- The duty of a Receiver appointed by a mortgagee to sell property is the same as that of the mortgagee;
- That duty is to obtain a proper price—the best price reasonably obtainable;
- The receiver is not a trustee of the power of sale;
- The mortgagee/receiver can have regard to its own interests in deciding how to sell and is free to prioritize its interest above

that of the debtor/mortgagor; and

- The receiver can choose both the time of sale and the method of sale even if that turns out to be disadvantageous to the debtor who could have recovered more had the property been sold later or by a different method.

The Court noted that inevitably decisions by a receiver on how and when to sell will be complex and multi-faceted, and references to the need to obtain the best price reasonably obtainable have to be read in this context. The fact that with the benefit of hindsight, an alternative strategy could or would have produced a higher return is not sufficient to prove negligence. The claimant must demonstrate that no competent valuer standing in the Valuer's shoes at the time with the information which he had available to him could reasonably have given the advice.

On the facts there was little dispute among the experts about the values attributed to the Properties either individually or as a portfolio. The real issue turned on the Receiver's early decision to sell the Properties as a portfolio, which effectively discontinued any real marketing of the Properties individually.

In the Court's view, there was nothing to suggest that the Valuer's recommendation and the Receiver's early decision to sell the Properties as a portfolio was not reasonable. It was based on his genuine view that this was the most prudent course available to the Receivers at the time. He came to this view based on various factors, all of which led to the conclusion that the certainty of a sale of the Properties as a portfolio

coupled with the early termination of the receivership with a consequent saving of expense, outweighed the possibility of a higher return to be gained by waiting and attempting to sell each property individually.

The Receivers' preference for the certainties of an early sale over the uncertainties of a longer period of marketing against a background of changing market conditions was one which they were entitled to adopt. Such an approach was consistent with their right to choose the time of the sale. As a matter of law it could not be suggested that the Receivers were bound to wait for an indefinite period in the hope of obtaining a higher return. The duties they owed to the Company do not require them to take those kinds of risks.

Lessons Learnt

While the decision is based on well settled law, it is nevertheless a welcome re-affirmation of the relevant principles at play in such situations. The Judge's practical application of these principles to the evidence before him is reassuring to receivers and mortgagees in the light of current volatile market conditions. While a receiver cannot disregard the interest of a mortgagor and indeed owes a duty to it to receive the best price reasonably obtainable, the decision confirms that this duty will not extend to requiring the Receiver to wait for the market to improve in the hope of achieving a better price. The Receiver appointed by a mortgagee may sell properties to satisfy the debt at a time and in a manner of their choosing, even if that sale is disadvantageous to the debtor. Provided the decision is taken reasonably, the Court will not interfere.



CROSS-BORDER TRANSACTIONS: MANAGING THE RISKS

Jonathan Walker & Stacy-Lee Daniell



With the increased globalization of the marketplace, there has been a rapid growth in the number of cross-border commercial transactions. Many of these transactions involve multiple parties and may even span more than two jurisdictions. In these types of transactions a question often arises as to what rules would govern a dispute between the parties (should one arise) and which Court has the authority to hear the dispute.

Many people assume that they will be entitled to commence proceedings in their local Courts. However, depending on the particular matter, and the circumstances surrounding the particular transaction, this assumption may not hold true. Indeed, as both parties may be contending that the dispute be heard in their respective territory, almost invariably one of them may be left disappointed.

Rather than leave this question to chance (or for the parties to resolve at a time when their relationship may be strained as is often the case in litigious matters) it is prudent to address these matters at the time of the drafting of the contract. In this regard, there are two mechanisms that parties can use in order to manage these risks. These are:

- (i) to expressly provide which system of law will govern their agreement and contractual obligations (i.e. a choice of law clause); and
- (ii) to expressly provide which court will hear and determine any dispute that may arise (i.e. a jurisdiction clause).

In so far as jurisdiction clauses are concerned, there are two types of such clauses, namely:

- (i) the exclusive jurisdiction clause, and
- (ii) the non-exclusive jurisdiction clause.

The main difference between these two types of clauses is that with an exclusive jurisdiction clause, the parties are mandated to have their claims determined by the court that they have selected, and no other court. Conversely, with a non-exclusive jurisdiction clause the parties have the option (but are not limited to) bringing their claims before the identified court.

Generally, the courts will respect the freedom of the parties to contract (and hence to select the forum in which they wish their disputes to be determined). However, there are some instances in which the Court may override that selection. As such, some care should be taken in making this selection as mere stipulation by way of an express jurisdiction clause may not be sufficient.

Furthermore, in those transactions where there are multiple agreements between the parties, extra attention ought to be given in order to avoid or minimise the potential for the agreements to contain conflicting jurisdiction clauses.

This issue of conflicting jurisdiction clauses was recently examined by the English Commercial Court in the cases of **ACP Capital Ltd and another v IFR Capital plc and another [2008] EWHC 1627 (Comm)** and **UBS AG v HSH Nordbank AG [2008] EWHC 1529 (Comm)**.

In the ACP Capital case, a dispute arose out of various contracts for the refinancing by ACP of IFR's debts. Amongst the various agreements was an Advisory Services Agreement (ASA) which contained an exclusive jurisdiction clause in favour of Jersey. However, each of the subsequent financing agreements conferred exclusive jurisdiction on the English courts. IFR argued that the English jurisdiction clauses in the financing agreements superseded the earlier selection of Jersey in the ASA jurisdiction clause.

The Court held that jurisdiction clauses made in a contract were not impliedly abrogated by a different jurisdictional choice in

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CROSS-BORDER TRANSACTIONS: MANAGING THE RISKS (cont'd)

(Cont'd from page 4)

another contract for a different type. As a result, the jurisdiction clause in the later agreements could not impliedly alter the jurisdiction clause in the ASA.

In the UBS case, UBS (a Swiss bank) and HSH Nordbank (a German bank) entered into a complex credit swap transaction which involved multiple agreements. Some of the agreements contained non-exclusive New York jurisdiction clauses while others contained exclusive English jurisdiction clauses. UBS alleged that the disputes between the parties fell within the scope of the English clauses and commenced proceedings in the English courts. On the same day, HSH Nordbank began proceedings in New York and applied for an order that the English courts had no jurisdiction to try the UBS claim.

The Court held that the contracts had to be construed against the background of the transaction as a whole including the other contracts that formed part of the transaction. In applying this approach the Court was of the view each of the relevant clauses focused upon matters directly relating to the contract in which it was found. As the claims that were being made were more closely related to the contracts which contained the New York jurisdiction clauses, the Court decided to apply that clause as opposed to the clause in favour of the English jurisdiction.

As these cases highlight, parties need to approach the issue of their jurisdiction clauses with an appropriate degree of prudence. In this regard, the following are some common myths which parties should try to avoid when drafting their contracts:

- A later agreement containing a different jurisdiction clause will not necessarily supersede a jurisdiction clause in an earlier agreement;
- It is not safe to presume that the provisions of a later agreement represents an intention by the parties that they want all related disputes to be tried together in the same forum;
- Where there is a conflict between exclusive and non-exclusive jurisdiction clauses, it is not safe to presume that the exclusive jurisdiction clause will take precedence over the non-exclusive jurisdiction clause.

DUE DILIGENCE – BEFORE YOU SEAL THE DEAL (cont'd)

(cont'd from page 2)

- most importantly, whether to proceed with the purchase.

Tying up the loose ends

After the purchase has been completed many of the issues identified during the due diligence investigation may assist you in determining areas for improvement of the business as well as the legal and regulatory steps to be performed to properly effect the purchase. In the case of the purchase of a company, this might include finalising and registering a transfer of shares, change of address, and change of Directors and Secretary of the company.

With the due diligence process completed and both parties happy with the outcome, you can finally put pen to paper and seal the deal.



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