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1 IN THE GRAND COURT OF THE CAYMAN ISLANDS
2 FINANCIAL SERVICES DIVISION

FSD 48/2009 (AJEF)

6 IN THE MATTER OF FREERIDER LTD. (OFFICIAL LIQUIDATION)

10 Coram: The Hon. Mr. Justice Angus Foster, QC

12 Appearances: Joint Official Liquidators – Mr. Aristos Galatopoulos and Ms.
13 Rebecca Collins of Maples and Calder

15 GC Funding Group LLC – Mr. Guy Manning and Mr. Alastair
16 Walters of Campbells

18 Mr. A. J. Heinen – Mr. Graeme Halkerston and Ms. Katie Brown of
19 Appleby

21 Mr. P. Le Comte – Mr. Alan Turner and Ms. Rowena Lawrence of
22 Turner and Roulstone

25 Heard: Thursday 2nd September 2010



RULING

- 32 1. This is the Ruling on the application of the Joint Official Liquidators (“the JOLs”) of
33 Freerider Ltd. (In Official Liquidation) (“the Company”) by summons dated 30th
34 August 2010 (“the JOLs’ summons”) seeking a declaration that the security over all
35 the assets of the Company (“the Security”) purportedly granted under two
36 Convertible Revolving Secured Promissory Notes and Security Agreements
37 respectively dated 17th August 2009 (“the First Note”) and 3rd December 2009 (“the
38 Second Note”) (together “the Notes”) in favour of 733 Properties Inc. (“733
39 Properties”) and subsequently assigned to its subsidiary, GC Funding Group LLC

1 ("GCF"), is not within the terms of a validation order made by consent on 29th June
2 2009 ("the Consent Validation Order"), not having been granted in the ordinary
3 course of the Company's business for proper value and is therefore void under
4 Section 99 of the Companies Law (2010 Revision) ("the Law"). The Ruling also
5 relates to the summons of GCF, also dated 30th August 2010, seeking an order that, if
6 the Court finds that the Security is not within the terms of the Consent Validation
7 Order, the grant of the Security should now be retrospectively validated and
8 accordingly not void pursuant to Section 99 of the Law.

9
10 **General Background**

- 11 2. The Company was ordered to be wound up on just and equitable grounds on 13th
12 May 2010 on the petition of Mr. Heinen, who is one of the two voting shareholders,
13 which was vigorously opposed by the only other voting shareholder, Mr. Le Comte.
14 Mr. Le Comte subsequently appealed to the Court of Appeal against the winding up
15 order but his appeal was refused on 24th August 2010. In a previous Ruling dated
16 11th November 2009 the Court had directed, pursuant to O.3, r.11 (2) of the
17 Companies Winding Up Rules 2008, that the Company itself should not be able to
18 participate in the winding-up proceedings as it was merely the subject matter of the
19 proceedings, which should be treated as *inter partes* proceedings between Mr.
20 Heinen and Mr. Le Comte.
- 21
22 3. The background to the dispute between Mr. Heinen and Mr. Le Comte concerning
23 the Company is fully set out in the Reasons for Winding Up Order dated 13th May
24 2010 and I do not consider it necessary to rehearse that background.

1 **The Consent Validation Order**

2 4. Section 99 of the Law provides that:

3 *When a winding up order has been made, any disposition of the company's property*
4 *and any transfer of shares or alteration in the status of the company's members*
5 *made after the commencement of the winding up is, unless the court otherwise*
6 *orders, void.*
7

8
9 Section 100 (2) of the Law provides:

10
11 *In any other circumstances not specified in sub-section (1) [none of the*
12 *circumstances specified in sub-section (1) are applicable here], the winding up of a*
13 *company by the Court is deemed to commence at the time of the presentation of the*
14 *petition for winding up.*
15

16
17 Both Section 99 and 100 (2) are intended to protect the unsecured creditors of the
18 company once winding up proceedings have commenced. The companies law in the
19 United Kingdom, Australia, Canada and most other Commonwealth common law
20 jurisdictions has been to the same effect since the 19th century.

21
22 5. On 22nd June 2009 the attorneys then representing the Company on Mr. Le Comte's
23 instructions, Turner & Roulstone ("T&R"), wrote to Mr. Heinen's attorneys,
24 Appleby, proposing that the parties should agree to a validation order to enable the
25 Company to carry on its general business notwithstanding the presentation of the
26 winding up petition and thus avoid the consequences of Section 99 of the Law in
27 doing so. T&R requested an urgent response. The following day, 23rd June 2009,
28 Appleby responded stating that they were taking instructions in relation to the
29 proposed validation order and in the meantime requested details of the transactions
30 which it was sought to validate. By reply email on 24th June T&R responded, again
31 requesting that Mr. Heinen's attorneys revert to them on the proposed orders without

1 delay. Their email then said "the company needs to have the ability to conduct its
2 general business and this type of order is given as of right where a just and equitable
3 petition has been issued. There is no obligation on the company to provide specific
4 details of the transactions which it wishes to conduct". [My emphasis]. By reply
5 letter dated 29th June 2009 Appleby confirmed that their client, Mr. Heinen, was
6 prepared to agree to the terms of the "draft Consent Order validating payments and
7 other dispositions of property made by the Company in the ordinary course of its
8 business for proper value pending the determination of the [winding up] Petition".
9 Appleby went on to contend that their client was entitled to details of all such
10 transactions and requested confirmation by return that such details would be
11 provided. It seems that no response to that request was ever received.

- 12
13 6. The Consent Validation Order, being a consent order, was dealt with
14 administratively and signed by the Clerk of Court. There was no hearing by or
15 involvement of the Court. The Consent Validation Order provided as follows:

16
17 *IT IS HEREBY ORDERED BY CONSENT THAT notwithstanding the presentation*
18 *of the petition against Freerider Ltd. (the "Company"):*

- 19
20 1. *Payments made into or out of the bank accounts of the Company in the*
21 *ordinary course of business of the Company; and*
22
23 2. *Dispositions of the property of the Company made in the ordinary course of*
24 *its business for proper value;*
25

26 *between the date of presentation of the petition and the date of judgment on the*
27 *petition or further order in the meantime shall not be void by virtue of the provisions*
28 *of Section 99 of the Companies (Amendment) Law, 2007 [now Section 99 of the*
29 *Law] in the event of an order for the winding up of the Company being made on the*
30 *said petition.*

31
32 It is paragraph 2 of the Consent Validation Order which is now in issue.

1 **Procedure**

2 7. I should note that Mr. Heinen had previously issued a summons dated 16th June
3 2010, subsequently amended on 15th July 2010, by which he himself sought a
4 declaration that the Notes and the Security were both void pursuant to Section 99 of
5 the Law. This summons as amended therefore predated the JOLs' summons, which
6 is the subject of this Ruling. Both counsel for GCF and counsel for Mr. Le Comte
7 raised an issue as to Mr. Heinen's locus to make such an application, contending that
8 the JOLs were the only appropriate parties to seek a declaration under Section 99 of
9 the Law. As the JOLs have since done that (albeit their application relates only to
10 the grant of the Security and not to the Promissory Notes as such) I declined to hear
11 Mr. Heinen's amended summons or the related arguments on the question of Mr.
12 Heinen's locus in the course of hearing the JOLs' summons. However, I indicated
13 that I would deal with any issues arising out of Mr. Heinen's amended summons, if
14 necessary, at some future date. Nonetheless, since Mr. Heinen and Mr. Le Comte
15 are both contributories and were respectively the petitioner and the respondent in the
16 winding up proceedings I did agree to hear and did hear submissions on behalf of
17 Mr. Heinen in support of the JOLs' summons and in opposition to GCF's summons
18 and submission on behalf of Mr. Le Comte in opposition to the JOLs' summons and
19 in support of GCF's summons.

20
21 8. I should also note that counsel for Mr. Heinen indicated that he wished to argue that
22 the grant of the Security was not anyway a disposition of the property of the
23 Company because, he contended, Mr. Le Comte had no authority to enter into the
24 Notes and to grant the Security on behalf of the Company. Since, at a previous

1 directions hearing on 27th August 2010, I had already directed that the sole issue for
2 determination at the hearing before me in the event that the JOLs issued a summons
3 would be whether the grant of the Security was made in the ordinary course of the
4 Company's business in terms of the Consent Validation Order, I declined to allow
5 Mr. Heinen's counsel to make his proposed argument at the hearing of the JOLs'
6 summons. However, I accepted that Mr. Heinen's counsel was entitled to consider
7 his position in light of this Ruling and, if he considered it necessary and appropriate,
8 to make an application in that regard at some future date.

9
10 **The Disposition in issue**
11

12 9. The affidavit evidence establishes that Mr. Le Comte, purporting to act on behalf of
13 the Company as the borrower, and 733 Properties as the Lender entered into the First
14 Note on 17th August 2009, approximately two months after the date of the Consent
15 Validation Order. 733 Properties is a company which is part of the Durst
16 Organisation of New York, USA, which carries on business principally as an owner,
17 builder and manager of commercial and residential real estate in New York. The
18 Durst Organisation is headed by Mr. Douglas and Mr. Jonathan ("Jody") Durst ("Mr.
19 Durst") who are cousins. Mr. Durst's wife is a close personal friend of Mr. Le
20 Comte's wife. According to the affidavit of Mr. Durst, he has been a friend of Mr.
21 Le Comte and his family for almost 20 years, principally through the friendship of
22 their respective wives and children. Mr. Le Comte's evidence confirms this.

23
24 10. The First Note relates to a sum of up to US\$1m together with interest. The Second
25 Note relates to a further sum of up to US\$1m together with interest. The Notes are

1 otherwise in substantially identical terms and by clause 3 in each case provide for the
2 grant by the Company of security (referred to in the Notes as “Collateral”) over all
3 the Company’s assets, wherever located, including all intellectual property rights and
4 any claims against third parties. The Notes also provide (clause 2) that *inter alia* the
5 institution against the Company of any liquidation proceeding which remains un-
6 dismissed for 90 days is an event of default as a result of which the Note in each case
7 becomes automatically and immediately due and payable and 733 Properties has the
8 right to exercise its rights under the Note with regard, *inter alia*, to the Security.

9
10 11. On 21st May 2010 (just over a week after the winding up order of 13th May 2010 was
11 made) 733 Properties gave formal notice that the winding up order constituted a
12 default under the Notes and that all sums and obligations under the Notes were then
13 due and payable and that 733 Properties intended to exercise its rights and remedies
14 under the Notes, including all its rights to proceed against the “Collateral” (i.e. the
15 Security). Since then there has been an ongoing disagreement between 733
16 Properties (and its subsequent assignee, GCF) and the JOLs and Mr. Heinen over the
17 right of the JOLs or 733 Properties, now GCF, to possession and control of the assets
18 of the Company, including the right to control the litigation instigated by Mr. Le
19 Comte in the name of the Company in New York and the Netherlands.
20 Subsequently, as I understand it, by consent of the parties, including the JOLs, the
21 legal proceedings in New York were stayed by the Court until 30th November 2010
22 to enable determination of the validity of the purported grant of the Security by the
23 Company, which is, of course, a matter of Cayman Islands law, by this Court.

24

1 **The relevant law on the ordinary course of business**
2

- 3 12. Section 99 of the Law applies when there is a disposition of a company's property
4 after the commencement of a winding up and the Court has not made an order that
5 the disposition concerned is not thereby void. It was accepted by all parties that the
6 expression "*disposition of property*" in this context encompasses encumbrances
7 granted over a company's property, such as the Security in this case. That is clearly
8 established by authority and not in doubt. Furthermore, as the petition for winding
9 up the Company was presented (i.e. filed with the Court and initiated) on 6th March
10 2009 and a winding up order has since been made, the winding up of the Company is
11 deemed, pursuant to Section 100 (2) of the Law, to have commenced on 6th March
12 2009. Accordingly, the Security was clearly granted after the commencement of the
13 winding up. There is again no doubt about that and there was no dispute in that
14 regard either between the parties.
- 15
16 13. The Court has not made any order specifically validating the granting of the
17 Security. The only validation order made is the Consent Validation Order which
18 validates dispositions made by the Company "*in the ordinary course of its business*
19 *for proper value*".
- 20
21 14. The phrase "*in the ordinary course of business*" has been considered by various
22 Commonwealth courts on a number of occasions and in a number of contexts, the
23 circumstances of all of which are inevitably different. However, the Judgment of the
24 Privy Council, which is of course binding on this Court, in **Countrywide Banking**
25 **Corporation Ltd. v Dean** [1998] AC 338, is in my opinion the appropriate authority

1 for determination of the meaning of that expression in Cayman Islands law. The
2 Privy Council made reference to several decisions in other courts but ultimately
3 declined to adopt any particular formulation of the phrase. At page 349 of their
4 judgment it was said:

5
6 *“There are difficulties in drawing upon formulations in different words of statutory*
7 *tests and treating them as applicable in all circumstances. Such difficulties are*
8 *increased where those formulations originate in different legal or factual contexts.*
9 *This is particularly so where the test is essentially one of fact in any event. For these*
10 *reasons, as presently informed by the argument in this case, their Lordships do not*
11 *adopt any particular formulation. Nor is it necessary for this case to make any*
12 *comprehensive statement, suitable for all cases, of the criteria for determining when*
13 *a transaction is to be held to have taken place in the ordinary course of business for*
14 *the purpose of [the English legislation under consideration]*
15

16 *Plainly the transaction must be examined in the actual setting in which it took place.*
17 *That defines the circumstances in which it is to be determined whether it was in the*
18 *ordinary course of business. The determination then is to be made objectively by*
19 *reference to the standard of what amounts to the ordinary course of business. As*
20 *was said by Fisher J. in the Modern Terrazzo Ltd. case, 10 October 1997, the*
21 *transaction must be such that it would be viewed by an objective observer as having*
22 *taken place in the ordinary course of business. While there is to be reference to*
23 *business practices in the commercial world in general, the focus must still be the*
24 *ordinary operational activities of businesses as going concerns, not responses to*
25 *abnormal financial difficulties. Their Lordships respectfully agree with the judge’s*
26 *conclusion by reference to the policy of the section.*
27

28 *“Whether a payment should be regarded as commercially routine*
29 *at a day to day trading and operating level will turn at least in part*
30 *upon a comparison with the practices of the commercial*
31 *community in general. But equally, the way in which the*
32 *particular company has acted in the past, and its dealings with the*
33 *particular creditor, would seem pertinent. That payment was*
34 *simply a repetition of past patterns of behavior would make it more*
35 *difficult to argue that it represented special assistance to an*
36 *insider or the result of special enforcement measures or a situation*
37 *in which the subject creditor ought to have investigated before*
38 *extending credit. So at a policy level there is something to be said*
39 *for the view that relevant considerations should extend to the prior*
40 *practices of the particular company”.*
41
42

1 15. It was submitted, in my opinion correctly, on behalf of the JOLs that the Judgment
2 of the Privy Council makes it clear that there are no comprehensive criteria for what
3 constitutes "*in the ordinary course of business*". It is essentially a matter of fact in
4 light of the particular circumstances in each case. Nonetheless, certain key points
5 were made clear namely:

- 6
7 (1) The transaction must be examined in the circumstances in which it occurred;
8
9 (2) The transaction must be such that an objective observer would view it as
10 having taken place in the ordinary course of business;
11
12 (3) The focus of the enquiry must be on the ordinary operational activities of
13 businesses, not responses to abnormal financial difficulties; and
14
15 (4) Prior practices of the company will be a relevant consideration.
16
17

18 Of course the Privy Council made it clear that none of these points is necessarily
19 applicable in every case, they are not conclusive and are not intended to be
20 comprehensive or exclusive. They are simply guidelines.

21
22 There was no substantial disagreement between the parties about this analysis,
23 although their respective interpretation of the circumstances of the granting of the
24 Security differed considerably and consequently their proposed application of these
25 guidelines to such circumstances also differed.

26
27 16. I also found assistance from the judgment in the English case: *Ashborder BV & Ors*
28 *v Green Gas Power Ltd. & Ors.* [2004] EWHC 1517, which was a case involving
29 interpretation of the phrase "*in the ordinary course of business*" in the context of a
30 floating charge over assets of a company which had borrowed funds from lenders in

1 the Enron group. The judge (Etherton J., now a judge of the English Court of
2 Appeal), in concluding that certain agreements fell outside the scope of the ordinary
3 course of the business of the company concerned, held that the words of the phrase
4 were ordinary words of the English language which had to be given the meaning
5 which ordinary business people would be expected to give them against the factual
6 and commercial background in which the agreements concerned were made. He said
7 that a transaction could be in the ordinary course of business even if it was
8 exceptional or unprecedented but that a transaction was not to be regarded as in the
9 ordinary course of a company's business merely because it was not fraudulent and
10 was within the company's objects in its memorandum of association. He said that
11 meaning must be given to the word "ordinary" in the phrase. He then held that in
12 the circumstances of that case the transactions were not in the ordinary course of the
13 company's business by reason *inter alia* of the non-disclosure to all the directors of
14 the material terms of the agreements and because of his concerns about concealment
15 of the transactions. He also relied on the fact that the company was in abnormal
16 financial difficulty at the time and the agreements were entered into as an
17 exceptional abnormal response to that. These factors were, in the view of the Judge,
18 sufficiently unusual features to take the transactions out of the scope of the
19 company's ordinary course of business.

20
21 **The circumstances of the grant of the Security**
22

23 17. There was no contemporaneous documentary evidence before me to indicate when
24 discussions between Mr. Le Comte and Mr. Durst, concerning the proposed First
25 Note started. The first available email communication is dated 6th April 2009. It is

1 from Mr. Le Comte to Mr. Durst under the heading "*Freerider – Durst Convertible*
2 *Secured Promissory Note*" and among other matters (as to which I shall comment
3 further below), attached a proposed agreement. In the email Mr. Le Comte said he
4 had "*tried to capture the spirit of our conversations in order to protect your interests*
5 *as best I could*". Clearly therefore, there had been previous conversations between
6 Mr. Le Comte and Mr. Durst about the proposed loan, as to which there was no
7 evidence before me. Clearly Mr. Le Comte was also endeavouring to protect the
8 interests of the Dursts. There then followed a series of email exchanges between Mr.
9 Le Comte and Mr. Durst which culminated with the execution of the First Note
10 dated 17th August 2009.

11
12 18. It is clear from this correspondence that the proposed and subsequent grant of the
13 Security was intentionally concealed by Mr. Le Comte from his co-director and
14 contributory, Mr. Heinen, and that Mr. Durst was expressly told that would be the
15 case. In fact Mr. Heinen was not made aware of the existence of either of the Notes
16 and the grant of the Security until after 733 Properties told the JOLs of them
17 subsequent to the winding up order. Mr. Le Comte sought to justify this to Mr.
18 Durst, at the time, and again in his affidavit evidence produced at the hearing before
19 me, on the basis that his purported grant of the Security on behalf of the Company
20 fell within his exclusive domain and overriding authority pursuant to the First
21 Shareholders Agreement dated 19th July 2003 between him and Mr. Heinen ("the
22 Shareholders Agreement"). I should add that it was also argued before me that Mr.
23 Heinen would anyway have had a conflict of interest with regard to the grant of the
24 Security since the borrowing secured thereby was, it was contended, to be used to

1 meet the Company's past and ongoing legal costs of the various litigation against
2 Mr. Heinen. Mr. Le Comte's position was that significant sums were and would in
3 future be owed to attorneys in New York, the Netherlands and the Cayman Islands
4 by, on his case, the Company, which the Company urgently required and would in
5 future require to settle in order to progress the litigation and that Mr. Heinen, as the
6 principal opposing party in such litigation would have had a conflict of interest in
7 being involved in the decision whether the Company should grant the Security in
8 respect of borrowing from the Dursts for such purposes.

9
10 19. It appears from the email correspondence between Mr. Le Comte and Mr. Durst that
11 Mr. Le Comte's request was that the Company should be given access to a credit-
12 line for sums up to US\$1m pursuant to each Note and this appears to be what in
13 practice occurred. GCF claims that Mr. Le Comte, purportedly on behalf of the
14 Company, drew down a total principal sum of US\$1,550,000 under the Notes and
15 that as at 31st May 2010 interest amounting to US\$38,836.77 had accrued on that
16 sum.

17
18 20. Mr. Le Comte provided no evidence as to how the various sums drawn down under
19 the Notes were in fact used. His affidavit evidence was that they were used to settle
20 outstanding debts of the Company due principally to the attorneys acting in the
21 litigation in New York, the Netherlands and in this country and to fund the ongoing
22 costs of such litigation. However, no evidence to support that general assertion was
23 produced. Evidence from certain of the Company's bank statements showed that a
24 significant portion of the sums drawn down were used by Mr. Le Comte to settle the

1 accounts of the Cayman Islands attorneys, T&R, acting on his instructions in the
2 winding up proceedings.

3
4 **Analysis and comment**

5 21. It seems to me that in order to determine whether the grant of the Security was in the
6 ordinary course of the Company's business I must first consider what the business of
7 the Company was. As explained in the Reasons for the Winding Up Order dated 13th
8 May 2010, the Company was established to enable payments generated by the
9 commercial exploitation of the intellectual property in TheWheel and associated
10 technology to be made to an entity in a tax free jurisdiction and also so that the
11 intellectual property rights concerned could be held outside the Dutch company, e-
12 Traction Europe BV, which actually carries out the physical work on and
13 development of TheWheel and associated technology - (see Reasons for Winding Up
14 Order paragraphs 13 and 57). Accordingly the Company's business essentially
15 consists of the holding and control of the intellectual property rights in TheWheel
16 and other related technology.

17
18 22. It was submitted on behalf of GCF that the Company's memorandum of association
19 provides that the Company's objects are unrestricted and that accordingly the grant
20 of the Security was within the Company's objects. I was also referred to article 95
21 of the Company's articles of association which provides that: "*the directors may*
22 *exercise all the powers of the Company to borrow money or to mortgage or charge*
23 *its undertaking, property and uncalled capital or any part thereof, to issue*
24 *debentures, debenture stock and other securities whenever money is borrowed or as*

1 *security for any debt, liability or obligations of the Company or of any third party”.*

2 It was contended that accordingly the provision of the Security pursuant to the Notes
3 was within the Company’s objects and within the powers of its directors.

4
5 23. It was submitted too that, since the Company has been reliant from time to time in
6 the past on loans from Mr. Le Comte to meet its day to day operating expenses,
7 borrowing money was within the ordinary course of the Company’s business. It was
8 said that the grant of security as a condition of borrowing is clearly a usual practice
9 of the business community in general.

10
11 24. It is, of course, the grant of the Security over all of the Company’s assets and rights
12 which is in issue, not the borrowing of money. The grant of such security obviously
13 impacts adversely upon the position of unsecured creditors and is clearly an
14 important and significant transaction. The principal purpose of the statutory scheme
15 applicable to winding up is to protect unsecured creditors and their entitlement to
16 eventual *pari passu* distribution in a winding up and to enable the winding up of the
17 Company in an orderly manner by officers of the Court. This is the principal reason
18 why, in my opinion, a proposal by the directors of a company to grant security over
19 all of its assets and rights after winding up proceedings have been initiated would
20 and should normally be the subject of a prospective validation application to the
21 Court so that the benefit to the Company, which the directors contend derives from
22 such secured borrowing, may be properly and fully analyzed and fairly balanced
23 against the rights and interests of unsecured creditors in advance of any such security
24 being granted. No doubt the Court, in doing so, would have regard to the views of

1 unsecured creditors but an overall approach, having regard to all the circumstances
2 will be taken.

3
4 25. In fact the Company has never previously granted security of any kind in respect of
5 its borrowings, which have always been from Mr. Le Comte as a shareholder and
6 investor in the Company. Both he and Mr. Heinen are on record as having said on
7 several occasions that they consider the intellectual property rights currently held by
8 the Company to be of very substantial value having regard to the considerable
9 financial potential from exploitation of TheWheel and associated technology. Those
10 rights are also the Company's only asset of any significance. Mr. Le Comte also
11 estimated the realizations from the litigation, particularly in New York, if successful
12 would be very significant. In such circumstances to grant security over all of the
13 Company's assets and rights, including all of the intellectual property rights it holds,
14 was, as I have said, clearly a very significant and important step, particularly having
15 regard to the fact that such security was granted pursuant to the First Note in respect
16 of a loan of up to US\$1m, a relatively small amount in proportion to Mr. Le Comte's
17 own opinion of the very high value of the Company's assets and rights.

18
19 26. It was also contended on behalf of Mr. Le Comte that since the Company has been,
20 albeit procured by him, carrying on litigation over the past 3 years, meeting the costs
21 of such litigation through borrowing has been a prior practice and become part of the
22 ordinary course of the Company's business. I shall comment on that suggestion later
23 in this Ruling.

24

1 27. As I have already mentioned, in deliberately not informing his co-director, Mr.
2 Heinen, of the proposed grant of the Security, Mr. Le Comte relied on the provisions
3 of the Shareholders Agreement and in particular Section 1, as he did in his
4 unsuccessful opposition to the winding up of the Company. In the present context
5 Mr. Le Comte contends that the effect of the Shareholders Agreement is that he has
6 the sole right to determine all management issues of the Company of a non-technical
7 nature and that accordingly it was solely up to him whether or not the Company
8 should enter into the Notes and grant the Security. In his view Mr. Heinen was not
9 entitled to any say in the matter. However, in my opinion, apart from the fact that,
10 as Mr. Le Comte was well aware at the time, it is anyway contended by Mr. Heinen
11 that the Shareholders Agreement is not valid, that is not quite what the Shareholders
12 Agreement provides. Section 1 (2) provides with regard to business and other non-
13 technical issues:

14
15 *“all votes [are] to be carried in favor of, and/or all actions to be taken and*
16 *documents and instruments [are] to be executed in accordance with, the*
17 *recommendation with regard thereto made by Le Comte in his sole discretion”.*
18
19

20 This clearly, at the least, requires there to be a recommendation with regard to the
21 proposed action by Mr. Le Comte provided to Mr. Heinen, and, arguably, also a
22 vote. The section does not, in my view, simply entitle Mr. Le Comte to ignore Mr.
23 Heinen entirely and to make decisions and take actions unilaterally in respect of the
24 Company without at least informing his co-director (described, as he and Mr. Le
25 Comte both are, in the Shareholders Agreement as a “Manager” of the business).
26 Mr. Le Comte, of course, alleges that he had removed Mr. Heinen as a director of the

1 Company. However, he was well aware that that was strongly disputed and that Mr.
2 Heinen had refused to resign. Mr. Le Comte was aware of all this when he claimed
3 to Mr. Durst that he had the sole right to procure the Company to grant the Security
4 and that he did not intend to inform Mr. Heinen of what he proposed. Nor do I
5 consider that the fact that he considered Mr. Heinen would have had a conflict of
6 interest meant that he was not required to inform Mr. Heinen of his proposed action
7 on behalf of the Company.

8
9 28. A further point which was the subject of argument before me related to the
10 provisions regarding default in the Notes. It was submitted by counsel for the JOLs
11 and counsel for Mr. Heinen that the wording of clause 2 (a) (iii) of each of the Notes
12 meant that upon execution the Notes would become automatically and immediately
13 due and payable because liquidation proceedings against the Company had at the
14 date of execution been commenced and had remained un-dismissed for 90 days.
15 This would have brought about an immediate acceleration of liability under the
16 Notes and the obligation of the Company to pay an increased interest rate and legal
17 and other expenses. There was affidavit evidence from the New York attorney
18 representing the Durst Group in which he commented on that submission. He stated
19 that the language in Clause 2 (a) (iii) of each Note is merely pro forma, that it was
20 not contemplated that the existence of the winding up petition, of which he and the
21 Company's New York attorneys were well aware, would qualify as a default and that
22 he did not believe the Company would have executed the Notes if it had believed
23 there was already an existing default. The Notes are, of course, governed by New
24 York law, although the law in this country is that foreign law is presumed to be the

1 same as Cayman Islands law in the absence of expert evidence of the relevant
2 foreign law. No such expert evidence on the law of New York relating to the
3 construction and interpretation of legal documents such as the Notes was made
4 available to me. Under Cayman Islands law it is well established that such
5 documents are to be construed and interpreted solely upon the basis of their wording
6 and that evidence of preliminary negotiations, of the subjective intentions of the
7 parties and those connected to them and of subsequent actions is not relevant or
8 admissible as an aid to their construction. There is no evidence before me as to
9 whether or not that also represents the law of New York but on a construction of
10 Clause 2 (a) (iii) in accordance with Cayman Islands law the submissions on behalf
11 of the JOLs and Mr. Heinen in this regard are, in my opinion, clearly correct. It
12 seems to me, to put it at its lowest, that the construction and effect of documentation
13 which the directors of a company subject to winding up proceedings propose to enter
14 into, allegedly in the best interests of the company, such as the Notes and the
15 associated security, should and would properly be the subject of scrutiny by the
16 Court in considering whether or not a disposition pursuant to such documentation
17 should be validated.

18
19 29. I have already made passing reference to some of the email communications
20 between Mr. Le Comte and Mr. Durst but in my view they warrant further analysis
21 and comment. I should say that the general tone of this series of emails is informal
22 and friendly and makes it clear that there is considerable family friendship between
23 Mr. Le Comte and his family on the one hand and Mr. Durst and his family on the
24 other. There do appear to me to be gaps in the correspondences produced to me. As

1 I have said, it is also clear from the correspondence that there were meetings and
2 discussions between Mr. Le Comte and Mr. Durst, the content of which were either
3 not recorded or such records were not produced and which was not disclosed nor
4 explained in the affidavit evidence.

5
6 30. The first email produced, dated 6th April 2009, from Mr. Le Comte to Mr. Durst, to
7 which I have already referred in part, commences as follows:

8
9 *"Dear Jody [Mr. Durst]*

10
11 *All went according to plan in Luxembourg, though not without noteworthy incidents.*
12 *AJH [Mr. Heinen] has been set up for the next round without knowing and/or*
13 *realizing it.*

14
15 *The "pearls of wisdom" have meanwhile materialized. Please find attached a*
16 *proposed agreement."*

17
18
19 I consider it reasonable to assume that Mr. Durst understood what Mr. Le Comte was
20 talking about. There is no evidence or suggestion otherwise.

21
22 31. In a subsequent email dated 29th May 2009 Mr. Le Comte informed Mr. Durst that it
23 was *"imperative that a parallel R & D [Research & Development] production*
24 *facility be created in the U.S. A successful participation in this project would*
25 *represent an enormous economic opportunity for the combined companies [Mr. Le*
26 *Comte then refers to a pilot program for a people-mover system at Frankfurt*
27 *Airport].....Let's talk about this at your leisure. Incidentally I did speak with your*
28 *friend Tedd and gave him my best advice based on my assessment of the financial*
29 *feasibility of his project...."*

1 Again it is not entirely clear what Mr. Le Comte is referring to by “the combined
2 companies” but Mr. Durst must have known.

3
4 The reference to Mr. Durst’s friend Tedd is to a contact he had provided to Mr. Le
5 Comte, who was interested in the possibility of using the technology associated with
6 TheWheel. Mr. Heinen emphatically denied in his affidavit evidence that he had
7 ever agreed that there should be a R&D facility in the USA and he gave various
8 credible reasons why he would never have agreed to that. It was submitted that this
9 email was indicative of Mr. Le Comte’s alleged plan to take over the intellectual
10 property rights in TheWheel and associated technology entirely. It also seems that
11 he may have been discussing doing so jointly with the Dursts.

12
13 32. On 5th June 2009 Mr. Le Comte emailed Mr. Marx at the Durst Organisation, with a
14 copy to Mr. Durst, attaching a copy of the original draft agreement. He said:

15
16 *“I have since come to the conclusion that a specific lien on the Intellectual Property*
17 *and/or certain rights thereto should be added to ensure the ability to have a priority*
18 *claim in recovering the debt, which should also serve in signaling the “opposition”*
19 *that the actions being contemplated by them at this time are unlikely going to allow*
20 *them to gain control over the principal company assets (e-Traction Europe B.V. and*
21 *the IP)....”*
22

23 A subsequent email, dated 15th June 2009, from Mr. Le Comte to Mr. Durst makes it
24 clear that there was also a conversation between them the same day as Mr. Le
25 Comte’s 5th June email.

26
27
28

1 33. Section 142 (1) of the Companies Law (2009 Revision) (now Section 142 (1) of the
2 2010 Revision) provides that:

3
4 *“Notwithstanding that a winding up order has been made, a creditor who has*
5 *security over the whole or part of the assets of a company is entitled to enforce his*
6 *security without the leave of the Court and without reference to the liquidator”.*
7

8 The evidence shows that Mr. Le Comte, Mr. Durst and their respective New York
9 lawyers were well aware of this provision.

10
11 34. In my view, the inference from the email correspondence between Mr. Le Comte
12 and Mr. Durst to which I have referred above, taken with Mr. Le Comte’s deliberate
13 action in not informing Mr. Heinen of his proposal to grant the Security and the
14 other circumstances at the time, is that Mr. Le Comte’s intention, at least in part, was
15 that the priority claim effected by the grant of the Security to his friends the Dursts’
16 company would prevent Mr. Heinen, through an official liquidator appointed on a
17 winding up pursuant to Mr. Heinen’s petition, from taking control of the assets of
18 the Company, particularly the intellectual property rights.

19
20 35. It was argued on behalf of GCF that the fact that Mr. Le Comte provided the Dursts
21 with joint personal guarantees by himself and his wife of the Company’s obligations
22 under the Notes is inconsistent with this inference. Having regard to the particular
23 circumstances of this matter, I do not agree. As I have already said, Mr. Le Comte
24 was clearly of the firm view, and is on record as emphasizing that view on several
25 occasions, including to Mr. Durst (see for example the email dated 20th July 2009),
26 that the assets of the Company *“make it a very valuable company”* with *“enormous*

1 *commercial prospects and valuable assets*". He said that it was "*simply*
2 *inconceivable that in three years, when the loan comes due, [the Company] would be*
3 *worth less than the maximum amount of the credit-line*". If, as Mr. Le Comte
4 believed, it was inconceivable that the Company would be unable to repay the sums
5 drawn down under the Notes the risk to him in providing the unsecured joint
6 guarantees was negligible. In my judgment the provision of the joint guarantees
7 does not detract from the inference from the email correspondence and from the
8 other circumstances which I have already mentioned, that Mr. Le Comte's offer to
9 add the Security to the proposed borrowing arrangements was intended, at least in
10 part, to prevent a liquidator appointed by this Court from taking possession and
11 control of the Company's assets. He wished to ensure that, in the event of a winding
12 up, the Company's assets would be under the possession and control of his friends
13 the Dursts.

14
15 36. Mr. Le Comte's deliberate concealment of the proposed and actual grant of the
16 Security is, in my opinion, entirely consistent with this analysis. Although by the
17 time of the Consent Validation Order on 29th June 2009 discussions and negotiations
18 between Mr. Le Comte and Mr. Durst with regard to the proposed borrowing and the
19 grant of the Security were well underway, no mention of the proposed transaction,
20 and particularly the grant of the Security, was made by Mr. Le Comte's Cayman
21 Islands attorneys, T&R, in their correspondence proposing the Consent Validation
22 Order to Mr. Heinen's Cayman Islands attorneys, Appleby. The explanation of the
23 proposed validation order in T&R's email dated 24th June 2009 that "*the company*
24 *needs to have the ability to conduct its general business* was, in the circumstances,

1 disingenuous to say the least. Despite requests from Appleby for details of the
2 transactions which it was sought to validate, no such information was provided, and
3 no indication of the proposed grant of the Security was given. I am also concerned
4 that no mention of the grant of the Security was made to the Court at any time prior
5 to or during the hearing of the winding up petition in April 2010. Given the extent
6 and effect of the purported grant of the Security, it was clearly likely to be a
7 significant factor in the Court's consideration of whether a winding up order should
8 be made and official liquidators appointed to take possession and control of the
9 Company's assets. In my opinion the existence of the Security should have been
10 disclosed.

11
12 **Conclusions on the ordinary course of business issue**

13 37. Eherton J. pointed out in *Ashborder BV& Ors v Green Grass Power Ltd. & Ors*
14 (ibid), that there may be circumstances in which the grant of security over all the
15 assets of a company may be held to fall within the scope of the ordinary course of
16 that company's business. Equally, however, even if *prima facie* such a grant may be
17 considered to fall within the scope of that phrase, there may nonetheless be such
18 unusual features surrounding such a disposition that it will nonetheless fall outside
19 the scope of the ordinary course of the Company's business.

20
21 38. In the present case I do not consider the grant of the Security, which extended to all
22 of the assets of the Company, which Mr. Le Comte himself expressly considered to
23 be of enormous commercial value, to have been in the ordinary course of the
24 Company's business at all. I have already explained the nature of the Company's

1 business. In my opinion the fact that Mr. Le Comte has procured the Company to
2 engage in litigation with his co-director and contributory in New York, the
3 Netherlands and Luxembourg over the past three years or so in no sense means that
4 litigation is a business of the Company. Certainly the litigation in this Court leading
5 up to the winding up order was not properly litigation by the Company anyway; it
6 was litigation between Mr. Le Comte and Mr. Heinen personally. It was essentially
7 and obviously a dispute between Mr. Le Comte and Mr. Heinen as quasi-partners in
8 the business, the subject of which was the Company. Furthermore, it was very
9 clearly not the ordinary business of the Company, or of any company, to borrow
10 money to fund litigation by one shareholder against another. Even the litigation in
11 New York and the Netherlands, which Mr. Le Comte has procured the Company to
12 engage in, is principally litigation against an equal shareholder/contributory of the
13 Company. In my opinion that does not fall within the realm of what an objective
14 observer would consider to be within the ordinary course of the Company's
15 business. Borrowing for that purpose, and the grant of security over the assets of the
16 Company to enable such borrowing, is no different.

17
18 39. The transaction between Mr. Le Comte and the Dursts was, on Mr. Le Comte's own
19 case, a response to abnormal financial difficulties and not within the ordinary
20 operational activities of the Company. It was in no sense a routine or typical
21 transaction for the Company. I am not persuaded by the argument that the prior
22 practices of the Company, in taking loans from Mr. Le Comte, a shareholder and
23 investor in the Company, were in any sense akin to the dispositions involving the
24 grant of the Security. Even if it is correct that in the past, before the deadlock

1 between them arose, Mr. Le Comte and Mr. Heinen together made attempts to obtain
2 third party financing for the Company and that such financing would probably have
3 involved the Company being required to give security for such financing, there is no
4 evidence at all with regard to the type or extent of any borrowing or of any security
5 which may have been discussed. Furthermore, there is no obvious evidence that at
6 that time any such borrowing was proposed to be used for the purposes of litigation
7 by the Company, still less litigation between the two principals of the Company, and
8 clearly that was not the case. In my opinion the only prior practice of the Company
9 in this respect has been the unsecured funding of the Company from time to time by
10 Mr. Le Comte as a shareholder and investor. That is entirely different from the grant
11 of security over all the assets of the Company in support of limited borrowing from
12 friends of Mr. Le Comte. It is not something the Company ordinarily would do. It
13 was clearly a highly significant and unusual step for the Company and one with
14 major potential consequences. I am of the opinion that, quite apart from the unusual
15 features surrounding the transaction, the grant of the Security pursuant to the First
16 Note, and repeated pursuant to the Second Note, was clearly not within the ordinary
17 course of the Company's business.

18
19 40. I am also of the opinion that the unusual circumstances surrounding the purported
20 grant of the Security by the Company through Mr. Le Comte anyway take the grant
21 out of the scope of the ordinary course of the Company's business. Not only were
22 the proposals to and discussions concerning the grant of the Security without the
23 knowledge of the only other director at a time when all involved with the transaction
24 knew that the winding up petition had been initiated but there was a deliberate

1 decision to conceal the proposal. Furthermore, Mr. Durst had been expressly told
2 that there was another director who had refused to resign and that he was not to be
3 informed about the proposed Notes. The actual grant of the Security was also
4 subsequently and deliberately concealed from Mr. Heinen, not only in his capacity as
5 a director of the Company but also as a contributory and as the petitioner for the
6 winding up, until after the winding up order had been made. It was concealed as
7 well from this Court.

8
9 41. I have already commented on the surprising terms of the Notes, which on a usual
10 construction meant that there was an immediate default as soon as they were
11 executed. In the circumstances such a provision was not clearly in the best interests
12 of the Company, notwithstanding that in the event and with hindsight notice of
13 default was not given until after the winding up order was made.

14
15 42. A further significant feature of the Security which I consider takes it outwith the
16 scope of the ordinary business of the Company is its extent, which seems to me
17 disproportionate to the amount of borrowing, which, pursuant to the First Note, was
18 up to US\$1m. There does not appear to have been any discussion about the
19 appropriate security or its nature or extent, simply the offer of security over all the
20 Company's assets by Mr. Le Comte. This in itself seems surprising and unusual to
21 me.

22
23 43. In my opinion it is also relevant that the whole transaction involving the grant of the
24 Security was with longstanding friends of Mr. Le Comte and his wife. Even if the
25 affidavit evidence of Mr. Durst that the Dursts "*would certainly not have made the*

1 *loans to Freerider without having the security which it obtained under the Notes*” is
2 accepted, he does say that he does “*not recall specifically when or how the question*
3 *of security was raised in our discussions*”. The fact of the matter is that it was Mr.
4 Le Comte who voluntarily proposed that the Security should be added to the
5 proposed agreement with the Dursts to ensure they had a priority claim in order that
6 from Mr. Le Comte’s perspective the winding up proceedings would not allow “the
7 opposition” to gain control over the principal assets of the Company.

8
9 44. Quite apart from the ostensible purpose of the borrowing in respect of which the
10 Security was purportedly granted by the Company and the misuse by Mr. Le Comte,
11 again purportedly on behalf of the Company, of at least a portion of that borrowing
12 for his own purposes (and this Court has already ordered Mr. Le Comte to refund to
13 the Company those monies which he procured the Company to pay to his Cayman
14 Islands attorneys for representing his interests in his dispute with Mr. Heinen about
15 the winding up of the Company on the grounds that such use was misfeasance by
16 Mr. Le Comte as a director), there is, as I have already explained, clear evidence that
17 there was a collateral purpose in Mr. Le Comte offering and purportedly granting the
18 Security on behalf of the Company. In my opinion that is a sufficiently unusual
19 feature of this transaction of itself, which takes the grant of the Security out of the
20 ordinary course of the Company’s business. However, there are anyway the other
21 unusual features which I have discussed which also render the circumstances
22 surrounding grant of the Security sufficiently extra-ordinary as to mean that it was
23 clearly not in the ordinary course of the Company’s business.

24

1 45. In my judgment, when all the circumstances surrounding the purported grant of the
2 Security are considered, it cannot reasonably be said that it was in the ordinary
3 course of the Company's business. Accordingly I make the declaration which the
4 JOLs seek that the grant of the Security is not within the terms of the Consent
5 Validation Order dated 29th June 2009.

6
7 **Retrospective validation**
8

9 46. In light of my conclusion that the grant of the Security was not made in the ordinary
10 course of the Company's business it is void pursuant to Section 99 of the Law
11 "unless the Court otherwise orders". In that case GCF, by its summons dated 30th
12 August 2010, now seeks an order by way of retrospective validation of the grant of
13 the Security.

14
15 **The relevant law on validation**
16

17 47. Neither Section 99 of the Law nor any other statutory provisions prescribe the
18 circumstances in which the Court may validate any particular disposition so that it is
19 not void under the section. The Court has an unfettered discretion whether to valid
20 any disposition(s) in the particular circumstances.

21
22 48. The equivalent position in England was stated in Re Steane's Bournemouth Ltd.
23 [1950] 1 All ER 21 at p.25:

24
25 *"the legislature, by omitting to indicate any particular principles which should*
26 *govern the exercise of the discretion vested in the court [by the equivalent section],*
27 *must be deemed to have left it entirely at large, and controlled only by the general*
28 *principles which apply to every kind of judicial discretion".*
29
30

1 That was confirmed by the English Court of Appeal by Buckley LJ in Re Gray's Inn
2 Construction Co. Ltd. [1980] 1 WLR 711 at p.717] who added that:

3
4 *"the discretion must, in my opinion, be exercised in the context of the liquidation*
5 *provisions of the [the UK companies legislation, which is generally equivalent to the*
6 *Law].*

7
8
9 Accordingly, the statutory scheme on winding up pursuant to the Law is clearly
10 relevant. I have already summarized the purpose of Section 99, which is part of that
11 scheme, earlier in this Ruling as being to preserve the assets of a company in
12 winding up for the protection of its creditors (see confirmation of this by the Hon.
13 Chief Justice in Scotiabank (Cayman Islands) Limited v Treasure Island Resort
14 (Cayman) Limited [2004-05] CILR 423 at 427).

15
16 49. Guidance on the matters to be taken into account by the Court in considering
17 validation was addressed in: Re Fortuna Development Corporation [2004 -2005]
18 CILR 533 (Henderson J.) as approved in Re The Cybervest Fund [2006] CILR 80
19 (Smellie, CJ). In the Cybervest case the Hon. Chief Justice agreed with and adopted
20 a summary of the guidelines set out in the Fortuna case, which in turn derived from
21 statements of "the broad guidelines" in an English case Re Burton & Deakin Ltd.
22 [1977] 1 WLR 390. In the Fortuna case it was said:

23
24 *"Thus there are four elements which must be established before an applicant is*
25 *entitled to a validation order. First, the proposed disposition must appear to be*
26 *within the powers of the directors.....Secondly, the evidence must show that the*
27 *directors believe the disposition is necessary or expedient in the interests of the*
28 *company....Thirdly, it must appear that in reaching the decision that the directors*
29 *have acted in good faith. The burden of establishing bad faith is on the party*
30 *opposing the application. Fourthly, the reasons for the disposition must be shown to*
31 *ones which an intelligent and honest director could reasonably hold".*

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The Hon. Chief Justice went on in the Cybervest case at page 89 to add:

“There is another consideration to add to this list, in light of the concerns raised in this matter, although arguably it is subsumed within the third and fourth elements. This would be whether irregularities in the conduct of the affairs of the company can be shown, even if the company is clearly solvent, as is alleged here”.

Of course these guidelines are neither exclusive nor necessarily applicable to every case in which the Court may or may not validate a disposition of a company’s property when the Company is subject to winding up proceedings. Every case will turn on its own particular circumstances.

50. It also appears that different considerations may apply depending on whether the company concerned is solvent or insolvent. Solvency in this context has been said to mean that the Court is satisfied by credible evidence that the Company is able to pay its debts as they fall due (see Re Fairway Graphics Ltd. [1991] BCLC 468 at p.468-469). As I will explain later, it does not appear to me that the Company was solvent in that sense at the relevant time.

51. The usual assumption in a case where the company is solvent is that the particular disposition would not be prejudicial to the creditors as it should not affect their debts being repaid (see Fortuna case (ibid)). However, even if a company is solvent, that is not necessarily conclusive where the winding up petition is based on grounds other than insolvency, such as the just and equitable ground (see the Cybervest case (ibid)), as in the present case.

- 1 52. If it cannot be established that the company concerned is solvent then the principal
2 concern of the Court in considering an application for a validation order will be to
3 seek to avoid prejudice to the interests of unsecured creditors of the company (see
4 *Denny v John Hudson & Co. Ltd.* [1992] BCLC 901). Occasionally, in appropriate
5 circumstances, the Court has sanctioned the grant of a charge over a company's
6 property as security for a loan to enable the company to continue its business as a
7 going concern so that it can be sold as such but in exercising its broad
8 discretion the Court must determine the question having regard to all the
9 circumstances in each case. In the present case I have, of course, already determined
10 that the grant of Security was not in the ordinary course of the Company's business.
11 It is, however, also clear that payments by a company (and by extension, security
12 granted in respect of borrowing to fund such payments) in respect of disputes which
13 are essentially between shareholders of the company would not be validated. (See
14 *Crossmore Electrical & Civil Engineering Ltd.* [1989] 5 BCC 37).
- 15
16 53. It was submitted on behalf of GCF, that it would be unfair to it (and the Dursts) if
17 the grant of the Security was not now validated. However, the purpose of Section 99
18 of the Law is to minimize hardship to the general body of creditors as a whole;
19 prejudice suffered by one particular creditor, in this case GCF/the Dursts, if the
20 disposition is not validated is to be given relatively little weight. (See *Re Tellsa*
21 *Furniture PTY Ltd.* (1985) 3 ACLC 763 at p.770). Of course the nature and extent
22 of any hardship suffered by the recipient of the disposition in issue will depend
23 entirely upon the facts and circumstances surrounding the disposition. As was said

1 in the same case, also at p.770 in quoting from Re Mal Bower's Electrical Centre
2 (in liquidation) (1974) 1 NSWLR 254):

3
4 "....the legislative intention, as disclosed by the terms of [the equivalent of Section
5 99 of the Law], is such as to require an investigation of what happened to the
6 property, that is to say, what was the disposition, and then to enable the liquidator to
7 recover it upon the basis that the disposition was void. It is recovery from the
8 disponent that forms the basic legislative purpose of [the equivalent section]".
9

10
11 **Analysis and comment on the retrospective validation application**
12

13 54. It is clear that the onus is on GCF to establish that a retrospective validation order
14 should now be made in all the circumstances. The First Note, pursuant to which the
15 Security was purportedly granted (it was in practical terms re-affirmed pursuant to
16 the Second Note) was signed as of 17th August 2009, a year before GCF made its
17 application for validation of it.

18
19 55. It is unclear whether the Company was solvent at the relevant time, which in my
20 view is at the time of the purported grant of the Security pursuant to the First Note.
21 As I have already mentioned, both Mr. Le Comte and Mr. Heinen are firmly of the
22 view that the Company was and is solvent on a balance sheet test. However, the
23 very reason why, accordingly to Mr. Le Comte, he procured the Company to borrow
24 from the Dursts was because the Company was unable to pay its debts as they fell
25 due. The JOLs have certified that the Company is of doubtful solvency but that
26 seems to be because they have had little or no access to the Company's records and
27 have accordingly been unable to reach a conclusion either way. The position
28 appears to be that at the time of the grant of Security the Company may have been

1 solvent on a balance sheet test but insolvent in being unable to pay its debts as they
2 fell due.

3
4 56. However, assuming, in GCF's and Mr. Le Comte's favour for the sake of argument,
5 that the Company was solvent at the relevant time, then the test approved by the
6 Hon. Chief Justice in the Cybervest case (ibid) should be applied to the
7 circumstances surrounding the grant of the Security, which I have already outlined in
8 determining that the grant of the Security was not within the ordinary course of the
9 Company's business. I do not think it necessary for me to repeat my summary of
10 and comment on those circumstances.

11
12 57. There was no "body of evidence" presented to me to satisfy me that the reasons for
13 the grant of the Security were ones that an honest and intelligent director could
14 reasonably have held. Indeed, apart from Mr. Le Comte's general comments in his
15 affidavit evidence that the purpose of the borrowing, which was secured by the
16 purported grant of the Security, was largely to pay the legal costs of the litigation in
17 New York, the Netherlands and this country, there was, as I have already mentioned,
18 no detailed information provided by him as to precisely how the funds borrowed
19 from the Dursts' company had been utilized, nor was there any evidence to justify
20 the submission on his behalf that such borrowing was in the best interests of the
21 Company. For example, there was no expert opinion evidence as to the merits of the
22 litigation in New York from the Company's perspective in order to justify further
23 expenditure on the litigation at that time, namely when the Company was the subject
24 of winding up proceedings. The evidence, and the inference I have drawn from it, is

1 that the money borrowed from 733 Properties/ the Dursts, was used, not only to
2 settle outstanding invoices, but also in order to enable the litigation to be progressed.
3 There was no explanation, still less professional opinion, as to why, for example, the
4 legal proceedings in New York, and perhaps in the Netherlands, could not have been
5 stayed on the Company's application pending the determination of the winding up
6 proceedings, rather than the Company spending more money on the litigation in such
7 circumstances. There was no evidence, other than the bare assertions of Mr. Le
8 Comte that continuing to spend money on the litigation was in the best interests of
9 the Company at that time, rather than it being in his personal interests. The
10 evidence, in my opinion, very much supported the latter interpretation.

11
12 58. I should also mention the consideration specifically referred to in the Cybervest case
13 (ibid), namely whether irregularities in the conduct of the affairs of the company can
14 be shown. The Court has already concluded that the members of the Company have
15 justifiably lost confidence in Mr. Le Comte based on a lack of probity in his conduct
16 of the affairs of the business, including the Company (see Reasons for Winding Up
17 Order, paragraph 60) and I have already explained why I infer a collateral purpose
18 on the part of Mr. Le Comte in offering and then purporting to grant the Security to
19 his friends' company. No authority has been submitted to me to the effect that the
20 Court has ever made a validation order, still less a retrospective one, in such
21 circumstances.

22
23 59. It seems to me, having regard to the circumstances surrounding the grant of the
24 Security, most improbable that it would have been validated at or about the time of

1 its proposed grant a year ago. Even if I am wrong about that, it does not follow that
2 the grant of the Security should now be validated retrospectively. The circumstances
3 are now clearly different in that a winding up order has since been made and the
4 JOLs, who are officers of this Court subject to this Court's supervision, have been
5 appointed to fulfil their statutory duties under the Law. The uncertainty with regard
6 to the outcome of the winding up proceedings which may have existed at the time
7 when the Security was purportedly granted now no longer exists. The grant of the
8 Security, which at the time may have possibly frustrated any official liquidators who
9 might have been appointed in taking possession and control of the Company's assets
10 now definitely would have that effect.

11
12 60. As far as 733 Properties, and the Dursts are concerned, it was their decision to rely
13 on an opinion by Mr. Le Comte's own attorneys, T&R, several of whose important
14 assumptions were under challenge by Mr. Heinen, of which, at least in some
15 respects, Mr. Durst was aware. For example, T&R did not point out the risks
16 involved in not informing Mr. Heinen of the proposed transaction in light of the fact
17 that Mr. Heinen had refused to resign as a director of the Company. They did not
18 point out the risk of the grant of the Security, once it became known, being
19 challenged and the risk of it being held by a Court that it had not been granted in the
20 ordinary course of the business of the Company. They did not point out the risk
21 involved in relying on the Shareholders Agreement which was under challenge and
22 anyway open to other possible interpretation, or indeed the risks generally arising
23 from the fact that Mr. Le Comte was involved in hostile litigation with Mr. Heinen
24 in several jurisdictions which he was not inevitably bound to win in all respects.

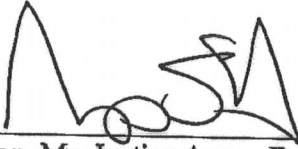

1 Furthermore, as I have already said, it seems to me reasonable to infer that Mr. Durst
2 understood that Mr. Le Comte had offered the Security at least in part for tactical
3 collateral reasons of his own relating to his dispute with Mr. Heinen and also related
4 to his suggestions concerning his future control and development of the Company's
5 intellectual property rights, involving a proposal for a R&D facility in the USA,
6 perhaps even as a possible venture with the Dursts.

7
8 **Conclusion re retrospective validation application**

9 61. Having regard to all the circumstances surrounding the grant of the Security and in
10 light of my analysis and comments above, in the exercise of my discretion I refuse
11 the application of GCF for retrospective validation. I am satisfied that the grant of
12 the Security would probably not have been validated prospectively if an application
13 for validation had been made prior to its grant, as in my opinion it should have been,
14 and I do not consider that it should now be validated retrospectively. Indeed it
15 seems to me that there are good additional reasons, as I have outlined above, why
16 that should not be done. I therefore refuse the application by GCF by their summons
17 dated 30th August 2010 and declare the grant of the Security to be void under Section
18 99 of the Law.

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20 62. In the circumstances I will reserve the question of costs for further submissions from
21 counsel in due course.

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25 Dated: 16th September 2010
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Hon. Mr. Justice Angus Foster QC
Judge of the Grand Court

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