IN THE GRAND COURT OF THE CAYMAN ISLANDS

FSD 16 OF 2009 ASCJ


12-08-11

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
HEARD ON 11TH NOVEMBER 2010

Appearances: Ms. Cherry Bridges and Mr. Alex Horsbrugh-Porter of Ritch and Conolly for the Joint Official Liquidators of the SPhinX Group of Companies ("the JOLs")

Mr. Alan Turner and Mr. Mark Goodman of Turner & Roulstone for the Liquidation Committee ("the LC")

**RULING**

1. The JOL's apply for court approval of an increase in their hourly rates of remuneration to be applied in the liquidation of the SPhinX companies going forward from 1st January 2010. Given the pattern of increases every two years, it is implicit that this new rate would be subject to review at end of 2011.

2. The rates of remuneration applicable as of 1st January 2008, the proposed new 2010 rates and the range of rates prescribed in the Schedule to the Insolvency Practitioners Regulations 2008 (as amended in 2010) ("the IPR") are as set out in the following table:

| Hourly Rates | 2008 Rates | 2010 Rates | Regulation Rates |
|---|---|---|---|
| Managing Director | 585 | 625-675 | 500-900 |
| Director | 440 | 540 | 425-680 |
| Senior Manager | 400 | 495 | 350-575 |
| Manager | 350 | 425 | 275-475 |
| Senior Accountant | 245 | 265-285 | 200-350 |
| Junior Accountant | 125 | 145 | 150-225 |
| Administrator | 65 | 85 | 50-200 |
| Consultant | 125-245 | 225-285 | 275-900 |

3. It is immediately apparent that the proposed 2010 rates fall generally within the mid-range of the IPR rates and so are within the rates which might be approved.

4. The JOLs have not however, managed to secure the approval of the LC who oppose because the new rates would involve an increase of 18% on top of the increases of 22% which have already been allowed since the JOLs were appointed in 2007. Hence this application.

5. The Court's primary jurisdiction for approving the remuneration of liquidators is given by Section 109 (2) of the Companies Law (2010 Revision) ("the Law").

6. However, the IPR (made under the provisions of Section 155 of the Law), prescribe the procedure and rates and provide that remuneration rates should be agreed, in the first place, as between the LC and the JOLs, by way of negotiation. In this regard, IPR provides that while a liquidator is not entitled to receive any remuneration out of the assets of a company in liquidation without approval of the Court, a liquidator may not make an application to the Court for approval without first seeking the approval of the creditors or shareholders, as the case might be. The prescribed IPR rates are intended to provide the framework for that process of negotiation. By virtue of IPR II, a liquidator may be remunerated on the basis of (i) time spent (expressed as hourly rates); or (ii) a percentage of amounts of

distributions; or (iii) a percentage of recoveries; or (iv) a fixed fee; or (v) a combination of some or all of the above..

7. In this case, the rates originally negotiated and approved by the Court and as approved at January 2008 were well within the IPR rates, as shown in the table above (apart from the Junior Accountant and Consultant levels which have been below the base IPR rates).

8. In the context of an application by the JOLs, failing agreement with the LC, the Court shall have regard to the views of the LC as representing the people having the ultimate financial interests in the liquidation, although the Court is by no means bound by those views. However the IPR are themselves silent as to the factors to which the Court should have regard in considering an application by the JOLs for an increase.

9. In this regard, I think the starting point must be to consider whether the increase is justified having regard to all the circumstances of the liquidation including, of course, the interests of the JOLs and those of the people having the ultimate financial interests in the estate.

10. This will involve of course, the consideration that having competent and properly remunerated liquidators is in the interests of the liquidation estate as a whole, even while recognising that liquidators are not entitled to an increase as of right. The liquidators must bear the burden of satisfying the Court that an increase is justified.

11. Support for this approach is found in paragraph 5.2(8) of the English Practice Statement, which has been accepted by the JOLs here (see 67th Affidavit of Ken Krys at para 15) as giving guidance for the local practice. Paragraph 5.2(8) states:

> *"Where the application for the fixing and approval of remuneration is in respect of a period of time during which the charge out rates of the appointee and/or members of his staff engaged in work in respect of the appointment have increased, the appointee [(shall)] provide an explanation of the nature, extent and reason for such increase and the date when such increase took effect."* (Emphasis added)

12. In opposing the JOLs' application for an increase in their hourly rates, the LC's view that the rates approved as at January 2008 are fair and reasonable is said by Mr. Turner to be supported by a number of factors:

(a) **Volume**: The JOLs have billed in excess of USD 20 million to this estate during the first four years of their engagement by way of hourly remuneration. Given the ongoing status of complex legal proceedings in which the estate is involved in the United States and here in the Cayman Islands, the liquidation may reasonably be expected to run for 2-4 more years. At current rates it is therefore to be expected that the JOLs will charge a further USD 20 million to the estate before winding up. Leaving aside future increases, the proposed increase now of 18% would result in USD 4 million more being charged to the estate. The volume of fees to be charged to the estate relative to the overall prospects of recoveries is a

factor to which the Court should have regard when considering the application for an increase. As things stand at the moment, the JOLs have recovered and have available for distribution something in the order of $540 million.

The proposed increase of 18%, with the prospect of further increases as of end of 2011, could result in the JOLs' remuneration itself amounting to 10% of the recoveries. When added to the JOLs' expenses and those of the LC (primarily legal expenses) the outgoings from the estate could turn out to be more than 25% of recoveries.

This would suggest that all reasonable efforts should be made to contain the amount of fees payable to the JOLs (and, it must follow, by them to their and the LC's lawyers).

(b) **Speed of Payment:** The JOLs pay themselves 80% of their fees upon rendering their invoices with only the remaining 20% to await the approval process before payment. This is allowed by the IPR subject to approval of the LC and the Court. To the extent that that approval is not given, the JOLs would be obliged to reimburse the estate. Thus, there is for these JOLs, no risk of non-payment (as explained above, the estate is highly liquid) and no additional costs incurred (or likely to be incurred) associated with delay in the payment of invoices. The fees paid by the estate therefore represent a regular and reliable source of cash for the JOLs, a positive benefit from their appointment to this estate not available

from all appointments and so a factor to be taken into account upon this application for an increase in their rate.

(c) **Increased Competition:** Since the commencement of this liquidation there has been a significant increase of competition in the provision of insolvency services in the Cayman Islands brought about by the advent of at least four new firms.

The tier of firms competing behind the establishment big-four has almost doubled in size since January 2008 and this, the LC contends, has caused downward pressure on the rates in the local market. The LC submits that if the management of the estate were put out to tender, the fee quotes received would be considerably lower than the new rates proposed by the JOLs. The LC describes as based merely on anecdotal accounts, claims by the JOLs that the costs of recruiting and retaining professional staff have increased. The LC says that this is not borne out by the industry reports as exemplified by an editorial featured in the Third Quarter 2010 edition of *Insol World* Magazine. I note immediately however, that while increased competition may well be a relevant factor when setting or revising rates of remuneration, I do not consider it to be a relevant factor here.

Here the LC does not propose to put out to tender for competitive rates and no one suggests that it would be even remotely in the interests of the liquidation estate that these JOLs be replaced.

Changing liquidators in mid-stream, so to speak, would likely be a very counter-productive and uneconomical thing to do given the large costs the

estate has had to pay for the knowledge and experience already acquired by the JOLs in relation to its affairs.

(d) **Comparable Rates:** At my request, other insolvency firms have been asked to provide information about the rates allowed in relation to estates being managed by them which are comparable to the SPhinX estate in size and complexity. It is submitted by the LC in this respect, nonetheless, that whilst it is accepted that rates approved in respect of other complex liquidations are of some guidance, the SphinX liquidation is unique in the Cayman Islands given the amount of cash in the hands of the JOLs.

The high liquidity of the estate resulting in the absence of risk and the benefit of prompt payment are both factors which the LC says should be taken into account in distinguishing this engagement even from other complex liquidations where such risks and delays are likely to attend. I note however, that in none of the comparable estates used in the comparison below, has cash flow or delay in payment been a problem.

In addition, the LC submits that the key factor to be drawn from the comparable rates is the range of increases which have been approved in those estates over time, rather then the headline rates.

13. I accept that the rates given in the IPR, when compared to the comparable rates obtained, as well as the proposed 2010 rates for SPhinX – all as shown together in the following Schedule – should be considered with those factors in mind subject to the limitations I have identified above:

| | IPR | | Firm 1 | Firm 2 | Firm 3 | Industry | K&A Proposed 2010 rates |
|---|---|---|---|---|---|---|---|
| | Low $ | High $ | Bear Sterns $ | BCCI $ | "Liquid-ation X" $ | Average $ | SPhinX $ |
| Managing Director/ Partner | 500 | 900 | 600 | 650 | 720 | 656 | 675 |
| Director | 425 | 680 | 450 | 545 | 544 | 513 | 540 |
| Senior Manager | 350 | 575 | | 490 | 460 | 475 | 495 |
| Manager | 275 | 475 | | 415 | 380 | 397 | 425 |
| Assistant Manager | | | 400 | 335 | 280 | 338 | |
| Senior Accountant | 200 | 350 | 225 | 285 | N/A | 255 | 285 |
| Junior Accountant | 150 | 225 | N/A | N/A | | N/A | 145 |
| Adminis-trator | 50 | 200 | 125 | N/A | | 125 | 85 |
| Consultant | 275 | 900 | 403 | 165 | | 284 | |
| Other | | | | | | | |

14. I regard these comparable rates arising from broadly similar complex liquidations when compared to the IPR rates and the SPhinX rates to be of use as guidance now in deciding upon the JOLs' present application. The primary reason for this is that the comparable rates give a general sense of what rates the market will currently bear for insolvency services in relation to complex liquidations like SPhinX and that, to my mind, is ultimately the fairest way of assessing whether the rates being charged are reasonable and fair economic rates.

15. I recognise however that there are important qualifications to this approach. Any comparison of absolute rates between different cases and different firms will inevitably be coloured by extraneous considerations such as:

(i) the volume of work performed (and the necessity for it or benefit derived from it) – hourly rates cannot be considered in isolation from the volume of hours charged;

(ii) the relative quality and experience of the staff employed (the IPR sets minimum qualifying standards for each grade rather than absolute standards, making direct comparison between individuals within a given grade a qualitative rather than a quantitative process);

(iii) the complexity of the matters addressed, or the amount of commercial risk taken by the insolvency practitioners' firm in committing to the engagement;

(iv) the frequency of billing or drawdown of fees.

Another factor described by one firm which has it in place for at least one liquidation, is the use of blended rates incorporating both time based and other methods of charging contemplated by IPR II. This, however, is not a factor that I feel able without the benefit of the specific arguments on both sides in the context of the relevant liquidation, to regard as appropriate. Whether it may be appropriate for a combination of hourly rates and percentage of recoveries and/or the fixed fee base to be routinely adopted, is a matter about which I make no express finding here.

What I think it is appropriate for me to venture, however, is that it is difficult to envisage justification for such a combination of methods of payment which could have the net effect of remuneration in excess of the maximum allowed by the

schedule of hourly rates, barring some risk of non-payment attendant upon acceptance by a liquidator of the engagement.

16. That said, I have however taken account of the four factors identified above and other distinguishing factors, in settling upon the comparables in the immediately foregoing Schedule as appropriate comparables for present purposes. Other comparables in terms of complexity and size of liquidation estates were available but not used after other distinguishing factors were considered. These distinguishing factors included the passage of time since fees were last reviewed in those estates; the length of time since fees were last paid because of cash flow problems within those estates and the fact that some of the compensation arrangements have not yet been finalised. The comparables actually used, I am therefore satisfied, provide sufficient similarities such as to allow for a fair comparison as shown in the Schedule by reference to the current industry normative rates being charged for broadly comparable assignments, those already approved in SphinX and those proposed to be charged in the SphinX estate by the JOLs.

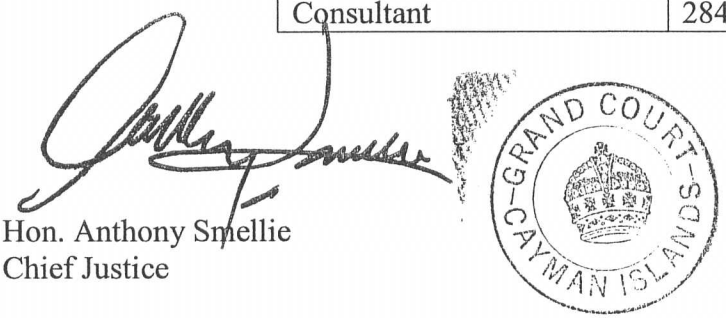
17. Still further considerations, such as whether the work actually done produces value for money, whether there is appropriate allocation of responsibilities at the appropriate levels of staff in order to leverage the appropriate charge rates and the like; are considerations to be brought to bear when the actual detailed bills of the JOLs, for specific time periods, are presented for approval.

18. Given the nature of the application now, I am concerned only to arrive at the appropriate rates of remuneration.

19. Having regard to all the foregoing, I am persuaded that the increase sought by the JOLs should be allowed as of 1st January 2010, but not to the level of 18% proposed by the JOLs. An increase of 12% across all levels of staff will lift the 2008 rates to levels almost exactly on par with the Industry Average evidenced by the comparables derived from the comparable liquidation assignments currently before the Court; even while still keeping the SPhinX rates within the mid-ranges of the IPR rates.

20. The result of the JOLs' application therefore will be the approval of the JOLs hourly rates as at 1st January 2010 as follows:

| **Staff** | **Hourly rate** |
|---|---|
| Managing Director/Partner | 655 |
| Director | 492 |
| Senior Manager | 448 |
| Manager | 392 |
| Senior Accountant | 274 |
| Junior Accountant | 140 |
| Administrator | 106 |
| Consultant | 284 |




Hon. Anthony Smellie
Chief Justice

29th November 2010

Judgment Released on 12th August 2011