IN THE GRAND COURT OF THE CAYMAN ISLANDS

FINANCIAL SERVICES DIVISION

CAUSE NO: FSD 26 OF 2015 (ASCJ)

IN THE MATTER OF THE COMPANIES LAW (2013 REVISION)

AND

IN THE MATTER OF CALEDONIAN SECURITIES LIMITED (IN OFFICIAL LIQUIDATION) ("CSL")

IN CHAMBERS
BEFORE THE HON. ANTHONY SMELLIE, CHIEF JUSTICE
THE 1ST APRIL 2016 and 5TH May, 2016

APPEARANCES: Mr. Robert Levy QC instructed by Mr. Rupert Bell and Mr. Niall Hanna of Walkers (with them Ms. Claire Loebell and Mr. Keiran Hutchinson of Ernst & Young (Cayman) as the Joint Official Liquidators of CSL;

Mr. Thomas Lowe QC, instructed by Ms. Grainne King of Harneys for Global Asset Allocation Fund ("Global"), Saad Investments Finance Company (NO. 5) Ltd. ("SIFCO5") and Bristol Investment Fund Limited ("Bristol");

Mr. David Harby of Loeb Smith for Nova Holding Group Limited ("Nova");

Ms. Jane Hale of Appleby for the Liquidation Committee of Caledonian Bank Ltd. (in liquidation) ("the LC" and "CBL" respectively).

Winding up of corporate trustee – whether liquidators assume the role of trustee or act as agents of the corporate trustee – whether liquidators may charge their fees and expenses to the assets held in trust or whether obliged to recover them only from the assets of the liquidation estate of the corporate trustee – if recoverable from the trust assets then by what apportionment and in what quantum.

JUDGMENT

1. This application concerns the entitlement of the Joint Official liquidators (the "JOLs") of CSL to fees and expenses from the assets held by CSL on trust for its customers and where such entitlement is established, the quantum of such fees and expenses.

2. The position of the JOLs is that they should be allowed to recover their fees and expenses from a reserve of a percentage of the assets which has been established by order of this Court, as explained below.

Background

3. CBL and CSL (together "the Companies") are ordinary resident limited liability companies, incorporated in 2007 and 2011 respectively, under the Companies Law (2013 Revision) (the "Companies Law"). CBL held a "Category A" Banking Licence in the Cayman Islands, and CSL held a full Securities Investment Business Licence to carry on business in and from the Cayman Islands.

4. The licences were revoked by the Cayman Islands Monetary Authority ("CIMA") on 16 February 2015, following the appointment of Claire Loebell and Keiran Hutchinson of Ernst & Young as Controllers of the Companies, on 10th February 2015.

5. Ms. Loebell and Mr. Hutchinson were later appointed as the JOLs of the Companies by winding-up orders made on 23 February 2013, upon a petition presented by CIMA.

6. CSL's business was the provision of fiduciary custody and brokerage services to its customers and the JOLs have established that it provided such services to 188 customers. The assets under CSL's custody and that of the various sub-custodians engaged by it (which included CBL) are comprised of cash and securities. As such their value has fluctuated, but as at the date of the appointment of the JOLs, the value was in the order of USD573 million.

7. Accordingly, and upon receiving confirmatory legal advice as to the nature of their position, the JOLs found themselves in control of substantial assets that did not belong beneficially to the Companies (generally referred to in the evidence as "Custody Assets"), but rather were controlled by the Companies as trust assets for their customers (likewise referred to as "Custody Asset Customers").

8. In keeping with further advice from leading counsel, the JOLs, by Summons dated 11 May 2015, (the "11 May 2015 Summons"), sought an order:

   (i) entitling them (subject to complying with all relevant anti-money-laundering regulations) to deal with Custody Assets at the direction of Custody Assets Customers; and

   (ii) directing that the Custody Assets Customers would pay the JOLs for acting in accordance with their instructions.

9. The 11 May 2015 Summons was heard on 24 June 2015, and on that day by order the JOLs were authorised:

   (i) to deal with those assets that are held to the order of CSL in its capacity as provider of custodian services to customers of CSL or are held to the order of CBL as sub-custodian of CSL, in accordance with the instructions of each

Custody Asset Customer and subject to the JOLs being satisfied, in each case, that the instructing Custody Asset Customer is properly bound by the Securities Terms and Condition[1];

(ii) to establish a reserve account equal to one per cent of each Customer Asset Customer's Custody Assets ("the Reserve") ; and

(iii) whereby the JOLs would not be required to deal with any Custody Assets Customer's Custody Assets until satisfied (in the JOLs' absolute discretion), that the relevant Custody Asset Customer had paid the one per cent or authorised the JOLs to deduct it from its Custody Assets, to form part of the Reserve.

10. On the basis of the 24 June 2015 Order, distributions have been made to a large majority of Custody Assets Customers and the Reserve has been established albeit, in some instances as will be discussed below, without the authorisation of certain Custody Asset Customers.

11. By her third Affidavit filed in these proceedings, Claire Loebell explains the circumstances which are presented as justifying the position taken by the JOLs for recovery of their costs from the Reserve.

12. In summary, she attests that the Companies' record keeping was far from perfect, and that it took a great deal of time for the JOLs to acquire a complete picture of the Companies' affairs as regard Custody Asset Customers and their Custody Assets. These investigations included determining (a) the identity of all the Custody Assets Customers; (b) the extent and location of their respective Custody Assets (that is: the

[1] Those comprising the contracts by which custody assets were held by CSL as custodian. Clause 2.1 of CSL's Securities Terms and Conditions expressly stated that: Broker [ie: CSL] shall hold the Property [ie: all cash, securities and investments deposited] in trust for you, viz: the respective Custody Asset Customer."

identity of the sub-custodian and the specific assets held by it, if not held by CSL itself); (c) what contractual documentation the Custody Asset Customers and/or the sub-custodians had with the Companies; and (d) whether the Custody Asset Customers had completed all relevant know-your-client and other anti-money laundering documentation; and so on.

13. Whereas when the 11 May 2015 Summons was issued it appeared to be the case that CSL had 175 Custody Asset Customers, it subsequently was established that in fact it had 188. For the purposes of the 11 May 2015 Summons, the JOLs segregated the Custody Asset Customers into six categories, each depending upon the contractual arrangements that the JOLs understood their members to have with CSL.

14. Pursuant to the Order of 24 June 2015, the JOLs were thus able to deal with the assets of a very large number of Custody Asset Customers. For the purposes of the present application the JOLs have broken down the general body of Custody Asset Customers into two groups, namely:

    (i) "Resolved Customers" – being those customers whose Custody Assets (save for their 1% contribution to the Reserve) have been, or will shortly be, dealt with in accordance with their instructions; and

    (ii) "Unresolved Customers" – being those customers who, for a variety of reasons, such as a refusal to contribute 1% to the Reserve, unresponsiveness or non-compliance with anti-money-laundering requirements, are not yet capable of having their Custody Assets dealt with in accordance with their instructions.

15. Whilst the hearing of the 11 May 2015 Summons determined how the JOLs could deal with Custody Assets, including the creation of the Reserve, it did not determine:

(a) whether the JOLs should be granted an allowance for their work in relation to Custody Assets generally;

(b) the extent of that allowance; or

(c) how such allowance should be satisfied (that is: whether from the Reserve generally, or in some other manner).

16. These three questions now arise for resolution. The essential difficulty is that the Custody Assets are trust assets held on behalf of the Customer Asset Customers and so do not belong to the liquidation estate of CSL. Accordingly, the JOLs have no direct legal entitlement to recover their fees and expenses qua liquidators of CSL, from the Custody Assets.

17. The distinction between the costs of the JOLs incurred in relation to the liquidation of CSL and the fees and expenditure of the JOLs relative to their work done in relation to the Custody Assets generally, must therefore be strictly observed. As will become clearer below, it is in respect only of the latter that I am asked to grant allowance from the Custody Assets upon the JOLs' present application.

18. While the vast majority of the Customer Assets Customers are on notice of the JOLs' application and have raised no objection, those four appearing as represented by Mr. Lowe QC and Mr. Harby, ("the Objectors") object on the primary basis that, as the Custody Assets are trust assets which do not belong to the liquidation estate of CSL, the JOLs have no right of recourse to them to meet their fees or expenses but are obliged simply to return them to the respective Custody Assets Customers; it

being conceded that they may withhold from the Reserve, only so much as is referable to the actual costs of returning the respective Custody Assets. While the Objectors are a tiny minority in number of 188, they represent (along with the LC which also expresses concern) some 55% in value of the Custody Assets and so are concerned that they would be disproportionately affected by having to contribute 1% of their assets to the Reserve. They assert that there is in law no basis for requiring the respective Custody Asset Customers to subsidize the costs attendant upon returning the assets of other customers or the general costs of the liquidation. That it is inequitable for those Custody Assets Customers whose legal position is straightforward to bear a comparatively higher proportion of costs, simply because they have a higher value of assets under custody than those who may have less valuable assets under custody but whose position may be more complex and/or time consuming and would therefore require more investment of resource to resolve.

19. The pivotal issues to be decided can therefore be framed as follows: (a) what jurisdiction may I invoke for the allocation of the costs so as to recognise the JOLs' entitlement to recover from the Reserve; (b) in what proportions are the costs to be allocated if, as proposed by the JOLs, there should be different apportionments for different groups of Custody Assets Customers; and (c) are the amounts of the costs reasonable and proportional?

The costs incurred by the JOLs

20. Ms. Loebell explains in her third Affidavit that the costs incurred by the JOLs are broken down into a number of categories (and sub-categories). On behalf of the JOLs, Mr. Levy QC emphasises the importance of the Court's understanding that the

JOLs were faced with a complicated task and invites me to pay close attention to Ms. Loebell's explanation of the work done and the costs incurred. The various heads of costs or expenses incurred and work done, are summarized as follows:

(i) Indirect costs – these included the costs of forensic investigations carried out by the JOLs' staff, the steps taken to secure data held by CSL, and the costs of the JOLs' preliminary attempt to sell the business of CSL:

(a) as regards computer imaging work, Ms. Loebell explains that this work was undertaken by a Forensic Investigation and Dispute Services Team engaged especially for the purposes. This work was necessary in order for the JOLs to have a complete forensic copy of all of CSL's data (wherever stored), not only for the purposes of identifying and preserving information relating to Custody Asset Customers, but also in order to respond to proceedings commenced by the United States Securities and Exchange Commission ("SEC") which exposed Custody Asset Customers to risk by way of a Temporary Restraining Order ("TRO") imposed at the request of the SEC Custody Assets Order and which was the most proximate cause of CSL's controllership by CIMA and its current winding up.

Some 107,360 documents were reviewed, 75,481 of which related to trading of securities that were the subject of the SEC Complaint.

(b) as to the costs associated with a possible sale of CSL's business, Ms. Loebell explains that had CSL's business been transferred to a third party, then the subsequent costs the JOLs incurred would likely have

been avoided as that third party would have become the custodian. Had the business been sold, it is to be assumed that the third party would have continued CSL as a going concern without disruption to the custodianships. The costs incurred in seeking to sell the business were therefore, it is proposed, largely incurred for the benefit of Custody Asset Customers and are properly recoverable from the Reserve.

(c) As things have turned out, the reality is that the indirect costs amount to USD1,457,706 and CSL's general liquidation assets (that is: non-trust property not comprised of the Custody Assets) are USD1,112,633; a shortfall of USD345,023. The manner in which this shortfall will be treated by the JOLs is discussed below.

(ii) Trading costs, which comprise:

(a) the costs of retaining essential CSL staff – those with the historical institutional knowledge of the Custody Asset Customers and their respective Custody Assets – knowledge which would otherwise not have been available to the JOLs except at great expenditure, time and costs to acquire that knowledge. Costs attributable to these staff members include salary and costs eventually associated with their termination;

(b) the overhead costs incurred by CSL (electricity, water, etc., and essential information services such as Bloomberg terminals);

(c) The JOLs' actual time costs (described as covering an array of work, such as reconciling accounts; dealing with CSL staff and sub-custodians, processing Custody Assets (including ensuring that know-your-client and other anti-money laundering provisions are complied with; dealing with lawyers; complying with the JOLs' statutory duties to the Court qua JOLs; etc.), and

(d) The costs charged to CSL by the independent sub-custodians and which the JOLs have, as far as possible, carefully allocated so as to ensure that they are charged to the respective Custody Assets..

(iii) Legal costs which include:

(a) Cayman Islands counsel's fees for preparing the 11 May 2015 Summons and supporting documentation, for advising on the legal status of Custody Assets Customers and dealing with correspondence from them; dealing with the instant Summons; and

(b) the costs of U.S. Counsel in dealing with certain foreign sub-custodians (Morgan Stanley and Trade Station), who refused to deal with the JOLs in the absence of an order from the U.S. Court recognising the JOLs' appointment.

(iv) Voluntary liquidation costs – these costs were incurred through the actions of third parties because shortly after the appointment of the Controllership over CSL, its sole shareholder resolved to place CSL into voluntary liquidation. There was a hearing on 12 February 2015 at which this Court held[2] that whilst

[2] Written ruling to similar effect in relation to CBL handed down in *FSD Cause 22 of 2015* on 12th February 2015.

the voluntary liquidation was validly commenced, the voluntary liquidators appointed did not have power to control CSL, as that power had vested in the Controllers. Thus, the costs of the voluntary liquidation must be met from the liquidation estate of CSL as no order was made against the sole shareholder personally.

(v) Disbursements – these are personal out of pocket payments made by the JOLs for which, to date, they have not been reimbursed and are said to have been incurred in relation to statutory advertising and filing of notices at the Registry of Companies.

21. Whilst the JOLs consider that item (i) – the Indirect Costs – are properly attributable to the Custody Asset Customers, they propose to meet them from CSL's general assets; ie: not from the Reserve. As Ms. Loebell explains and already mentioned, the Indirect Costs amount to USD1,457,907 and CSL's general assets are only USD1,112,633. There will therefore be the shortfall of USD345,023 also already mentioned and this will be absorbed by the JOLs. She explains that the JOLs are prepared to absorb these costs by way of providing a discount to their remuneration for the benefit of their liquidation estate. It is said that in reality this (along with future indirect costs of USD27,499 to be incurred), amounts to a substantial discount of 13.5% in the costs which would otherwise be proposed to be passed on to the Custody Asset Customers. As will become clearer at paragraph 26 below, these two sums amounting to USD372,522, approximate a reduction of 25% in the JOLs' fees for their own services.

Apportionment of costs

22. The JOLs have communicated with the Custody Asset Customers setting out the bases for the costs incurred (as described above) and the JOLs' proposed methods of meeting them. Such communication was first sent on 5 October 2015 to 152 recipients but feedback was received from only three (now among the Objectors) who opposed on differing bases, namely:

(i) A Custody Asset Customer who had only cash on deposit and who argued that as its cash position was easier to deal with, it did not believe the JOLs' Proposal (which included a proportional weighting of costs depending on the relative ease or complication of dealing with respective Custody Assets) was equitable so far as it was concerned;

(ii) A Custody Asset Customer whose assets comprised of cash, securities and certificates and who objected to the JOLs' entitlement to recover their costs as against its assets at all, as a matter of principle; and

(iii) A Custody Asset Customer who disputed that it is subject to the Order of 24th June 2015 and has therefore refused to provide its consent to the JOLs withholding its contribution to the Reserve (resulting in the JOLs being unable to distribute its assets).

23. The JOLs recognise that despite having spent a very significant amount of time dealing with the small minority in number of the Custody Asset Customers who oppose (and who include the Objectors), it would have been inappropriate to have entered into any agreement with them as the JOLs are obliged to deal equitably with all Custody Assets Customers and any "deal" with one or more could be to the

financial detriment of the others. Hence the instant application for the approval of the Court, in relation to the JOLs' ultimate proposal for apportionment of the costs.

The JOLs' ultimate proposal for apportionment

24. Having identified some seven different methods for apportionment, none of which received the acceptance of the Objectors, the JOLs now propose for the Court's acceptance, their seventh method. They do so even while recognising that none of the possible methods of apportionment is precise or perfect. The JOLs acknowledge that the only near precise solution would be that which is proposed by the Objectors – viz: to determine exactly how much time and money was spent in dealing with each Custody Asset Customer and its respective Custody Assets (which in itself would be extremely difficult in relation to costs incurred prior to the commencement of distribution of Custody Assets; that is: prior to 24 June 2015). However, and in any event such a methodology, even if practicable, would still be imperfect as it would involve a degree of allocation by the JOLs as certain work and expenses[3] are not specific to particular Custody Asset Customers. Accordingly, "precision" or "perfection" could only be achieved following an enormous amount of reconstructive work and at enormous cost. And even this premise, the JOLs say, should itself be queried because it would be no more than a mathematical apportionment of costs to each individual Custody Asset Customer, which would not necessarily be truly reflective of the relative value and impact of the work undertaken in relation to the individual Customer's Custody Assets.

[3] Such as reconciliation of accounts, electricity costs, Bloomberg fees, costs of CSL staff who did not and do not keep time sheets with narratives of tasks undertaken, etc.

25. Accordingly, the JOLs propose to base the apportionment on the actual costs incurred as at 26 February 2016, and further on the JOLs' budgeted figures going forward until (the "Crystallisation Date"); by which time they hope to have dealt fully with the Customer Asset Customers. That would result in a total costs figure of USD4,233,419 (the "Total Costs") and which figure makes a full allowance for the Indirect Costs.

26. That being the overall context, it is important to note that of the Total Costs, the JOLs' own remuneration will be less than one-quarter; viz: USD987,315. The rest – USD3,246,104 – will comprise the trading costs, legal costs, voluntary liquidation costs and a small sum for disbursements, all as discussed above. And this figure of USD987,315 takes account of the USD372,500 in liquidation costs which the JOLs will forego.

27. The JOLs say that they have estimated as accurately as they can, the total value of all Custody Assets as at the Crystallisation Date ("the Total Value") and the Reserve of each Custody Asset Customer would bear a proportionate share of the Total Costs by reference to the Total Value, subject to a "cash to securities adjustment" of 30:70, which will reflect the respective costs of dealing with cash as opposed to securities. This would be their ultimate proposal for apportionment and would be applied to costs incurred after 24 June 2015, the date when the distribution of Custody Assets actually commenced.

28. Their proportionate share having been identified to be withheld from the Reserve, Resolved Customers will each have a specific amount deducted and the balance

attributable to their 1%, will be returned to them following the outcome of this application.

29. As regards Unresolved Customers, if their assets are dealt with following the hearing of the instant Summons and before the Crystallisation Date, they would have been dealt with in the same manner save that in cases where their 1% contribution to the Reserve has not yet been received, the exact calculated reserve amounts would be deducted from their assets and retained by the JOLs prior to transfer of their Custody Assets. However, Unresolved Customers remaining after the Crystallisation Date will also be charged individually for any costs incurred that are directly attributable to them. This is only fair say the JOLs, as the costs of dealing with those who object to the process should fall on them and not be charged to the Resolved Customers, who are entitled to have the balance of their 1% returned as soon as possible. It is, of course, possible that an Unresolved Customer may need to contribute more than 1% of its Custody Assets if the resolution is protracted. However, the JOLs do not anticipate that there will be many such customers and there may well be the need for a further application to the Court after the Crystallisation Date, for directions on how to deal with such customers, once the final quantum of costs is known.

30. At paragraph 147 of her third Affidavit, Ms. Loebell sets out a table showing the impact of the JOLs' ultimate proposal on the customers as described above. This shows that, depending on the nature and value of the assets, customers will eventually pay less than 1% - they will actually pay between 0.57% and 0.882% of the value of their Custody Assets – with "cash only" customers paying the lower percentage and "securities only" customers paying the higher percentage.

31. It is further noted by the JOLs, that certain Custody Asset Customers had their Custody Assets held by certain sub-custodians (namely MMO Harris/Curtland and RBC Investor Services Trust) who required CSL to pay the fees of executing transactions, rather than charging them directly to the assets under their respective sub-custodianship. As mentioned above, it is therefore proposed that those Custody Asset Customers should bear the actual fees referable to such transactions, to be recovered by the JOLs from their respective reserves.

32. I now turn to consider the pivotal issues as framed at paragraph 19 above.

The first issue: Jurisdiction and Entitlement

33. As first expounded in *In re Berkeley Applegate Investment Consultants) Ltd. (in liquidation)*[4] and as applied on many subsequent occasions[5], it must now be regarded as settled principle that the Court has an inherent equitable jurisdiction to direct that fees and expenses are paid from trust property held by a company in liquidation, where such fees and expenses are reasonably incurred by the liquidator in returning the trust property to those entitled to it.

34. In *Berkeley Applegate,* the business of the company prior to its liquidation was to place funds on behalf of individual investors on the security of mortgages of freehold property, which mortgages were taken in the company's name. All investors were provided with an investment scheme which stated, inter alia, that no costs whatsoever would be incurred by them. Apart from the assets of the liquidation estate of the company itself, moneys held in clients' accounts awaiting investment and the benefit of the mortgages were held as assets on trust by the company for the investors. At the

[4] [1989] 1 Ch. 32
[5] Including by this Court in *AHAB v SICL et al* 2010(1) CILR 553 and see footnote 12 below.

commencement of the winding up, funds standing to the credit of the clients' accounts amounted to about £1.2 million plus interest of £29,509 and the total loans made and secured by mortgages amounted to about £10.2 million. The expenses and fees of the liquidator were considerable and greatly exceeded the free assets of the liquidation estate of the company which were therefore insufficient to meet them.

35. In directing that the liquidator could recover the excess of his expenses and fees from the trust assets, the principle was stated by Deputy Judge Edward Nugee QC (now Nugee J.) as follows (at p. 50 H):

> *"The authorities establish, in my judgment, a general principle that where a person seeks to enforce a claim to an equitable interest in property, the court has a discretion to require as a condition of giving effect to that equitable interest that an allowance be made for costs incurred and for skill and labour expended in connection with the administration of the property. It is a discretion which will be sparingly exercised; but factors which will operate in favour of its being exercised include the fact that, if the work had not been done by the person to whom the allowance is sought to be made, it would have had to be done either by the person entitled to the equitable interest (as in In re Marine Mansions Co. (867) LR 4 Eq. 601 and similar cases) or by a receiver appointed by the court whose fees would have been borne by the trust property (as in Scott v Nesbitt (1808 14 Ves Jun 438); and the fact that the work has been of substantial benefit to the trust property and the persons interested in it in equity (as in*

Phipps v Boardman [1764] 1 WLR 993). In my judgment this is a case in which the jurisdiction can properly be exercised."

36. Apart from the nature of the assets being trust assets, other circumstances of *Berkeley Applegate* are strikingly comparable to those presented here.

37. Not only was the liquidator in *Berkley Applegate* required to perform functions relative to the general liquidation of the company, he was also required to undertake time-consuming, complicated and costly functions which were directly and exclusively referable to the administration of the trust assets, their investment and ultimate return to the investors. These included:

(1) preliminary investigations to anticipate the consequences of the liquidation which subsequently occurred, including a preliminary identification of potential claimants and the classes into which they fell;

(2) dealing with inquiries from investors and borrowers (at peak involving up to 100 telephone calls and up to 50 letters per day);

(3) ascertainment of assets, including matching the sums paid to the company by the investors with the sums advanced by the company to borrowers, confirming the respective investments by reference to certificates of investment, reconciling the company's client's accounts with associated records to confirm the respective interests in the clients' accounts, and so on;

(4) management of the investments, including recoveries from delinquent mortgagors and reconciling loans which had in fact been repaid; in short, carrying on the Company's mortgage business, although without lending money afresh pending winding-up.

38. That was all work which had to be carried out by the liquidator apart from a certain amount of work in relation to pure liquidation matters. That work incurred 250 man-hours whereas about 3,300 man-hours had been spent (by the time of the hearing before Deputy Judge Nugee) on the matters described above, referable to the investors' trust claims.

39. As it is accepted by Counsel before me would be the case here, it was common ground before Deputy Judge Nugee that there was no statutory authority for the payment of any part of the liquidator's expenses and fees out of trust assets. In this regard, the statutory authority for recovery of a liquidator's costs comes primarily from section 115 of the Insolvency Act 1986 (and in almost identical terms here from section 109 (1) of the Companies Law (2013 Revision):

> *"All expenses properly incurred in the winding up, including the remuneration of the liquidator, are payable out of the company's assets in priority to all other claims."*

40. It is clear, as Deputy Judge Nugee also observed[6] that the company's assets did not for the purpose of these statutory provisions[7], include assets held by it in trust for others. And this is so notwithstanding that the duty of the liquidator as prescribed by the statute to wind up the company's affairs, may necessarily involve dealing to some extent with assets which the company holds as trustee.

41. The inherent jurisdiction to be invoked to make allowance for the liquidators' costs and expenses from assets held in trust, is therefore grounded entirely in equity.

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[6] At p.41 A-B.

[7] Including also Insolvency Rule 4.127 of the Insolvency Rules 1986 UK or the comparable Insolvency Practitioner's Regulations ("IPR"), Cayman Islands, dealing with payment of liquidators' remuneration and expenses.

42. In tracing its roots, Deputy Judge Nugee harkened back to the earlier cases in equity which treated expenditure by trustees on the preservation or protection of trust property as being closely analogous to the "salvage" jurisdiction earlier recognised in *In re Marine Mansions Co.* L.R. 5 Eq. 601, *Scott v Nesbitt* 14 Ves Jun. 438, *Phipps v* [1964] 1 W.L.R. 993, *In re Duke of Norfolks Settlement Trust* [1982] Ch 61 and said by Evershed M.R. and Romer LJ in *In re Downshire Settled Estates* [1953] Ch 218, 235, to be exercisable:

> *"...where a situation has arisen in regard to the [trust] property (particularly a situation not originally foreseen) creating what may be fairly called an "emergency" - that is a state of affairs which has to be presently dealt with, by which we do not imply that immediate action then and there is necessarily required – and such that it is for the benefit of everyone interested under the trusts that the situation should be dealt with by the exercise of the administrative powers proposed to be conferred for the purpose."*

43. The situation which had arisen in this case particularly from the intervention of the SEC, presented CSL as trustee with no less an unforeseen "emergency" than of the kind contemplated in that dictum. It was an emergency which fell to the JOLs to be dealt with as agents of CSL[8] once CSL's winding-up commenced.

44. The work which they subsequently undertook as described in detail by Ms. Loebell and as outlined above in this judgment, was both "necessarily required", as well as intended and indeed has redounded, to the benefit of all the Custody Assets Customers, albeit in varying degrees of benefit if viewed individually and separately.

[8] As will be further explained below.

45. "Benefit" has undoubtedly been the result, even if the import of what was done cannot, except now at further great expense, be precisely attributed or related to the respective Custody Assets of each customer.

46. The question which I am now called upon to answer is thus the same question of principle as confronted Deputy Judge Nugee in *Berkeley Applegate*, which is whether any part of the JOLs' expenses or fees can be paid out of the trust assets, either directly or by way of payments to CSL. Here, I am further asked to decide how the expenses and fees should be allocated, questions which the Deputy Judge left for later determination and which came to be determined by Peter Gibson J[9], as will also be discussed below.

47. At this juncture, what is clear here is that as in *Berkeley Applegate* itself (and in the several earlier cases considered by Deputy Judge Nugee) – as a condition of giving effect to the equitable right of the Custody Asset Customers, this Court has a discretion to ensure that a proper allowance is made to the JOLs for their fees and expenses. Their skill and labour may not have added directly to the respective value of the underlying Custody Assets of each trust, but taken as a whole, I am satisfied that they have doubtlessly added value to the Custody Assets, in the sense that the work undertaken was as a whole necessary before any of the assets could be retrieved for the benefit of the Custody Assets Customers.

48. And as was also observed in *Berkeley Applegate* (p.50 D-E), if the liquidator (here the JOLs) had not done this work, it was inevitable that it, or at all events a great deal of it, would have had to have been done by someone else, most likely here a receiver, and at similar if not greater expense.

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[9] *In Re Berkeley Applegate (Investment Consultants) Ltd.* (No. 3) [1989] 5 BCC 803.

49. The circumstances of this case therefore bear all the hallmarks of one suitable for the application of the "salvage" jurisdiction and, subject to the further discussions on apportionment and quantum, as justifying the allowances of the JOLs' fees and expenses as defined by the Total Costs to be paid from the Reserve.

50. Nonetheless, Mr. Lowe QC invites me to distinguish the *Berkeley Applegate* case and the application in it of the inherent equitable jurisdiction by Deputy Judge Nugee, on the basis that it is no authority for the proposition which he sees as presented by the JOLs here. This, as he sees it, is the proposition that the JOLs who are not themselves trustees but liquidators and as such are only the agents of CSL, may receive their compensation in a manner that would be inconsistent with CSL's duties as trustees and inconsistent with the contracts under which the Custody Asset Customers invested their assets with CSL in their respective trusts. To the contrary, submits Mr. Lowe, CSL itself would have had no authority to deduct from trust assets, fees and expenses that were not strictly referable to the account of such assets as undertaken for the benefit of the respective trusts and so the JOLs can themselves have no such authority either. Put bluntly, said Mr. Lowe, the JOLs have no authority to require any of the separate trusts comprised of the respective Custody Assets, to subsidise the costs of any other trust. Yet that is what is proposed here by the JOLs, as he sees it, as some trusts, including those of higher values of the Objectors, would pay much more in dollar terms than the value of the work actually undertaken for their assets.

51. *Berkeley Applegate*, he submits, is no authority for the proposition that the court has an inherent jurisdiction to allow the JOLs to apply such a subsidy, which would be

the result of the JOLs' ultimate proposal if it is approved. For this submission, Mr. Lowe relies heavily on his understanding that, unlike in the present case where there are 188 separate trusts for the Custody Asset Customers, in *Berkeley Applegate* Deputy Judge Nugee's analysis and decision were premised on there having been a single trust fund, as all the investments taken by the company had been taken in and "pooled" as a single fund for lending on mortgages. It is on that basis, says Mr. Lowe, that the commensurate "pooling" of costs was justified in *Berkeley Applegate*.

52. A thorough reading of Deputy Judge Nugee's judgment shows however, that Mr. Lowe is mistaken in that understanding of its premise.

53. First, at page 41 letters B-C where Deputy Judge Nugee examined what would have been the likely outcome if the liquidator had not intervened to deal with the trust assets:

> *"It is clear also that if a receiver of the trust assets had been appointed by the court, the court would have had jurisdiction under R.S.C. O.30 r.3*[10] *to authorise payment of remuneration out of the trust assets or their income. The appointment of a receiver would have presented difficulties in the present case, however, because until the liquidator had done a good deal of work the necessary basis of fact for such an appointment had not been established and moreover <u>each mortgage was held as a distinct trust for a distinct investor or group of investors.</u>"* (Emphasis added.)

54. Directly on point here, the words in emphasis confirm the fact that in *Berkeley Applegate* as in this case, the investments were held on distinct and separate trusts.

[10] As this Court would have had under Grand Court Rule O.30 r.3

Accordingly, to my mind, the present circumstances as explained above and those in *Berkeley Applegate* are sufficiently analogous to justify the application here of the principles from that case.

55. The analogy is particularly borne out by the comparable work undertaken here by the JOLs. Although the JOLs were not in the same "impossible situation" as the liquidator found himself in *Berkeley Applegate*, in having first to do extensive investigatory work before being able to identify just what assets belonged to each individual trust, the JOLs report that the record-keeping by CSL was "far from perfect" and significant investigatory work had to be done to identify and locate the respective Custody Assets, as described above. So too was the work necessarily done to secure the return of Custody Assets which were subject of the SEC Complaint and TRO. Similarly, the work undertaken by the JOLs to recover the assets from those recalcitrant sub-custodians in New York who refused at first to release them in the absence of the JOLs having obtained Court Recognition there. These, along with the other areas of activity undertaken in relation to the Custody Assets, were all valuable and important undertakings for the benefit of the Custody Assets Customers, viewed as a whole.

56. Nonetheless, in dealing with Mr. Lowe's objections, and in adopting the *Berkeley Applegate* approach, I should elaborate upon my understanding of the principles by addressing the fact that the Custody Assets are indeed trust assets held by CSL as trustee, as distinct from the assets of CSL forming part of its liquidation state. This fact also defines the relationship between the JOLs acting as liquidators and their role as agent of CSL as corporate trustee.

57. As was authoritatively explained by the House of Lords in *Ayerst v C.K. Construction) Ltd.*[11] a liquidator does not obtain the legal title to the assets of the company by way of them being vested in him as trustee (still less the legal title to assets held by his company as trustee). As Lord Diplock explained in *Ayerst* (p.177 D-E); emphasizing the difference between the assets of the company itself and those which it may hold for the benefit of others:

> *"(3) All powers of dealing with the company's assets, including the power to carry on its business so far as may be necessary for its beneficial winding up, are exercisable by the liquidator for the benefit of those persons only who are entitled to share in the proceeds of realisation of the assets under the statutory scheme. The company itself as a legal person, distinct from its members, can never be entitled to any part of the proceeds. Upon completion of the winding up, it is dissolved (section 274).*
>
> *The functions of the liquidator are thus similar to those of a trustee (formerly official assignee) in bankruptcy or an executor in the administration of an estate of a deceased person. There is, however, this difference: that whereas the legal title in the property of the bankrupt vests in the trustee and the legal title to property of the deceased vests in the executor, a winding-up order does not of itself divest the company of the legal title to any of its assets. Though this is not expressly stated in the Act it is*

[11] [1976] A.C. 167, 177. Considered and approved on appeal from this jurisdiction by the Privy Council in Wight, Pilling and Mackey v. Eckhardt Marine G.m.b.H. 2003 CILR 211, 219 para 22.

implicit in the language used throughout Part V, particularly in sections 243 to 246 which relate to the powers of liquidators and refer to "property ... to which the company is... entitled," to "property... belonging to the company," to "assets... of the company" and to acts to be done by the liquidator "in the name and on behalf of the company."'' (Emphasis added.)

58. This limitation on the liquidator's legal title was expressly, albeit in different words, recognised by Deputy Judge Nugee in coming to his decision that the jurisdiction nonetheless existed in equity to grant a liquidator his reasonable fees and expenses from assets held by his company in trust, when properly incurred in dealing with such assets for the benefit of those beneficially interested in them (p.44 C-D):

"A liquidator is not a trustee for anyone: he is a substitute for the board of directors. He is only the agent of the company, and is more akin to the board than is a trustee in bankruptcy; and even a trustee in bankruptcy acquires no title to trust assets vested in the bankrupt...."

59. And further at p50 B as regards the circumstances of *Berkeley Applegate's* liquidation:

"It is true that the legal title to the mortgages and to the client account is not vested in the liquidator but remains in the company; but the investors still need the assistance of a court of equity to secure their rights.... As a condition of giving effect to their equitable rights, the court has in my judgment a discretion to ensure that a proper allowance is made to the liquidator. His skill and labour may not have added directly to the value

of the underlying assets in which the investors have equitable interests; but he has added to the estate in the sense of carrying out work which was necessary before the estate could be realised for the benefit of the investors. As was the case in Scott v Nesbitt (1808) 14 Ves 438, if the liquidator had not done this work it is inevitable that the work, or at all events a great deal of it, would have had to be done by someone else, and on an application to the court a receiver would have been appointed whose expenses and fees would necessarily have had to be borne by the trust assets. On the evidence before me, the beneficial interests of the investors could not have been established without some such investigation as has been carried out by the liquidator.

The allowance of fair compensation to the liquidator is in my judgment a proper application of the rule that he who seeks equity must do equity."

60. And so the Deputy Judge squarely recognised that the jurisdiction was not premised on any notion of legal or contractual title to the assets of the Company being vested in the liquidator but was firmly rooted in equity.

61. Thus, I am further fortified in my conclusion that the jurisdiction exists and can appropriately be applied in this case. It is a jurisdiction which can be exercised in relation to a liquidator (or other fiduciary such as a receiver) by analogy with an ancient jurisdiction developed in relation to a trustee which is based upon the Court's inherent power to ensure the proper administration of trusts. As Deputy Judge Nugee also explained, it was declared in *In re Norfolk Settlement Trust* (above at 77 and 78) that:

"When the court authorises remuneration, it is not giving effect to any supposed contract between the trustees and the settlor but is exercising its ancient jurisdiction to secure the competent administration of the trust property."

62. And so, while it is accepted that the costs and expenses strictly referable to the winding up of a company (including the liquidators' remuneration) are payable out of the company's own assets and not out of assets it holds on trust, *Berkeley Applegate* is now established authority[12] for the principle that the trust assets will be available for fees, costs and expenses incurred in sorting out what is trust property and in continuing to manage or administer that property, as opposed to the costs of winding-up the corporate trustee.

63. I accept that the jurisdiction should be applied here having regard to the work that was necessarily done by the JOLs for the benefit of the Custody Assets Customers and so as to allow the JOLs their reasonable fees and expenses from the Custody Assets by way of the Reserve. This was work which would have had to have been done by someone else if not done by the JOLs and at untold expenses. And by way of emphasis, I add that the JOLs, having assumed their role as officers of the court,

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[12] And so regarded in the leading text books: see *Underhill and Hayton: Law of Trusts ad Trustees, 17th Ed. Para 43.14; Snell''s Equity 31st Ed. Chp. 7-59; Lewin on Trust 18th Ed. Chp 20-17*; Goff and Jones, the Law of Unjust Enrichment, 8th Ed. Ch. 18. *Berkeley Applegate* was also recently cited with approval in a case before the Supreme Court of England and Wales in *Lehman Brothers v CRC Credit Fund* [2012] Bus. L.R. 667, per Lord Walker at 705 A (albeit in a partially dissenting judgment).

Berkeley Applegate has also been applied in Australia and Canada on many occasions as cited in *Goff and Jones* (op. cit.) See also in *Re G.B. Nathan & Co. P & Y Ltd. (in liquidation) (1999) 24 NSWLR* where it was assumed that the liquidator had taken over the office of trustee formerly occupied by his insolvent company and allowed to recover his costs qua trustee by reference to *Berkeley Applegate* and specific Australian statutory provisions the equivalent of which we do not have in the Cayman Islands.

Counsel also brought to my attention the very recent judgment in *Allenfield Property Insurance services Ltd. et al v Aviva Ins. Ltd. et al* [2015] EWHC 3721 (Ch), in which Judge Keyser applied *Berkeley Applegate*, albeit obiter.

are not mere officious inter-meddlers and so are not to be expected to undertake their work done for the benefit of the Custody Asset Customers at their own expense.

Issue 2: apportionment

64. In accepting the reasonableness of the JOLs' ultimate proposal for apportioning the fees and expenses as described above[13], I should add some further observations here.

65. Requiring them to now attempt the improbable task of allocating the costs as they were incurred before 24th June 2015 and strictly for the account of the respective Custody Assets Customers, would not only subject them to further onerous and expensive work, it would also place them at further risk of not recovering the costs for that work. This would obviously be the case because, apart from the Reserve, the Custody Assets (but for the Unresolved Customers) have been paid out and so there would be no fund available to meet the further costs or to meet any difference which would be found to be allocatable to and owed by the Resolved Custody Asset Customers, those who have already been paid out.

66. Thus for this further reason also, it would be inequitable to require the JOLs to attempt the exercise of exact accounting proposed by Mr. Lowe on behalf of the Objectors.

67. In accepting the JOLs' ultimate proposal which is acknowledged to be both imprecise and imperfect, I must recognise though that there might indeed be an element of cross-subsidy as between the Custody Assets in the distribution of the Total Costs. The JOLs do not pretend that the costs to be allocated to some of the larger trusts of

[13] I note that among the other six proposals, and as further explained in response to a query from me, the JOLs did consider the "Equal Method" of apportionment but this was discounted as unworkable quite early on for reasons including that the resultant costs ($4,233,419 ÷ 188 = $22,518) would have exceeded the total value of the assets of many Custody Asset Customers (ie: 22% of all Custody Asset Customers).

Custody Assets at say 0.882 % of their value amounting to several hundreds of thousands of dollars[14], precisely reflect the costs of the work done respectively in relation to or on account of those specific Assets.

68. On this view of the exercise, the apportionment and allocation is, as I have acknowledged, in no sense an attempt at an exact accounting for the costs of administering the respective Custody Assets. Rather, it is in broad terms the best that the JOLs can do to meet the rule that equality is equity – "equality" in this sense meaning that the respective Custody Assets are all allocated the same percentage share of the costs (subject to the 30:70 cash to securities ratio).

69. In applying the ancient jurisdiction developed for trustees by analogy here to the liquidation of the corporate trustee that is CSL, the JOLs are made an allowance for their expenses and fees arising in the context of the overall administration of all Custody Assets under the trusteeship of CSL for which they act as agent. They have not assumed the role of CSL as trustee nor the strict duty to account that would ordinarily be appurtenant to that role and it is on this basis that, within the bounds of what is fair and reasonable, the Custody Asset Customers who seek the assistance of a court of equity, must do equity by contributing what is a fair, if imprecise, share of the overall costs.

70. Finally on this issue, as already noted[15] in *Berkeley Applegate*, the question of apportionment and quantum were not dealt with by Deputy Judge Nugee but left and came to be dealt with later by Peter Gibson J.

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[14] For instance, the Custody Assets comprised of the trust held for one of Mr. Lowe's clients, Global, is worth about $64 million, resulting in an allocation of costs of some USD530,412 to Global, as Mr. John Cullinane of Global explains (and protests) in his affidavit filed in these proceedings.

[15] At para. 46 and Fn. 9 above.

71. As to how the costs and expenses were to be apportioned between mortgage investors and investors who simply had monies on client accounts, the respective claimants in *Berkeley Applegate* were at odds. The former advocated a *pari passu* sharing of expenses, whereas the latter submitted that the costs of distributing funds held on trust in the client accounts were obviously less than those for dealing with mortgage investors. Accordingly, they proposed that only 5% of the costs should be attributed to client account investors and the balance as between the mortgage investors.

72. The liquidator proposed a third approach, referencing a cut-off date, and explained that prior to that date, all the work had been undertaken for the benefit of investors generally, and suggested that prior to that date, the costs should be apportioned on a *pari passu* basis. After that date, he suggested an apportionment of 90/10 as between the mortgage investors (who had been more expensive to deal with) and the client account investors (who had been less expensive to deal with).

73. Noting that the liquidator's proposed method for apportioning costs was not precise, and suffered from being "rough and ready", Peter Gibson J nonetheless accepted it.

74. The *Berkeley Applegate* case thus serves as precedent also for the further proposition which I adopt and apply here: that a liquidator allowed to recover his costs on the basis of the principle which the case decides, will not necessarily be required to follow the same strict accounting approach as would be expected of a trustee.

Question 3: Quantum

75. In anticipation of my decision as explained above to allow the JOLs to recover their costs from the Reserve, Mr. Lowe, supported strongly by Ms. Hale on behalf of the

LC in this regard, submitted that I should not approve of the quantum of the Total Costs without requiring the JOLs to explain and justify each aspect, specifically.

76. Mr. Lowe emphasised that the basis upon which liquidators can recover fees and expenses from trust assets at the expense of trust creditors without their respective agreement, is in their role as agents of necessity and so is rooted in the principles of restitution and unjust enrichment. Thus, the JOLs would not be entitled to recover whatever expenses they incur or remuneration they generate in terms of work hours. Rather, since they are to be treated as agents of necessity (as in a situation of *salvage*[16]) in return for taking care of the goods (here the assets), the JOLs have "*a correlative right to charge the owner of the goods with the expenses reasonably incurred*", per Lord Diplock in *The Winson* (at 960 C-F) .

77. That test of reasonableness, submits Mr. Lowe, is whether a prudent man faced with similar circumstances would lay out or hazard his money in the way that the JOLs have done. Further, that it is not enough to say that the JOLs have acted within their powers: the expenditure and remuneration must "*be reasonable in itself as well as proportionate to the end to be achieved*"; citing the famous dictum of Ferris J from *Re Mirror Group*[17] as approved and applied by this Court in *Re SPhinX*[18].

78. In *Re SPhinX,* it was held that when the court determined whether it would approve liquidators' fees and expenses under section 109(2) of the Companies Law and reg. 10 of the Insolvency Practitioners' Regulations ("IPR"), it would ask if the remuneration sought was fair and reasonable in all the circumstances. These

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[16] As discussed in *Berkeley Applegate* by analogy with the rules of maritime salvage, rules which were authoritatively explained in *The Winson* [1982] A.C. 939 H.L. per Lord Simon.
[17] [1988] BCC 324 at 333-324.
[18] FSD 16 of 2009 (ASCJ), 13 Nov. 2012 and Noted at 2012(2) CILR Note 11.

considerations included (i) the amount of time worked; (ii) the complexity of the case; (ii) any exceptional responsibilities required; (iv) the effectiveness of the liquidators' operation; and (v) the value and nature of the property involved [here the value of the Custody Assets] relative to the expense of the work undertaken. Thus, a central issue will be the proportionality of the work done to the results achieved.

79. In assessing all of these factors, it was also recognised in *Re SPhinX*, that the Court will give significant latitude to the commercial judgment of the liquidators.

80. Mr. Lowe, supported by Ms. Hale for the LC, submits that these principles are to be no less applicable to an assessment of the fees and expenses of the JOLs simply because they are to be recovered on the equitable basis of agency of necessity rather than on the statutory basis as liquidation expenses, as discussed above.

81. This is a proposition which I readily accept and adopt as applicable in the circumstances of this case. However, Mr. Lowe and Ms. Hale invite me to go further – again citing *In Re SPhinX* as precedent – and appoint an independent assessor to scrutinize the JOLs' work and charges and then to report on and advise the Court on the reasonableness or otherwise of their claim for fees and expenses.

82. I just as readily refuse this invitation as I see no need here for an independent assessor where three-quarters of the JOLs' expenses do not involve payments of their own fees but payments to third parties for work done at the behest of the JOLs. I see no justification for requiring either the liquidation estate or the Custody Assets (neither was specified in the arguments) to incur the expense of an independent assessor.

83. What I will grant the proposers though, is that there is as yet an absence of detail of the kind of information identified in *In Re SPhinX* (items (i) – (v) above) as needed to

explain the JOLs' fees and expenses to the standards of the IPRs or as may be required to meet with a liquidation committee's or the court's approval.

84. There being no formal liquidation committee in place for CSL, I am therefore persuaded that it is appropriate to require the JOLs to provide the records and other relevant information to the LC (representing CBL as a Custody Asset Customer) and to the Objectors (and to any other Custody Asset Customer who may ask) and invite their agreement as to quantum. This is the process that would ordinarily apply for the approval of a liquidator's fees and expenses incurred in relation to a liquidation estate and can be adapted here to afford the Custody Asset Customers a similar degree of transparency and accountability.

85. I should note in fairness to the JOLs that, as Mr. Levy explained, they do not object to this course. Indeed, the records are already available in the form of receipts, time-sheets and the like and I am assured that they can be made presentable for the purposes of the assessment of the LC and the Objectors, in keeping with the standards of the IPR by analogy to the practice which is established for the approval of liquidator's fees and expenses.

86. But it is expected that this will involve some further work on the part of the JOLs for which, says Mr. Levy, they are also entitled to recover the costs.

87. I reserve my views on this issue of further costs to await the outcome and on that basis will direct the JOLs to prepare and present the records to allow for the scrutiny of the LC and the Objectors.

88. It is very much to be hoped that there will be agreement over the quantum of the Total Costs, especially as but less than 25% of them represent the JOLs' own remuneration.

89. The rest, as explained above, are said to comprise their expenses incurred on behalf of the Custody Assets and it would be surprising if the JOLs, as officers of this Court and experienced fiduciaries, have been less than reasonable in allowing them to their third party service providers.

90. If the LC and Objectors manage to agree on quantum, then there would of course be no need for further recourse to the Court. This too is very much to be desired, as experience has shown that contested hearings over the quantum of fees and expenses can themselves be time consuming and costly.

91. Accordingly, I approve of the JOLs' ultimate proposal for the apportionment and allocation of the costs as among the Custody Assets Customers to be recovered from the Reserve and defer the issue of quantum to be agreed, failing which that issue may be returned for determination by the Court.

92. The JOLs are entitled to the costs of the instant summons to be paid on the indemnity basis from the Reserve and it is so ordered.

Hon. Anthony Smellie
Chief Justice

5th May, 2016