IN THE COURT OF APPEAL OF THE CAYMAN ISLANDS

CICA NO 6 OF 2015

FROM THE GRAND COURT OF THE CAYMAN ISLANDS FINANCIAL SERVICES DIVISION FSD 0016 OF 2009 AND FSD 45 OF 2014 – ASCJ

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

THE HONOURABLE JUSTICE SIR ANDREW MORRITT

BETWEEN:

1. **DEUTSCHE BANK AG LONDON**
2. **REFCO PUBLIC COMMODITY POOL LP**
3. **HFC LIMITED**
   (each in their capacity as Scheme Claimants and collectively as the Scheme Committee of the SPhinX Group)

APPELLANTS

- AND-

1. **KENNETH KRYS** (as Official Liquidator of the SPhinX Group)
2. **KRIS BEIGHTON and RICHARD HEIS** (as Scheme Supervisors of the SPhinX Group)
3. **BEUS GILBERT PLLC**
4. **BROWN RUDNICK LLP**

RESPONDENTS

BEFORE:
THE HON ELLIOTT MOTTLEY, JA
THE HON DENNIS MORRISON, JA
THE HON SIR RICHARD FIELD, JA

Appearances

Mark Phillips QC instructed by Andrea Dunsby of Turners appeared for the Appellants

Graeme Halkerston instructed by Mr Christopher Young of Forbes Hare for the 3rd & 4th Respondents

Hearing: 13 & 14 July 2015
Judgment delivered: 11 November 2015 (embargoed)
Judgment released for publication: 2 February 2016

JUDGMENT

The Hon Sir Richard Field, JA

Introduction

1. The Appellants are Scheme Claimants in the estates of the SPhinX Group ("SPhinX") which consists of 22 companies incorporated in the Cayman Islands. The Group was established by Plus Funds Inc, a Delaware company, and from 2004 carried on business as open ended investment companies. The group was assisted in this enterprise by various entities, including DPM LLC ("DPM") and its associates as administrators, Deutsche Bank and its affiliates as custodians and sponsors, and Refco Group LLC ("Refco") as its prime broker.
2. Refco collapsed in 2005, the victim of a massive fraud by its management. As a result, SPhinX was unable to satisfy investors' redemptions with cash and on 30 June 2006 SPhinX went into voluntary liquidation. The 1st Appellant, Deutsche Bank AG London ("DB") and the 3rd Appellant, HFC Limited ("HFC") are now SPhinX's principal investors.
3. On 23rd October 2014 the Appellants issued a summons ("the Second Release Summons") which, in relevant part, sought:

> 1. A direction that the Joint Official Liquidator ("JOLs") and the Scheme Supervisors of the SPhinX Group shall not retain any reserves out of any current or future assets of the SPhinX Group for the purposes of satisfying any claim or potential claim by Beus Gilbert PLLC or Brown Rudnick LLP either pursuant to the terms of the Legal Representation Agreement dated 3 July 2007, as amended, or otherwise, arising out of a settlement or resolution of legal claims by or against the SPhinX Group to the extent such settlement or resolution did not result in a cash payment to the SPhinX Group, including:
>
> > (i) the settlements with and releases of Deutsche Bank Securities Inc., and related entities and BAWAG PSK Bank Fur Arbeit Und Wirtschaft Und Osterreichische Postsparkasse Aktiengesllschaft which took effect pursuant to the terms of the Scheme;
> > (ii) the reduction of alleged contingent claims of Indemnity Claimants (as defined in the Scheme), or the indemnity reserves maintained by the SPhinX Group in respect of the same, which for the avoidance of doubt shall extend to any future reductions of such alleged contingent claims or indemnity reserves; and

(iii) the agreement the SPhinX Group entered into with PlusFunds on 26 April 2007 (the "Settlements and Releases")".

2…

3. A declaration that neither the JOLs nor the SS have or will have any personal liability to the SPhinX Group as a result of distributions made or to be made pursuant to the terms of the Scheme or any Released Funds Ruling, including, without limitation, any liability to disgorge their remuneration.

4. A declaration that neither the JOLs nor the SS have or will have any personal liability to the Claimants, whether pursuant to the terms of the LRA or otherwise, as a result of:

(i) The Settlements and Releases; and

(ii) Distributions made or to be made pursuant to the terms of the Scheme or any Released Funds Ruling,

including, without limitation, any liability to disgorge their remuneration.

5. Such further or other relief as may be appropriate in all the circumstances.

4. On 1st December 2014 the 1st Respondent issued a summons seeking an order staying the Second Release Summons. On the direction of the Chief Justice this summons ("the Stay Summons") was heard by Justice Sir Andrew Morritt before and separately from the Second Release Summons. By a decision dated 24th February 2015, Sir Andrew ordered that the Second Release Summons should be stayed until three months after the conclusion of an arbitration to determine the liability of SPhinX or its liquidators to the 3rd Respondent, Beus Gilbert PLLC ("BG") in respect of the matters referred to in paragraph (i) to (iii) of paragraph 1 of the Second Release Summons. Sir Andrew also gave the parties liberty to apply for the stay to be lifted not earlier than three months after the conclusion of proceedings in the USA known as "the DPM action", including any appeals, if no such arbitration has been commenced by then. He further ordered that the hearing of the Second Release Summons that had been fixed for 16th March 2015 should be vacated.

5. It is this decision of Sir Andrew Morritt that the Appellants now seek to overturn in this appeal.

The factual background

6. It is necessary to set out the factual background to this appeal in some detail. In doing so I have relied to a considerable extent on Sir Andrew Morritt's narration of the facts in his judgment below.
7. The June 2006 voluntary liquidation of SPhinX was subsequently brought under the supervision of the court. SPhinX had suffered a loss of approximately US$260 million.
8. On 6th June 2007, the First Respondents, as the joint official liquidators ("JOLs") and with the sanction of the court, engaged the services of BG a firm of attorneys based in Arizona USA to pursue claims against various third parties. BG in turn retained the 4th Respondent, Brown Rudnick LLP ("BR") as their New York agents. BG was retained pursuant to a Legal Representation Agreement dated 3rd July 2007 ("the LRA") under which BG was to be remunerated on a contingency fee basis.
9. In March and April 2008, the JOLs started two actions on the advice of BG in the USA, one in New York, the other in New Jersey. The New York action was against 60 defendants including DB.
10. In May 2011, DB and HFC proposed a scheme of arrangement under which the assets of the 22 companies would be pooled and from which the liabilities to the creditors of any one of them would be paid. The scheme also involved a release of the liabilities owed to SPhinX by DB and by BAWAG PSK Bank Fur Arbeit Und Wirtschaft Und Osterreichische Postsparkasse Aktiengesllschaft ("BAWAG"). The claims against DB and BAWAG in the US proceedings had to this point been dismissed by the assigned judge, Judge Rakoff, but had not been finally determined because of the possibility of appeals. On 22nd September 2011, the day the Petition for obtaining the sanction of the court to this scheme was presented, BG informed the JOLs that if the scheme were approved they would claim to be discharged from any further performance of the LRA and would seek recompense from the JOLs by means of a *quantum meruit*. In a

memorandum written for the benefit of the SPhinX Group members, BG stated (inter alia):

> The releases will thus put Beus Gilbert in the position of asking a jury and Judge Rakoff to award the JOLs hundreds of millions of dollars, half of which will go to Deutsche Bank and BAWAG, both or whom were active participants in Refco's fraud. This will adversely affect our ability to negotiate in settlement discussions and mediation and undermines our ability to recover damages suffered by SPhinX and Plus Funds….
>
> In sum, we believe the Proposed Scheme is unfair to SPhinX's innocent Investors and Creditors and will compromise, if not undermine completely, the US litigation.

11. BG's threat of a *quantum meruit* claim and other matters caused the Chief Justice to direct the determination of the following two issues to ensure that the court had jurisdiction to sanction the proposed scheme: (1) whether on sanction of the scheme there was any risk that the assets and reserves of SPhinX would be exhausted by the appropriate reserve for satisfying the "Indemnity Claimants"; and (2) the potential liability to BG if the scheme were implemented.
12. The "Indemnity Claimants" were parties which had provided services to SPhinX prior to its liquidation and had been joined in as third party defendants in the US litigation on the basis that they were partly responsible for SPhinX's losses. They were called "Indemnity Claimants" because they sought to enforce indemnities conferred by SPhinX under the articles of association of the SPhinX companies (or otherwise) in respect of losses incurred as result of providing the services contracted for.
13. Sir Andrew Morritt tried the above two issues in June and July 2013. BG neither attended nor was represented. In a judgment handed down on 9th July 2013, Sir Andrew concluded that: (1) the total reserve required was US$138,918,394; and (2) BG was not entitled to any compensation by way of *quantum meruit* and no reserve was required in respect thereto, save for the sum of US$15 million to be held against the costs of defending any claim BG might bring. BG had no entitlement to a *quantum meruit* because the approval of the scheme and its sanction by the court would not constitute conduct by BG's counterparty (the JOLs) amounting to just cause for termination of the LRA. Indeed the JOL's disapproved of the

scheme and would have done no more than apply to the court under s. 86 of the Company Law (2012 Revision) for an order convening meetings for the consideration of the scheme.

14. Shortly after Sir Andrew Morritt's judgment had been delivered, the JOLs became concerned that if they distributed the available funds without reserving sufficient sums to satisfy the claims advanced by BG on some basis other than *quantum meruit* they would be personally liable to BG. On 26th August 2013, the JOLs informed the Appellants that they had had further discussions with BG which suggested that the claim of the latter might be capped at a manageable level. On 30th August 2013, the JOLs suggested an increase of US$50m in the reserve on account of a potential liability to BG. This was attested to in an affidavit of one of the JOLs sworn on 23rd September 2013. On 27th September 2013 it was agreed at a meeting of all those involved in the sanction of the Scheme of Arrangement to add US$50 million to the General Reserve, although it was not designated a specific BG reserve.

15. The Scheme of Arrangement, having been duly approved by the various classes of creditor and member, was sanctioned by the Chief Justice on 8th November 2013. It became effective on 22nd November 2013. The general reserve was, as agreed, increased by US$50m and the claims of SPhinX against DB and BAWAG were thereby released. The scheme provided in paragraph 5.3.5 that:

> "The JOLs…and/or any Scheme Claimant may apply to the Cayman Court for a direction that…part of the General Expenses Reserve is no longer required and that it should become available for distribution to Scheme required and that it should become available for distribution to Scheme Claimants."

16. On 20th December 2013, the members of the SPhinX Group Liquidation Committee applied by summons ("the First Release Summons") for an order that:

> "The Joint Official Liquidators be instructed to release $50m from the General Expenses Reserve, such amount should be available for distribution to the Scheme Claimants and that this order take effect as a Released Funds Ruling under clause 5.3.6 of the Scheme of Arrangement."

The affidavit of James Carroll sworn on behalf of the Scheme Claimants in support of the summons on 19th December 2013 clearly indicated that the US$50 million to be released was in respect of the increase in the reserve of the like amount agreed to cover the potential liability to BG.

17. On 8th January 2014, the JOLs sought the approval of the court to a compromise with BG. The response of the Scheme Claimants was to pass a resolution of no confidence in the JOLs at a meeting ordered on 27th November 2013 and held on 16th January 2014. The application to remove the JOLs had been issued on 26th September 2013. The disputes between the Liquidation Committee and the JOLs were resolved by an Amendment Scheme sanctioned by the court on 10th June 2014 which transferred most of the functions of the JOLs to the 2nd Respondents, the Scheme Supervisors ("SS") and reconstituted the Liquidation Committee as the Scheme Committee. As part of the compromise all outstanding applications were withdrawn including both the summons to remove the JOLs issued on 25th September 2013 and the summons to release US$50m issued on 20th December 2013. Coincidentally, on the same day, BG wrote to the SS quantifying their claim as US$242,874,849, alternatively US$36,753,163.
18. Negotiations in respect of the fees due to BG took place from June to October 2014. In the course of those negotiations the SS at least twice, on 15th August and 6th October 2014, refused to institute the arbitration for which the LRA provided (see paragraph 22 below). These negotiations culminated in the issue on 23rd October 2014 of the Second Release Summons which sought relief in all material respects the same as that sought by the First Release Summons issued on 20th December 2013.
19. The Second Release Summons was supported by an affirmation of Mr Joshua Trump to which was exhibited copies of many pages of correspondence between the JOLs and BG and its attorneys in which BG's claims for fees in respect of settlements made with Indemnity Claimants and work done on the claims against BG and BAWAG were ventilated. In paragraph 21 headed "THE CLAIMS NOW MADE BY BG AND BR", Mr Trump sets out details of these claims and in paragraph 27 states that the Scheme Claimants are firmly of the view the claims are without

foundation and the prospects of them being successfully asserted are fanciful.

20. The evidence in support of the Stay Summons consisted only of the affidavits or affirmations of Leo Beus, the principal of BG, David Molton, a partner in BR and the expert reports of the Hon. Robert S. Smith and the Hon Stanley G. Feldman. No evidence was adduced by the Appellants. An affidavit of Kris Beighton, one of the SS, indicated that the SS supported the position of the Appellants. There was no cross-examination of any of the witnesses.

21. Mr Beus stated in his affirmation that BG and BR were entitled to a minimum of US$47 million in fees, plus interest, under paragraph 2.2 (e) of the LRA in respect of work done on indemnities, the DB and BAWAG claims and the Scheme. He estimated that the total hourly fee for this work was US$18.85 million which, upon application of the 2.5 multiplier referred to in paragraph 2.2 (e) of the LRA produced a total minimum fee of over US$47 million, which figure had been communicated to the SS by letter of 19 September 2014. (Paragraph 2.2 (e) is set in the next following paragraph of this judgment).

The Legal Representation Agreement

22. The LRA was the product of extensive negotiations and expert legal advice on both sides. It was made on 3rd July 2007 in New York by and between Kenneth M Krys and Christopher Stride "as joint official liquidators of SPhinX Managed Futures Fund SPC et al (as identified in Appendix 1) (hereinafter referred to as "Client")" and Beus Gilbert referred to as "Counsel". Section 3.10 provides that the governing law is the law of the State of New York, save that Arizona law is to govern those clauses concerned with ethical responsibilities and rights of Counsel.

23. Section 1 provides (in relevant part):

> 1.SCOPE OF ENGAGEMENT
>
> 1.1 <u>Matter Involved.</u>
>
> Client has engaged Counsel to undertake the legal representation of Client in a matter (hereinafter referred as the "Matter") involving:

The investigation of activities surrounding the SPhinX Fund's losses and litigation against those culpable for said losses, as well as related matters as directed by the Client, advising the Client as to an overall litigation strategy, the merits of any claims/litigation to be brought and the appropriate parties to be sued, pursuing such litigation and reporting thereon to the Client. The Client shall have the discretion to approve all parties to be sued and claims/litigation to be brought. Nothing contained herein shall prevent Client from pursuing any potential parties or claims which Client has not approved with a law firm other than Counsel or otherwise. Claims/litigation against potential parties which have not been approved by Client shall not be included in the definition of "Matter" and shall not be the subject of this Agreement. The definition of "Matter" shall not include any action or proceeding commenced by Client to avoid or recover any payment or transfer made by SPhinX to any investor or creditor based on a preference, fraudulent conveyance, or similar claim, cause of action or theory of recovery. All lawsuits, pleadings and related documents will be forwarded to the Client for review, comment and approval and no such documents shall be served or filed without the prior consent of Client."

24. So far as relevant, Section 2 provides:

LEGAL FEES AND EXPENSES

2.1(a) Client agrees to pay Counsel a fee contingent upon any cash recovery in this Matter on Client's behalf a sum equal to:

- If settled within 90 days of the date of this agreement, an amount calculated on the basis of two times (2) actual work hours expended at Counsel's normal schedule of hourly rates in effect at the time, and for all costs and expenses incurred pursuant to Section 2.3 hereof.

  .....

- 33 1/3% of the Gross Recovery if settlement or agreement or judgment is reached after ninety (90) days after the date of this Agreement."

....

If there is no cash recovery, there shall be no fees owed by Client to Counsel for representation in this Matter, except as provided in Section 2.1(d)(ii). Client agrees, however, that, regardless of cash recovery, Client is responsible for and will pay all other costs and expenses as described in Section 2.3 herein.

(b) …

(c) Counsel's fee shall be computed on the basis of the "Gross Recovery". The Gross Recovery shall consist only of:

(i) cash (or immediately negotiable instruments) actually received by Client in connection with the resolution, by settlement or otherwise, of a claim asserted by Counsel for Client.

(ii) with respect to any settlement or agreement that results in the direct reduction of the liabilities, taken as a whole and on a consolidated basis, of the SPhinX Fund, Gross Recovery shall be calculated exclusively as follows: liabilities recorded on the accounting books of SPhinX Funds as at June 30, 2006, or shares held in the SPhinX Funds as of that date, multiplied by the amount of dividend that would have been paid on those liabilities or shares, excluding any benefit that is derived from other recoveries made by Counsel. As to any contingent fee under this Section 2.1(d)(ii), the fee shall be determined and paid to Counsel only when dividends are declared and paid and only as if those liabilities or shares were to be included in any distribution. For illustrative purposes, if the Client enters a settlement with Mr. X which includes a compromise of Mr. X's shares in SPhinX Funds with a NAV of

$1million as at June 30, 2006, and the Client subsequently pays an interim dividend of 15% to the shareholders of SPhinX Funds (of which 5% is sourced from recoveries arising from claims pursued by Counsel on behalf of the Client), Counsel will receive 33 1/3% of $1million [calculated as (15%-5%) of 1$ million];

(iii) "Gross Recovery" shall not include (x) any recoveries from PlusFunds or the Refco bankruptcy estate and (y) any liabilities, shareholdings, or other claims that are reduced, rejected or otherwise compromised in connection with, or resulting in whole or in part from, any effort by the Client or its consultants, attorneys (other than Counsel) accountants, or professionals to reconcile, dispute, or object to Proofs of Debt assertion of debts or claims, or assertions of rights as shareholders submitted to the Client or against any SPhinX entity.

(d)…

(e) Notwithstanding anything to the contrary contained in Section 2.2, Counsel, in its sole and absolute discretion, shall have the right to accept the decision of the Arbitrator or, in lieu thereof, to accept an amount equal to two point five (2.5) times the aggregate hourly rate of all attorneys and paralegals of Counsel (including local counsel) who worked on the matter. In the event Counsel elects to receive two point five (2.5) times its aggregate hourly rate (plus costs and expenses, as defined in Section 2.3 below), the parties agree that said amount shall be made the award of the Arbitrator and shall be entered as a final judgment. …

(f)….

2.2 Fee Arbitration

If, for any reason, the parties to this Agreement are unable to reach agreement on the legal fees and expenses owed by Client to Counsel within thirty (30) days of the date of compromise or settlement of the Matter, or any portion of the Matter, or within thirty (30) days of any verdict or final judgment should the Matter proceed through trial, then in such event ether party may submit written notice to the other specifying that the issue of legal fees and expenses shall be submitted to arbitration in the manner described in this section 2.2 (the "Arbitration").

(a) Except as specifically provided in this section 2.2, the Arbitration shall be conducted pursuant to part 137 of the Rules of the Chief Administrator for the statewide attorney/client fee dispute resolution program for the Courts of the State of New York.

(b) The Arbitration shall be held in New York City.

(c) The Arbitration shall be held within thirty (30) days of the date the Arbitrator is selected or as soon thereafter as is reasonably possible.

(d) The decision of the Arbitrator shall be final, binding and non-appealable. Each party agrees to cooperate fully with the other in taking any and all steps necessary to effectuate the entry of the Arbitrator's decision as a final judgment.

(e) Notwithstanding anything to the contrary contained in Section 2.2, Counsel, in its sole and absolute discretion, shall have the right to accept the decision of the Arbitrator or, in lieu thereof, to accept an amount equal to two point five (2.5) times the aggregate hourly rate of all attorneys and paralegals of Counsel (including local counsel) who worked on the matter. In the event Counsel elects to receive two point five (2.5) times its aggregate hourly rate (plus costs and expenses, as defined in Section 2.3 below), the parties agree that said amount shall be made the award of the Arbitrator and shall be entered as a final judgment. Counsel assumes no financial responsibility for Client's U.S or non-U.S. counsel not hired by Counsel. Any financial obligations with respect to other

> counsel hired by client shall be the soles exclusive responsibility of Client."

25. Part 137.1(a) of the Rules of the Chief Administrator for the statewide attorney/client fee dispute resolution program for the Courts of the State of New York (referred to in sub-paragraph (a) above) ("the Rules of the Chief Administrator") provides:

> "This Part shall not apply to
> (1)…
> (2) amounts in dispute involving a sum of less than $1000 or more than $50,000, except that an arbitral body may hear disputes involving other amounts if the parties have consented;
> (3)-(8)"

The Respondents' Stay Summons

26. The Respondents' Stay Summons was grounded on Section 2.2 of the LRA and section 4 of the Foreign Arbitral Awards Enforcement Law (1997 Revision) ("FAAEL"). The latter section provides:

> "If any party to an arbitration agreement, or any person claiming through or under him, commences any legal proceedings in any court against any other party to the agreement, or any person claiming through or under him, in respect of any matter agreed to be referred, any party to the proceedings may at any time after appearance, and before delivering any pleadings or taking any other steps in the proceedings, apply to the court to stay the proceedings; and the court, unless satisfied that the arbitration agreement is null and void, inoperative or incapable of being performed or that there is not in fact any dispute between the parties with regard to the matter agreed to be referred, shall make an order staying the proceedings."

27. Section 4 FAAEL is in substantially similar terms to section 9 of the UK Arbitration Act 1996. Both sections are modelled on

Article II of the Convention on the Recognition and Enforcement of Foreign Awards (1958) (the New York Convention).

The expert evidence adduced at the hearing of the Stay Summons

28. The expert evidence put before Sir Andrew Morritt consisted of reports prepared by the aforementioned Stanley G. Feldman and the Robert S. Smith. Mr Feldman is a former Chief Justice of the Supreme Court of Arizona and is now a member of the Bar of the State of Arizona. Mr Smith is a former associate judge of the New York Court of Appeals and is now a member of the Bar of the State of New York.
29. Mr Feldman opined that:

> "…absent the client's consent and while continuing to represent the client, an Arizona lawyer is ethically forbidden to commence arbitration proceedings against his client in the on-going litigation which gave rise to the fee dispute…. I know of no impediment to the client commencing arbitration proceedings to resolve the dispute so long as the lawyer consents."

30. As Sir Andrew Morritt observed in paragraph 17 of his judgment dated 24th February 2015, this explains why BG did not itself commence arbitration proceedings against the JOLs, but instead requested the SS/JOLs to do so against BG.
31. Mr Smith summarised his conclusions as follows:

    (1) The fee claims of BG set out in paras (i) to (iii) of the Second Release Summons fall within the scope of the arbitration agreement contained in paragraph 2.2 of the LRA.
    (2) The LRA is not limited to quantum but includes liability.
    (3) The recovery of funds is not a pre-requisite to commencing an arbitration under paragraph 2.2 of the LRA.
    (4) The reference in paragraph 2.2(a) to Part 137 of the Rules of the Chief Administrator for the Courts of the State of New York did not invalidate the arbitration agreement or limit its scope to claims below a specific value.

(5) If the parties co-operate in good faith in the conduct of the arbitration it could be completed in 90 to 120 days.

(6) In relation to the merits of the claims summarised in sub-paragraphs 1(i) and (ii) of the Second Release Summons, based on the facts stated in the affirmations of Leo Beus "there is a valid claim for at least a minimum fee and (even assuming that there is no Gross Recovery) a claim for a larger amount cannot…be called fanciful."

32. Mr Smith's conclusion (4) was based on paragraphs 27 and 28 of his report in which he stated:

> "27. The present dispute, and the attorney-client relationship from which it arises, do not resemble the situations for which Part 137 was primarily designed……The amounts involved in the contemplated litigation made it plain from the start that any fee dispute was highly likely to involve more than $50,000. The parties were certainly not obligated by New York law to provide in their agreement that any fee dispute would be arbitrated under Part 137.
>
> 28. Yet the LRA does so provide. This can only be interpreted as a deliberate choice of Part 137 procedures; the parties, ably represented as they were, could not have believed that they were compelled to follow this course."

The findings and conclusions of Sir Andrew Morritt in his judgment dated 24th February 2015

33. Sir Andrew Morritt held that all the conditions of section 4 FAAEL to establish entitlement to a stay were satisfied. First, he concluded that the Second Release Summons was a legal proceeding commenced by the Scheme Claimants. Second, adopting a broad conception of the requirement that an essential element of the cause of action or defence must have been vested in or exercisable by a party to the legal proceedings, as proposed in *Flint Ink NZ Ltd v Hutamaki Australia Pty* [2014] VSCA 166, he found that the Second Release Summons raised issues of claim or defence available to SphinX or the JOLs as the other party to the LRA. Third, he noted that the Second Release Summons was

against BG, the other party to the LRA. Fourth, adopting Andrew Smith J's approach in *Lombard North Central plc v GATX Corpn* [2013] Bus. L. R. 68 that "the court should consider what questions will foreseeably arise for determination in the proceedings and whether they include referred matters", he found that the Second Release Summons was "in respect of any matter to be referred" as required by section 4 FAAEL. He further decided that although BG's claims were for sums substantially in excess of US$50,000.00, for the reasons given by Mr Smith in his expert testimony noted in paragraphs 31 and 32 above, the reference to Part 137 (1) (a) of the Rules of the Chief Administrator in paragraph 2.2 (a) of the LRA did not take BG's claims outside the reach of section 2.2 of the LRA.

34. Sir Andrew then went on to reject the submission advanced on behalf of the Scheme Claimants that the issues raised by the Second Release Summons involved the exercise of a power vested in the JOL's as officers of the court regulating class rights of the members and as such were not arbitrable at all. It was submitted that a liquidator is under a duty to fix reserves and in doing so is under the supervision of the court, not an arbitral tribunal. In advancing these submissions, the Scheme Claimants relied on *Exeter City Association Football Club Ltd v Football Conference Ltd & Another* [2004] 1 WLR 2910 and *Re Cybernaut Growth Fund LP* 23rd July 2013 (unreported), a decision of Jones J.

35. In the first of these cited cases, Exeter City Football Club ("Exeter City") had petitioned for an order under s. 459 of the Companies Act 1985 on the ground that the affairs of the Football Conference ("the Conference") were being conducted in a manner unfairly prejudicial to Exeter City's interests. Having fallen into financial difficulties, Exeter City had applied for a creditors' voluntary arrangement that included a proposal that certain "football creditors" should be paid in full over 5 years, unlike the general creditors (including the Inland Revenue) who were to receive only 10 pence in the pound. Exeter City adopted this proposal because the Football Conference pursued a policy of only allowing a club in financial difficulties to remain a member of the Conference if "football creditors" were paid in full. The Inland Revenue objected to the CVA and intervened with a revocation application on the ground that the CVA unfairly

prejudiced it. Exeter City therefore found itself between a rock and a hard place. If it wished to continue to play in the Conference it had to favour "football creditors" but its proposal to do so put its CVA at risk of being revoked on the application of the Inland Revenue. Faced with this dilemma, Exeter City presented its unfair prejudice petition but the Conference sought a stay of the petition under s.9 of the Arbitration Act 1996 relying on an arbitration agreement made between the Conference and Exeter City by which it was agreed that any dispute or difference shall be referred and finally resolved by arbitration. The Conference's stay application was heard by Judge Weeks QC sitting as a High Court Judge. Judge Weeks rejected the application on the ground that the statutory right to petition for a winding up order on grounds of unfair prejudice was inalienable and could not be diminished or removed by contract or otherwise. In his view, the court was the appropriate tribunal to decide both the s. 459 petition and all related issues. In so holding, Judge Weeks declined to follow the decision of Rimer J (as he then was) in *In re Vocam Europe Ltd* [1998] BCC 396 wherein that learned judge stayed a s.459 petition in favour of an arbitration agreement

36. In *Re Cybernaut Growth Fund LP* five limited partners petitioned under s.15(4) of the Exempted Limited Partnership Law (2007 Revision) to wind up a limited partnership constituted by an agreement that included an arbitration clause in relation to "[a]ny dispute arising out of or relating to this agreement…". The petitioners pleaded they had lost trust and confidence in the General Partner and alleged (inter alia) that there had been a failure: (i) to make distributions; (ii) to devote the necessary time and attention to the partnership; (iii) to establish a board of advisers; and (iv) to convene partnership meetings. Relying on the arbitration agreement, the general partner applied for an order striking out the petition or staying it. Justice Jones refused the application. In paragraph 7 of his judgment he said:

> "As a matter of principle, I think this type of dispute is non-arbitrable for two inter-related reasons. Firstly, a winding up order (whether relating to a company or an exempted limited partnership) is an order in rem which is capable of affecting third parties. Because the source

> of an arbitral tribunal's power is contractual, its scope is necessarily limited to making orders which will be binding only upon the contracting parties. Secondly, any dispute about who should be appointed as liquidator of a company or exempted limited partnership is a matter involving the public interest, especially if it is carrying on a regulated business…..There is a public interest in ensuring that all businesses are properly liquidated in the interests of all their stakeholders….I regard winding up orders, supervision orders and orders for the appointment/removal of liquidators as class remedies, which in turn leads me to the conclusion that such proceedings fall within the exclusive jurisdiction of the court."

37. Sir Andrew Morritt's reasons for rejecting the submission that the issues raised by the Second Release Summons were non-arbitrable and thus within the exclusive jurisdiction of the court are contained in paragraphs 32 to 38 of his judgment.

> 32. There are, in my view, two answers to that submission. The first is based on the substance of the Second Release Summons. This makes it plain that the reserve in question is entirely dependent on whether or not BG is entitled to remuneration for all or any of the items listed in sub-paragraphs (i)- (iii). That question is subject to the arbitration clause in paragraph 2.2 LRA. In addition to the form of the summons demonstrating the nature of the substance of the dispute referred to in paragraph 23 above it also shows that the dispute is about fees first and then only about reserves. The latter question is wholly dependent on the answer to the first.
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> 33. The second arises from decisions in three very recent cases. I will take them in chronological order. They are **Fulham Football Club (1987) Ltd v Richards** [2012] Ch 333; **Assaubayev v Michael Wilson Partners Ltd** [2014] EWCA Civ 1491 and **Salford Estates (No:2) Ltd v Altomart Ltd** [2014] EWCA Civ 1575.
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> 34. In **Fulham** the parties had agreed that all disputes between the members of the club, including the petitioner, should be referred to arbitration. The petitioner sought an order under s.994 Companies Act 2006 on the ground that the actions of the chairman R had caused the affairs of the company to be conducted in a manner unfairly prejudicial to him as one of its members. The company and R sought a stay of proceedings under s.9 Arbitration Act 1996 which is in substantially the same form as s.4 Foreign Arbitral Awards Enforcement Law. A stay was granted by Vos J. The club appealed. The relevant principle

was stated by Patten LJ, with whom Longmore and Rix LJJ agreed, in paragraph 40 to be:

> "it does not follow from the inability of an arbitrator to make a winding-up order affecting third parties that it should be impossible for the members of a company, for example, to agree to submit disputes *inter se* as shareholders to a process of arbitration. It is necessary to consider in relation to the matters in dispute in each case whether they engage third party rights or represent an attempt to delegate to the arbitrators what is a matter of public interest which cannot be determined within the limitations of a private contractual process."

In paragraph 78 he considered that the decision of Judge Weeks QC in **Exeter City** was wrong.

35. In **Assaubayev** the claimants had been clients of the defendant, a solicitor, under a retainer which contained an arbitration clause. The Solicitor had sent them a bill which they challenged by a part 8 claim. The solicitor applied to stay that claim on the ground that the costs were within the scope of the arbitration agreement. The stay was granted by the judge and the claimants appealed. Clarke LJ with whom Aikens and Black LJJ agreed, dismissed the appeal. In paragraph 68 he said:

> "I can, however, see no valid reason why in this case the public interest should require the arbitrator not to consider the issues that have been referred to him. These are, in essence, the legality of MWP's actions (including whether the Retainers are champertous), the effect of any such illegality on the recoverability of costs and, if relevant, the reasonableness of the costs claimed. These issues are covered by the terms of the arbitration agreements and well within an arbitrator's reach. As the judge rightly held [205] the relief sought (cancellation or an assessment) is not such as to render the claims incapable of arbitration. The fact that the arbitrator cannot exercise the Court's supervisory jurisdiction is no reason to refuse a stay. No one is asking him to exercise that jurisdiction. In any event, the fact that an arbitrator cannot give all the remedies which a Court could give does not afford any reason for treating an arbitration agreement as of no effect: *Fulham Football Club* [103]."

36. Just over two weeks later a similar point was again considered by the Court of Appeal. In **Salford** a petition to wind up a company was based on a debt which was itself subject to arbitration. The judge had ordered a stay, the petitioner appealed. The contention of leading counsel for the petitioner is described in paragraph 25 of the judgment of the Chancellor in these terms:

> "She said that, unlike an ordinary money claim where the proceedings are for payment of what is due, a winding up petition is not a claim for payment. She said that it is in the nature of a class action in the public interest: it brings into

> operation the statutory regime for realising and distributing the assets of the company for the benefit of its body of creditors. An arbitrator has no power to wind up a company. She submitted that a winding up petition is, accordingly, not "arbitrable" and not a "claim" within section 9 of the 1996 Act. On that basis, she contended that, in accordance with long established jurisprudence, the Court should only stay or dismiss a petition based on an unpaid debt if the debt is bona fide disputed on substantial grounds."

37. This argument was rejected for the reasons stated by the Chancellor, with whom Longmore and Kitchin LJ agreed, in paragraph 41 in the following terms:

> "There is no doubt that the debt mentioned in the Petition falls within the very wide terms of the arbitration clause in the Lease. The debt is not admitted. In accordance with the decision in *Halki Shipping*, that is sufficient to constitute a dispute within the 1996 Act, irrespective of the substantive merits of any defence, and, were there proceedings on foot to recover the debt, to trigger the automatic stay provision in section 9(1) of the 1996 Act. For the reasons I have given, I consider that, as a matter of the exercise of the court's discretion under IA 1986 s. 122(1)(f), it was right for the court either to dismiss or to stay the Petition so as to compel the parties to resolve their dispute over the debt by their chosen method of dispute resolution rather than require the court to investigate whether or not the debt is bona fide disputed on substantial grounds."

38. The upshot of these three cases is that it is now shown that it is no bar to a stay in order that a contractual arbitration may take place that the same issue may arise in associated legal proceedings. What is not permitted is the reference to arbitration of a matter which is within the exclusive jurisdiction of the court. A matter of public interest cannot be delegated to a private contractual process. These three cases appear to me to confirm that the Second Release Summons is wholly dependent and consequential on whether SPhinX is liable for the fees claimed by BG in the three matters specifically referred to in the summons. As such there is no reason why the arbitration should not proceed. Indeed I would go further. There is every reason to stay this summons so that it may not be used to by-pass the agreed resolution processes.

38. Sir Andrew Morritt's conclusion that, all the conditions for ordering a stay pursuant to s.4 FAAEL having been made out, he was bound to grant a stay meant that there was no need for any resort to the inherent jurisdiction. He observed, however that "[had] it been necessary I would not have hesitated to grant such a stay. It would have been needed to avoid the claimants and the JOLs/SS seeking to avoid the agreed forum for resolving disputes as to the fees payable under the LRA." (para 39)

The Appellants' submissions before the Court of Appeal.

39. The Appellants were represented by Mr Mark Phillips QC who had been their counsel below.

40. Mr Phillips' overriding contention was that Sir Andrew Morritt had erred in holding that the Second Reserve Summons was "in respect of any matter agreed to be referred" within the meaning and effect of section 4 of FAAEL. Mr Phillips submitted that the question whether or not a liability should be reserved was not a "matter agreed to be referred" because the fixing of a reserve by a liquidator did not involve a determination of whether the claims sought to be reserved against were legally due and owing but instead involved deciding whether the claims were fanciful and if not, at what level the reserve be should fixed. He further argued that the fixing of a reserve by a liquidator pursuant to his statutory duty and under the supervision of the court is by its very nature incapable of being arbitrable under an arbitration agreement. It was not the function of an arbitral tribunal to determine what reserves, if any, a liquidator should make. Rather, the function of such a tribunal was to determine the legal outcome of disputes between the parties to the arbitration agreement in question. Accordingly, it was legally impossible to delegate to an arbitrator the question of fixing a reserve. A liquidator can no more contract out of the control of the court than a company can contract out of the statutory scheme that governs liquidations.

41. Mr Phillips contended that *Re Cybernaut Growth Fund LP* was correctly decided and went on to submit that if Sir Andrew Morritt's judgment were to be upheld, there would be dangerous consequences for the world of liquidation because of its impact on the duty of liquidators imposed by Order 18 rule 4 of the Companies Winding Up Rules 2008 which provides that in calculation and distribution of a dividend the official liquidator shall make provision for … (d) expenses of the liquidation which are anticipated but not yet incurred.

42. Mr Phillips argued that Sir Andrew Morritt was wrong to conclude in paragraph 38 of his judgment that *Fulham Football Club (1987) Ltd v Richards*, *Assaubayev v Michael Wilson Partners Ltd* and *Salford Estates (No. 20)* confirmed that the Second Release Summons was wholly dependent and consequential on whether SPhinX was liable for the fees claimed in the three matters referred to in the Second Release Summons (viz (i) the settlements with and releases of DB and BAWAG; (ii) the reduction of alleged contingent claims of Indemnity Claimants or the indemnity reserves maintained in respect of the same; and (iii) the agreement SPhinX Group entered into with PlusFunds on 26 April 2007). In Mr Phillips' submission, these three cases were to be distinguished from the instant case in that, in each of them the dispute subject to arbitration was the subject matter of the other proceedings and had to be resolved as a first step. Thus: (i) in *Fulham Football Club*, whether there had been a breach by Sir David Richards' of obligations he owed to the club had to be determined before the question of unfair prejudice could be decided; (ii) in *Assaubayev*, the question of what sum was due had to be determined regardless of questions of the court's supervisory jurisdiction; and (iii) in *Salford Estates (No2)* the existence of the debt on which the winding up petition was based had to be determined before questions of winding up could be considered.

43. By contrast, the Second Release Summons would not determine what sums, if any, were due to BG. On the contrary, the only question that that summons raised was whether or not a reserve of US$50 million was required to ensure that BG would be paid if one day it were subsequently found that a sum was to due to them. As is demonstrated by the decision of the English and Wales Court of Appeal decision in *In Re Danka Business Systems plc* [2013] 2 WLR 1398, a liquidator either values or makes a provision for a claim, or both, but in none of those instances is he determining the legal liability of the estate to meet the claim.

Discussion and decision

44. I do not accept Mr Phillips' submissions, ably and forcefully presented as they were. In my judgment, for the reasons that I give below, Sir Andrew Morritt's conclusion that the four conditions stipulated in section 4 FAAEL for the grant of a stay of the Second Release Summons were satisfied was well founded for the reasons he gave.

45. It was not disputed in this appeal that for the purposes of s. 4 FAAEL the Second Release Summons was a legal proceeding commenced by the Scheme Claimants and in issuing that summons the Scheme Claimants were claiming through or under SPhinX and the JOLs who were parties to the LRA. And, in my judgment, Sir Andrew Morritt did not err in implicitly accepting the approach adopted by Andrew Smith J in *Lombard North Central plc v GATX Corpn* [2013] Bus.L.R.68 para 14 that "…the court should consider what questions will foreseeably arise for determination in the proceedings and whether they include referred matters…" in deciding whether the Second Reserves Summons included referred matters within s. 4 FAAEL.

46. Nor, in my view, did Sir Andrew Morritt err in holding that: (a) the substance of the Second Release Summons makes it plain that the reserve in question was entirely dependent on whether or not BG was entitled to remuneration for all or any of the items listed in sub-paragraphs (i)- (iii) of the summons; and (b) the question of BG's entitlement to the claimed remunerations was subject to the arbitration clause in section 2.2 of the LRA. I say this for three reasons. First, it is manifest that in order to establish that BG's fee claims described in the summons were fanciful and therefore not in need of a reserve the Scheme Claimants would have to establish that under the law of New York those claims had no legal validity. Indeed, Mr Phillips accepted in argument that if the Second Release Summons proceeded to a hearing, the Scheme Claimants would debate the relative merits of the heads of claim described in the summons relying on expert testimony given on New York law by Mr Richard Holwell, a former District Court Judge for the Southern District of New

York who gave evidence at the hearing in June and July 2013 presided over by Sir Andrew Morritt.

47. Second, it is obvious that BG's fee claims are disputed by the JOLs/SS and that this dispute falls within section 2.2 of the LRA. Neither BG nor the JOLs/SS has submitted the dispute to arbitration, in BG's case because this is not ethically open to it, as confirmed by the expert evidence of Mr Feldman, and in the JOLs/SS's case because (so it is reasonably to be inferred) they did not want to undermine BG whilst it was actively conducting trial litigation on behalf of the SPhinX estate against DPM. But the fact that the arbitration process has not been activated is no bar to a stay under s.4 of FAAEL, see the decision of the UK Supreme Court in *AES Ust-Kamenogorsk Hydropower Plant LLP v Ust-Kamenogorsk Hydropower Plant JSC* [2013] UKSC 35 at paras [22] and [23].

48. As to Sir Andrew Morritt's conclusion that the Second Release Summons was "a matter to be referred", he was in my judgment entirely correct to hold (albeit implicitly) that the Second Release Summons foreseeably engages issues within the scope of paragraph 2.2 of the LRA. He was also correct to deduce from the reasoning in *Fulham Football Club (1987) Ltd v Richards*, *Assaubayev v Michael Wilson Partners Ltd* and *Salford Estates (No. 20)* that the court could and should give effect to the arbitration agreement in Section 2.2 of the LRA in circumstances where the Second Release Summons turned on the issue of the legal validity of BG's claims, the Scheme Claimants contending that they were bad in law and therefore fanciful and BG contending the opposite. In so holding, Sir Andrew was not delegating to an arbitral tribunal the function of determining whether a reserve should be maintained or released. Instead, he was enforcing BG's private contractual right pursuant to s. 4 FAAEL to have the dispute between it and the JOLs/SS as to its remuneration claims identified in the Second Release Summons determined by arbitration and not by a judicial proceeding. The flaw in Mr Phillips' argument was his insistence that the Second Reserve Summons was not concerned with a finding of legal entitlement but only with a determination whether the claims were fanciful. The correct analysis of the situation is that adopted by Sir Andrew, namely, that the question whether the claims are fanciful

so that the US$50 million reserve can be released depends entirely on whether those claims are bad in law; and this issue being squarely within paragraph 2.2 of the LRA, it is a matter to be referred under s. 4 FAAEL.

49. Following the determination of BG's claims by arbitration, the Scheme Claimants can proceed with the Second Reserve Summons if the claims are found to be bad in law. It follows in my view that in substance this case is not to be distinguished from *Fulham Football Club (1987) Ltd v Richards*, *Assaubayev v Michael Wilson Partners Ltd* and *Salford Estates (No. 20)* in the manner contended for by Mr Phillips.

50. I recognise that the enforcement of an arbitration agreement in a liquidation context may delay the liquidation court process and add to the expense of administrating the estate but that cannot be a reason for failing to protect the contract right to arbitration as required by s.4 FAAEL.

51. Mr Halkerston for DG submitted that, if it was necessary to do so to uphold Sir Andrew Morritt's judgment, this court should overrule the decision in *In Re Cybernaut Growth Fund LP*. In that case Justice Jones QC distinguished the matter before him from *Fulham Football Club (1987) Ltd* on the ground that the only remedy sought before him was a winding up order, whereas the court in *Fulham Football Club (1987)* had a wide discretion under s. 996 of the UK Companies Act 2006 to make such order as it thought for giving relief in respect of the matters complained of. He also observed that the parties were all agreed that the partnership should be wound up, so that the real issue was not determination of the petitioners' allegations but whether the partnership should be wound up by the general partner or a qualified insolvency practitioner. Whether these points of distinction justify the decision not to enforce the arbitration clause by granting a stay is I think debatable, but in my view it is not necessary to overrule Justice Jones' decision for this Court to dismiss this appeal and I do not think that we should do so without hearing fuller argument on the point than was presented to us.

Conclusion

52. For the reasons given above, I would dismiss this appeal.

53. The LRA was a post-liquidation agreement entered into by the JORs for the benefit of the estates of the SPhinX group. It was a closely negotiated document with each side having the benefit of expert legal advice. Under Section 2.2 of the LRA both parties are under a clear negative obligation not to seek relief in respect of any dispute over BG's fees in some forum other than arbitration. It follows that, as Sir Andrew Morritt observed, if the court were not to stay the Second Reserve Summons it would be allowing the SS/JOLs to escape from this freely undertaken obligation.

54. I conclude by observing that it is most regrettable that BG was not joined into the hearing before Sir Andrew Morritt that took place in June and July 2013. Had that been the position the question of BG's entitlement to claim the fees identified in the Second Reserve Summons would I think have been resolved much sooner than is now going to be case because BG could have been required to declare whether it proposed to advance any other fee claims if its *quantum meruit* claim was held to be legally unsustainable and BG would also have had to elect whether to seek a stay under s.4 FAAEL of that part of the Grand Court proceedings concerned with its entitlement to fees.

Richard Field, JA

Elliott Mottley, JA

I agree that this appeal should be dismissed for the reasons given by Sir Richard Field, JA.

Dennis Morrison, JA

I too agree that this appeal should be dismissed for the reasons given by Sir Richard Field, JA