IN THE GRAND COURT OF THE CAYMAN ISLANDS

FSD 16 OF 2009
(ORIGINALLY CAUSE NO: 258 OF 2006)

IN THE MATTER OF THE COMPANIES LAW (2013 REVISION)

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

IN CHAMBERS
BEFORE THE HON. CHIEF JUSTICE
ON THE 3RD FEBRUARY 2014

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

Ms. Felicity Toube QC instructed by Mr. David Collier of Charles Adams Ritchie and Duckworth for Deutsche Bank (an investor)

Mr. Alan Turner of Turner & Roulstone for the Liquidation Committee.

Liquidators entitled to indemnity from estate for costs and other expenses incurred in the successful defence of claims against them. Whether liquidators also entitled to an indemnity reserve for those costs, not to be distributed to investors pending the resolution of such claims.

RULING

1. The JOLs have been notified by Deutsche Bank ("DB") by letter of 19 November 2013 (the "Notification") of certain claims that one or more of the SPhinX Companies and/or DB contemplate bringing against the JOLs in respect of alleged losses and/or liabilities relating to or arising out of acts done or omitted to be done by the JOLs in relation to the liquidation of one or more of the SPhinX Companies.

2. This has come about notwithstanding that a scheme of arrangement for the compromise of all investor claims in the liquidation of the SPhinX Companies (the "Scheme") has

been agreed and sanctioned by the Court. Under the Scheme, the JOLs would be entitled to be released and discharged from office unless scheme claimants notify them of any claims against them within the time stipulated by the Scheme Document.

3. The Notification purports to be effective for those purposes and identifies ten (10) heads of claim which would traverse events, harkening back to the very early stages of the liquidation of the SPhinX companies. Although far-reaching and general in those ways, the Notification does not give particulars of the heads of claim. Indeed DB says, through Ms. Toube QC, that it is not yet required to give such particulars and the Notification simply at this stage provides notice of its claim in keeping with the terms of the Scheme, for the purposes of putting the JOLs on notice that they are not to be released from any liabilities which may have accrued from the conduct of their office.

4. An effect of the Notification would be to allow distributions to be made to the investors under the Scheme, including DB; without the JOLs being assured of release from liability upon their discharge from office in the usual way contemplated by Clause 12.6 of the Scheme Document. Under the Scheme, the JOLs would however, be entitled to an indemnity for their costs and expenses from the liquidation estate, in the event the claims prove unsuccessful.

5. The JOLs now therefore bring an application for an increase of the General Expenses Reserve ("GER") proposed to be established under the Scheme, to include an amount roughly estimated to indemnify the JOLs against costs and expenses to which they would be exposed in defending DB's claims and so to which they would be entitled in the event DB's claims prove to be unsuccessful. As the GER must be set finally by 24 February 2014 and the net assets of the estate pooled and transferred to the Scheme Supervisors by

that date for distribution to investors by 6 March 2014, the JOLs regard this application as urgent.

6. The JOLs rely on clauses 12.6.5 and 5.3.3 of the Scheme Document which provide in relevant parts respectively as follows:

> *"12.6.3. In the event that the JOLs or their advisors are notified of a claim in accordance with the provisions of Clause 12.6.2, the JOLs shall be entitled to apply to the Cayman Court in accordance with Clause 5.3.5 for an order that the General Expense Reserve be increased in order to reflect the JOLs' or their advisors' potential entitlement, in respect of their exposure to such claim, to an indemnity out of the assets of the SPhinX Companies.*
>
> *For the avoidance of doubt, such entitlement shall be without prejudice to the rights of any Scheme Claimant and/or the Scheme Supervisors to apply to the Cayman Court for a direction that the General Expenses Reserve (or any part of the General Expenses Reserve) is no longer required and that it (or part of it) should become available for distribution to the Scheme Claimants."*

And by Clause 5.3.3.

> *"There shall be paid in full out of the General Expenses Reserve all outstanding debts and claims of the SPhinX Companies and/or the JOLs (save insofar as already reserved for and/or paid in full out of the Indemnity Reserve or the Portfolio Managers and Trade Creditors Reserve) whether incurred before or after the Effective Date and whether*

payable or payable in the future by a SPhinX Company out of the assets of the SPhinX companies or any of them pursuant to the CWR 2008 and the Insolvency Practitioners Regulations 2008 or otherwise ordered to be paid out of the General Expenses Reserve by the Cayman Court. Such debts and claims shall include all costs, charges, liabilities, expenses and disbursements incurred by, and the remuneration of the JOLs to the extent that such costs, charges, liabilities, expenses, disbursements and remuneration are referred to the affairs of a SPhinX Company...."

7. To the extent relevant, Clause 12.6.2 also explains that the JOLs and their advisors shall be released from liability for all claims, save those notified in writing (as by way of the Notification).

8. It is acknowledged by DB that such claims would have to be based upon the unreasonable conduct of the JOLs, such as gross negligence, fraud or dishonesty. To the extent the nature of the notified claims have been intimated by DB during the arguments before me, my impression is that they would allegedly fall within the category of unreasonable conduct in the nature of gross negligence, but not fraud or dishonesty.

9. The JOLs' application is resisted by DB and the LC, represented by Ms. Toube QC and Mr. Turner respectively.

10. In response to the JOLs' application, their argument is essentially two-fold. First, that the GER – already established in the amount of $101 million set aside to meet various contingencies – has within it sufficient buffer to ensure protection for the JOLs in respect of any claim they might have if successful in resisting DB's notified claims. For that reason, no further amount needs to be added to the GER. Second, that if the JOLs are

actually sued, they will likely have already been removed from office[1] and thus then liable as ordinary defendants who can bring an application for security for costs. In that event, DB would likely be regarded as jointly and severally potentially liable for the JOLs' costs, should the JOLs succeed. However, as a large and well known international bank, DB would be more than capable of meeting any order for security and indeed, any ultimate award of costs that the JOLs might obtain.

11. In any event therefore the argument goes, increasing the GER now is neither necessary nor appropriate and would only serve unduly to hinder the distribution of more of their assets to investors, who have been awaiting distribution for more than seven (7) years.

12. The JOLs should therefore be required to wait and see whether there will indeed be particularized claims brought against them by DB, in which event they may apply for security for costs and at which time the Court would be able to quantify with some degree of accuracy, what the amount of security should be.

13. These arguments are unconvincing. This is for the most obvious reason that, if accepted, the result would be to deny the JOLs' clear right of indemnity from the SPhinX Companies in the event they succeed in resisting the claims which have been notified. This is as distinct from any rights the JOLs might have to seek security for costs against investors/shareholders bringing derivative claims of the kind notified by DB.

14. Neither Ms. Toube QC nor Mr. Turner denies that a right to a full indemnity would arise in favour of the JOLs in these circumstances. Nor do they deny that such a right must be viewed as a contingent liability of the SPhinX estate within the terms of Clauses 5.3.3 and 12.6 of the Scheme Document and for which reserves must be set.

[1] There is pending a removal application set for hearing on the 12TH May 2014.

15. Nor, further, do they deny that any order for security for costs to be obtained against DB would not provide the full indemnity to which the JOLs would be entitled if successful in resisting the claims. It is trite that costs as between party and party are not ordinarily awarded on the indemnity basis.

16. As to the possible resort the JOLs might have to the GER already set at $101 million; I may not overlook the fact that that reserve has been set by reference to specific contingent liabilities already identified. There is therefore no clear or proper basis upon which I could now conclude that it already contains the "significant buffer" for which Ms. Toube QC and Mr. Turner contend. In the result, I can see no basis for refusing the JOLs' application for an increase to the GER, save for the question of quantum.

17. As to quantum, I have been presented only with what Ritch & Conolly on behalf of the JOLs describe as a "broad brush guesstimate" of likely costs and expenses – the best that they say they can do at this stage in the absence of any particularization of the notified claims.

18. While this guesstimate strikes me as being rather crudely calculated on the maximum amounts that Ritch & Conolly can reasonably imagine, I have, at this stage, no basis for saying that they are clearly wrong.

19. On the other hand I bear in mind that if they have been overly cautious in their calculations, the only harm would be that perhaps too much is kept back in reserve and this, only insofar as the distribution of the excess to investors would be delayed. In the end, any such excess (with accretions from investment) would be distributed.

20. DB, speaking here as it does on behalf of investors, cannot have its cake and eat it too – the investors may not expect to maximize early distributions while avoiding the consequencies of issuing the Notification.

21. The imperative of the Scheme to make distributions on 6 March 2014 also underscores the need to quantify the indemnity reserve for the JOLs now.

22. So, given the deadline of 24 February 2014 for the final setting of the GER, I direct that it be increased by the amount of US$40,000,000 (being the median of the three amounts "guesstimated" by Ritch & Conolly) for legal costs and US $5,000,000 for the JOLs' own professional time costs likely to be taken in resisting the claims; for a total GER of US$146,000,000.

Hon. Anthony Smellie
Chief Justice

Dated the 3rd February, 2014