

**IN THE COURT OF APPEAL OF THE CAYMAN ISLANDS  
ON APPEAL FROM THE GRAND COURT  
FINANCIAL SERVICES DIVISION  
FSD 95 of 2013 (AJEF)**

**BEFORE**

**The Rt Hon Sir John Chadwick, President  
The Rt Hon Sir Anthony Campbell, Justice of Appeal  
The Hon John Martin, Justice of Appeal**

**IN THE MATTER OF ARAMID ENTERTAINMENT FUND LIMITED**

**AND IN THE MATTER OF THE COMPANIES LAW (2012 Revision)**

**BETWEEN**

**ARAMID ENTERTAINMENT FUND LIMITED**

**Appellant/Respondent**

**-and-**

**KBC INVESTMENTS V LIMITED**

**Respondent/Petitioner**

**Mr Stephen Alexander** of Maples and Calder appeared for the Appellant, Aramid Entertainment Fund Limited

**Ms Laura Hatfield** of Solomon Harris appeared for the Respondent, KBC Investments V Limited

Hearing: 2 April 2014

Reasons released: 5 May 2014

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**REASONS FOR JUDGMENT**

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**Sir John Chadwick, President:**

1. This is an appeal from an order made by Justice Foster on 25 October 2013 in relation to the costs of a creditor's petition to wind up Aramid Entertainment Fund Limited

("the Company"). The petition had been presented on 10 July 2013 by KBC Investments V Limited ("the Petitioner"). It was withdrawn on 1 August 2013 by consent. The only question before the judge was whether he should make an order for the payment of the Company's costs of the petition; and, if so, what order. After a hearing on that question which extended over two days the judge decided to make no order as to costs. The Company seeks leave to appeal from that decision.

2. The application for leave to appeal, with an application for an extension of time for filing notice of appeal, came before this Court on 2 April 2014. In addressing those applications the Court heard full argument on the merits of the appeal itself. At the conclusion of the oral argument, the Court indicated that it would extend time, grant leave to appeal and allow the appeal. The Court stated that it would put its reasons in writing and deliver those reasons as soon as convenient.

*The underlying facts*

3. The Company is an exempted company incorporated in the Cayman Islands. It carries on business as a mutual fund under the Mutual Funds Law (2009 Revision). Its investment business consists, primarily, in the provision of short and medium term finance to producers of film, television and other entertainment media secured over the assets of the borrower.
4. As at April 2011, Charles Frederic & Co Ltd ("CFC") was the registered owner of 88,730.4950 Class B redeemable shares in the Company (the "Shares"). It held those shares as custodian for the Stillwater Market Neutral Fund 111 SPC on behalf of Stillwater Matrix Segregated Portfolio ("Stillwater"). Between May 2011 and April 2012 a proportion of the shares in the Company (including the Shares) were the subject of compulsory redemption. The redemption monies due in respect of the Shares were US\$1,068,530.31. Those redemption monies were withheld from CFC by the Company pending determination of proceedings (the "Stillwater Proceedings") which the Company had instituted against Stillwater, CFC and others in the Supreme Court of the State of New York.
5. The Petitioner, KBC Investments V Limited, had provided finance facilities to Stillwater secured on the Shares. During 2012 the Petitioner foreclosed on the Shares. Stillwater's rights and interests in the Shares were transferred to the Petitioner. On 13

April 2013 the right to the redemption monies payable in respect of the Shares was assigned by CFC to the Petitioner. Notice of that assignment was given to the Company on 24 April 2013.

6. In the meantime, the trial judge in the New York Court had dismissed the claims made by the Company (and other plaintiffs) in the Stillwater proceedings. The Company appealed from that order. On 30 April 2013 the Appellate Division of the Supreme Court of New York refused the appeal and affirmed the judgment of the trial judge.
7. On 3 May 2013 the Petitioner served on the Company a statutory demand pursuant to section 93 of the Companies Law (2012 Revision) for payment of the redemption monies in respect of the Shares. The Company rejected that demand for reasons set out in a letter from its attorneys, Maples and Calder, dated 17 May 2013: the debt, it was said, was disputed on the grounds that, pending final determination of the Stillwater Proceedings, the Company maintained that it had the right to set off its claims in those proceedings against the redemption monies. On 28 May 2013 the attorneys for the Petitioner, Solomon Harris, responded with a letter which contained the assertion that the Stillwater Proceedings had been concluded with the decision and order of the Appellate Division of the New York Court. On 8 June 2013 Maples and Calder replied, denying that the Stillwater Proceedings had been concluded. It was said that, on 30 May 2013, the Company (and other plaintiffs in the Stillwater Proceedings) had filed a motion for re-argument, or in the alternative for permission to appeal to the Court of Appeals; that it was confident that that motion would be granted and that the motion would succeed. A copy of the appeal motion was enclosed with that letter.
8. The Company's motion in the New York State Court of Appeals was heard on 7 June 2013. On 10 July 2013 – before the Court of Appeals had ruled on that motion – the Petitioner presented its petition to wind up the Company. The petition was based on the non-payment of the monies demanded in the statutory demand.
9. On the same day (10 July 2013), but after service of the petition upon it, the Company commenced further proceedings (“the KBC Proceedings”) in the State Court of New York against the Petitioner and related entities. In those proceedings the

Company asserts claims against the Petitioner (and the other defendants) which, if established, would exceed the amount of the redemption monies.

10. On 24 July 2013 the Company filed an affidavit of Roger Hanson, one of its directors, in opposition to the petition. That affidavit was reserved, after revision, on 30 July 2013. In paragraphs 13, 14, 15 and 16 of that affidavit Mr Hanson referred to what he described as “on-going proceedings against Stillwater, CFC and the Petitioner”: in particular (at paragraphs 15 and 16) he described the claims made in the KBC Proceedings which had been commenced on 10 July 2013. On receipt of that evidence the Petitioner decided to withdraw the Petition. The application to withdraw was made on 1 August 2013. Leave to withdraw was granted by Justice Foster on that day; reserving to argument at a later hearing the question whether an order should be made for payment of the costs thrown away.

*The determination of the costs issue by the judge*

11. The order made by the judge on 1 August 2013 had directed that the costs issue should be determined at a hearing on 15 August 2013. It had further directed that the Petitioner should serve any affidavit evidence in support of its application concerning costs by no later than noon on 6 August 2013; and that the Company might serve affidavit evidence in reply no later than noon on 12 August 2013.
12. Pursuant to that order, and following the withdrawal of the petition on 1 August 2013, further evidence was filed by both parties in support of their contentions on the costs issue. That evidence included an affidavit sworn by David L Molner, the chairman of Aramid Capital Partners LLP (the Technical Services Provider to the Company) in which he deposed (at paragraph 9) that, although the KBC Proceedings were not commenced until 10 July 2013, the Petitioner had been on notice of claims made in those proceedings (in respect of a transaction known as the Beverly Slate) since 8 February 2012. In paragraphs 10, 11 and 12 of his affidavit Mr Molner set out the basis for that assertion; explaining that 8 February 2012 was the date on which the Company had commenced proceedings in the Los Angeles Supreme Court (to which the Petitioner was not a party) against Fortress Investment Group LLC and certain of its subsidiaries. At paragraph 13 of his affidavit Mr Molner went on to say this:

“Even if the Petitioner was not aware of the Fortress Complaint and the possibility of legal action against the Petitioner in February 2012, the very

latest it was aware was June 2012. I say this because of my communications with Mr Tom Melsens who was (as he later explained to me) the Managing Director of KBC Investments, an affiliate of the Petitioner.”

At paragraphs 15 and 16 of his affidavit, Mr Molner set out particulars of the discussion which he had had with Mr Melsens in a telephone call in or about the first week of June 2012. In the course of that telephone call Mr Molner informed Mr Melsens (as he deposed) that the Company held the Petitioner partly responsible for the damage caused to the Company in connection with the Beverly Slate.

13. On 14 August 2013 Solomon Harris sent to Maples and Calder, by email, a copy of an affidavit sworn by Tom Melsens on that day; in which Mr Melsens responded to the assertions made by Mr Molner in his affidavit of 12 August 2013. Maples and Calder objected to the proposed use of Mr Melsens’ affidavit at the hearing that was to take place on the following day. Copies of their letter of objection and of Solomon Harris’ letter in response (asserting that the affidavit could and would be relied upon) were sent to the judge. In an email sent to Maples and Calder and Solomon Harris on the afternoon of 14 August 2013 the judge’s secretary wrote:

“The Hon Judge has advised that the order dated 1<sup>st</sup> August 2013 is perfectly clear. The proposed affidavit of Mr Melsens may not be referred to at tomorrow’s hearing.”

14. We have been provided with an attendance note of the hearing on 15 August 2013 prepared by Maples and Calder. The note has not been agreed by Solomon Harris, nor submitted to the judge for his approval. The note supports the view that, quite properly, Ms Laura Hatfield (who appeared as advocate for the Petitioner at that hearing, as she did before this Court) accepted that she was not able to put Mr Melsens’ affidavit before the judge. It is recorded (at paragraph 4.16 of the note) that she said this:

“ . . . LH noted that Mr Melsens swore in an affidavit that he had never heard of such a discussion [to which Mr Molner had deposed]. KH (*semble*, LH) went on to say that because Mr Molner’s rebuttal affidavit (*semble*, Mr Melsens’ affidavit) is barred from the proceedings, the best she could do was to refer the court to the letter of 10 July.”

Confirmation that Mr Melsens’ affidavit was not before the judge, either at the hearing on 15 August 2013 or at the adjourned hearing on 23 August 2013, is found in Maples and Calder’s attendance note of the adjourned hearing. It is recorded in that

note (at section 2) that Mr Alexander (who appeared for the Company) referred to the conspicuous absence of testimony from Mr Melsens.

15. In those circumstances it was, perhaps, a matter of some surprise to the attorneys on both sides when, on or about 11 October 2013, they received an unapproved draft of the Ruling which the judge proposed to deliver on the costs issue. In addressing the question – which he described as “the principal dispute between the parties” – whether the Petitioner knew of the claim made against it in the KBC Proceedings before the issue of the petition, the judge referred (at paragraph 41 of the draft Ruling) to Mr Molner’s evidence of his telephone conversation with Mr Melsens in June 2012. He went on to refer to Mr Melsens’ affidavit (which must have found its way into the bundle of documents then before him), stating that:

“Mr Melsens denied that at any time had Mr Molner asserted that the Company held KBC partly or at all responsible in relation to the alleged actions of Fortress in connection with the Beverly Slate. He said that if Mr Molner had done so it would have changed the whole context of their subsequent discussions concerning possible settlement in relation to the Distribution Proceeds.”

The judge then observed (at paragraph 42) that:

“In the circumstances I find what Mr Melsens says to be more plausible and probable. . . .”

And, he went on to say (*ibid*) that:

“Overall I find Mr Melsens’ evidence more likely and more persuasive in this respect and I am not at all convinced that the Company’s alleged claim against KBC in connection with Fortress and the Beverley Slate was raised with KBC in any meaningful or significant way in the communications between Mr Molner and Mr Melsens.”

After examining other affidavit evidence directed to the question whether the Petitioner knew of the claim made against it in the KBC Proceedings before the issue of the petition, the judge concluded (at paragraph 45) that;

“I find the Company’s case that KBC was made aware of the claim now made in the KBC Proceedings before it filed and served the petition to be unconvincing and not established.”

16. Following receipt of the unapproved draft Ruling, Maples and Calder, by letter dated 11 October 2013, drew the judge’s attention to the direction in his order of 1 August 2013; and to the subsequent confirmation, in the e-mail from his secretary sent on 14 August 2013, that Mr Melsens’ affidavit was not to form part of the evidence on the hearing of the costs issue. They invited the judge to reconsider his conclusions as set

out in the draft Ruling (which, as they accepted, correctly, he was entitled to do) in the circumstances of what they described as “the Learned Judge’s manifest error in reading and relying on the Melsens affidavit”. Solomon Harris wrote on the same day asserting that the judge’s jurisdiction to reconsider the draft Judgment at any time before final Order “extends to the consideration of evidence not referred to at the hearing”. On that basis, it was said, the reference by the judge to Mr Melsens’ affidavit was “not necessarily a manifest error.” That contention appears to overlook that the complaint was not that the judge took account of evidence that was not referred to at the hearing: the complaint was that the judge took account of evidence in an affidavit which he had ruled could not be relied upon in the context of the costs issue.

17. The judge’s response, in an e-mail sent by his secretary to both Maples and Calder and Solomon Harris on 15 October 2013, was in these terms (so far as material):

“The Hon Judge accepts that he directed by letter dated 14 August 2013 that the affidavit of Mr Melsens may not be referred to at the hearing on 15<sup>th</sup> August 2013. He did so because the affidavit was served late, not because it was not relevant.

When the Hon Judge came to prepare the ruling he naturally reviewed the court’s bundles, amongst which the petitioner’s Evidence Bundle which contains Mr Melsens’ affidavit exhibit at tabs 5 and 6 respectively. The Hon Judge found the affidavit to be relevant and of assistance and he consequently referred to it in the draft ruling.

In the light of the complaint by Maples and Calder in their letter dated 13<sup>th</sup> October 2013, the Hon Judge is prepared, in the circumstances, to consider revising the draft ruling to remove any reference to and reliance on Mr Melsens’ affidavit and to make any necessary consequential amendments he considers appropriate. However, the Hon Judge has asked me to say, in fairness, that having regard to all the other circumstances he would have reached the same decision whether or not he had placed any reliance on Mr Melsens’ affidavit.

The Hon Judge invites the parties to now indicate their views on whether the draft ruling should be revised in this way so that it can be re-circulated for review in accordance with the relevant Practice Direction. . . .”

On 25 October 2013 Maples and Calder responded to that invitation, stating that, having taken their client’s instructions, their client’s position was that:

“the draft ruling should remain in the form as currently drafted by the Honourable Judge, subject to the clerical amendments suggested by Solomon Harris”.

In the light of that response, the judge's Ruling was signed issued, without substantial amendment, on 28 October 2013.

18. It is, I think, appropriate to make three observations in relation to the matters to which I have just referred:

(1) Mr Melsens' affidavit should not have been included in the Petitioner's evidence bundle. To include that affidavit in the bundle without leave was to ignore the direction given in the order of 1 August 2013. If the bundle had already been lodged by the time Solomon Harris received the e-mail from the judge's secretary on the afternoon of 14 August 2013, immediate steps should have been taken to remove the Melsens affidavit from that bundle before the hearing commenced on the following day; or, failing that, to remove the affidavit from the bundle as soon as the hearing commenced on 15 August 2013. No explanation has been offered to this Court as to why the affidavit was included in the Petitioner's bundle, or was allowed to remain in that bundle. Allowing the affidavit to remain in the bundle after the judge had directed, on 14 August 2013, led the judge into error; in that, when he came to prepare his draft ruling some weeks after the hearing on the basis of the material in the bundles, he must be taken to have overlooked the fact that the Melsens affidavit (although in the evidence bundle) was not evidence in the proceeding which were before him.

(2) The judge was correct to recognize that he had been wrong to rely on the Melsens affidavit when that error was pointed out to him by Maples and Calder on 11 October 2013. But, if I may say so, his response was incorrect. He should not have invited the parties to indicate whether they agreed to his suggestion that the draft ruling be withdrawn. He should, on his own initiative, have withdrawn the draft ruling and addressed the question (inviting the parties' submissions if he thought appropriate) whether he could properly deliver a judgment at all; given that he had read and formed a view as to the weight to be placed on statements by Mr Melsen which should not have been before him. If, having addressed that question, the judge was satisfied that he could put out of his mind the statements in Mr Melsens' affidavit, he should have said so; and then re-issued a draft explaining how he reached the conclusion which he did without reliance on that material. To inform the parties, before addressing that question and revisiting the matter with a mind which was not influenced by the statements in Mr Melsens' affidavit, that he

was going to reach the same conclusion anyway was not a course likely to lead to confidence on the part of the Company that the judicial process had worked fairly.

- (3) That the ruling in the form in which it was signed and issued – that is to say, in a form which did not differ in any material respect from the unapproved draft sent to the parties’ representatives on or about 11 October 2013 – is plainly flawed; in that the judge’s reasons for exercising the discretion as to costs, which was entrusted to him under the law, were based (in part, at least) on findings of fact which he made after taking account of material which was not in evidence before him.

19. In those circumstances it is necessary for this Court to address the question: what order should be made in respect of the costs thrown away by the presentation and subsequent withdrawal of the petition. That requires this Court to consider – I think for the first time in this jurisdiction – how a court should approach the issue of costs which have been wasted by the presentation of a winding up petition which is not pursued.

*The approach to costs thrown away by the presentation of a petition which is not pursued*

20. The approach adopted by the Courts in England and Wales to the question who should bear the costs thrown away by the presentation of a creditor’s winding up petition which is not pursued is founded on observations of Mr Justice Warner in *Re Fernforest Ltd* [1990] BCLC 693. As the judge explained (*ibid*, 693h – 694e), on 19 June 1989 the petitioners, a firm of accountants, had served a statutory demand on the company for part payment of fees alleged to have been incurred for professional services. As he said:

“Both before and after the service of the statutory demand there had been correspondence between the solicitors to the parties in which the solicitors for the company had said that the debt was disputed on a number of grounds. It is fair to say, however, that what they said in their letters about those grounds, as regards the substance of the company’s defence to the claim was not very convincing though there was categorical notice to the petitioners’ solicitors that the claim was disputed and that if a winding up petition was presented an injunction would be sought to restrain further proceedings.”

Notwithstanding that notice, a winding up petition was presented on 2 August 1989 the petition. On 17 August 1989 the company obtained an injunction restraining advertisement of the petition. The injunction was granted on the basis of affidavits filed on behalf of the company which (as Mr Justice Warner put it) “put forward in

slightly more detail the company's defence to the claim". The petition came before the court *inter partes* on 7 September 1989 and was dismissed by consent. The costs of the petition were reserved to the Companies Registrar. The Registrar took the view that he had no jurisdiction to decide the question of costs because the petition had been dismissed. The matter came before Mr Justice Warner on appeal from that decision.

21. Mr Justice Warner explained (*ibid*, 694h) that it was said on behalf of the petitioners that it was not until they were served with an affidavit sworn by a director of the company on 31 August 1989 that the petitioners could see what the case for the company really was and that it raised a dispute which could not be determined in the winding up proceedings. In those circumstances it was submitted that it would be unfair to the petitioners that they should be ordered to pay the costs of their abortive winding up proceedings: the appropriate course would be to order that the costs thrown away in the winding up proceedings should be costs in an action to establish the debt which had, subsequently, been commenced by the petitioners against the company by writ issued on 24 October 1989. Mr Justice Warner rejected those submissions. He said this (*ibid*, 694j-695f):

"Costs, of course, are in the discretion of the court but there is a general principle that in the absence of other factors they follow the event. As I told counsel, I have held more than once that, consistently with that principle, whilst there are circumstances in which it may be appropriate for a petitioner not to be ordered to pay the costs of an abortive petition, in general, unless there are special circumstances, it is appropriate that the petitioner should pay those costs. It may well have been perfectly reasonable for these petitioners and their solicitors at the outset of these proceedings to have thought that the company had no defence to their claim and it may well have seemed reasonable to them to pursue the winding up proceedings right up to 7 September 1989 and they may well have thought that the conduct of the company and its solicitors up to the time when they served Dr Sortis's affidavit of 31 August had been unreasonable, they may well have thought that what was said in the correspondence to which I have referred, and in the affidavits that were before Morritt J [on 17 August 1989], was inadequate as a defence, but in my view as a matter of general approach to this type of case a claimant against a company who chooses to take the short cut of a statutory demand followed by a winding-up petition instead of the procedure of first issuing a writ to establish his claim, does so at his own risk that the claim will be disputed and that the petition will be dismissed or will have to be abandoned. It is no part of the duty of a person against whom a claim is made to formulate in detail, before proceedings are taken against him to enforce the claim, what his defence to those proceedings may be. Instructing solicitors to do that can be costly and the costs of doing it if as a result proceedings do not

eventuate will be irrecoverable. That is a consideration which to my mind is material. Another material consideration is that experience in this court shows that if in every case of the withdrawal or dismissal of a winding-up petition the court is to go into the whole history of the case to assess whose conduct at which stage was reasonable and whose unreasonable, an enormous amount of the court's time and consequent costs will be spent on disputes of this kind. I think the principle should be adhered to that, unless there be exceptional circumstances, a petitioner whose petition fails on the ground that the debt is bona fide disputed on substantial grounds should pay the costs of that failure."

And Mr Justice Warner went on to say this (*ibid* 695 -h):

"If I adopted the suggestion of counsel for the petitioners that I should here order the costs to be costs in the action, I would really be saying that someone who has a claim against a company can always try first to enforce that claim by serving a statutory demand and presenting a petition; if he succeeds he will be paid or the company will go into liquidation; if he fails the costs of the winding-up proceedings will simply be added to the costs of the writ action that he will then have to bring to establish his claim. It seems to me that that cannot be a proper view of the winding-up procedure."

22. In referring, in that passage, to having held more than once that ". . . in general, unless there are special circumstances, it is appropriate, that the petitioner should pay those costs [of an abortive petition]", Mr Justice Warner may well have had in mind his decision, some 14 months earlier, in *Re Cannon Screen Entertainment Ltd* [1989] BCLC 660. In that case, the question was whether a creditor who had served a statutory demand should pay the costs incurred by the company in seeking an injunction to restrain presentation of a winding up petition. The evidence upon which an undertaking (in lieu of an injunction) was offered had not been forthcoming until the day of the hearing. In holding that, nevertheless, the creditor should pay the costs thrown away, Mr Justice Warner had said this (*ibid*, 662j -663d):

". . . It is perfectly true, as counsel for [the creditor] submits, that there is nothing improper in a creditor who has no notice of a substantial defence to his claim, serving a statutory demand, but to my mind he does that at his own risk, because the normal course for a creditor to adopt, if he wants to enforce a debt by proceedings, is to issue a writ, and, of course, if he issues a writ and is sufficiently confident that there is no defence to his claim, the procedure under RSC Ord. 14 is available to him. If instead of adopting that course the creditor takes the shortcut of serving a statutory demand with a view to presenting a winding up petition without having obtained a judgment, in my opinion he does so at his own risk as to costs. If it should turn out that there is a defence to his claim he must pay the costs of the company against whom he has chosen to take such proceedings.

The alternative is to say that it is incumbent on a company on which a statutory demand is served, if it disputes the debt payment of which is

demanded, is to give the author of the demand particulars of the grounds on which it is disputed before issuing any application for an injunction to restrain the presentation of a winding up petition. Bearing in mind that the period within which the company has to comply with the statutory demand or face a winding up petition is only 21 days, and that, as counsel for [the company] says, it may take time to assemble the information needed to give particulars of the grounds of defence, I do not think that that is a reasonable view to take, quite apart from the fact that it would mean of course that the work of the solicitors instructed by the company, in so far as it had to be done before proceedings were issued, would have to be done without any possibility of their costs being recovered from the claimant.”

23. The principles set out in *Re Fernforest* were applied by Mr Justice Blackburne in *GlaxoSmithKline Export Ltd v UK (AID) Ltd* [2003] EWHC 1383 (Ch); [2004] BPIR 588. In dismissing the petition in that case ([2003] EWHC 1383; [2003] 2 BCLC 351) Mr Justice Blackburne had said this (at paragraph 74 of his judgment):

“74. Although GSK advances a very powerful case against the company based upon the unpaid invoices, especially given the company's failure to respond in any substantive way to GSK's demands for payment until after being served with a statutory demand; I entertain sufficient doubts about the matter to cause me to feel unable to say with confidence that there is no substance to the disputes which the company has raised. To reject the company's claim that the prices agreed were not those appearing from the face of the invoices involves not just a rejection of Mr Mitchell's repeated and detailed assertions that, for reasons, he says, concerned with Mr Jones's wish to increase GSK's turnover in its dealings with the company in eastern Europe, the parties had agreed to make retrospective (downward) adjustments to the higher levels at which the goods were being invoiced to the company to reflect the various discounts, rebates and other terms which they had agreed, but also a conclusion that the documents to which Mr Mitchell refers, admittedly all of them internal to the company, evidencing what he says were the terms actually agreed (notably the typed note of the meeting on 3 October 2000) are false, ie that they have been produced with a view to presenting a false account of the company's dealings with GSK. That is not a conclusion that I feel I should reach on what is, after all, a summary proceeding where there has been no cross-examination of either Mr Jones or Mr Mitchell unless it is perfectly plain that that is what has happened or, as Mr Lopian endeavoured to persuade me, because those documents and Mr Mitchell's assertions cannot stand in the face of subsequent documents or conduct on the part of the company. Although I entertain doubts about the genuineness of some of those documents and about the accuracy of some at least of Mr Mitchell's assertions, I cannot say simply from a reading of a series of witness statements and from an examination of the invoices and other documents, that they are to be dismissed as either false or, if genuine, that they have been overtaken by subsequent events.”

When the matter came back to him on the question whether the petitioner should pay the costs of its unsuccessful petition – the petitioner seeking an order that those costs

should be reserved to the hearing of a summary judgment application in proceedings to establish its debt which the petitioner intended to commence by writ, Mr Justice Blackburne observed ([2004] BPIR 528, [2]) that:

“The basis for such an order is that, as [counsel for the petitioner] put it, my decision was as close to the line as it could get in the sense that I was strongly minded to make a winding-up order but felt unable on the basis of various assertions set out in the judgment to go that far. He submits that in the light of that, and in the light particularly of the fact that claims by Mr. Mitchell based upon documents which he produced may, when this matter is investigated, be disbelieved and, indeed, that some of these documents may be found to be wanting in one respect or another, fairness would suggest that his client's narrow failure in these proceedings should not carry with it the ordinary consequence where a petition is dismissed. That is that the petitioner should bear the successful respondent company's costs.”

He referred, also, to the submission advanced by counsel for the company (*ibid*, [3]):

“[Counsel] submits that there is really nothing unusual about this case. He submits that launching a winding up petition in the teeth of the respondents company's opposition, the petition being based upon the debt set out in a statutory demand but otherwise not one which has been substantiated, is a high risk strategy. If at the end of the day the petitioner fails, well then it must bear the consequences of that.”

He observed that his attention had been drawn to the decision of Mr Justice Warner in *Re Fernforest*; and set out the circumstances in which that judge had “declined to depart from the ordinary practice”. He went on to say this (*ibid*, [6], [7]):

“[6] . . . In my experience, very often where there is a contested winding up petition, there is an issue of credibility: one side is telling the truth and the other side is probably telling lies. It is only when the matter comes to trial and it is possible for the witnesses in the case to be cross-examined that the court is in a position to say where the truth lies and in particular who is telling the truth and who is not. That is in my experience fairly common in the case of contested winding-up proceedings. But it is a risk the petitioner runs when without the benefit of judgment he launches winding-up proceedings, there are assertions which are irreconcilable and it is likely that one side is telling the truth and the other is not.

[7] In this case, although at the end of the day it may be when the matter comes to trial that the court will disbelieve him, Mr. Mitchell's stance on behalf of the company was set out at length by Bates, Wells & Braithwaite on behalf of the company in their letter of 17 October. Thus before these proceedings were launched, the petitioner was aware of the matters upon which the company would be relying. No doubt believing that there was no substance to those various contentions, it nevertheless launched these proceedings. As [counsel] submitted, and as I accept, that is a high risk strategy. It failed.”

Mr Justice Blackburne went on to say (*ibid* ) that “the considerations which weighed with Warner J [in *Re Fernforest*] are no less applicable in the circumstances of this case.” He held that “The ordinary course should follow”; and he ordered the petitioner to pay the costs of the unsuccessful petition.

24. *Re Fernforest* was considered, more recently, by Mr Richard Snowden QC, sitting as a Deputy High Court Judge in the Chancery Division, in *In re Sykes & Sons Ltd, Teamforce Labour Ltd v Sykes & Sons Ltd* [2012] EWHC 1005 (Ch); [2013] Bus LR 106. He referred to Mr Justice Blackburne’s decision in *GlaxoSmithKline Export Ltd v UK (AID) Ltd*. At paragraph 22 of his judgment he said this:

“There is no doubt that the general rule in CPR 44.3, that the losing party should pay the costs of the successful party in litigation applies with added force in the context of winding up petitions. It is well-known that the presentation of a winding up petition can put heavy pressure to pay upon a respondent company, and the Companies Court always has been assiduous to discourage the use of a winding up petition as a short cut instead of issuing a claim form to establish liability in the normal way. I also accept Warner J’s observation that the court should do nothing to encourage any belief that a person who thinks that he has a claim against a company can first try his luck in the Companies Court on the basis that if he fails, the costs of that exercise will simply be added to the costs of a subsequent Part 7 claim. There is therefore considerable merit in adhering to the principle that save in exceptional circumstances, a petitioner whose petition fails on the basis that the debt is genuinely disputed on substantial grounds should pay the costs of that failure.”

The deputy judge then went on to consider whether there were exceptional circumstances to justify a departure from that general rule. He thought that it was open to the court to take account of communications between the parties prior to the presentation of the petition; a feature which, as he observed, could be found both in *Re Fernforest* and in *GlaxoSmithKline Export*. Having set out his conclusions on the facts in the case before him the deputy judge said this (at paragraph 31 of his judgment):

“Whilst having full regard to the principles set out in *Re Fernforest* and *Re UK (Aid) Limited* which I have discussed above, I do regard the combination of these circumstances in which the Company did not give any meaningful account of its defence prior to the Petition, and only belatedly produced documents which might, if authentic, be capable of supporting its case, as wholly exceptional and as justifying a departure from the general rule as to costs which I have considered above.”

Having reached the conclusion that the case was “wholly exceptional” and justified a departure from the general rule, the deputy judge asked himself what order he should

make to ensure that justice was ultimately done between the parties. He held, on the facts of that case, that justice would not be served if, on the basis of documents produced at a late stage, which might well turn out to have been fabricated in a deliberate attempt to advance a false defence, he were to order the petitioner to pay the company's costs. Accordingly, he decided to adjourn the question of costs to await the outcome of proceedings to resolve the dispute: a course which, as he said, had been rejected in *Re Fernforest* and in *GlaxoSmithKline Export* but adopted by Mr Justice Neuberger in *Re a Company (No 0012209 of 1997)*.

25. It is clear, therefore, that *Sykes* was a case in which the deputy judge accepted the principles set out in *Re Fernforest*; but found that the facts were “wholly exceptional” and so justified a departure from the general rule that a petitioner who presents a petition which fails (or is withdrawn) should be ordered to pay the company's costs. Properly understood the decision of Mr Justice Brightman in *Re M McCarthy & Co (Builders) Ltd (No 2)* [1976] 2 All ER 339 – decided some 14 years before *Re Fernforest* – is also a case in which the facts were wholly exceptional. The petition failed because it had been brought against a company which was not the debtor; although it bore exactly the same name as the debtor company (which had been struck off some months earlier for failing to file returns). The judge took the view that those promoting the new company had “only themselves to blame” for confusion resulting from their decision to incorporate the new company with the same name as the old. The decision provides no support for the proposition that the principles set out in *Re Fernforest* should not be followed. Nor, in my view, does the decision of the same judge, Mr Justice Brightman, a month later, in *Re Lanaghan Brothers Ltd* [1977] 1 All ER, in which the petition had been presented on the basis of a default judgment debt: in circumstances in which the company had taken no steps to set aside the default judgment. That, again, must be seen as a case in which the circumstances were wholly exceptional: the creditor had established his debt by obtaining a judgment.

26. The judge directed himself (at paragraph 29 of his Ruling) that the question which he had to decide was whether “the presentation of the petition was reasonable in all the circumstances”. He reached that conclusion after referring to a decision of Master Lee QC, in the Supreme Court of Queensland, in *Re Mailright Pty Ltd* [1985] ACLR 863. That was a case in which the petitioner had contended that it had no notice prior to the

presentation of the petition that the debt was disputed by the company. It does not appear from the report of the case that the Master was referred to *Re Fernforest*.

27. The judge referred, also, to the decision of Mr Justice Kawaley in *Re Gerova Financial Group Ltd* [2012] SC (Bda) 18 Com (19 March 2012). That was a case in which the petitions were founded on judgment debts. The first petitioner (Eric V Seal) had petitioned on the basis of a default judgment debt which, on the day that the petition was presented, it assigned to Aramid Entertainment Fund Ltd (the respondent to the petition in the present proceedings). The default judgment had been set aside after the presentation of the petition; The third petitioner, Marseilles Capital LLC, had petitioned on the basis of a debt founded upon a summary judgment; that debt had subsequently been bought out by a third party, CAC Group Limited, friendly to the company, which opposed that petition. Mr Justice Kawaley relied on *Re Lanaghan*. He made no order for costs in respect of the first petitioner: he refused the second petitioner (Aramid) its costs on “intense tactical manoeuvring” which led him to take the view that it had acted unreasonably; and he awarded the third petitioner its costs. That, if I may say so, was entirely consistent with the relevant principles that would be applicable in England and Wales in circumstances where the petitions had been presented on the basis of judgment debts. Aramid, as the second petitioner, was denied the costs which it could otherwise have expected to be awarded in accordance with those principles because its conduct was deemed to be unreasonable. In the course of his judgment Mr Justice Kawaley referred to *Re Fernforest* with apparent approval. He said this(at paragraph 23 of his judgment) :

“Of course where a petition is dismissed because it was improperly presented, for instance, being based on a disputed debt, the petitioner will ordinarily be required to pay the costs of the abortive petition as [counsel] contended in reliance upon *Re Fernforest* [1990] BCLC 693 on behalf of the Company.”

There is nothing in his judgment in *Re Gerova* which suggests that Mr Justice Kawaley thought he was departing from the principles set out by Mr Justice Warner in *Re Fernforest*; and, upon a proper analysis of his judgment, he was not doing so. Properly understood, *Re Gerova* was not a disputed debt case: the petitions were founded on judgment debts. The relevant English authority was *Re Lanaghan*, as Mr Justice Kawaley appreciated.

28. Nevertheless, in choosing to approach his task as he did in the present case, the judge chose to disregard the guidance given by Mr Justice Warner in *Re Fernforest* that the court is not concerned in a disputed debt case (absent wholly exceptional circumstances) to investigate whether the petitioner acted reasonably in presenting and pursuing its petition. At the risk of repetition, it is pertinent to have in mind the passage already cited:

“It may well have been perfectly reasonable for these petitioners and their solicitors at the outset of these proceedings to have thought that the company had no defence to their claim and it may well have seemed reasonable to them to pursue the winding up proceedings right up to 7 September 1989 and they may well have thought that the conduct of the company and its solicitors up to the time when they served Dr Sortis’s affidavit of 31 August had been unreasonable, they may well have thought that what was said in the correspondence to which I have referred, and in the affidavits that were before Morritt J [on 17 August 1989], was inadequate as a defence, but in my view as a matter of general approach to this type of case a claimant against a company who chooses to take the short cut of a statutory demand followed by a winding-up petition instead of the procedure of first issuing a writ to establish his claim, does so at his own risk that the claim will be disputed and that the petition will be dismissed or will have to be abandoned.”

Save in an exceptional case (of which *Re Sykes* provides an example), the reasonableness, or otherwise, of the petitioners’ conduct, in a case where the debt is known to be disputed at the time when the petition is disputed, is not a matter for enquiry. In a disputed debt case, the petitioner presents his petition at his own risk.

29. One reason for adopting that principle, as Mr Justice Warner explained in *Re Fernforest* (again, in a passage already cited), is that:

“. . . that experience in this court [the Companies Court of the Chancery Division of the High Court of England and Wales, in which Mr Justice Warner had unrivalled experience] shows that if in every case of the withdrawal or dismissal of a winding-up petition the court is to go into the whole history of the case to assess whose conduct at which stage was reasonable and whose unreasonable, an enormous amount of the court’s time and consequent costs will be spent on disputes of this kind.”

The present case provides a striking illustration of the consequence of departing from that wise advice. Justice Foster embarked upon two days of hearing in order to decide whether the petitioner had acted reasonably in pursuing its petition. Substantial affidavit evidence was prepared and filed. The judge prepared a ruling extending to 56 paragraphs over 28 pages. In the course of that Ruling he decided disputed questions of fact on the basis of untested affidavit evidence. We were told that the amount of

costs thrown away by the abandoned petition was of the order of US\$20,000 to US\$30,000; and that the amount of further costs (excluding the costs of this appeal) incurred in arguing about who should pay the costs thrown away is of the order of US\$250,000 to US\$300,000. It is appropriate to ask whether the judge's decision to disregard the advice given by Mr Justice Warner some 25 years ago – and consistently applied in the Courts in England and Wales – has served the interests of justice.

30. It is for those reasons that, at the conclusion of the oral argument, I was satisfied that the appeal should be allowed; and the order of the judge should be set aside. There is, in my view, nothing in the facts of this case which justify a departure from the general rule. The petition was founded on a debt known to be disputed; the Petitioner withdrew the petition, appreciating that to pursue it would be hopeless; the Petitioner must bear the costs thrown away.

**Sir Anthony Campbell, Justice of Appeal**

31. I agree.

**John Martin, Justice of Appeal**

32. I also agree.