IN THE GRAND COURT OF THE CAYMAN ISLANDS

31-3-09

CAUSE NO: 258 of 2006

IN THE MATTER OF THE COMPANIES LAW (2004 REVISION)

AND IN THE MATTER OF SPHINX LIMITED (IN VOLUNTARY LIQUIDATION)

IN CHAMBERS
BEFORE: The Honourable Chief Justice Smellie
THE 26TH AND 31ST MARCH 2009

APPEARANCES: Ms. Cherry Bridges of Ritch and Conolly for the Joint Official Liquidators ("the JOLs")

Mr. Alistair Walters of Campbells for DPM Mellon LLC and DPM Mellon Ltd. (together "DPM")

Mr. Alan Turner and Ms. Rowena Lawrence of Turner & Roulstone for the Community of Creditors ("the Community")

RULING

1. By written ruling delivered on 23rd February 2009, I refused DPM's application for the direction of the trial of certain issues as preliminary issues.

2. The JOLs and the Committee were represented by counsel at that hearing and both now seek to recover their costs as against DPM.

3. DPM's application for the trial of preliminary issues was brought in the context of its pending appeal against the JOLs' rejection of DPM's proof of debt and against the background of pending proceedings in New York. In the New York proceedings, DPM (along with others) is sued by the JOLs for, among other things, breach of fiduciary duty, fraud and conversion. DPM's proof of debt seeks to recover, among other things, all costs which DPM may incur in these or

in any other proceedings (including those now pending in New York) in which DPM may have incurred costs. DPM will also seek to recover any amounts for which it may become liable by way of damages in respect of its former role as the administrator of the Sphinx entities. DPM seeks to rely on indemnities in its contracts with the Sphinx entities as the basis for protection against all such liabilities to the extent liability is found to arise from DPM's mere negligence, as distinct from its gross negligence, malfeasance or willful misconduct. It is DPM's right to rely on these indemnities which has been denied by the JOLs in their rejection of its proof of debt and which right DPM will need to establish in order to succeed on its appeal.

4. The questions which arise before me now may, against that background , be framed as follows:

(i) Is DPM liable in the ordinary way – having been unsuccessful in its application for the direction of the preliminary issues – for the costs of the successful parties?

(ii) If so, should DPM be ordered to pay those costs forthwith or should they be ordered to await the outcome of DPM's appeal when, if DPM is successful, they would be covered in any event by DPM's indemnity and so not ultimately become a liability of DPM's?

(iii) In any event should the Committee, having only of its own volition participated in opposition to DPM's application, be regarded as a successful party or should the Committee be obliged to recover its costs of participation from the estate?

The JOLs and the Committee agree that the Committee's recourses as to costs should be framed in terms of those two alternatives but DPM argues – as a claimant having a potential interest in the estate – that the Committee should bear its own costs.

5. I will take these questions in turn.

(i) DPM's primary contention is that it should not be held liable now for the costs of the application for trial of preliminary issues. Mr. Walters submits that because DPM's application was merely interlocutory, seeking only proper case management directions in these and in respect of the New York proceedings which have not yet been concluded and which could potentially be determinative of these proceedings, the proper order now should be to reserve the costs to await the final outcome. A similar approach, it is said, was taken by Henderson J. upon an earlier interlocutory application in this matter. I note however, as a point of distinction, that I regard the refusal of directions for the trial of preliminary issues as being finally determinative of DPM's application in that regard. Further, Mr. Walters submitted that if the costs here are now ordered to be paid instead of being reserved, it could transpire nonetheless that the estate must ultimately indemnify DPM against all its costs, including these costs. In that event, any dispositive costs order made now could ultimately be rendered nugatory.

I am unable to accept DPM's contention. DPM's appeal against the JOLs rejection of its proof of debt - the context in which the application for trial

of preliminary issues arose - is, as Ms. Bridges and Mr. Turner both seek to emphasise, hostile litigation. In the ordinary course, the costs will therefore follow the event of the outcome of any step taken within it, as they would the outcome in any other kind of adversarial contest. While its proof of debt remains rejected, DPM can claim no special standing to apply to the Court as a creditor and so can claim no special right to be protected against the costs of litigation arising from its appeal against the rejection of its proof. If DPM succeeds in its appeal and then becomes an established creditor, different considerations would apply. Until then, DPM is at risk as to cost as would be any other hostile litigant.

This conclusion finds support in the case law.

The adversarial stance which the JOLs must assume, in defending the assets of the estate against a claimant whose proof of debt has been rejected, is clearly recognized.

See, for example ***Re Kentwood Constructions Ltd. [1960] 1 WLR 646*** and ***Tanning Research Laboratories Inc. v O'Brien (1990) 169 C.L.R. 332, (1990) 8 A.C.L.C. 248***. In the latter case in the Australian High Court, Brennan and Dawson JJ in their joint judgment, explained the position of a liquidator when responding to an appeal against a rejection of a proof of debt in these terms:

> ***"In such a proceeding...a liquidator who defends his decision to reject a proof of debt is no longer acting in a quasi-judicial capacity; he is cast in the role of an adversary, defending the assets available for distribution against a liability which, according to the view he formed when acting quasi-judicially, is not legally enforceable.***

> ***The liquidator may defend those assets against the creditor's claim on any ground on which the company might have defended the claim had it been sued by the creditor."***

I accept the patent validity of that dictum. I conclude that the answer to the first question is "Yes".

(ii) The second question is whether DPM should be ordered to pay these costs forthwith.

DPM's further contention is that even if as I have determined, a dispositive costs order should now be made, the further exceptional requirement that it be paid forthwith – which is contended for by the JOLs and the Committee – cannot be justified.

The normal costs order to be made in respect of an interlocutory proceeding such as the present is that the costs be taxed if not agreed in the usual way, to be paid at the conclusion of the case.

An order for payment forthwith would therefore be exceptional and so acknowledged by the other parties.. The Rules of Court would clearly so regard such an order. GCR Order 62 Rule 9 (1) provides that the costs of proceedings shall not be taxed until the conclusion of the cause or matter in which the proceedings arise unless, subject to sub-rule 9(2), earlier taxation is deemed suitable by the Court.

A cause or matter is concluded when the Court in question has finally determined the matters in issue, whether or not there is an appeal from that determination. So said Saville J in ***Kafsanjan Pistachio Producers Corp v Bank Leumi (UK) Ltd.*** (cited at RSC para 62/8/1 1999 Edition) indicating

that an interlocutory application such as the one being discussed here as to the incidence of its costs, would not ordinarily be a proper stage at which to make an order for costs to be taxed forthwith.

In the absence of any exceptional circumstances, I take the same approach here and refuse to order that there should be taxation and payment forthwith.

(iii) The remaining question is whether DPM should be liable for the Committee's costs or whether those costs should be met by the estate. The JOLs support Mr. Turner's argument which is primarily that DPM should be liable for them but, in the alternative, that if DPM are not made liable for the Committee's costs, then the Committee should be entitled to recover them from the estate.

A bit more of the background must be considered. At the hearing of DPM's application, DPM objected to the Committee being allowed to appear to argue against the application. DPM's primary reason was that the Committee's argument would merely be repetitive of what the JOLs would have to say. DPM's secondary reason was that at all events, DPM should not be at risk for the Committee's costs of participation, the lis over DPM's appeal against rejection of its proof of debt then being joined only as between DPM and the JOLs.

Mr. Phillips Q.C. for the Committee, then responded to DPM's objection, by asserting a right to be heard on the basis that the Committee holds the

real financial interest in the liquidation and that it was "none of DPM's business" whether or not the Committee participated.

Mr. Lowe Q.C. for the JOL's, then advised the Court, that there is in place a "regime" – a reference to an earlier order of Justice Harrison (Acting) – "to make sure that the Committee gets its costs of this sort of application out of the estate." (See transcript of hearing on 2nd October, 2008)

Against that background, while making no pronouncement on the matter, I allowed the Committee to participate with what appeared to me to have been a clear understanding that DPM would not have been at risk of having to meet the Committee's costs. I can see no basis for departing from that understanding now.

The remaining issue then is whether in these particular circumstances, the Court should approve of the Committee's costs being met from the estate.

The Companies Winding Up Rules 2008 (which came into effect on 22nd January 2009) and its predecessor (the UK Insolvency Rules 1986 which applied until then *mutatis mutandis* in this jurisdiction) are both silent as to whether a creditor is entitled to challenge another creditor's appeal against rejection of a proof of debt. The Rules are therefore also silent as to the incidence of the costs of such challenges.

This deficiency of the rules must be squarely addressed here because the intervention of the Committee in DPM's application may properly be characterised as being in the nature of such a challenge. The Committee's

intervention within DPM's application for the direction of preliminary issues was itself brought in the context of DPM's pending appeal.

It seems the case law is sparse on this topic. The issue did arise however, in ***Australian Consolidated Investments Ltd. v Woodings*** *(1996) 14 A.C.L.C. 1187.* As cited in McPherson's Law of Company Liquidation (Sweet & Maxwell, London 1st Ed) at page 707-708; in that case a creditor whose claim had only been admitted to the extent of $23 million of $45million claimed, found that its appeal against rejection of the rest was opposed by a second creditor. The second creditor argued for its joinder to the appeal in opposition to the appeal on the basis, inter alia, that if the appeal was successful, its dividend would be reduced substantially. The Court, while acknowledging that such a concern was a matter to be taken into account, held that it was itself not sufficient to justify the order sought.

Given the silence of the Rules together with this Australian case authority, the editors of McPherson (ibid) submit that it is correct to say that another creditor would not be entitled to oppose appeals against rejection of proofs of debt.

I am not satisfied on the basis only of the foregoing discussion, that so wide a proposition is acceptable.

It is true that an appeal against a rejection of proof of debt is joined peculiarly as between the particular appellant/claimant and the liquidator. There could well however be circumstances in which the interests of a

third party stakeholder or claimant in the outcome cannot be properly or fully represented by the liquidator and in which it may be only fair that the third party be heard.

The silence of the Rules should not in such circumstances be deemed to operate as an obstacle to fairness. Viewed in the light of such potential unfairness, the Australian case must, in my view, be seen as one decided based on its own particular facts and circumstances.

In the present case, the Committee was allowed to participate albeit in what must be acknowledged to have been only an interlocutory procedural stage, rather than at the hearing of the substantive appeal itself.

Nonetheless, the Committee did so with the approval of the Court and, in the end, without the steadfast objection of DPM, the appellant. The submissions made by Mr. Phillips QC on its behalf, were helpful to the Court.

Accordingly, I regard this final question whether I should approve of the Committee's cost being paid from the estate, as being a matter for the exercise of discretion.

6. On the foregoing and further basis that the Committee, having already had in place, the "regime" to which Mr. Lowe alluded – may not have anticipated that it was itself at risk of paying its own costs of participation; I order that they be met from the estate on the indemnity basis. Having so decided, I should be careful to explain that I do not regard the aforementioned "regime" – that set out in Harrison, Acting J's order of 28th July 2006 in this matter (at para 12) – as

providing *carte blanche* for the costs of whatever steps the Committee might wish to take in these appeal proceedings. Indeed, it should be noted that that paragraph of the order which allowed the Committee's "reasonable fees incurred – in properly discharging its functions", is governed by the earlier paragraphs which speak only expressly to the specific role of the Committee in the determination of the fees and expenses of the JOLs.

7. It follows, that, in my view, the Committee will need the approval of the Court for the costs of any further steps taken in the context of DPM's appeal.

Hon. Anthony Smellie
Chief Justice

Dated this 31st day of March 2009

GRAND COURT CAYMAN ISLANDS