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IN THE GRAND COURT OF THE CAYMAN ISLANDS
FINANCIAL SERVICES DIVISION

CAUSE NO FSD 15 OF 2009 (AJJ)

BEFORE THE HON MR. JUSTICE ANDREW J. JONES, Q.C.
IN CHAMBERS, 14th December 2011

IN THE MATTER OF SECTION 92 OF THE COMPANIES LAW (2009 REVISION)

AND IN THE MATTER OF BELMONT ASSET BASED LENDING LTD (IN LIQUIDATION)

Appearances: Mr Peter Hayden and Mr Simon Dickson of Mourant Ozannes for the Official Liquidators ("the JOLs") of Belmont Asset Based Lending Ltd ("the Fund")

Mr Fraser Hughes of Conyers Dill & Pearman for Finter Bank Zurich Ltd ("Finter") as representative of the "Non-Leveraged Shareholders" and "Non-Leveraged Creditors"

Mr Andrew Bolton of Appleby on behalf Bear Stearns Alternative Assets International Ltd ("Bear Sterns")

REASONS

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1. This is an application by the Official Liquidators of Belmont Asset Based Lending Ltd (referred to as "the Fund" and "the JOLs") for an order that my Order for Directions made on 24th November 2011 in connection with a sanction application be varied or, alternatively, for leave to appeal to the Court of Appeal.

2. The Fund was put into compulsory liquidation on the basis of a contributory's petition presented by Bear Stearns [1] on the ground that the Fund had "lost its substratum" in that it was no longer possible to carry on its investment business in accordance with the reasonable expectations of its participating shareholders. [2] For present purposes it is relevant to make two observations about the hearing on the winding up petition. First, Bear Stearns were represented by Mourant Ozannes and Mr Simon Dickson, a Senior Associate of the firm, appeared on its behalf. Second, Bear Stearns did not claim to be a creditor and the winding up order was made on the assumption that the Fund was solvent as against its ordinary unsecured creditors.

3. Bear Stearns subsequently claimed to be an ordinary unsecured creditor for US$62, 865,599, being the amount of the "strike" allegedly payable by the Fund as at 31st December 2008 pursuant to the Option Agreement dated 27th April 2007. [3] The JOLs took advice about this claim from Mourant Ozannes, the attorneys who acted for Bear Stearns on the winding up petition. They obtained an opinion from Mr Ian Milligan QC. Based upon this legal advice, the JOLs have concluded that, upon the true construction of the Option Agreement, Bear Stearns should be admitted to proof as an ordinary unsecured creditor. This conclusion and their reasons for it are set out in their Second Report dated July 8, 2011, paragraph 6.1.4 of which states as follows –

   "Of particular significance, the Liquidators have carefully considered the position of [Bear Sterns] and concluded that [Bear Sterns] should rank as an unsecured creditor of the [Fund] for approximately $61 million, plus accruing interest. This claim, discussed further below, will rank ahead of all other parties including deferred creditors, ie redeemed but unpaid shareholders".

   Section 6.5 of the Second Report comprises a detailed analysis of the Option Agreement and sets out the JOLs' reasons for reaching their conclusion that

[1] Bear Stearns petition (as amended) was presented on the basis that it was the registered holder of 1,185,958.4978 Class F shares, which represented the whole of the Class F shares in issue

[2] *In Re Belmont Ltd* [2010] CILR 83

[3] Bear Stearns has not actually submitted a proof of debt and the manner in which its claim was asserted has not been explained to the Court.

Bear Sterns' claim should be admitted to proof. However, for reasons which have not been satisfactorily explained to the Court, the JOLs have *not* actually admitted Bear Stearns to proof.

4. The conclusion that Bear Stearns is an ordinary unsecured creditor for US$61m is highly significant from the point of view of the Fund's shareholders and unpaid redeemed shareholders. The JOLs' estimate of the likely realizations is between US$41.3m (at worst) and US$51.6m (at best). It follows that the consequence of admitting this claim is that the Fund would be insolvent and there will be no distribution to the shareholders. Nor will there be any distribution to the unpaid redeemed shareholders whose claims rank behind those of the ordinary unsecured creditors. The only other ordinary unsecured creditors whose claims would rank equally with Bear Stearns are three former service providers. Section 7.2 of the Second Report states that US$79,654 has been paid (presumably at a time when the JOLs still considered the Fund to be solvent) and that further claims of €16,545, $24,092 and CHF5,816 have been received. By themselves, these claims are not material to the final outcome of the liquidation but the interest of these creditors coincides with that of the Six Shareholders. Their claims will be paid in full only if Bear Sterns' claim is rejected.

5. In spite of publishing a report to the shareholders in which the JOLs state unequivocally their conclusion that Bear Stearns should be admitted to proof as an ordinary unsecured creditor for approximately $61m, they have not actually done so. Instead, they issued a summons on 5th August 2011 by which they seek a direction of the Court that Bear Stearns be admitted to proof in the amount of US$59,957,747 plus interest pursuant to section 149 of the Companies Law. The time estimate given for the hearing of this summons was two days. On 26th August 2011 a copy of the Summons was sent to all the Fund's shareholders and creditors under cover of a letter from the JOLs' attorneys in which they proposed a timetable for serving evidence and skeleton arguments in opposition. In response, Bear Stearns gave notice of its intention to appear and support the JOLs' application. Three shareholders, namely Belmont SPC, Finter Bank Zurich Ltd and Commerzbank AG [4], issued a summons for directions on 25th October 2011 and argued, inter alia, that the JOLs should take no further part in the

[4] For present purposes these three entities have been treated as shareholders of the Fund, notwithstanding that their shares are in fact registered in the name of a custodian, namely Citco Fund Services (Europe) BV.

proceeding. When this summons came on for hearing on 18th November 2011 the three shareholders were supported by three unpaid redeemed shareholders whose claims will rank after Bear Sterns' claim. They are ABN Fund Services Bank (Cayman), Barclays Bank Plc and Andorra Banc Agrigol Reig SA. For convenience, I shall refer to all these shareholders and unpaid redeemed shareholders collectively as "the Six Shareholders".

6. The position adopted by the Six Shareholders may be summarized as follows. Firstly, they rightly make the point that official liquidators must be independent and must act with complete impartiality as between the various stakeholders who have competing claims as against the Fund. In particular, CWR O.16, r.1(4) states that "It is the duty of the official liquidator to adjudicate the creditors' claims, for which purpose he acts in a quasi-judicial capacity", which implies a duty to ensure that interested parties are given a fair hearing and a duty to observe the rule against bias. It is said that the JOLs' have offended these rules by retaining Bear Sterns' former attorney to make the sanction application in respect of its own claim. For this reason alone, it is said that the JOLs should take no further part in this proceeding, in spite of the fact that Bear Stearns is now represented by different attorneys. There may be circumstances in which it is not inappropriate for official liquidators to retain the same attorneys who acted for the petitioning creditor/shareholder, but this case illustrates why it is generally wrong to do so. However, I decline to make any ruling about the propriety of retaining Mourant Ozannes, or continuing to do so after it became known that Bear Stearns would make what was bound to be a contentious claim. I would have made the same order for directions even if this issue had not been raised.

7. Secondly, it was submitted that the JOLs should have dealt with Bear Sterns' proof of debt in one of two alternative ways. It is said that they should have adjudicated the proof, as it is their duty to do under CWR O.16, r.1(4). If the JOLs had decided to admit the claim, then the Shareholders would have been entitled to inspect the proof and the supporting documents, including any legal opinions[5], and make an application to the Court for an order that it be expunged[6]. Alternatively, if the JOLs considered that it was inappropriate for them to resolve the legal issues raised on this particular claim, they should have adopted a neutral position and made a sanction application, thus allowing each side of the argument to be put before the Court in an *inter*

[5] CWR Order 16, rule 8.
[6] CWR Order 16, rule 20.

partes proceeding between the competing stakeholders. I agree with these propositions. In fact, the JOLs have not adopted either course. On the one hand, they have not actually adjudicated the claim, with the result that the Shareholders' right to inspect the proof and make an expungement application has not been triggered.[7] On the other hand, they did not adopt a neutral stance. Instead, the JOLs have published a report in which they have stated, in unequivocal terms, their conclusion that Bear Stearns is entitled to be admitted to proof and they have issued a summons which seeks an order to this effect. The Six Shareholders felt that the JOLs were, in effect, "acting as Bear Sterns' advocate" on the sanction application and doing so at the expense of the estate. During the course of the original hearing on 18th November the JOLs' counsel (Mr Simon Dickson) told me that it was their intention to adopt a neutral position at the hearing and "to put both sides of the argument". Today, their counsel (Mr Peter Hayden) said that the JOLs in fact intend to argue that Bear Stearns should be admitted to proof. The Six Shareholders say that Bear Stearns should be left to argue its own case and that it will serve no useful purpose for the JOLs to participate any further in this proceeding.

8. Thirdly, the Shareholders submitted that the JOLs' refusal to disclose the opinion of Mr Ian Milligan QC unfairly prejudices all the stakeholders, including Bear Sterns. Whether or not the JOLs were entitled to assert a claim of legal professional privilege as against the Fund's shareholders and creditors, it was submitted that the JOLs ought not to do so. It was submitted that copies of the Opinion, which has been obtained at the expense of the estate, should be disclosed to both the Shareholders and to Bear Sterns. In the event, the JOLs undertook to provide a redacted copy of the opinion to both sides with the result that it was not necessary for me to make any ruling on this part of the Six Shareholders' summons.

9. In all the circumstances of this case, I came to the conclusion that the proper course, and the most expedient course from a case management perspective, was to make a direction that the sanction application brought by the JOLs be treated as an application by Bear Stearns (as applicant) against Finter Bank Zurich Ltd ("Finter")(which agreed to act in a representative capacity) as respondent to determine whether, upon the true construction of the Option

[7] I was told during the original hearing that Bear Stearns of not actual submitted, or been required to submit, any formal proof of debt.

Agreement between Bear Stearns and the Fund, Bear Stearns is a creditor for the principal amount of US$59,957,747. I was told that there is no dispute about the underlying facts and so I directed that the parties should prepare an agreed statement of facts. Nor is there any dispute about quantum. It is agreed that Bear Stearns is either entitled to be admitted for the full amount of US$59,957,747 (plus interest) or not at all. I directed that the JOLs should take no further part in the application, except to the extent that their assistance might be sought in connection with the statement of facts.

10. Bear Stearns had notice of the hearing which took place on 18th November, but were not represented by counsel on that occasion. For this reason a draft of my intended order was sent to Bear Sterns' attorneys who were given an opportunity to make submissions. In the event, I made an order reflecting directions which were to a large extent agreed between the attorneys for Bear Stearns and the Six Shareholders, as set out in their joint letter dated 24th November. In summary, I directed, inter alia, that –

    (1) The sanction application by which the JOLs seek an order authorizing and directing them to admit the claim of Bear Stearns shall be treated as an application by Bear Stearns (as applicant) against Finter Bank Zurichj Ltd ("Finter") (as representative respondent) to determine whether, upon the true construction of the Option Agreement, bear Stearns is a creditor for US$59,957,747 plus interest;

    (2) The JOLs shall take no part in the application;

    (3) Bear Stearns and Finter shall prepare (with the JOLs' assistance) an agreed statement of facts on the basis of which the application will be determined; and

    (4) Various orders for costs.

11. By their summons dated 24th November 2011 the JOLs now seek orders that (1) they be "joined as a party to the application for directions" and (2) "permitted to attend and make representations" to the Court. Expressed in this way, the summons reflects a misunderstanding of the Order for Directions because the JOLs are a party to the sanction application and they have already been heard on it. What they actually seek is a variation of the

direction that they take no further part in the application[8]. Their grounds for varying this particular part of my order are as follows.

12. Firstly, it is submitted that, by virtue of CWR O.11, r.3(2), official liquidators have an absolute right to be heard on every aspect of every sanction application whether or not their participation would serve any useful purpose and that the Court has no jurisdiction to deprive them of their right or, if it does have an inherent jurisdiction, it should not have been exercised in the circumstances of this case. CWR O.11, r.3(2) provides as follows –

    "The official liquidator has the right to be heard on every sanction application and it is the official liquidator's duty to attend and be prepared to assist the Court in respect of any sanction application made by the liquidation committee or any creditor or contributory."

    It goes without saying that an official liquidator has a right to be heard on his *own* sanction application. The purpose of CWR O.11, r.3(2) is to give him a right to be heard on a sanction application made by a liquidation committee or any individual creditor or contributory, in effect preventing them from making an *ex parte* application. I do not accept that, upon its true construction, this rule gives official liquidators an unqualified right to appear and be heard at every stage of every application at the expense of the estate, even if the application takes on the character of an *inter partes* action between stakeholders in which substantive rights against the company will be determined. In the ordinary case the purpose of a sanction application is to provide the liquidator with guidance (which may be permissive or prescriptive) and to protect him against a claim for breach of duty. However, a sanction application may raise substantive issues in which case the Court can go on and resolve substantive rights, thus making it unnecessary for a separate action to be commenced by or against the company. The JOLs' counsel referred me to *Trainedes –v- Mercury Brands Group Pty Ltd* (2010) FCA 1140, a decision of the Federal Court of Australia in which Finkelstein J. observed that it common for the Australian court to proceed in this way. This Court has followed the Australian example, as it did most recently *In Re Emergent Capital Ltd (In Liquidation)* (Unreported 23rd November 2011). In that case the official liquidators commenced a sanction application by which they sought a direction whether or not to rectify the company's share register, which necessarily required the Court to determine the validity of a share issue which had had the effect of substantially diluting the interest of one of the shareholders. The resolution of this issue turned on a number of disputed

[8] Order for Directions, paragraph 4.

matters, in particular whether the company's directors had acted in breach of fiduciary duty. I directed that the issue be determined as been the company's two shareholders, who were the only parties in interest, for which purpose I directed the service of pleadings and matter proceeded in the same manner as the trial of an action commenced by writ. Having found that the directors had acted in breach of duty, the resulting order took the form of a direction that the liquidators rectify the register. Having commenced the sanction application and obtained directions for trial of the substantive issue, the official liquidators took no further part in the proceeding because it would have served no useful purpose for them to do so.

13. When a sanction application takes on the character of an *inter partes* action, it is open to the Court to authorize or direct that the official liquidators take no further part in the proceeding which they have commenced. The purpose of giving such a direction is to avoid incurring unnecessary expense. Mr Hayden submits that this approach is wrong in law and that official liquidators have an unqualified right to participate in every aspect of every such proceeding, whether or not it would serve any useful purpose, although he concedes that they might thereby expose themselves to an order that their fees and expenses of doing so be disallowed. I do not accept this proposition. By section 110(3) of the Companies Law "the exercise by the liquidator of the powers conferred by this section is subject to the control of the Court". This means that the Court has jurisdiction to make orders which either (a) direct a liquidator whether or not to exercise a power or (b) authorize him to exercise or refrain from exercising a power. It also means that the Court has jurisdiction to direct the liquidator to exercise a power in a particular way. In the ordinary course, the Court's jurisdiction is exercised in response to a sanction application but it can be exercised of its own motion. However, it is also well established that the Court does not exercise this jurisdiction by substituting its own commercial judgment for that of its official liquidator. In the context of this case, the Court has jurisdiction to direct the JOLs to exercise their power of adjudication by directing them to admit Bear Stearns to proof or not, as the case may be. Similarly, the Court has jurisdiction to direct them not to participate any further in the sanction application or, alternatively, authorize them not to do so. In my judgment Mr Hayen's interpretation of CWR O.11, r.3(2) is inconsistent with section 110(3); inconsistent with the established practice of this Court; and would lead to an absurd result. Logically, if Mr Hayden is right that official liquidators have an unqualified right to participate in every stage of every sanction application, including those which take on the character of *inter partes* proceedings,

whether or not it would serve any useful purpose, of which the liquidator is the sole judge, then they (and their lawyers) must be entitled to be remunerated for doing so. This would be an absurd result. Mr Hayden recognizes that the Court must have jurisdiction under section 109(1) and CWR O.24, r.9 to disallow payment of the liquidator's remuneration and legal fees out of the assets incurred in connection with the conduct of a sanction application, notwithstanding that it was properly commenced. I think this amounts to an acceptance that the Court's jurisdiction to control official liquidators extends to controlling the way in which they deal with or participate in sanction applications. As officers of the court, official liquidators are never given a blank cheque.

14. It is also submitted that the JOLs have a duty under CWR O.11, r.4(2)(b) to swear an affidavit in reply to any evidence adduced by Bear Stearns and/or Finter. As I understand this submission, it is another aspect of the jurisdictional argument in that it is said that I had no jurisdiction to make paragraph 4 of the Order for Directions because it somehow interferes with the JOLs' duty under CWR O.11(4)(2)(b). Mr Hayden's submission that the JOLs must remain actively involved in this application and must review all the legal arguments deployed by Bear Stearns and Finter in order to avoid the risk, no matter how remote, that some material factual evidence might not be put before the Court is wholly unrealistic. It reflects a misunderstanding of the JOLs' role in this case. They have already sworn an affidavit to which they have exhibited copies of all the relevant documentary evidence. [9] This evidence is undisputed and all counsel (including Mr Heydon) are agreed that it appears to be complete. As reflected in paragraph 5 of my Order for Directions, counsel are also agreed that the outstanding issue can and should be determined on the basis of an agreed statement of facts. In these circumstances, Mr Hayden's submission based upon CWR O.11(4)(2)(b) appears to me to be artificial and contrived. The JOLs have already put the relevant documents in evidence. There is no suggestion that the bundle of documents is incomplete, but if it turns out that some relevant document has been omitted, the JOLs may be asked (or directed) to swear an additional affidavit.

15. Secondly, it is said that because the purpose of the sanction application is to resolve an issue about the contractual rights as between Bear Stearns and the Fund, "it is [the Fund] which must be the respondent" and that I had no

[9] The 3rd Affidavit of Stuart Sybersma sworn on 14th October.

jurisdiction "to deprive the Fund of its right to be heard". This argument reflects a misunderstanding of the liquidation process and the liquidator's role, which is to collect and realize the assets and then distribute them in accordance with the statutory scheme. The Fund continues to exist as a legal entity throughout the liquidation process and ceases to exist only when the order for dissolution is made. However, it is wrong to characterize the Fund as a "party" to the liquidation proceeding. It is the "subject-matter" of the proceeding. The right to commence a sanction application is a right arising under the Law and the Rules which belongs to its official liquidators personally. They do not make the application as agent on behalf of the company. The company is not a party to the application. It is the subject-matter of the application, the outcome of which will be an order directing or authorizing the liquidator to exercise or refrain from exercising his powers in some way. The mere fact that a sanction application takes on the form of an *inter partes* proceeding between stakeholders, does not change the fact that the company is the subject-matter of the proceeding. The Fund never was a "party" to the sanction application in the sense that the JOLs commenced the application as agent on its behalf. The JOLs commenced the sanction application in their own right and the end result will be a direction addressed to them personally requiring them to admit Bear Stearns to proof or not, as the case may be. It follows that paragraph 4 of my Order for Directions has not deprived the Fund itself of any right to be heard. It merely constitutes a decision that, in the particular circumstances, it is appropriate for the Court to determine what direction to give to the JOLs without any further input from them.

16. The Order for Directions is a procedural one which does not itself determine any substantive rights and is therefore capable of being varied but I should only vary it if there has been some material change of circumstances or some relevant point has arisen which was not taken into account at the original hearing. Clearly, there has been no change of circumstance. In effect, I have given counsel for the JOLs a second opportunity to explain why it would serve some useful purpose to incur the cost of their continued involvement in the application. Mr Hayden's arguments are wholly unconvincing. The reality is that Bear Stearns is perfectly capable of arguing its own case. Since the JOLs have already come down in Bear Sterns' favour, the only person who can put the contrary argument in the interests of the other stakeholders is Finter, acting in its representative capacity. Since the issue is a pure point of law which will be decided upon an agreed statement of facts, based upon documentary evidence which has already been put before the Court by the

JOLs, counsel instructed by Finter should be perfectly capable of putting the contrary argument against treating Bear Stearns as an ordinary unsecured creditor. In reality, there is nothing more for the JOLs to do, or at least not unless they are asked by the Court to contribute for some reason which is at present unforeseeable.

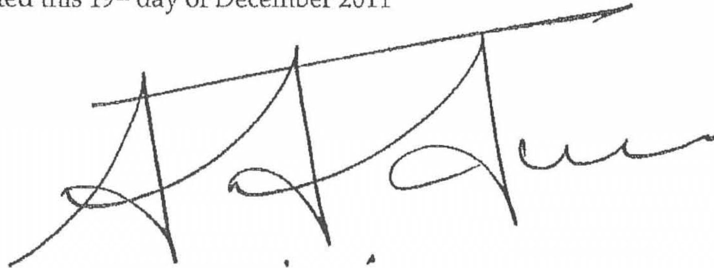
17. In my judgment this case has given rise to an ordinary liquidation case management issue, which has to some extent been obscured and made unduly contentious by an unfortunate combination of circumstances. The fact that Bear Sterns' own attorneys are now acting for the JOLs' and are advocating a position which is highly favourable to their former client and highly unfavourable to all the other stakeholders inevitably exposes the JOLs and Mourant Ozannes to criticisim. The fact that the JOLs claim to have devoted a substantial amount of time, effort and money towards establishing that Bear Stearns is entitled to be treated as a creditor raises questions because Bear Stearns originally claimed to be a shareholder and has not even filed any proof of debt. Whilst it is perhaps understandable that this combination of circumstances should have generated some heated argument, at the end of the day this is a straightforward liquidation case management issue. I am not persuaded that the JOLs' continued participation in this application will serve any useful purpose but, on reflection, I do think that paragraph 4 of my Order for Directions was unnecessarily prescriptive. I will vary it to provide that "the JOLs are authorized to take no further part in the Application". If they participate, they will do so at their own risk as to costs. The Six Shareholders accept that the JOLs are entitled to their costs of commencing the sanction application and preparing the evidence, but they have put the JOLs on notice that if it turns out that their continued participation has served no useful purpose, they will be faced with an argument that the additional costs incurred should be disallowed under CWR O.24, r.9(2)(a).

18. Having allowed the JOLs' application to vary my Order for Directions, it is not necessary for me to go on and consider whether to grant leave to appeal. However, I would have refused leave to appeal on the basis that this is a pure liquidation case management issue and it raises no point of principle which ought to be considered by the Court of Appeal.

19. Finally, I reject the Six Shareholders' application for an order pursuant to CWR O.24, r.9(a) and (b) depriving the JOLs of their right to be paid the costs of this application out the Fund's assets. The JOLs have succeeded in

persuading me to vary paragraph 4 of my Order for Directions and so it cannot be said that their application was "unnecessary" or "unreasonable" within the meaning of these rules.

Dated this 19th day of December 2011



The Hon Mr. Justice Andrew J. Jones QC
JUDGE OF THE GRAND COURT