IN THE GRAND COURT OF THE CAYMAN ISLANDS
FINANCIAL SERVICES DIVISION

CAUSE NO. FSD: 0016 OF 2009 – ASCJ
(Formerly Cause No. 258 of 2006)

IN THE MATTER OF THE COMPANIES LAW (2012 REVISION)

AND IN THE MATTER OF THE SPHINX GROUP OF COMPANIES (IN OFFICIAL LIQUIDATION) AS CONSOLIDATED BY THE ORDER OF THE GRAND COURT DATED 6TH JUNE 2007

IN CHAMBERS

BEFORE: **The Rt Hon Sir Andrew Morritt, Judge of the Grand Court of the Cayman Islands**

HEARING DATES: **17th June 2013 to 2nd July 2013**

APPEARANCES: **Mr. Thomas Lowe QC (instructed by Mrs. Cherry Bridges of Ritch & Conolly) for the Joint Official Liquidators of the SPhinX Group of Companies (the "JOLs")**

Mr. Mark Phillips QC (instructed by Mr. Alan Turner and Mrs. Andrea Dunsby of Turners) for the Liquidation Committee of the SPhinX Group of Companies (the "LC")

Mr. Richard Sheldon QC (instructed by Mr. Guy Manning of Campbells) for DPM Mellon LLC and DPM Mellon Ltd ("Indemnity Claimants")

JUDGMENT

Introduction

1. The SPhinX Group ("SPhinX") consists of 22 companies all incorporated in the Cayman Islands. It was set up by Plus Funds Inc, a company incorporated in the state of Delaware, to carry on business as open ended investment companies. SPhinX operated as a

fund of funds designed to track a hedge fund index set up by Standard and Poor by means of a three tiered structure, comprising 'feeder', 'master' and segregated portfolio companies, designed to accommodate various investment strategies.

2. SPhinX commenced business in 2004. Its directors included Robert Aaron. It carried on its business with the assistance of, amongst others, Plus Funds Inc as investment manager, DPM LLC and its associates as administrators, Price Waterhouse US and Cayman as auditors, Deutsche Bank and its affiliates as custodians and sponsors and Refco Group LLC as its prime broker. Certain of those service providers, and others, amounting, in all to 34 entities and persons ("Indemnity Claimants" or "ICs"), were entitled to the benefit of indemnities given by SPhinX in various forms in their terms of engagement, under the articles of association of the SPhinX companies and otherwise. In one form or another, and the variations are immaterial to this application, such indemnities provided, in substance, that SPhinX agreed:

> "to indemnify ... and hold harmless [the service provider] and their respective officers and employees and their respective successors and permitted assigns from and against any and all liabilities, claims, costs, fines, damages, expenses or losses incurred by [such service provider] in consequence of the performance of their obligations under this Agreement. Nothing contained herein shall require either party to indemnify the other for acts of the others, which constitute gross negligence, malfeasance or wilful misconduct."

3. As is now notorious, Refco collapsed in September 2005 due to fraud committed by its management. This affected the viability of the business of SPhinX. On 31st December 2005 it was unable to satisfy investors' redemptions with cash. On 6th March 2006 its founder and investment manager, Plus Funds Inc, filed for Chapter 11 protection in the US. On 30th June 2006 SPhinX was put into voluntary liquidation. On 24th July 2006 its liquidation committee ("the Liquidation Committee") was set up on an ad hoc basis. Shortly thereafter the winding up of SPhinX and all its constituent companies was brought under the supervision of the court; the 22 liquidations have been consolidated by order of the court made on 6th June 2007. The Joint Official Liquidators ("JOLs") became and still are the liquidators of the SPhinX Companies. At the commencement of the winding up of the SPhinX companies there were 107 investors. The value of their investments, based on the net asset value at 31st March 2006 was $769,171,925. Since then the JOLs have received notice of 10 assignments of investments with net asset values as at that date of $80,005,152 (approximately 10% by number and value); all save a very small number in favour of Deutsche Bank ("DB") or hfc, the principal proponents of this scheme.

4. On 3rd July 2007 the JOLs, with the sanction of this court, engaged the services of Beus Gilbert PLLC ("Beus"), a firm of attorneys based in Arizona, USA, on the terms of a legal representation agreement which included a contingent fee arrangement. I shall refer to the terms of this agreement ("CFA") in some detail later. For the present it is sufficient to record that Beus were engaged to undertake:

> "The investigation of activities surrounding the SPhinX Fund's losses and litigation against those culpable for said losses, as well as related matters..."

They were to be remunerated by, inter alia, a contingent fee on any cash recovery at the rate of 33.3% of any gross recovery.

5. On the advice of Beus and with the sanction of this court, in March and April 2008, the JOLs commenced two actions in the US, subsequently consolidated, to recover losses sustained by SPhinX allegedly due to breaches of contractual and fiduciary duties by one or more of the defendants. The first was commenced in New York in March against some 60 defendants, some of whom had the benefit of indemnities from SPhinX. The second was issued in New Jersey in April. The defendants included DPM and Mr Aaron, both of whom had such benefit. The relief sought was the recovery of $263m of money of one of the SPhinX companies misapplied in payment to a company in the Refco group and compensation for the destruction of the business of Plus Funds. The total amount claimed in both actions amounted to some $750m as at November 2011 (including pre-judgment interest but excluding punitive damages). Over the years the judge to whom they were assigned, Judge Rakoff, has made a number of orders to some of which I shall refer in greater detail, as necessary, later.

6. It was apparent from an early stage that the winding-up of the companies in the SPhinX group would give rise to a number of problems in relation to the pooling of their assets and the priorities of the various members between themselves. With a view to compromising them, in June 2007, the JOLs applied for an order staying the determination of those issues so that a scheme of arrangement ("the First Scheme") might be promulgated. Such a course necessitated the ascertainment of the reserve necessary to satisfy the companies' potential liabilities to those holding its indemnities as contingent creditors. An application for that purpose was made to the Chief Justice in December 2009. In his judgment handed down in February 2010 the Chief Justice made a number of rulings, namely:

(1) such reserve should be the full amount of the potential liability (para 17);

(2) the contingent claims which might arise were "entirely within the realm of the unknown" and could not be estimated at that stage (para 22);

(3) but the court could and should, at that stage, ascertain the reserve which would be sufficient to satisfy the maximum amount of costs which might reasonably be incurred by the ICs in defending themselves against claims which might be made against them and potentially fell within the scope of their indemnities (para 38);

(4) the maximum costs which might be reasonably incurred by the 34 ICs was $117,332,912 (para 104).

7. In March 2010 the discussions designed to formulate an acceptable scheme of arrangement broke down and steps were taken to obtain rulings on the various liquidation issues. In May 2011 DB, which had been joined as an additional defendant to the proceedings in the US in March 2010, and hfc, both substantial investors in SPhinX, proposed a different scheme of arrangement ("the Second Scheme"). I shall refer to its terms in some detail in due course. For the present it is sufficient to record that it was proposed to members of SPhinX, but without their commendation, by the JOLs, not DB or hfc. It involves a pooling of assets and liabilities of all the companies in the group and the ascertainment of a reserve to satisfy all creditors, in particular the ICs. If approved and sanctioned by the Court it will constitute a release of DB from all liability to SPhinX. The petition for its approval was presented to the court on 21st September 2011. On 10th November 2011 the Chief Justice directed the requisite 22 meetings of members to be convened. On 13th December 2011 the scheme was approved by those attending 20 of the 22 meetings. Further meetings were directed and, on 22nd October 2012 held, of the members of the two outstanding classes. Those attending one of them duly approved the proposals but those attending the other did not. Thereafter the interests of the latter were bought by DB which signified its approval to the Second Scheme. The scheme was positively supported by 64.5% by number and 98.5% by value of the whole body of investors.

8. On the same day as the Petition was presented to the court, namely 22nd September 2011, Beus indicated to the JOLs that if the scheme was approved they would claim to have been discharged from further performance of the CFA and would seek from the JOLs recompense by means of a *quantum meruit*. This was because the effect of the scheme, if approved, would be to discharge DB from all further liability to SPhinX. Beus considered, and submitted detailed memoranda to that effect, that the release of DB would be for

inadequate consideration and would be damaging to the US litigation as a whole. Their memoranda were reproduced in Annex 5 to the Confidential Explanatory Memorandum.

9. On 5th and 6th December 2012 the petition to sanction the second scheme came before the Chief Justice for directions. In his judgment dated 21st December 2012 he made a number of rulings, namely:

> (1) As DB supported the Second Scheme the requisite majorities had been obtained in all classes (para 6).
>
> (2) The change of circumstance constituted by the acquisition of the interests of the members of the dissentient class by DB and its consent to the Second Scheme did not necessitate an order to reconvene the meetings to reconsider the Second Scheme in the light of such acquisition.
>
> (3) It was necessary to ascertain whether or not the net assets available to the JOLs ($500m) exceeded the amount of the reserve required to satisfy the ICs and Beus (together with the other reserves to be established under the Second Scheme). If it did the balance would be available for distribution under the Second Scheme; if it did not there would be no jurisdiction to sanction the Second Scheme anyway.

10. By his order the Chief Justice directed the resolution, but only to the extent necessary for considering whether or not the Court has jurisdiction to sanction the scheme of arrangement ("the Scheme") of the questions:

> "(1) whether upon the sanction of the Scheme there is no real risk of a liability to Beus Gilbert or no risk of liability which, when added to the Indemnity Reserve and the other reserves to be established under the Scheme, would exhaust the cash assets of the SPhinX Companies ("the Beus Gilbert Reserve Issue"); and
>
> (2) the appropriate Indemnity Reserve in accordance with paragraphs 9 to 18 below."

11. Paragraphs 9 to 18 contained procedural directions designed to ascertain the issues the parties considered must be decided in order to ascertain the amount of the appropriate indemnity reserve and whether the reserve for the costs of the ICs should be more or less

than the sum of $117,332,912 set by the Chief Justice in his judgment handed down in February 2010 (see para 6(e) above).

12. The hearing before me is that directed by the Chief Justice in his judgment of 21st December 2012. The parties have identified 20 issues they consider to be relevant to the ascertainment of the Indemnity Reserve to which I shall refer later. They have called expert evidence on both questions. I will determine them in due course. First it is necessary to describe the Second Scheme and the course of the US proceedings in greater detail.

The Second Scheme

13. The Second Scheme is unusual. As the executive summary to the Explanatory Statement states:

> "...the JOLs believe that the Scheme does not offer a quicker or a bigger payout; will have an adverse impact on the US litigation; will put the existing current assets at risk; and will reduce the assets available for an initial distribution."

The summary went on to explain that DB, amongst others, did not share the concern of the JOLs. The rival views were set out in various annexes to the Explanatory Statement. Accordingly, as the JOLs continued:

> "Each investor should read what the JOLs, DB and hfc have to say on these matters in order to make their own commercial assessments of the merits of the Scheme, having regard to each investors own rights and commercial interests."

14. Paragraph 1.11.1 of the Explanatory Statement explained that the Second Scheme would not affect the rights of the ICs or other creditors of SPhinX. The former would continue to enjoy the rights and protections afforded to contingent creditors by the Companies Law and the Companies Winding up Rules

> "...whereby no distribution can be made until a satisfactory reserve has been made under CWR Order 18 rule 4. Assets will not be pooled and transferred to the Scheme Supervisors for distribution to Scheme Claimants until the Indemnity Reserve has been quantified and established."

15. The essential elements of the Second Scheme, as explained in the Explanatory Statement, may be summarised as follows:

(1) The application for the determination of the liquidation issues would be withdrawn, the costs of DB and hfc in connection with the promulgation of the Second Scheme would be paid and the US litigation would be continued. (para 10.2)

(2) On the establishment of the necessary reserves, in particular the Indemnity Reserve, the remaining assets of all SPhinX companies would be pooled and transferred to the Scheme Supervisors. (para 10.4)

(3) The net proceeds of litigation received by any SPhinX company would be added to the Indemnity Reserve. (para 10.6)

(4) DB and another defendant to the US litigation, BAWAG, would be released from all liability to any SPhinX company. (para. 13)

(5) The rights of investors as scheme claimants would be in substitution for any claims they might have against any SPhinX company (para 13.6) and they would be required to execute a release to that effect as a condition of receiving any payment under the Scheme (para 13.9.3).

(6) The JOLs intended to take such steps as might be necessary for the Scheme to be recognised as effective in the US, UK and Ireland, such recognition not being a condition to the effectiveness of the Scheme (para 14.1.4).

(7) The Scheme would remain operative until all the third party litigation (as defined) had been concluded and the net proceeds distributed to the investors to the extent that they did not form part of the Indemnity Reserve.

16. Each of these propositions is set out at greater length in the Scheme itself. The only aspect of it to which I should draw attention is paragraph 5. Paragraph 5.1.1 provides that:

> "until the Indemnity Reserve Ruling [as defined] has been obtained there will be no cash distribution."

In addition, paragraph 5.2.1 states that:

> "The rights of indemnity claimants will not be compromised under the Scheme and they will retain any claims they may have against the SPhinX

Companies. Provision for any and all contingent liabilities to Indemnity Claimants will be made by establishing the Indemnity Reserve."

17. There might appear to be some inconsistency in those statements. The rights of Indemnity Claimants are being compromised in that their statutory right to have all the assets of the SPhinX companies applied in accordance with the Companies Law is being translated into an equivalent right over the Indemnity Reserve which, by definition, will be something less than the total pool of assets. This will not matter if the Indemnity Reserve is sufficient to pay all Indemnity Claimants in full. I understand that the point was considered by the Chief Justice when he ordered the meetings to be convened. He did not consider that it was necessary to have a meeting of ICs. Nevertheless this consideration reinforces the need, to which he referred, to ensure that the reserve is sufficient. If it is not then the ICs will have legitimate complaints.

The US Proceedings

18. As I have already indicated in paragraph 5 above, these proceedings were commenced in March and April 2008 in New Jersey and New York respectively. Though consolidated and assigned to Judge Rakoff the expert evidence indicated that as and when the interlocutory processes are concluded the separate actions will be sent for trial by jury in New Jersey and New York respectively.

19. Originally there were 7 defendants to the New Jersey action comprising DPM and four of its associates and the two directors, Mr Aaron and Mr Castranova. The New York proceedings were against some 60 defendants. The combined claims sought to recover some $263m being the net sum of SPhinX companies' money misapplied and the value of Plus Funds which had been lost. The total sum sought was quantified in the Explanatory Statement to the Second Scheme as $750m. The causes of action relied on were many and various. In the course of the next five years the number of defendants has been reduced by settlement or court order to 13, 3 in the New Jersey and 10 in the New York actions. The trial of the New York action is fixed for 3 weeks in September 2013; no date has yet been fixed for the trial of the action in New Jersey.

20. Though the list is inevitably incomplete, I should give some indication of the number and nature of the interlocutory proceedings before Judge Rakoff. In March 2010 he

dismissed the actions against PWC Cayman on grounds of forum non conveniens. In the same month DB was joined as an additional defendant to the New York action. In March 2011 Judge Rakoff dismissed most of the counts against DPM. In August 2011 DPM and another defendant to the New Jersey action counterclaimed for an indemnity from SPhinX. In August 2012 Judge Rakoff dismissed some of the indemnity claims of DPM. In December 2012 Judge Rakoff dismissed the proceedings against both DB and PWC US. His reasons given in writing on 6th June 2013 were to the effect that the losses claimed by SPhinX had been sustained before the conduct of DB and PWC US on which SPhinX relied. Accordingly that conduct had not caused the loss.

21. As I understand the procedure in the US, most of these orders are classed as interlocutory and can only be appealed after final judgment in the action. It was not suggested that appeals against those which were final and capable of appeal before final judgment were now out of time. There was no proper evidence before me in relation to the merits of any of the potential appeals. Accordingly, as counsel for the ICs submitted, I cannot assume that the present constitution of the actions will remain unchanged. I shall refer to other aspects of the US proceedings as and when necessary in the course of dealing with the submissions made to me.

The Indemnity Reserve

The Evidence

22. As I have recorded in paragraph 11 above, the Chief Justice directed the formulation of issues necessary for determination in quantifying the Indemnity Reserve. I have set them out in the Appendix to this judgment. In the same order the Chief Justice ordered that DPM should represent all ICs. The parties represented before me were DPM, the JOLs and the LC. On this issue the JOLs were largely neutral. For the reasons I have already explained in paragraph 17 above, the ICs, and therefore DPM, were concerned to maximise the Indemnity Reserve for their protection. By contrast, the LC which includes the investors most concerned to obtain this scheme, sought to minimise the Indemnity Reserve.

23. Each of them called a New York lawyer to give expert evidence on their behalf. DPM called Mr Martin Karlinsky. He is a member of the bars of the States of New York and

California and of the District of Columbia. He had previously given evidence in the proceedings before the Chief Justice which concluded with the latter's estimate of $117m as the maximum costs likely to be reasonably incurred by ICs in defence of the US proceedings. Mr Karlinsky's revised estimate, for the detailed reasons given in his expert's report dated 28th May 2013 was $109,106,305. The LC relied on a report dated 7th June 2013 of Mr Richard Holwell a member of the bar of the state on New York and formerly, from 2003 to 2012, a US District Court Judge for the Southern District of New York. He considered that the estimate given by Mr Karlinsky was excessive and that the Indemnity Reserve should not, for the detailed reasons given in his report, be more than $45,802,522. On 19th June 2013 the two experts produced an agreed Joint Report. It did little, if anything, to narrow the gap between them on the figures.

24. Each expert was extensively cross-examined. Neither impugned the good faith or honesty of the opinion held by the other. Each modified his position slightly. Overall the evidence demonstrated the impossibility of putting a number on any particular party's costs of any particular future stage of the process. The process is not complete so there is no certainty as to what those future processes will be. Moreover there is no independent yardstick of what may be reasonably incurred and at what cost because there are not in the US any procedures comparable to the assessment of costs by a costs judge.

The Submissions of Counsel

25. Counsel for each party relied on extensive written submissions and, after the completion of the oral evidence, supplemented by a written note. Counsel for DPM relies strongly on the judgment of the Chief Justice to which I have referred in paragraph 6 above, in particular paragraphs 12 to 19, 22 and 23 and 38 to 44. He points out that the object of setting the Indemnity Reserve is to avoid any risk to the ICs from the modification of the statutory procedure to which the scheme would give rise, that there should be no reduction from the full amount of the liability on the ground that the creditor is contingent only and that the Court must be satisfied to a high degree of assurance that the reserve will be sufficient.

26. DPM accepted that it was appropriate for the legal costs reserve set by the Chief Justice in December 2010 at $117m to be reconsidered. On 28th May 2013 their attorneys wrote to those for the JOLs indicating that in their view the reserve should be $191,365,965 but subject to reduction on account of various settlements between JOLs and various ICs and

other matters. In their written submissions dated 10th June 2013 they indicated various other matters which had to be taken into account. In counsel's note produced on 21st June 2103 the final figure from DPM for the quantum of the Indemnity Reserve for costs is not less than $131,280,955; that being the maximum sum which, in DPM's view, might reasonably be incurred by the ICs in defending claims made against them. The breakdown of that sum is set out in paragraph 5 of the Note produced on 21st June 2013 and paragraph 48 below.

27. The list of issues (Appendix) is not confined to costs but extends to liabilities which may be incurred in proceedings brought by others. Counsel for DPM pointed out that there is no evidence as to the merits or otherwise of any such claims. He accepted that in States where the relevant period of limitation is six years, no new claim against an IC which might fall within the scope of the indemnity is now possible. In any such case issues 1, 2, 5, 7 and 11 to 13 shown in Annex 1 fall away.

28. Counsel for DPM pointed out that the expert evidence established that in 12 states of the USA the limitation period is 10 or more years. However in the Joint Experts' report produced by Mr Karlinsky and Mr Holwell on 19th June they pointed out that there is jurisdiction in those 10 states 'to borrow' the limitation statute most closely connected with the controversy so as to bar claims which would still lie under the limitation statute of the borrowing state but expressed no view as to the consequences for this case. In these circumstances counsel for DPM submitted that I could not assume that each claim within the description of issues 1, 2, 5, 7 and 11 to 13 is now time barred.

29. Counsel for DPM pointed out that the expert evidence demonstrated that contribution claims are not time barred because time only runs from payment under the judgment for which contribution is sought. In addition, it was common ground between the experts that cross-claims between defendants inter se cannot be time barred. Accordingly, so he submitted, not all claims could be time barred. In relation to all those claims he submitted that I had no basis for setting any particular or no reserve. As the Chief Justice said in paragraph 27 his judgment given in February 2010

> "Such potential indemnity liabilities as may arise from separate investor claims are at present entirely unknown and unquantifiable; and are thus obviously not given to the setting of a monetary reserve."

30. Counsel for the LC submitted that there are now no viable claims against ICs for which provision should be made. He relied on the operation of the various statutes of limitation and on the releases for which the Scheme provides to which paragraph 13 of the explanatory statement referred. He accepted that claims for contribution could still be available but contended, for various reasons, that they could not give rise to any need for a reserve. In relation to legal costs, counsel for the LC invited me to prefer the evidence of Mr Holwell to that of Mr Karlinsky. Mr Holwell's final maximum figure was $45,802,522. For the reasons explained in counsel's note the final figure for costs for which the LC contended was $80.65m.

My Conclusions

31. In pre-hearing correspondence the attorneys for the ICs questioned whether this court is entitled to revisit issues determined by the Chief Justice in his previous rulings, see also issues 18 and 19 set out in the Appendix 1. Though raised specifically in relation to the reserve for costs the same point could be made concerning the existence of claims available to ICs generally. Counsel for the JOLs very properly took up this issue in his written argument. He referred me to **Re Barrel Enterprises** [1973] 1 WLR 19 and **Re: L** [2013] 1 WLR 634. He pointed out that no one has challenged any of the legal rulings of the Chief Justice. He submitted that there is no reason why the conclusions of the Chief Justice on the facts as they then were cannot be revisited in the consideration of the facts as they are now. I agree. The Chief Justice was concerned to fix a reserve to answer future and/or unquantified liabilities in relation to the first scheme. What is an adequate reserve at one time may be too much or too little at another. The fact that in February 2010 the Chief Justice considered that the reserve for costs should be $117m or that the contingent claims were "entirely within the realm of the unknown" does not exclude arguments in support of a different figure or consideration of certain facts which produce certainty.

32. In the latter category come three fundamental points on which counsel for the LC relies, namely (1) the effects of the passage of time, (2) the provisions of the Second Scheme dealing with releases and (3) the provisions in the Second Scheme for an increase in the Indemnity Reserve. Each of them has arisen since the judgment of the Chief Justice. Each is fundamental to more than one issue and is conveniently dealt with at the outset. I will consider them in that order.

Limitation of Actions

33. Messrs Karlinsky and Holwell agreed in their joint experts' report that:

> "All third party claims against Indemnity Claimants for breach of contract or breach of fiduciary duty would be time barred in New York State and the other major commercial jurisdictions in the US."

They went on to point out that virtually all US jurisdictions have power "to borrow" statutes so as to apply the statute of limitation having the closest connection to the controversy. Thus, in this case, if the state law having the closest connection with the investor and other associated claims is that of New York the limitation period may be taken to be six years rather than the longer period for which the first state law provides.

34. The analysis carried out by the LC demonstrated that the addresses for all investors save four was that of New York or some other state with a six year limitation period. Two of those four provided mailing addresses in Illinois and two in Wyoming. In those states the limitation period is one which has not yet expired. The experts were agreed that a statute providing a shorter limitation period could not be 'borrowed' against the wishes of a party resident in the state having the longer period. Thus, in the four cases in which the issue of borrowing a statute with a shorter period might arise the ability would be excluded if the investor wished to do so by reason of his residence. But that is of academic interest only as the evidence clearly established that all four voted in favour of the scheme. It is hardly likely that they would oppose the borrowing of the shorter limitation period.

35. The conclusion is inescapable; all investor and third party claims are barred by the relevant statutes of limitation. That conclusion must also cover claims of both investors who have assigned their investments and the assignees who claim through them. For these reasons alone, as counsel for ICs accepted, no reserve is required on account of the matters mentioned in issues 1, 2, 5 and 7. It follows that the only claims which require further consideration are contribution and cross-claims.

The Releases

36. The Second Scheme, unlike the first, contains a detailed and apparently all-embracing scheme of releases. First, the expression "Scheme Claimant" is defined in clause 1.1 to include any assignee or other person entitled to claim in succession to or in substitution for any such Scheme Claimant in respect of the same Scheme Claim. Paragraph 2.2.1 indicates that the Scheme will bind Scheme Claimants and SPhinX Companies. As paragraph 2.3.1 states one of the principal purposes of the scheme is to provide for Scheme Claimants to release their claims against ICs. I have already referred to the provisions of paragraph 5.2.1. Paragraphs 5.2.3 and 5.2.4 are in these terms:

> "5.2.3 Any Net Litigation Proceeds achieved after the Indemnity Reserve Ruling has been obtained will be added to and become part of the Indemnity Reserve save insofar as, upon an application by the JOLs and/or the Scheme Supervisors and/or any Scheme Claimant under Clause 5.2.5, the Court otherwise directs.
>
> 5.2.4 Once the Indemnity Reserve has been established pursuant to Clause 5.2.2 and provided for, it shall be retained following the First Cash Distribution Date (and following any other Cash Distribution) for the purpose of satisfying or settling Indemnity Claims in accordance with Clause 10, save insofar as upon an application by the JOLs and/or the Scheme Supervisors and/or any Scheme Claimant under Clause 5.2.5, the Cayman Court otherwise directs."

Thus the Indemnity Reserve will be increased by any net litigation proceeds received after the constitution of the Indemnity Reserve. The purpose is to increase the reserve by the amount of a successful claim made by the JOLs which might trigger an indemnity claim. But, as the definition of Net Litigation Proceeds in paragraph 1.1.1 makes clear, the net proceeds are likely to be only 2/3rds of the amount of any judgment obtained by the JOLs because of the deduction of the contingency fee of Beus. In addition, as paragraph 5.2.4 makes clear, this court may sanction a reduction in the reserve if it thinks fit.

37. Paragraph 10 and following regulate payments from the reserve. The general rule, as stated in paragraph 11.1.1 is that a Scheme Claimant is only entitled to receive a payment under the Scheme if it enters into a Deed of Direct Release in the form stipulated in Appendix 14. That Deed deals with 4 scenarios. Scenario A as proposed to be amended contains in clause 2 a comprehensive release by the SPhinX companies of all concerned,

including the ICs. Clause 6.1 provides that the Deed is entered into by the JOLs on behalf of the Scheme Claimants, the SPhinX Companies and on behalf of the named Indemnity Claimant. Thus the Scheme provides for the release of claims by and against an Indemnity Claimant personally and by the JOLs on its behalf. In addition, the Assignee of a claim is required by paragraph 11.1.7(iii) to enter into the same Deed.

38. In addition Scheme Claimants are bound (paragraph 12.9.1) to treat ICs as if they were released from each and every claim such Scheme Claimant might have against them. In addition as soon as possible after the effective date the JOLs are required to invite the ICs to enter into an individual bilateral release in the form stipulated in Appendix 14 and an individual deed regarding set-off in the form stipulated in Appendix 15. The latter deed provides for all claims between SPhinX Entities and an IC to be set off one against the other. These provisions appear to be applied to Scheme Claimants in paragraphs 12.15 and 12.16. The former requires a scheme claimant to enter into a release in the form of Appendix 14 and the latter provides for the set off of SPhinX Entities claims against Indemnity Claims and the execution of deeds in the form set out in Appendix 15.

39. These provisions are relied on by the LC as precluding all and any claims against an IC by providing for claims to be satisfied out of the Reserve only. Thus, investors are bound to execute a release as a condition for a distribution and are bound by a release entered into on their behalf by the JOLs. If the investors cannot sue the ICs outside the Scheme then the Indemnity Reserve will be sufficient. To this, as I understood it, ICs make three objections:

> (1) The Indemnity Reserve may not be sufficient due to the deduction of 1/3rd by Beus from any recovery made by the JOLs in the US proceedings.
>
> (2) An investor is not bound to participate in the Scheme but might, if he wished, take proceedings against an IC and recover what he may from the IC without deduction.
>
> (3) The scheme, including the compulsory release, may not be recognised in foreign jurisdictions.

40. I would reject the third objection. It is not the Scheme, assuming it to be regarded merely as a foreign bankruptcy proceeding, which matters but the authority conferred on JOLs to execute the various deeds on behalf of investors. There is no doubt that if the Scheme is sanctioned it will bind all investors and other members. They will thereby have conferred the relevant authority on the JOLs. No reason was given why that should not be recognised in other jurisdictions.

41. I would also reject the second objection. This scheme was approved by members constituting 64.5% by number but not less that 98.5% by value. The 1.5% is made up by 26 abstentions constituting $9.6m or 1.25% by value and 12 negative votes amounting to $1.9m or 0.25%. In my view it is inconceivable that any investor, who was properly advised and paid regard to his commercial interests, would ignore the indemnity reserve and sue the IC. Aside from any other defences which would be open to him the IC would no doubt rely on the compulsory release given by the JOLs with the authority of that investor by means of the Scheme. Of course, in this field, as in others, there may be 'cranks'. I do not consider that in determining the amount of the Indemnity Reserve this court is bound to take account of that possibility.

42. This leaves the first objection. It is undeniable that the proceeds of successful litigation received by the JOLs will be reduced by the 1/3 contingency fee charged by Beus. Thus, in theory a successful claim against a defendant to the US proceedings for $1,000 will only generate an increase in the Indemnity Reserve of $666; but the unsuccessful defendant may have a claim over against an IC for the full amount of $1,000. The validity of that objection needs to be considered in the context of permissible claims still available, namely contribution and cross claims. It would be quite possible, if it were necessary, given the existing cash resources in the hands of the JOLs of $500m, to increase the initial size of the Indemnity Reserve by way of compensation for the loss of 1/3 from subsequent recoveries.

The Agreed List of Issues

43. I turn then to the issues set out in the Appendix 1 to this judgment. As was common ground in the light of my conclusions in relation to the limitation of actions there are now no viable Direct Investor Claims whether brought by the original investor or an assignee or assignor. Similarly it was accepted that there can be no third party claims. These conclusions dispose of Issues 1 to 5 and 7 to 10.

44. The real problems arise with contribution claims. They are not time-barred and only 2/3rds of the liability towards which contribution is sought will have been retained in the indemnity reserve. They may be brought by a defendant to the US proceedings or by a defendant to proceedings brought by the JOLs in another jurisdiction. If the defendant is himself an IC his liability to SPhinX will be set off against SPhinX's liability to him under the indemnity. In all other cases he must have satisfied the judgment against him before

seeking contribution from others. So the question appears to me to be whether a defendant found liable to SPhinX in the US or elsewhere who does not himself have the benefit of an indemnity from SPhinX but has satisfied the judgment against him will obtain an order for contribution against an IC for more than 2/3rds of that liability. Counsel for the LC accepts that it is possible but submits that it is so unlikely as to be fanciful.

45. I have not been provided with an analysis of the remaining 13 defendants to the US proceedings (see para 19 above). In addition I have to bear in mind the prospect of further proceedings in Cayman. I agree with counsel for LC that the likelihood of a successful contribution claim satisfying all the conditions I have summarised above is small but I cannot say that it is so small as to be ignored. The solution is, as forecast in paragraph 42 above, to supplement the 2/3rds retention. The amount is not susceptible to any logical calculation, but a supplement of $10m is, in my view, most likely to be more than is, in fact, required.

46. I have also dealt with the efficacy of the releases, both consensual and compulsory. I see no need to add anything to deal with issues 11 to 13. There is no doubt that a number of Judge Rakoff's rulings are liable to appeal either now because it was a final judgment or after the jury trial because it is interlocutory. I have no sufficient evidence to enable me to assess the prospects of success or otherwise even if it was appropriate for me to enter into the subject. The appeals may result in some parties being rejoined to the US proceedings and some counts being restored. This may affect the issues relating to the reserve for costs but will not affect any of my conclusions so far. In the case of settlements the evidence of both expert witnesses was that a settlement insulates the settling party from all further proceedings at the suit of any other party. The remaining issues relate to the legal costs reserve to which I now return.

The Costs Reserve

47. The one issue on which there is no dispute is that there must be a sum set aside to answer SPhinX's liability under the Indemnities for the various costs, actual and prospective, incurred in relation to the US proceedings. I have already referred in general terms to the evidence given by the experts (paragraphs 23 to 25 above). In addition I have pointed out the present disparity. At the top end of the bracket is the contention for DPM that the reserve should be $131,280,955 (paragraph 26 above). At the bottom is the contention of the LC that $80.65m is enough. As I have already indicated there is no doubting each expert's expertise

and no one questioned the honesty of their rival opinions. In those circumstances I cannot simply prefer the evidence of one to that of the other. Given the high degree of assurance I need to have if a reserve is not to be made it is, in my judgment, for the LC to demonstrate that a provision Mr Karlinsky considered should be made is wholly unnecessary.

48. The total of $131,280,955 for which DPM contends is made up of 7 constituent items:

(1) $43,876,166 costs to date of the US proceedings and proceedings in the Cayman Islands incurred to date but not paid.

(2) $43,502,522 costs to be incurred in future US proceedings.

(3) $23,599,148 potential costs of PWC Cayman in litigation on the Cayman Islands.

(4) $6m being the provision made by the Chief Justice for proof of debt proceedings in the Cayman Islands.

(5) $7,526,926 potential costs of ICs defending contribution claims in Cayman Islands brought by PWC Cayman (50% for each of them).

(6) $6,564,771 in respect of indemnity caps agreed by JOLs in settlements with ICs.

(7) $211,472 in respect of costs of inactive ICs in defending contribution claims.

49. The LC contends that only $30m should be allowed in respect of costs to date because, so they contend, $23.7m has been incurred in relation to the claim in the US against PWC. They point out that PWC also acted as auditors for Refco. They submit that "it is highly likely" that a significant part of that sum falls outside the indemnity provision altogether but PWC will not produce any breakdown. Similarly in the case of DPM the LC contends that some of their costs will have been incurred in respect of work done on their claim against Plus Funds Inc. The LC suggests that 1/3 should be deducted from the full amount. On this basis the sum for existing costs would be $30m only.

50. DPM points out that the full amount was broken down in the letter from their attorneys dated 28th May 2013. They claim that the full amount is due under the indemnity and no deduction is appropriate for Refco or Plus Funds Inc work. I am not satisfied to the necessary degree of assurance that the objection of the LC is made out. At the moment it appears to rest on an assertion by the LC. I have no material by which to test it in the case of

the costs of PwC US. In the case of DPM the assertion is denied. That is not a dispute which I can resolve on this application.

51. The future costs of the US proceedings generated more disputes than any other issue. The LC contended, on the basis of Mr Holwell's evidence, that Mr Karlinsky's figure of $43,502,522 should be reduced to $23,956,984. This reduction is spread over some 10 stages of litigation in the US and a number of parties. Four are an across the board reduction of 20%. In five others the percentage deduction suggested is higher. I cannot be satisfied to the requisite degree of assurance that Mr Karlinsky is so wrong. I am not prepared to reduce his estimate to the extent suggested or to any extent.

52. Items 3 and 5 relate to proceedings in the Cayman Islands by or against PWC Cayman. The fact is that at the moment there are none. As I understand it there will not be any unless the JOLs commence them. I am not prepared to make any reserve for possible future proceedings when it is for the JOLs to decide whether or not there will be any. Further neither expert witness is an expert in litigation or costs in the Cayman Islands. The only other evidence is that of Mr Anderton, a partner in PWC Cayman. In 2010 he indicated satisfaction with a figure of $10m for defending proceedings in Cayman. I see no reason to allow more than that in respect of item 3 at this stage. In the case of Item 5 until the JOLs determine to sue PWC Cayman in the Cayman Islands there will be no occasion for PWC Cayman to institute contribution proceedings against anyone else. Unchallenged evidence sworn on behalf of the ICs in 2010 put the costs of an IC defending such proceedings at $3,763,463. Item 5 is double that figure. Whilst justified in 2010 it cannot be justified now as the only other IC is DPM.

53. In those circumstances I can make no final provision for either items 3 or 5 at this stage. If the JOLS decide to sue PWC in Cayman then $13,763,463 is to be added, $10m for their defence to the claim and the balance for the defence of DPM to contribution proceedings if any.

54. There is no issue in respect of the reserve of $6m made by the Chief Justice for proof of debt proceedings in the Cayman Islands. The issue in relation to the cap on indemnities contained in the settlements concluded by the JOLs appears to be limited to $400,000. I see no purpose in making reductions of that order if not agreed. In summary, therefore, I consider that the legal costs reserve should be $113,918,394 made up as follows:

(1) unpaid actual costs to date $43,876,166;

(2) future costs of the US proceedings $43,502,522;

(3) Costs in relation to proceedings against PWC Cayman $13,763,463, if but only if JOLs indicate to the court within 14 days their intention to commence proceedings in the Cayman Islands against PWC Cayman;

(4) $6,564,771 in respect of the indemnity caps contained in the Settlement Agreements;

(5) $6m in respect of proof of debt proceedings in the Cayman Islands; and

(6) $211,472 in respect of the costs of inactive ICs.

55. Accordingly, my conclusion on the amount of the Indemnity Reserve is that it should be $123,918,394(see paragraphs 45 and 54) but reduced by $13,763,463 if the JOLs do not elect within 14 days to take proceedings against PWC Cayman similar to those which were struck out in the US actions. It will be necessary to make some provision for interest. I assume that calculation of the appropriate rate can be agreed if the date from which it runs is ascertained. This point was not fully argued. In my view, interest on the legal costs reserve should run from March 2008 when the first of the US actions was commenced. If any party wishes to argue for a different commencement date then opportunity to do so must be provided.

56. In addition I have been asked by the LC to set up some process whereby sums may be released therefrom periodically as circumstances change. It is clear from paragraph of 5.2.4 of the scheme that the Indemnity Reserve must remain as originally set up save insofar as this court directs otherwise. I do not understand what more is required. If it becomes apparent that the Indemnity Reserve is higher than is needed then any member of the LC may apply for the release of further sums by means of a distribution. I turn now to the second issue, the Beus Reserve.

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Summary of Conclusions

99. In summary I conclude that:

(1) $10m should be added to the Indemnity Reserve by way of replacing the 1/3 deduction from any cash recovery made by Beus (para 45);

(2) $113,918,394 should be added to the Indemnity Reserve in respect of legal costs reduced by $13,763,463 if within 14 days from today the JOLs do not elect to commence proceedings in Cayman against PWC Cayman (para 54 and 55);

(3) $15m should be added to the General Reserve (para 98).

100. The total of the reserves I consider should be made is $138,918,394. That is well short of the present value ($500m) of the assets under the control of the JOLs. Accordingly, in response to the questions posed by the order of the Chief Justice, I consider that this court does have jurisdiction to sanction the Second Scheme. Whether it should exercise that jurisdiction is not a matter now before me. But the argument before me has thrown up consequences which, in my view, should be considered as and when application is made for the sanction of the scheme by the court.

101. Those considerations arise from the matters to which I drew attention in paragraph 17 above. Whether or not it is its purpose, the effect of this scheme is to invert the normal liquidation processes. Normally members, for that is what the Investors are, would have to await the proper evaluation of proofs of debt submitted by creditors, actual, contingent and prospective. Those creditors, which include the ICs, would have the normal rights of appeal and the ability to compel the liquidators to wind up the company in accordance with the Companies Act (2012 Revision). The risk of an insufficiency of assets would fall on the members not the creditors.

102. Under this scheme the risk of an insufficiency of assets falls on the creditors not the members because its purpose is to distribute to the members all but the reserves I have set

long before the various sets of proceedings have been finally concluded. If my assessment of the necessary reserve is wrong the loss will fall on the creditors, including the ICs; the balance will have been distributed to the members without possibility of recall. It is for consideration whether distributions should be conditional on some secured obligation to repay if the reserves prove in the event to be insufficient. This did not arise from the questions I was required to determine. If no such provision is inserted into the Scheme it may be that the court would require one as a condition of its sanction.

Appendix

INDEMNITY RESERVE ISSUES

Direct investor claims

1. Irrespective of whether or not direct investor claims are actually statute barred (which is considered below), should the Court conclude that there continues to be a non-fanciful risk of direct investor claims, or conclude that it can disregard the risk of direct investor claims?

2. Is there a non-fanciful risk of investors who have assigned their claims at a loss bringing direct investor claims?

Independent damages and third party claims

3. Is there a non-fanciful risk of independent damages claims by parties to the US Litigation against other parties to the US Litigation, perhaps where there is a special relationship between the parties, that would fall within the scope of the indemnities? Or is there no non-fanciful risk, because there is no non-fanciful possibility of there being such a special relationship, or of the existence of any other circumstances giving rise to an independent damages claim 7.

4. Is there a non-fanciful risk of claims by third parties (i.e. those who are not investors or assignees) against Indemnity Claimants which could fall within the scope of the indemnities?

Assigned claims

5. Do the proposals contained in the Scheme provide adequate protection for the Indemnity Claimants against potential claims by assignees? If not, what amount should be credited to the Indemnity Reserve to protect the Indemnity Claimants in respect of potential liability for, and the legal costs of dealing with, claims by assignees?

Contribution claims

6. Assuming there is a non-fanciful risk of contribution claims and that time does not begin to run on contribution claims until the date of payment, and given that the Scheme currently provides in Clause S.2 for Net Litigation Proceeds to become part of the Indemnity Reserve unless otherwise directed by the Court, is it nevertheless necessary, in

order to protect the Indemnity Claimants, to amend the Scheme (I) to provide that the Net Litigation Proceeds, together with any sum not reserved for in the General Expenses Reserve that could otherwise have been deducted by the Jolts pursuant to their statutory or other rights to fees, etc, shall be retained in the indemnity Reserve for at least 6 years and (ii) to provide that an amount equal to the amount due to BeuS Gilbert in respect of contingency fees arising out of contribution claims shall also be credited to the Indemnity Reserve? If the latter amendment in (ii) is required, would such amendment make it unnecessary to make any further reserve in respect of any claim that BeOS Gilbert might make arising out of the Scheme providing for the release of DB and BAWAG? If such further reserve is required, to what extent should it include an amount in respect of the potential costs of replacement US Counsel?

7. The proposal for retention of Net Litigation Proceeds seeks to provide protection for the Indemnity Claimants in respect of contribution claims arising in and from the US Litigation. To the extent that the Court considers that claims by persons not parties to the US Litigation (which might be investors, assignees or third parties), whether brought against Indemnity Claimants or others, are non-fanciful, what protection should be provided to the Indemnity Claimants, by way of crediting an amount to the Indemnity Reserve, in respect of potential contribution claims against the Indemnity Claimants arising in and from such non-US Litigation claims?

Limitation

8. Is there a non-fanciful risk of claims that, by their nature, are not subject to being statute barred?

9. In 2010, there was at least one jurisdiction where claims that were, or were capable of giving rise to, non-fanciful indemnity claims could have been brought and would not have been statute barred. In 2013 (over 3 years later), is there still at least one jurisdiction in which claims that are, or that could give rise to, non-fanciful indemnity claims could still be brought and not be statute barred; or have the limitation periods relevant to such claims, in every jurisdiction, already expired?

10. Are the independent damages claims referred to above not statute barred, because claims between parties are tolled at the date of the commencement of the action? If so, does that mean that there is a non-fanciful risk that there are claims that are not statute barred?

Impact of the consensual and compulsory releases contained in the Scheme, and their enforceability outside the Cayman Islands.

11. Any claim by an investor that would otherwise have given rise to an indemnity claim will not do so to the extent that it is (I) the subject of consensual releases entered into as a condition of payment under the Scheme and/or (ii) the subject of compulsory releases provided for in the Scheme, provided any such claim is not brought in a jurisdiction which either does not recognize the compulsory releases contained in the Scheme, or which does not recognize the Scheme generally.

12. As regards consensual releases: Should the Court assume that every investor that voted in favor of the Scheme did so because they wished to receive a distribution pursuant to the Scheme (and therefore would enter into a consensual release), such that the only investors in respect of whom there is a non-fanciful risk that they would not enter into a consensual release are those investors who did not vote on the Scheme or who voted against the Scheme?

13. As regards compulsory releases: In jurisdictions outside the Cayman Islands, the compulsory release provisions in the Scheme will be enforceable only to the extent that the JOLs obtain an order for the recognition of the Scheme and/or the Scheme will be recognized without such an order. Given that the JOLs are not intending to seek recognition of the Scheme prior to the Scheme being sanctioned:

    a. Should the Court disregard as fanciful the risk of a claim being brought in a jurisdiction other than the UK or the US (including Ireland), and consider only whether the Scheme, and/or the compulsory releases contained in the Scheme, would be recognized as enforceable in the UK and the US?

    b. Is there a non-fanciful risk that the US (which is the jurisdiction in which claims are most likely to be brought) will not recognise the Scheme's compulsory release provisions?

Appeals

14. Should the Court assume that for as long as a ruling in the US Litigation is capable of being reversed on appeal, it should be treated as, or as potentially giving rise to, a non-fanciful claim which must be provided for? This issue arises in relation to the appeals that might be brought by the JOLs in respect of the rulings in part 1of Schedule 1, and also in relation to the appeals that might be brought by the ICs in respect of the rulings in part 2 of Schedule 1.

Settlements

15. Should the Court assume that a claim that has been the subject of a settlement that purports to be a binding settlement does not have to be provided for? Are there any circumstances in which a claim that has been the subject of what purports a binding settlement ought to be provided for?

The Court's existing ruling on legal costs

16. Although the Court's existing ruling on legal costs is not the subject of an order, does Cayman law and/or practice render the ruling binding?

17. Assuming that the ruling on legal costs is not binding, have the developments in relation to claims against the Indemnity Claimants made the ruling on legal costs one that is no longer appropriate and ought to be reviewed and the amount of the reserve in respect of legal costs re-set?

Interest

18. Should the Court provide for interest on the amount required to be credited to the Indemnity Reserve, in accordance with Companies Law section 149 and/or the Companies Winding Up Rules 20087

PwC Cayman LLP

19. What protection should be provided to the Indemnity Claimants, by way of crediting an amount to the Indemnity Reserve, in respect of the legal costs of a claim against PwC Cayman LLP?

Further litigation

20. Does the protection of the Indemnity Claimants require the Scheme to be amended to provide that the JOLs will not commence any proceedings (save to commence an appeal in existing proceedings) if such proceedings could give rise to a claim that would fall within the scope of the indemnities?

Dated this 9th day of July 2013

The Rt Hon Sir Andrew Morritt
Judge of the Grand Court of the Cayman Islands

GRAND COURT CAYMAN ISLANDS