25-5-09

IN THE GRAND COURT OF THE CAYMAN ISLANDS

CAUSE NO. 284 of 1991

IN THE MATTER OF BCCI (OVERSEAS) LIMITED ("BCCI")
(IN LIQUIDATION)

AND IN THE MATTER OF THE BANK AND TRUST COMPANIES LAW 1989

AND IN THE MATTER OF THE COMPANIES LAW (2007 REVISION)

IN CHAMBERS
THE 21st MAY 2009
BEFORE THE HON. ANTHONY SMELLIE, C.J.

APPEARANCES: **Mr. Nigel Clifford Q.C. instructed by Mr. Robin McMillan of Appleby for the Joint Official Liquidators ("the JOLs")**
Ms. Sheridan Brooks of Brooks and Brooks for the Committee of Creditors

REASONS FOR DECISION

1. The worldwide liquidation of the BCCI companies is now in its final stages.

2. The bleak prospect of recoveries at the date of liquidation has since been transformed into the reality of actual dividends paid to creditors in the Global Liquidation of 86.5% to date.

3. A major reason for this level of success has been the close co-operation between the Global Liquidators of the principal BCCI companies.

4. The question now arising for resolution by this Court is this: at what rate of exchange should dividends be paid in meeting the hotchpot claims of the so-called "rump creditors" of the BCCI Overseas liquidation?

5. A brief overview of the history, as taken from the latest report of the JOLs to this Court, will set the relevant context.

6. At the outset of the Global Liquidation, the Global Liquidators recognised that, in a number of material respects, the BCCI Group had conducted its affairs as a single entity, without clearly identifying which company or entity within the Group was concerned with or responsible for any particular transaction. It became the decided view of the Global Liquidators and their legal advisers that the intermingling of the affairs of BCCI SA and BCCI Overseas was such that it would have been impracticable without considerable delay and enormous expense (and might well have been impossible) to determine, as between those two major companies, their respective assets and liabilities. In addition, many of the different companies in the BCCI Group and the branches of BCCI SA and BCCI Overseas became the subject of a multiplicity of separate "ring-fencing" local liquidations or similar proceedings in the jurisdictions in which they were incorporated or located.

7. In order to avoid the expense, difficulty and delay which would otherwise have arisen, a Pooling Agreement was negotiated between the Principal BCCI Companies and executed in November 1994.

8. In brief, the Pooling Agreement provides for the pooling of the assets of the Principal BCCI Companies (and their branches which agreed to participate), and for admitted creditors to all receive the same rate of dividend out of the pooled assets.

9. Although the Pooling Agreement contained specific provisions for participation by the branches of BCCI SA and BCCI Overseas, very few of the branches

actually participated. China was the only branch of BCCI Overseas which entered into a branch participation agreement and of the BCCI SA branches, only Japan, Cyprus, Bahrain, and the United Arab Emirates participated.

10. This low rate of participation of the branches in the Pooling Agreement was due largely to decisions taken very early on in the liquidation process by the local regulatory authorities in the countries in which the branches operated. They appointed their own local liquidators, who acted in the separate interest of the local creditors by "ring-fencing" local branch assets and by purporting to deal to some extent with the branch liabilities.

Branch Ring Fencing

11. The laws of the Cayman Islands, under the principle of universality, do not recognise a branch as being a separate legal entity form the head office. See ***Wight v Eckhart Marine GMbH [2004] 1 AC 147 PC (at 157.F.)***

12. Accordingly, where a branch had been ring-fenced but the process put in place at its location of business did not result in the complete discharge of its obligations owed to creditors, those creditors – but not those whose obligations had been entirely assumed or discharged – would continue to have a provable debt in the liquidation of the head office.

13. Such claims would, however, be limited by the pari passu principle which, in order to ensure fairness to all creditors, has been deemed to apply globally, throughout the liquidation of the principal BCCI companies.

14. Although the Liquidators attempted to take control of the BCCI Overseas branch network, the operations of all twenty-seven branches of BCCI Overseas outside

the Cayman Islands were individually ring-fenced under local laws and were treated by the local regulators as separate legal entities with local authorities appointed over their affairs (although China later participated in the Pooling Agreement). In some countries, the ring-fencing was effected by way of a local law that gave a separate legal existence to the BCCI Overseas operations in that country. However, in most cases the ring-fencing occurred on a practical level by way of local laws that prohibited the repatriation of funds from the country, controlled the conversion of local currency to foreign currency, or gave preference to local creditors from the branch assets.

15. The decision of the local regulatory authorities to ring-fence particular branch operations was likely influenced by the low initial dividend assessment of the Global Liquidators. These were necessarily conservative and exclusive of the possibility of recovery from the Majority Shareholders, U.S. Government, former auditors, major debtors and other third parties – recoveries which have since then been realised.

16. Taking into account the negative factors then prevailing, the original estimate of the Global Liquidators of return to creditors participating in the pooling arrangements was in the range of 5% to 10%.

17. In most cases, the return to local creditors was estimated by local authorities to be higher than the initial pooling estimate if the ring-fenced assets of the particular branch were realised and paid for the benefit of the local creditors, and the local authorities rejected the pooling arrangement accordingly.

18. Although, from this ring-fenced competitive process, distributions to creditors were higher than 10%; in a number of cases the return to creditors is less than the

86.5% global dividend rate now achieved and paid to date from the BCCI Group Companies who are participants in the Pooling Agreement (with even a bit more expected before final winding up).

19. In keeping with the principle of universality, although these ring-fenced branches are not signatories to the Pooling Agreement, their creditors are eligible to participate in "top up" or hotchpot payments from the BCCI Overseas head office liquidation provided that the Liquidators can obtain information from the respective branches to verify their claims. While this verification process remains a major challenge for the JOLs because, in particular, of the lack of control over branch records; provisions must be made for the potential verification of the claims of these creditors, now conveniently classified as "rump creditors".

Branch Rump Creditors

20. Of 2,597 such claims submitted with a value of $738 million, 1,113 have been admitted with a value of $408 million.

21. Of the 1,113 admitted claims, the top-up dividends applicable to 486 of them, is valued at $17.8 million. This amount will remain blocked until satisfactory evidence has been received of the closure of the relevant branch liquidation or of there being no possibility of further dividends being paid on such branch liquidation (the China Branch having subsequently remitted its assets to the global pooling arrangement, its creditors have now been paid the 86.5% global dividend rate by the JOLs).

Rump Creditors Foreign Exchange Rate Issue

22. This issue has been raised before the Luxembourg Court by the Liquidator of the Dutch branch of BCCI S.A. supported by the Liquidator of the German branch. It relates to the top-up dividends to be paid to rump creditors who have received dividends in their local branch liquidations.

23. Applying the hotchpot principle in keeping with the principle of universality already discussed, it is accepted by the Global Liquidators that such creditors are entitled to claim in the principal liquidations, but subject to bringing into account dividends received from their branch liquidations.

24. The issue then becomes that which was identified first above; that is: what rate of exchange shall be applied to the dividends received in the branch liquidation in local currency for conversion into US dollars (the currency of the Global liquidation) for bringing those dividends into hotchpot.

25. From the earliest dates of the Global Liquidation, all debts which are proved in the Principal Liquidations have been converted (where necessary) and paid in US dollars.

26. In the case of BCCI Overseas, it was ordered by this Court on 19 June 1992 that as at the date of liquidation (14 January 1992), the currency into which all debts shall be converted is to be dollars in the currency of the United States of America. In so ordering, this Court applied Rule 4.91 of the English Insolvency Rules 1986, which applied to Cayman liquidations in appropriate circumstances until replaced by local Insolvency Rules in 2009.

27. In Cayman (as, indeed I am advised, in London and Luxembourg as well) this practice has resulted in a fixed rate approach.

28. Having so fixed the value of these claims, the approach of the Cayman Liquidators has been to convert all local distributions made by branch liquidators in local currency into US dollars at the same 14 January 1992 exchange rate, rather than to use fluctuating exchange rates since 14 January 1992.

29. This approach has been followed on the basis that it is one which is equitable to creditors overall and appropriate in the complex situation arising from the existence of 27 BCCI Overseas branches. For example, it avoids the need to receive, process and verify information such as payment dates, and to identify varying conversion rates. It is the view of the JOLs that by fixing the exchange rate at 14 January 1992, for both the claim value and for valuing subsequent payments by the local branch liquidator in local currency, the dividend rates paid calculated in local currency will exactly match dividend rates paid if calculated in US dollars.

30. When the issue was raised in Luxembourg by the Dutch Liquidator, the Cayman approach was set out in a memorandum dated 24 January 2008, prepared by one of the JOLs Mr. Michael Pilling.

31. This approach, I am told, found favour with the Luxembourg Liquidators and ultimately with the Luxembourg Court at first instance. The matter has however been taken on appeal to the Luxembourg Court of Appeal by the Dutch Liquidator with the support of the German Liquidator.

32. The Dutch Liquidator has contended for a different approach in relation to the conversion of the six previous EUR interim distributions to the Dutch creditors into US dollars. I am told that his argument is that, as a matter of Dutch law, the determination of the amount of the distribution has to be made on the basis of the

conversion rate applicable on the day of the distribution. This is said to be consistent with the European Convention known as the CEME-Treaty of 1968. The argument then put forward is that in the absence of any provision to the contrary in other relevant EU or Luxembourg law, the system of the CEME-Treaty and the Dutch law should be followed, and therefore the conversion rate at the moment of the distribution to the creditors concerned in the Dutch insolvency proceedings should apply. It must be recognised however, that if this approach prevails, then all the foibles of fluctuating rates of conversion as discussed above, would attend the process of top-up payments.

33. A third alternative approach put forward by the Luxembourg Liquidators would require conversion at the time of actual payment in the principal liquidation in Luxembourg. While there may be an apparent logic to this approach, it gives rise to a practical problem: As top-up payments will only be made in the future when branch liquidations are closed and so branch dividend payments will have been concluded, it would not be possible, using this third alternative approach, to make accurate provisions in advance for such top-up payments.

34. The matter was brought to the attention of this Court by way of the JOLs' application on 11 May 2009. Then it was ordered that the JOLs shall apply the fixed rate of conversion to future top-up payments as it has been applied for all other purposes of the liquidation since 1992. Any other approach would create significant differences in the treatment as between creditors on the basis of arbitrary changes in their national exchange rates as against the US dollar since January 1992. It would also create significant and possibly insuperable operational problems for the administration of the liquidation estates.

35. A quick illustration will show the potential arbitrariness and unfairness: If, at the date of liquidation a foreign debt was, at the rate of exchange then prevailing (say 4 units of local currency to 1 US dollar) worth USD 1 million, that same debt if the rate of exchange became 2:1, would be worth $2 million.

36. Conversely, if the rate of exchange changed in the other direction.

37. As in every exchange of currency someone gains and someone loses, the recipient of a favourable varying rate of exchange would gain at the expense of those other creditors who are not in that position.

38. Such an outcome is anathema to the concept of equal treatment upon which the fundamental pari passu principle is based.

39. Those creditors who are to be paid in US dollars – the denominated currency of the liquidation estate – are not at fault vis-à-vis the foreign currency creditors. The BCCI Companies are the defaulters. The creditors are all, so to speak, together in the same boat.

40. There is therefore no clear reason why the risk of depreciation (or appreciation as the case might be) in the value of the U.S. dollar, as against the foreign currency pending distribution of the asset, should be borne by those creditors whose claims were from the outset denominated in U.S. dollars.

41. In addition to those sound practical reasons discussed above, there is sound legal basis as well for directing that the fixed rate of conversion should apply.

42. I now turn to a discussion of the legal reasons; as a matter of Cayman and, indeed, English law.

LEGAL ANALYSIS

43. The liquidation of an insolvent company is a process of collective enforcement of debts owed by the company for the benefit of the general body of its creditors. Its purpose is to enforce, on the pari passu basis, the payment of the admitted or proved debts of the company.

44. When the liquidation starts, whether by voluntary resolution or by order of the Court, it brings into operation a statutory scheme for dealing with the assets of a company which is being wound up.

45. Under the statutory scheme, the creditors' right to be paid becomes a statutory right to share in the trust fund which is deemed to be created and vested in the liquidator comprising all the assets of the company.

46. The size of the trust fund has to be ascertained as soon as possible because until it is ascertained, it cannot be applied in satisfaction of the company's liabilities.

47. A common currency must be adopted for the valuation of both the assets and the liabilities, otherwise there would be no rational basis for comparing the value of the assets vis-à-vis the value of the liabilities.

48. It follows that whenever a liquidator must value a foreign debt which is expressed in a currency other than the currency of the liquidation, he must convert the foreign debt into the currency of liquidation.

49. Hence, in the case of BCCI Overseas, the adoption at the outset of the liquidation of the US dollar as the currency of the liquidation.

50. Not only as a matter of practice but also of law ever since 1869, the common law courts have determined that the value of the statutory trust fund should be struck as at the date of liquidation.

51. In ***In Re Humber Ironworks and Shipbuilding Co. 1869 LR 4 Ch. App 643,*** the English Court of Appeal was faced with the question whether an insolvent company which was indebted to a creditor for a fixed amount plus ongoing interest, should be liable to pay that interest as it accrued from dates subsequent to the winding up order. The Court of Appeal decided that only the principal and the interest that had accrued as at the date of the winding up could be proved in the liquidation. This, on the basis that all the assets and liabilities had to be struck as at that date. That principle has been recognised and applied by the Courts over the years.

52. As Selwyn LJ said in his judgment in the Court of Appeal (at pp646-647):

> ***"I think the tree must lie where it falls; that it must be ascertained what are the debts as they exist at the date of the winding up, and that all dividends in the case of an insolvent estate must be declared in respect of the debts so ascertained."***

53. Lord Justice Gifford expressed the same view, emphasising not only the convenience of administration, but also fairness as well (at p 647):

> ***"...if we are to consider convenience, it is quite clear that, where an estate is insolvent, convenience is in favour of stopping all the computations at the date of the winding up.... I am of the opinion that dividends ought to be paid on the debts as they stand at the date of the winding up; for when the estate is insolvent this rule distributes the assets in the fairest way;..."***

54. One could be forgiven for concluding simply by parity of reasoning, that if the liabilities and assets are to be valued as at the date of liquidation, the actual

subsequent payments out against those liabilities by use of the assets so valued, must be based on the same values. That being so, it would follow that subsequent fluctuations in the rate of exchange as between the currency of the liquidation and any foreign currency in which the liability may have originated, must be ignored.

55. But parity of reasoning is not all that there is to support this analysis. The English Court of Appeal, albeit in adopting a similar approach based upon ***In Re Humber Ironworks and Shipbuilding Co.*** (above) and other early cases, has clearly so decided. ***In re Lines Bros. Limited (in liquidation) [1983] 1 Ch 1***, the question was whether the liquidators were right to have converted all foreign currency debts of the company into sterling (the currency of the liquidation) at the rate of exchange prevailing at the date of the resolution to wind up and to have calculated dividends in respect of such debts in accordance with those sterling valuations and paid in sterling.

56. The opposing creditor, a Swiss Bank, objected to that approach because, due to the depreciating value of sterling as against Swiss francs in which it had originally made its loan to the company, it would recover at the time of distribution of dividends only 58.7 per cent of the amount loaned.

57. Instead, it argued therefore for the rate of exchange prevailing at the date of distribution.

58. The Court of Appeal held that a foreign currency debt should be proved in a liquidation according to its sterling value as at the date of the commencement of the winding up, since that was in accordance with the general rate for the valuation of liabilities on a winding up and, because liquidation being a process of collective enforcement of a company's liabilities, in accordance also with the

other long standing practice of converting a foreign currency judgment debt into sterling as at the date when leave to enforce such a judgment was given, rather than as at the date of actual recovery of the judgment debt (applying in this latter respect, the case of ***Miliangos v George Frank (Textiles) Limited*** *[1976] A.C. 443,* where that other long standing practice was endorsed and settled by the House of Lords). The following excerpt from the judgment of Lord Justice Brightman in the Court of Appeal (at p 16 E – 17 A) I think best captures the rationale for the adoption of the fixed rate of conversion:

> ***"There is no particular reason, in the field of abstract justice, why the currency risk should be borne by one description of creditor rather than by another description of creditor when they are all directed to rank pari passu. They do not rank pari passu if the sterling creditors are required to underwrite the exchange rate of the pound for the benefit of the foreign currency [(here Swiss Franc)] creditors. The just course, as it seems to me, is to value the foreign debt once and for all at an appropriate date, and to keep that rate of conversion throughout the liquidation until all the debts have been paid in full. The loss and the benefit from changes in exchange rates will then lie where they fall. In terms of sterling, if that is the currency of the liquidation, the amount of the debts will be unaffected by movements on the foreign exchange market. In the case of a debt expressed in a depreciating currency the other creditors will stand to gain nothing from a protracted liquidation. In the case of a debt***

expressed in an appreciating currency, the liquidator will not be faced with the question whether expedited payment of such foreign debt, if that can be effected, might be to the advantage of sterling creditors. All the creditors will be treated alike. No re-calculations will have to be made of the company's indebtedness, and no forecasts of distributions will need to be revised on account of exchange factors. The position will be stablized and all creditors will be treated alike."

59. By way of juxtaposition with the duty of a liquidator in the case of a wholly solvent liquidation; Lord Justice Brightman went on to explain – correctly in my view – (at p 21 F); that unlike in the case of insolvency, if a foreign currency creditor has been paid less than his full contractual foreign currency debt, the liquidator of a solvent company may be obliged to make good that shortfall before he pays any dividends to shareholders.

60. The decision from ***In re Lines Bros. Limited*** later found statutory expression in the form of the 1986 Insolvency Rules, Rule 4.91 (1) which provides:

"For the purpose of proving a debt incurred or payable in a currency other then sterling, the amount of the debt shall be converted into sterling at the official exchange rate prevailing on the date when the company went into liquidation."

61. This, as explained above, is the rule which applied - adapted as circumstances allowed – in the Cayman Islands until replaced by Companies Winding Rules 2008 which came into force in March 2009. Order 16 Rule 13 of the new Rules

re-captures the principles from ***In re Lines Bros. Limited*** and in relevant part provides as follows:

> ***" (1) In the case of a solvent liquidation, the creditors are entitled and the official liquidator is required to pay the company's debts in the currency of the obligation.***
>
> ***(2) In the case of an insolvent liquidation, a company's liabilities shall be translated into the functional currency of the company (referred to in this Rule as the "currency of the liquidation") at the mid market exchange rates prevailing – (a) on the date of the commencement of the voluntary liquidation; or (b) on the date on which the winding up order was made (referred to in this Rule as the "applicable exchange rate").***
>
> ....
>
> ***(5) When a creditor proves for his debt in a currency other than the currency of the liquidation, the amount claimed shall be translated into the currency of the liquidation at the applicable exchange rate.***
>
> ***(6) A creditor shall not be entitled to claim against an insolvent company in liquidation any compensation for exchange losses resulting from changes in the market exchange rate occurring during the period between the date on which the winding up order was made and the date on which the dividend is paid."***

62. Thus, the validity of the approach adopted by the JOLs since 14 January 1992, has now been reinforced by these provisions of the Rules of 2008.

63. While – it must be noted – the Rules do not deal specifically with a situation where dividends have been paid to creditors in another (in this case branch) liquidation for the purpose of bringing those payments into hotchpot, the scheme of them is nonetheless clear. For the purpose of computing liability to a creditor for a debt in a currency other than the currency of the liquidation, a liquidator must utilize "the applicable exchange rate" and changes in market exchange rates occurring between the date of the winding up order and the date on which a dividend is paid are not to be taken into account.

64. As Mr. Clifford Q.C. argued on this application; consistency requires any branch dividends to be converted at the same applicable exchange rate for the purpose of computing any remaining liability to rump creditors. This is the only approach which is both practicable in the complex circumstances which arise, and, importantly, which maintains the fundamental principle of equal treatment of creditors.

65. To adopt any approach other than the fixed rate of conversion at the date of liquidation would necessarily result in inconsistency and inequality of treatment which the conduct of the global liquidation strives to avoid.

66. It was accordingly ordered on the 11 May 2009 that in calculating the payment of top-up dividends to branch rump creditors, the JOLs are to adopt a single fixed

67. rate of foreign exchange and convert all dividends paid from a branch liquidation in local currency into United States of America dollars at the rate prevailing on the date when BCCI (Overseas) went into liquidation, namely 14th January 1992.

Hon. Anthony Smellie
Chief Justice

May 25 2009

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