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IN THE GRAND COURT OF THE CAYMAN ISLANDS
FINANCIAL SERVICES DIVISION

Cause No. FSD 2[illegible] of 2011 (AJJ)

The Hon Mr. Justice Andrew J. Jones QC
In Chambers, 5th January 2012

IN THE MATTER OF THE COMPANIES LAW (2011 Revision)

AND IN THE MATTER OF EMERGENT CAPITAL LIMITED (In Liquidation)

BETWEEN:

KTC — **Applicant**

and

RAAL LIMITED — **Respondent**

Appearances:

Mr. Timothy Haynes of Walkers on behalf of RAAL

Mr. Jayson Wood of Appleby on behalf of KTC

Mr. Nigel Meeson QC of Conyers Dill & Pearman for the Joint Official Liquidators of Emergent Capital Limited (In Liquidation) ("the Company")

RULING

1. This is an application by RAAL Limited ("RAAL") for leave to appeal against the order for costs which I made on 23rd November 2011, consequential upon my ruling that KTC was entitled to have the Company's share register rectified to reflect that the issue of 49,900 shares to RAAL was invalid. I made an order that RAAL should pay KTC's costs of the Application (as defined), such costs to be taxed on the standard basis if not agreed. RAAL now seeks leave to appeal, essentially on two grounds. First, it is submitted that I erred in principle by making an order on the basis that the costs of the Application should follow the event, whereas it is said that I should have made an order that both parties' costs be paid out of the assets of the Company as an expense of the liquidation. Mr Haynes' written submission made no reference to Order 24 of the Companies Winding

Up Rules, but I think that his case could only be put on the basis that I should have made an order pursuant to CWR O.24, r.9(4). Secondly, it is submitted that in exercising the Court's discretion I failed to take account and/or have regard to the fact that KTC failed on every pleaded issue apart from the claim that the directors had acted in breach of fiduciary duty at the board meeting on 28th January 2010 and exercised their power to issue new shares for an improper purpose. It is also submitted that I failed to take account and/or have regard to the fact that during his closing speech counsel for KTC withdrew one of his pleaded claims.

2. In order to address the first of these grounds of appeal, it is necessary to understand the procedural history of the Application. By their amended summons dated 10th May 2011 the Official Liquidators made an application for directions in respect of the dispute about the respective shareholdings of the Company's only two shareholders, namely KTC and RAAL. This summons was a sanction application made by the Official Liquidators pursuant to the powers conferred upon them by CWR Order 11. Having heard counsel for the Official Liquidators and counsel for the two competing stakeholders, I made an order for directions on 2nd June 2011 ("the Order for Directions"), the effect of which was that the sanction application would take on the character of an *inter partes* action between KTC (as applicant) and RAAL (as respondent) by which their substantive rights against the Company would be determined. Accordingly, I directed the service of pleadings and the exchange of witness statements as if the matter was an action commenced by writ. Although I did not actually direct the Official Liquidators to take no further part in the proceeding, it was in fact agreed that they would not do so. The expression "the Application" is used to mean the trial of the issues defined in the Order for Directions. In the event, the trial of the Application lasted five days and was conducted in exactly the way in which it would have been conducted had the originating process been a writ issued by KTC, as opposed to a sanction application issued by the Official Liquidators. I delivered judgment on 23rd November 2011 and, having heard brief submissions on the question of costs, I made an order on the basis that the costs of the Application should follow the event, which meant that RAAL should pay KTC's costs, such costs to be taxed on the standard basis if not agreed.

3. The point of principle raised by counsel for RAAL turns on how one should characterise the Application. If it is properly characterized as a sanction application, then the Court should make orders for costs in accordance with the principles contained in CWR Order 24. Alternatively, if it is properly characterized as an *inter partes* action between KTC as applicant and RAAL as respondent, then the Court should apply the principles contained in GCR O.62, r.4.

4. As a matter of procedure, it is perfectly clear that the Application is a sanction application within the meaning of CWR Orders 11 and 24. It was initiated by the amended summons issued by the Official Liquidators pursuant to their statutory powers and the end result was a direction that the Official Liquidators shall rectify the Company's register of members and distribute the available assets to KTC and RAAL on the basis that they each own 50% of the issued share capital. It follows that the Official Liquidators were entitled to have their costs of the Application paid out of the Company's assets pursuant to CWR O.24, r.9(2). If the Application should continue to be treated as a sanction application, notwithstanding the consequences of the Order for Directions, then, *prima facie,* the Court should have made orders for costs pursuant to rule 9(4) which provides as follows –

> "In the case of a sanction application which is made or opposed by a creditor or contributory, the general rule is that –
> (a) his costs of successfully making or opposing the application should be paid out of the assets of the company, such costs to be taxed on an indemnity basis if not agreed with the official liquidator; and
> (b) no order for costs should be made against a creditor or contributory whose application or opposition is unsuccessful, unless the Court is satisfied that his position was wholly unreasonable or he is guilty of having misled the Court or otherwise acting improperly in connection with the application."

The principle underlying this rule is that sanction applications, made by official liquidators or stakeholders, are the mechanism whereby the Court gives directions (which may be permissive or prescriptive) about the way in which the official liquidators should exercise or refrain from exercising their powers in the interests of all the creditors or shareholders as the case may be. The directions resulting from a sanction application take

effect for the benefit of the estate as a whole. For this reason rule 9(4)(a) provides that an individual creditor or shareholder who successfully makes or opposes a sanction application should have his costs of doing so paid out of the estate as an expense of the liquidation. Since the Court's direction operates for the benefit of the creditor/shareholder class, it would be wrong in principle to impose the cost on the individual who successfully acted in their interest. If the individual's application/opposition was unsuccessful, rule 9(4)(b) provides that he should not be ordered to pay the official liquidator's costs, unless the position which he adopted was wholly unreasonable or he is guilty of having misled the court or otherwise acted improperly. So long as he is acting properly in the interests of the estate, the Court should not make any order for costs against him merely because his argument has been rejected. If it had been appropriate to apply these rules in the circumstances of this case, I would have made an order that KTC's costs be paid out of the Company's assets on an indemnity basis because it was "successful" and I would have made no order for costs against RAAL as the unsuccessful party, because it was not guilty of conducting its case in a way which was unreasonable or improper. It should be noted that there was no basis under rule 9(4) for making an order that RAAL, as the unsuccessful party, should have its costs out of the assets. However, I was satisfied that there were exceptional circumstances and special reasons, within the meaning of rule 9(5), which justified departing from rule 9(4) altogether and making an order that RAAL pay KTC's costs on the standard basis.

5. As a matter of procedure and as a matter of form, the Application was a sanction application. In substance it was not. In substance, the Order for Directions had the effect of converting it into an *inter partes* action between KTC as applicant and RAAL as respondent. They are the *only* parties in interest. The official liquidators took no part in the Application. KTC cannot sensibly claim to have been acting in the interests of "the estate". It was asserting its own cause of action for its own benefit. Likewise, RAAL cannot claim to have been defending the action on behalf of the Company in the interests of the stakeholders generally. RAAL is the only other shareholder. It was defending KTC's claim in its own interest. In substance, the Application was litigation between KTC and RAAL, by which the Court determined their respective rights as against the

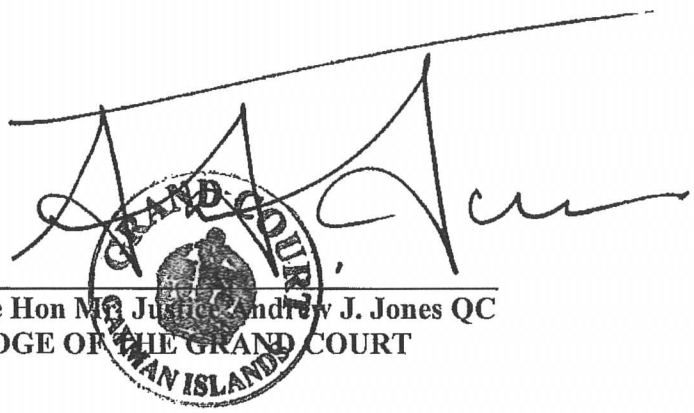
Company. For the purposes of costs, it is plainly obvious in my judgment that rule 9(5) enables the Court to have regard to the substance of the matter and not merely its procedural form. The proposition that the conversion of the sanction application into an *inter partes* action between the only two parties in interest is *not* an exceptional circumstance or special reason for departing from the rules applicable to ordinary sanction applications is unarguable. It seems to me that the circumstances of this case make it the classic example in which the Court should depart from the principles set out in rule 9(4)(a) and (b). The Application was akin to the circumstances addressed by rule 8(2)(b). When the Court directs that a contributory's winding up petition be treated as an *inter partes* proceeding between two shareholders, the general rule is that none of the costs should be paid out of the assets of the company and the unsuccessful party should pay the costs of the successful party, to be taxed on the standard basis. In my judgment, exactly the same approach should be adopted when the Court directs, as I did in this case, that a sanction application should be treated as an *inter partes* action between the only two shareholders. In my judgment, the proposition that I erred in principle by adopting this course is quite simply unarguable.

6. The second and alternative limb of the application for leave to appeal is that I failed to exercise the Court's discretion properly, even if I did adopt the correct approach by applying the principles of GCR O.62, r.4 rather than CWR O.24, r.9. I concluded that KTC is the successful party and that RAAL is the unsuccessful party. KTC succeeded by establishing that the debt/equity swap transaction was invalid and that it is consequentially entitled to receive 50% of the assets (net after payment of the creditors and expenses of the liquidation). Although KTC's counsel withdrew his argument that the draft shareholders' agreement was the governing document and KTC lost on all its other pleaded claims except the critical one, it seemed to me that the trial would have taken essentially the same course even if these various other points had not been pleaded. The key issue was whether or not the directors had acted in breach of fiduciary duty and exercised their power to issue shares for a proper purpose. The resolution of this issue turned upon disputed factual evidence which necessarily involved wide ranging cross-examination of the witnesses about the parties' evolving relationship over a period of

some eighteen months. It was counsel for RAAL who sought to expand the scope of the cross-examination. I considered whether I should give KTC only part of its costs, but it seemed to me that the issues on which KTC lost probably did not add to the costs of the Application in a very material way. In particular, it seemed to me that all the same witnesses would have been called and cross-examined. On balance, I concluded that it was right in all the circumstances to treat KTC as the successful party and that it should have the whole of its costs of the Application.

7. Having come to the conclusion that the point of principle is unarguable, I think that an appeal based solely upon the way in which I exercised the Court's discretion under GCR O.62, r.4(5) would have no real prospective of success in the circumstances of this case. The mere fact that KTC lost on a number of pleaded issues does not necessarily lead to the conclusion that the Court should not make an order that the costs follow the event. For these reasons RAAL's application for leave to appeal against the order for costs is dismissed.

Dated this 5th day of January 2012



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