IN THE GRAND COURT OF THE CAYMAN ISLANDS

FSD 16 OF 2009 ASCJ

IN THE MATTER OF THE COMPANIES LAW (2007 REVISION)

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

IN CHAMBERS
BEFORE THE HON. CHIEF JUSTICE
THE 5TH AND 6TH DECEMBER 2012

Appearances: **See Representation Chart attached.**

JUDGMENT

1. On the 10th November 2011 I directed the convening of meetings at which the respective classes of shareholders interested in the SPhinX liquidation estate would vote on whether to approve a scheme of arrangement. The Scheme was in terms proposed by Deutsche Bank ("DB"), a member of the Liquidation Committee ("LC") and hfc Ltd., each the holder of very significant interests in Sphinx and together "the Scheme Proponents". The Scheme was presented by the Joint Official Liquidators ("JOLs") to shareholders under directions from this Court, although the JOLs felt unable to recommend its terms. The Scheme was therefore presented on the basis that it was for the shareholders themselves – all of them sophisticated investors – to decide whether or not the Scheme was in their own best interests. It was understood that ultimately, if approved at the Court meetings, the test for whether the Scheme should be sanctioned by the Court, would be whether it is one that "an intelligent and

honest man, a member of the class (of investors) concerned and entirely in respect of his interest, might reasonably approve": **Re Telewest Communications** ***[2005] BCC 36***. The details of the Scheme, and the information needed for its consideration by shareholders, were contained in Explanatory Memoranda approved by the Court for those purposes.

2. At the Court meetings held on 13th December 2011, the necessary statutory majorities in number and value were attained in all but two classes. At reconvened meetings, subsequently directed by the Court in those two classes on the basis that there was good reason to think that the voting might change and held on 22nd October 2012, the necessary majorities were attained in one but not in the other of the two classes.

3. That other was Class 10 in which a certain investor holding a blocking position, again voted against the Scheme.

4. As the structure of the Scheme is such that the necessary statutory majorities must be attained in each and every class, this single investor effectively came to hold a blocking position over the entire Scheme. In those circumstances, the Scheme could not proceed to a hearing at which its sanction by the Court could have been obtained as required by the Companies Law and so as to be binding and effective on all stakeholders.

5. Since that second unsuccessful meeting of Class 10, there has been a change of circumstance. This is that DB has acquired the shares of all investors formally in Class 10 making DB the sole owner of Class 10 shares.

6. As DB continues to support the Scheme, this means that the required statutory majorities are now satisfied in all classes; and this is acknowledged by the JOLs and by the LC.

7. I confirm that to be the case for the following reasons. I have already decided and directed, as an aspect of the Scheme, that DB should not exercise any voting rights in the classes in which it might otherwise be entitled to vote because the release that is to be granted to DB under the Scheme (to be described below) renders DB's rights under the Scheme different from those of other investors. That being so and given that DB has already given its consent to the Scheme in respect of all rights beneficially held by it; DB need not give its separate consent in respect of the rights held pursuant to its acquisition of Class 10 shares.

8. Furthermore, there having been other Court meetings (there were 22 classes at the Court-directed Scheme meeting), it is not necessary to convene a Court meeting for a class of investors that comprises only of one member, if the Court is satisfied that that class consents to the Scheme: see ***Oceanrose Investment Ltd.*** ***[2008] EWHC (Ch) 3475 Bus. LR 947.***

9. The special context in which it is possible to dispense with the convening of a meeting for a class of investors comprising only one member was explained by David Richards J (at paragraph 20) by reference to his earlier dictum in ***In re Hastings Deering Pty Ltd.*** ***(1984) 3 ACLC 474.*** He explained that where, as the result of the division of members or creditors into different classes required for voting for the purposes of a scheme, a class comes to comprise only one person; in such a case it will not be essential to convene a meeting of that class if that person consents to the

scheme. This is provided also that such consent is given in the context where meetings have been held in other classes or at least in one other class. The rationale, as I understand it, is that in the total absence of any meeting whatsoever at which the consensus of required majorities had been achieved, there would be nothing to which a sole member of a class could consent resulting in it being bound by the scheme.

10. In the context of the Scheme where there were 21 other meetings, the consent of DB given without the need for the formal convening of a meeting in its class of one, will therefore clearly suffice.

11. The question has been raised nonetheless by the JOLs for my consideration, whether the change of circumstance of DB's acquisition of the Class 10 shares ("the DB Purchase") is such as to necessitate the reconvening of Court-directed meetings in all the other classes. This, as the JOLs postulate the question, and while taking a position of neutrality on it, would be so as to allow those scheme participants voting in the other classes, to consider whether, in light of the change of circumstance in Class 10, they would still wish to approve the Scheme.

Factual Background

12. Some understanding of the nature of the Scheme is essential to an examination of this question. Though the background is complicated, a fundamental understanding can be gleaned from the following essential factors which themselves gave rise to the perceived need for the Scheme. A further explanation of the background can be obtained from earlier reported judgments on this liquidation. See for instance: ***2010 (1) CILR 234*** and ***2010 (2) CILR 1***.

13. The SPhinX Liquidation involves a group structure of various companies whose assets and liabilities (held within more than 80 segregated portfolios involving more than 400 broker accounts) were found by the JOLs upon taking office, to be in their view, "hopelessly intermingled".

14. This assessment of the state of affairs has however, not been accepted by some of the investors, including and most notably DB. It is an assessment the accuracy or otherwise of which, is nonetheless of critical importance to the proper liquidation of the affairs of the SPhinX companies, where assets and liabilities were required by their corporate constitutional documents to be kept and managed separately, including in the case of many of the SPhinX companies, by way of the more than 80 segregated portfolios within those companies.

15. A major issue that led to the collapse of the SPhinX Group, was the discovery of the allegedly fraudulent transfer away of some USD 320 million of SPhinX Group assets. These assets were held in a particular SPhinX entity SPhinX Managed Futures Fund SPC ("SMFF") but were transferred to a non-related Bermuda entity called RCM (a member of the RefCo Group then involved with SPhinX Group as its broker). The RefCo Group having itself been forced into bankruptcy by the revelation of systemic fraud within it, the USD 320 million of assets which RefCo held on SphinX's behalf triggered the demise of the SPhinX Group. The inevitable litigation followed and is now expected to go to trial in New York in June 2013 against former RefCo entities and officers, as well as against others who are alleged to have been fraudulently or grossly negligently involved in the misappropriation of SPhinX assets. A number of those others were officers or contractors of SPhinX and held indemnities which

would allow them to recover from SPhinX, if they are successful in the New York action (the indemnity claimants or "ICs").

16. Given the intermingled state of the accounts discovered by the JOLs, a major issue in the SPhinX liquidation became to which SPhinX entities should the impact of the RefCo fraud – resulting from the SMFF loss – be ascribed?

17. Another issue became how should the interest of those shareholders who had purported to redeem their shares in various SPhinX entities before the liquidation but were never actually paid in full and who therefore had been issued "special situation shares" prior to the date of liquidation ("the S Shareholders") be treated? Should S Shareholders be regarded strictly as shareholders and so required to rank pari passu with other shareholders in the SPhinX liquidation, or should they be regarded as creditors? And if so, as ranking ahead of shareholders?

18. More generally, given the state of affairs found by the JOLs and described by them as "hopelessly intermingled", should the liquidation proceed on the basis that all assets and liabilities of the SPhinX entities be pooled and all claimants dealt with on the pari passu basis, or proceed on the basis that claims are resolved based on the state of affairs and accounts as they were found at the date of liquidation: that is; on the basis of the "let the tree lie as it fell" proposition for winding up?

19. A further concern became how would the contingent claims of ICs be treated? This was an issue that had already led to the setting of a reserve of USD117 million by this Court for meeting the legal costs of ICs and further reserves had to be considered. See ***2010 (1) CILR 234*** (above).

20. These, and various subsets of questions numbering 23 in total, were all identified as "liquidation issues" which this Court would be required to resolve before any distribution of assets could take place.

21. Everyone recognized that this would be a daunting task - very time consuming for the JOLs, the representative parties and the Court and extremely expensive for the liquidation estate.

22. A scheme of arrangement was proposed by the JOLs in the hope of resolving these liquidation issues by way of enjoining all interested parties; but that scheme proved unsuccessful.

23. The liquidation issues became even more involved when it was determined that the JOLs (on the advice of their New York lawyers and with the approval of this Court) should join DB as a defendant to the New York action.

24. DB is now therefore alleged to have either fraudulently or grossly negligently breached its duties of care owed to the SPhinX Group; duties it owed as one of SPhinX's investment managers and advisors also in relation to the SMFF loss. DB also, however, is the single largest investor in the SPhinX Group and a major proponent of the "let the tree lie as it fell" proposition for the winding up of the estate. This, as I understand it, is on the basis that the bulk of the assets, although not the liabilities, were found to be recorded within the accounts of those entities in which DB is invested.

25. Other major investors, those whose investments are not registered in those entities whose books show the assets, but in those entities at or towards the other end of the spectrum of liabilities; do not see things that way. They naturally argue for the

pooling of assets on the basis that that would be the only fair way of resolving claims in the "hopelessly intermingled" state of the SPhinX Group's affairs. Among these investors is hfc Ltd., the second single largest investor holding some 14% of the shares and, along with DB, the other Scheme proponent.

26. Against all that background, the JOLs have, for much of the six years of the liquidation, held some $500 million in recoveries awaiting distribution. But distribution is an event which may not occur until at least the liquidation issues are resolved, including that as to whether or not the assets and liabilities are to be pooled; and that as to the full extent of the indemnity reserve to be set aside to meet the ICs' contingent claims. These are claims which, if they become actualized, will rank *pro tanto* as creditor claims ahead of shareholders' claims.

27. It is against that background that DB and hfc Ltd. came to be the Scheme Proponents. They propose through the Scheme that, if sanctioned, the Scheme would, among other things, result in the pooling of all assets and liabilities. This would involve an important concession from DB's point of view and an important advantage from the point of view of hfc Ltd. and other investors whose investments are mired at the unfavourable end of the liabilities spectrum, in the "hopelessly intermingled" accounts of the SPhinX companies.

28. A second component of the Scheme would allow for the setting aside of a full indemnity reserve to meet IC claims, such reserve to be finally quantified by this Court.

29. A third component, and that which is most germane to the present question of whether or not I should direct the reconvening of class meetings, is that DB would

obtain its release from liability in the New York action. This would be a most important quid pro quo, from DB's point of view, to its agreement to the pooling of assets.

30. A final issue to note now by way of background but only in passing, is the newly emergent and related concern that Beus Gilbert - the JOLs' lawyers in the New York action - have notified the JOLs that should the Scheme be sanctioned and proceed so as to result in the release of DB from the New York action, Beus Gilbert would regard that as a breach of its contract with the JOLs (which is based upon a contingency fee arrangement); because it would undermine the prospects of success in the New York action. Thus, say Beus Gilbert, the JOLs would be liable in damages to them potentially in the order of magnitude of at least $250 million, representing the amount that they say their contingency fees would yield if the New York action were to succeed.

31. The relevance of the potential Beus Gilbert claim now, is that it too may have to be provided for by way of a reserve under the scheme before sanction can be granted.

32. The premise upon which the Beus Gilbert claim is based had been brought to the attention of all Scheme participants for the purposes of the first and reconvened Court meetings. They nonetheless (but for the investor formerly holding the blocking position in Class 10) voted in favour of the Scheme. Scheme participants have agreed that the proper treatment of the Beus Gilbert claim in the event of sanction of the Scheme and before any distributions might be allowed, would be to create a separate reserve to meet it if it becomes actualised. Thus, the setting of the appropriate

reserves – both for the IC's and Beus Gilbert claims - would be prerequisites to the giving of sanction to the Scheme.

33. All have agreed that should this Court determine that the combined total of the ICs' reserve and the putative Beus Gilbert reserve could exceed the available assets of approximately USD500 million, there would be no jurisdiction in the Court to sanction the Scheme so as to allow for an early distribution of assets since the ICs and Beus Gilbert have had no vote on the Scheme. This is of course in recognition of the fact that creditors must be paid before shareholders, and this has all been explained to Scheme participants.

34. Against that background, the present issue raised by the JOLs for my consideration before any further steps might be taken towards sanctioning the Scheme, can be restated thus: has there been a material change of circumstance brought about by the acquisition by DB of the shares of all blocking investors in Class 10, such as to require me now to direct the reconvening of meetings in all other classes before this Court could proceed to sanction the Scheme?

The Case Law

35. The case law is clear that where there is a material change of circumstance, such as might cause a scheme participant acting reasonably in the protection of his own interest to reconsider and change his vote by which he had approved of a scheme; the Court must consider whether to direct the reconvening of Court meetings. With the principle framed in those terms in mind, the JOLs say that even while they do not positively argue for the reconvening of the Court meetings, they are duty bound to raise the question.

36. The starting point for the answer to this question is that recognised in ***Re Equitable Life Ass.*** ***[2002] EWHC 140 (Ch),*** where it is stated that the Court is required to consider whether, were the scheme in question to proceed to the sanction stage without the reconvening of meetings, it could reasonably be said that sanction should be withheld because there is "a blot on the scheme".

37. The discussion of the principle can be picked up from the judgment of Lloyd J in ***Re Equitable Life Ass.*** at page 531 letter A where the following passage appears:

> *"That phrase ("blot on the scheme") derives from the judgment of Lindley LJ in Re English, Scottish and Australian Chartered Bank [1893] 3 Ch 385 at 409 where he said:*
>
> > *"The Court does not simply register the resolution come to by the creditors or shareholders, as the case may be. If the creditors are acting on sufficient information and with time to consider what they are about, and are acting honestly, they are, I apprehend, much better judges of what is to their commercial advantage than the Court can be. I do not say it is conclusive, because there might be some blot on a scheme which had passed that had been unobserved and which was pointed out later. While, therefore, I protest that we are not to register their decisions, but to see that they have been properly consulted, and have considered the matter from a proper point of view, that*

> *is, with a view to the interest of the class to which they belong and are empowered to bind, the Court ought to be slow to differ from them. It should do so without hesitation if there is anything wrong; but it might not do so, in my judgment, unless something is brought to the attention of the court to show that there has been some material oversight or miscarriage."* (emphasis supplied).

38. With that statement of principle in mind, the question then becomes: would the failure to direct the reconvening of Court meetings in light of the fact that since meetings were held DB has acquired the Class 10 shares, (even presuming it to have been acquired for a premium), be a "material oversight or miscarriage" such as could reasonably prevent the Court from granting its sanction of the Scheme later on?

39. The answer clearly depends upon whether or not it can reasonably be thought that the change of circumstances involving the DB Purchase, would be material to the decision of a reasonable scheme participant contemplating the approval of the Scheme.

40. In ***Re Minster Assets Plc*** ***1985 1 BCC CR.D. 99,299,*** Harman J. considered circumstances where, after the issue of the circular recommending the proposed scheme to the shareholders (including disclosure of the participating interests of the board members as they then were), there were dealings by the directors with their shares before the date of the meeting at which the proposed scheme was approved. Those transactions remained undisclosed to the shareholders at the approval meetings

and the petitioners, seeking sanction of the scheme nonetheless, argued that the dealings by the directors were not such as to cause the court to withhold its sanction to the scheme as a whole.

41. Harman J. agreed, adopting the test earlier applied by Slade J. in ***Re Jessel Trust Ltd [1985] BCLC 119*** that "the role of the court is to be satisfied that no reasonable shareholder would change his decision as to how to act on the scheme if the changes had been disclosed."

42. Further, in reference to the share transactions in question before him, Harman J. said (at page 99,301):

> *"Those were transactions which, had they been specifically disclosed in a separate circular to shareholders before the meeting, could not have changed the mind of a reasonable shareholder in considering the commendation made by the directors in respect of all their then holdings in the company and could not have led to any reasonable shareholder taking a different view from those which were in fact taken. Upon that ground, I am satisfied that there is a proper jurisdiction to approve this scheme, notwithstanding the dealings which took place."*

43. That approach strikes me as the appropriate one to take in the present circumstances where the issue is whether I should direct the reconvening of scheme meetings in light of the DB Purchase since the meetings. I am compelled to ask the obvious question: would a reasonable scheme participant change his decision to vote for the Scheme being now aware of the DB Purchase?

44. The clear answer to that question to my mind is "No".

45. Nothing about the DB Purchase alters the material terms of the Scheme - in all its complexity as described above - and as was fully known and understood by Scheme participants, including the fact that DB would obtain its release from the New York action. Nothing about the DB Purchase suggests that the information given to scheme participants when they voted in favour of the Scheme was inadequate (the test in ***Re Equitable Life*** (above)).

46. The Scheme remains the same as when it was voted upon at the Court meetings and nothing about the DB Purchase would be relevant to a reasonable consideration of whether the terms of the Scheme themselves would or would not be in the commercial interests of any scheme participant or class of scheme participants.

47. I can therefore see no reasonable basis upon which a scheme participant would wish to reconsider his affirmative vote in light of the DB Purchase. The result of the DB Purchase is to remove the final obstacle to the attainment of the statutory majorities for the approval of the Scheme – the very objective with which the notional reasonable Scheme participant must be regarded as having agreed when voting in favour of the Scheme. (I need not for these purposes consider the position of the small minorities who voted against as a change of view by them would change nothing.)

48. It is, of course, recognised that a scheme participant could wish to change its vote on the gambit that DB might offer a premium to secure again its very approval earlier given. This is again assuming that the DB Purchase was indeed made at a premium to obtain the blocking investor's shares. But that would neither be a reasonable nor a

realistic view of how an investor might behave. No reasonable scheme participant should expect to be able in such an opportunistic way to hijack the Scheme, intended as it is in the spirit of open compromise, to operate for the benefit of all scheme participants. Nor would such behavior be realistic because DB could not be expected to offer each and every potential blocking investor or group of blocking investors a premium to secure its vote.

49. The Court may not be expected to direct the reconvening of Court Meetings to create an opportunity for an unscrupulous investor or group of investors holding a blocking position or collective blocking position to exercise unjustifiable commercial leverage on the Scheme Proponents: that is, by trying to extract an inflated price for their shares in exchange for the renewal of their vote in favour of the Scheme.

50. Furthermore, all indications already are that the scheme participants agree that reconvened meetings are not necessary. They have been made aware of the DB Purchase by notices issued by the JOLs on the SPhinX website (the usual place for such notices) but none has expressed concern. This is despite having also been made aware that the JOLs would be seeking directions from the Court "*...on the next steps with respect to the Scheme in light of this development*" and that *"any investors or creditors who wish to express a view on [(among others)] (this) issue are asked to contact the JOLs in order that their views can be brought to the attention of the Court...."*

51. There is, moreover, nothing unusual or inherently exceptionable about the acquisition of shares of investors by other investors in SPhinX. A number of such transactions have occurred since the commencement of the liquidation and the ongoing trading in

SPhinX shares has been encouraged as a means of sustaining values. This obviously operates to the benefit of investors. While one of the JOLs (Margot McInnis in her 22nd Affidavit) disputes the LC's argument on this point (against the reconvening of meetings) that there has been considerable trading in SPhinX shares throughout the course of the liquidation, she does acknowledge that there have been at least 5 instances of trading known to the JOLs.

52. The DB Purchase is therefore described as unusual only insofar as it occurred after the Scheme meetings; although I must accept that it was only then that the importance of the acquisition to the success of the Scheme became clear.

53. So what then, at the end of the day, could be the real meaning of the DB Purchase from the point of view of other investors? While DB sees its own commercial interests as being best served by the sanction and implementation of the Scheme, so too, it must be assumed, do all other scheme participants who voted for it. Accordingly, the DB Purchase has resulted in no change of circumstances that could be regarded as being detrimental to the interests of other investors. Quite the opposite as the DB Purchase removed the final obstacle to the attainment of the statutory majorities and so allows the Scheme to be considered for sanction by the Court.

54. Nor is it alleged that any irregularity has occurred in or as a consequence of the DB Purchase itself. While it proceeded by private negotiations between DB and the blocking investor, the outcome was timeously disclosed to the JOLs who, in turn, informed all scheme participants in a timely fashion. The terms of the purchase, while still remaining confidential, have been disclosed to me in the 6th and 7th Affidavits of Joe Kohler, DB's legal counsel to its Markets Division. Based on his

evidence, Miss Toube QC explains, and the JOLs do not doubt, that the DB purchase resulted from arm's length negotiations and was unconditional (i.e. on terms that are not dependent upon any contingency whether in relation to the ultimate sanction of the Scheme or otherwise).

55. I accept that, as the transaction resulted in an arm's length acquisition by DB of the Class 10 shares, there is no imputation of a clandestine deal such as could influence the voting in any class. The blocking investor has taken its money and exited the Scheme and the SphinX liquidation. It can no longer vote and can therefore in no way influence the voting on the Scheme or the outcome of the Scheme.

56. It follows also that there is no irregularity such as could need to be "cured" by the notice which has been given to scheme participants by the JOLs and thus would otherwise have required providing investors with an opportunity to object. That is however the kind of irregularity which, even had it occurred, could have been considered cured (on the authority of the Australian case of ***Re Telford Inns Pty Ltd.*** ***10 ACLR 312***) by the notice given in this case by the JOLs and the absence of any objection from scheme participants.

57. This case is also to be distinguished from ***Cadbury Schweppes plc v Somji*** ***[2001] 1 615.*** There some scheme participants had been induced to vote in favour of a proposed voluntary arrangement only by a secret collateral advantage offered to them but not disclosed to others and for that reason the court's sanction of that voluntary arrangement was not given. I have explained why no such secret collateral advantage or inducement is involved here.

58. It must all the same, be emphasized that a proposal for a scheme of arrangement must be characterised by complete transparency and good faith (***Somji*** (above) and ***Kapoor v National Westminster Bank Plc & Anor*** ***[2011] EWCA Civ 1083)***; and material events to justify reconvening meetings will include matters which occurred after scheme meetings have been convened (***Re Telford Inns Pty Ltd***. (above) and ***Re Adams Int'L Food Traders*** ***[1998] 13 ACLR 586)***. But the question remains the same in this case: has there been a material change of circumstances? Or, as a final exposition of the proper approach to the task at hand in a comparable situation was offered in ***Re Jessel Trust*** (above) per Slade J:

"...the court must look closely to see that after the meeting of creditors nothing should have occurred that had it been known to the creditors at the time of the meeting might have induced them to vote differently."

59. Approaching that proposition from the point of view of the behaviour of a reasonable scheme participant acting in good faith, I am satisfied that the DB Purchase is not such an occurrence.

60. While I note the JOL's assiduousness in having raised the matter for the Court's consideration, and thank Mr. Lowe QC for his able arguments in so doing on the JOLs' behalf, I am satisfied that the DB Purchase raises no basis upon which to direct the reconvening of Court meetings and I decline to do so.

61. Before the Scheme might proceed to sanction by the Court, there must be however, as explained above, the setting of such reserves to meet a Beus Gilbert claim and the final quantum of the ICs' reserves, as the Court may determine.

62. Directions have been given and dates for the hearings for those purposes will be agreed and settled with the Listing Officer.

Hon Anthony Smellie
Chief Justice

December 21st 2012.

REPRESENTATION CHART

Counsel/Attorney Appearing	Law Firm Appearing	Representing
Tom Lowe QC Ceri Bryant QC Cherry Bridges Thomas Williams	Counsel Ritch & Conolly	The Joint Official Liquidators of the SPhinX Group of Companies
Mark Phillips QC Alan Turner Andrea Dunsby	Counsel Turners	Liquidation Committee
Felicity Toube QC (by videolink from London) Graham Ritchie QC David Collier	Counsel CARD	Deutsche Bank
Sarah Dobbyn Anthony Akiwumi	Of Counsel Stuarts	hfc Limited
Richard Sheldon QC (by videolink from London) Guy Cowan Guy Manning	Counsel Campbells	DPM and Robert Aaron
John Harris	Higgs & Johnson	PWC Cayman
Neil Timms QC Roger Nelson	Counsel Nelson & Co.	PWC LLP
Marc Kish (watching brief)	Maples and Calder	Refco Public Fund
Ben Hobden (watching brief)	Conyers Dill & Pearman	BAWAG