IN THE GRAND COURT OF THE CAYMAN ISLANDS

FINANCIAL SERVICES DIVISION

CAUSE NO. FSD 27 OF 2013 (IKJ)

IN THE MATTER OF THE COMPANIES ACT (2023 REVISION)

AND IN THE MATTER OF HERALD FUND SPC (IN OFFICIAL LIQUIDATION)

Appearances:

Mr Matthew Goucke and Mr Jonathan Turner of Walkers on behalf of the Principal Liquidators of Herald Fund SPC (In Official Liquidation) ("**Herald**")

Before: The Hon. Justice Kawaley (in Chambers)

Heard: On the papers

Draft Judgment circulated: 23 May 2024

Judgment Delivered: 4 June 2024

Joint official liquidators' costs and expenses - impact of foreign confidentiality laws - confidential application for Court approval without usual Liquidation Committee scrutiny - governing principles - lacuna in rules-Companies Act (2023 Revision), section 109-Insolvency Practitioners Regulations (2023 Consolidation), regulations 12-13-Companies Winding Up Rules (2023 Consolidation), Order 11

RULING ON FEE APPROVAL APPLICATION

Introductory

1. By a Letter Application dated 11 April 2024, the Principal Liquidators of Herald ("PLs") sought approval of their fees and expenses for "*the seven month period from 1 February 2018 up to and including 31 August 2018 (the 'Relevant Period') in the total amount of US$586,014.29 (the 'Relevant Fees and Expenses')*". The unusual feature of this application is that Herald's liquidation committee ("Liquidation Committee") has not been served with full particulars of the application. The PLs were unable to share those particulars with them because the application related to work done which was subject to strict confidentiality obligations under applicable foreign law.

2. The Liquidation Committee has left it to the Court to decide whether the application can properly be disposed of without their having considered it. This is a scenario not provided for in either the Companies Winding Up Rules (2023 Consolidation) ("CWR") nor in the Insolvency Practitioners Rules (2023 Consolidation) ("IPR").

Legal findings: statutory framework

3. The relevant provision on remuneration in the Companies Act (2023 Revision) ("Act") is section 109:

> "***Remuneration of official liquidators and restructuring officers***
> ***109****. (1) The expenses properly incurred in the winding up, including the remuneration of the liquidator, are, subject to subsection (2)*[1]*, payable out of the company's assets in priority to all other claims.*
>
> *(3) There shall be paid to…the official liquidator, such remuneration, by way of percentage or otherwise, that the Court may direct acting in accordance with rules made under section 155.*
> *(5) If more than one official liquidator is appointed by the Court when a company is wound*

[1] This subsection confers priority on the fees and expenses of any pre-winding-up restructuring officers.

up, the remuneration paid under subsection (3) shall be distributed among the official liquidators in such proportions as the Court may direct."

4. At the primary legislation level, the Court alone is empowered to approve remuneration in general terms, but the detail is left for rules to prescribe.

5. The CWR Order 11 pertinently provide as follows:

> "***Service of Sanction Applications (O.11, r.2)***
> *2. (1) Every sanction application made by the official liquidator shall be served on —*
>
> *(a) each member of the liquidation committee; or*
>
> *(b) counsel to the liquidation committee, if an attorney has been appointed by the liquidation committee with authority to act generally; and*
>
> *(c) such other creditors or contributories as the Court may direct….*
>
> ***Hearing of Sanction Applications (O.11, r.3)***
>
> *3. (1) Sanction applications shall be heard in chambers unless —*
> *(a) the Court has directed that the application be advertised, in which case it must be heard in open court; or*
>
> *(b) the Court directs, for some special reason, that it should be heard in open court.*
>
> *(2) It shall be the duty of the official liquidator to attend and be prepared to assist the Court in respect of any sanction application made by the liquidation committee or any creditor or contributory.*
>
> *(3) The Court may direct that, when a sanction application gives rise to an issue in respect of the substantive rights as between the company and any creditor or contributory or any class thereof, it shall be adjudicated as an inter partes proceeding as between shareholders, creditors or any class of shareholders or creditors (as the case may be)…*".

6. The CWR are expressed in mandatory terms and appear on their face to mandate service of a sanction application, which would clearly include a fee approval application, on the liquidation committee in un-redacted form. The Rules also appear to contemplate an in-person Chambers hearing as the standard procedure, although in the post-Covid19 era, most uncontentious sanction applications are heard on the papers.

7. The IPR make important provision for remuneration applications. Regulation 10 enunciates the dominant principle reflective of the position under section 109(1) of the Act:

> "*(1) Subject to paragraph (2), an official liquidator is not entitled to receive any remuneration out of the assets of a company in provisional or official liquidation (including liquidation under the supervision of the Court) without the prior approval of the Court.*"

8. Regulation 12 ("*Consideration of Remuneration by the Liquidation Committee*") provides most importantly as follows:

> "(1) *An official liquidator may not make an application to the Court under Regulation 13 without first:-*
>
> *(a) Seeking the liquidation committee's approval of the basis of his remuneration and the amount of the remuneration for which he intends to seek the Court's approval; or, if there is no liquidation committee*
>
> *(b) convening a meeting of creditors and/or contributories in accordance with CWR Order 8 at which the official liquidator proposes a resolution approving the basis of his remuneration and the amount of the remuneration for which he intends to seek the Court's approval; or*
>
> *(c) complying with the requirements of any international protocol (insofar as it relates to the official liquidator's remuneration) which has been approved by both the Court and a foreign court.*
>
> *(2) The official liquidator shall prepare a report and accounts containing all the information reasonably required to enable a creditor or contributory to make an informed decision about the reasonableness of the proposed basis of remuneration and amount for which the official liquidator intends to seek the Court's approval…*"

9. Regulation 13 ("*Application to Court*") provides in salient part as follows:

> "*(1) An application by an official liquidator for approval of his remuneration shall be made by summons in CWR Form No 16 and shall be served on –*
>
> *(a) Each member of the Liquidation Committee; or*
>
> *(b) counsel to the Liquidation Committee, if an attorney has been appointed by the liquidation committee with authority to act generally…*".

10. The scheme of the IPR clearly envisages as a starting assumption, that the basis of remuneration and the actual remuneration received by official liquidators will be approved (or disapproved) by the liquidation committee. Applications for approval of remuneration (or the basis of remuneration) cannot be made without first seeking the committee's approval (where a committee exists). What is problematic for present purposes is that the requirement under Regulation 12 (1) (a) and (2) to seek the liquidation committee's approval and to prepare reports and accounts in relation to the remuneration application are expressed in rigid mandatory terms. They do not explicitly provide for exceptional cases.

The Court's jurisdiction to approve a remuneration application in circumstances where the liquidation committee approval process is unavailable

Source of the jurisdiction

11. For my part, the modern legislative drafting drift towards attempting to draft comprehensive codes is not an entirely beneficial development. The Companies Act 1948 (UK) and subordinate legislation was drafted in a broad style which assumed that commercial life would throw up unforeseeable 'gaps' which judicial discretion could fill. Progressive law reform is obviously a good thing but, as Ghanaian columnist K.B. Asante wrote almost 25 years ago, "*I am not a slave to modernity*". The Companies (Winding Up) Rules 1949 (UK) contained the following invaluable rule which is no longer found in England and Wales and is not in either the CWR or the IPR:

> "*226 (1) No proceedings under the Act or the Rules shall be invalidated by any formal defect or by any irregularity, unless the Court before which an objection is made is of opinion that substantial injustice has been caused by the defect or the irregularity and that the injustice cannot be remedied by any order of that Court.*"

12. The practical effect of the old English rule 226 was that the Court was free to depart from the strict requirements of the Rules in appropriate circumstances, provided that substantial injustice was not caused. This is entirely consistent with the dominant character of the winding-up field as a flexible, pragmatic and results-oriented sphere of the law. Commenting on the Bermudian equivalent of the old English rule 226(1), I observed in *Re Company No. EC 31586* [2010] SC (Bda) 61 Com (at

paragraph 13) that the relevant rule "*in effect provides that no departure from the Rules may be authorised which causes substantial injustice*".

13. Under Order 2 of the Grand Court Rules (2023 Consolidation) ("GCR"), by way of comparison, although irregularity does not result in the nullity of irregular steps, the Court has an almost unfettered jurisdiction to set aside on the grounds of irregularity. This understandably, in the procedural context of civil proceedings as a whole, attaches greater sanctity to strict adherence to the express terms of the procedural code. And it is Order 2 of the GCR which is incorporated into the CWR. This provides:

> "***Non-compliance with rules (O.2, r.1)***
> *1. (1) Where, in beginning or purporting to begin any proceedings or at any stage in the course of or in connection with any proceedings, there has, by reason of anything done or left undone, been a failure to comply with the requirements of these Rules, whether in respect of time, place, manner, form or content or in any other respect, the failure shall be treated as an irregularity and shall not nullify the proceedings, any step taken in the proceedings, or any document, judgment or order therein.*
>
> *(2) Subject to paragraph (3), the Court may, on the ground that there has been such a failure as is mentioned in paragraph (1) and on such terms as to costs or otherwise as it thinks just, set aside either wholly or in part the proceedings in which the failure occurred, any step taken in those proceedings or any document, judgment or order therein or exercise its powers under these Rules to allow such amendments (if any) to be made and to make such order (if any) dealing with the proceedings generally as it thinks fit.*
>
> *(3) The Court shall not wholly set aside any proceedings or the writ or other originating process by which they were begun on the ground that the proceedings were required by any of these Rules to be begun by an originating process other than the one employed.*"

14. It is difficult to extract from GCR Order 2 any proper legal basis for this Court modifying the express terms of the CWR or IPR to deal with matters not contemplated by these Rules. On the other hand, Order 2 arguably only deals with irregular steps taken by parties, not by the Court. Paragraph 2/2/1 of the Hong Kong 2024 White Book states:

> "…*any alleged non-compliance with the rules by any tribunal or judge was an error in law and could only be corrected by an appeal to the appellate court*…".

15. Absent an express power to fill gaps or depart from the Rules, some other source of jurisdiction must be found to circumvent the apparent roadblock created by the inability to apply the existing

Rules. Properly framing the legal problem helps to provide the relevant solution. The problem is that the Act provides an overarching principle that official liquidators are entitled to remuneration but only with Court approval following a procedure to be prescribed by rules. Rules have been created and do provide a procedural framework within which that principle should be implemented, a central feature of which is liquidation committee scrutiny and approval (or disapproval as the case may be). That framework adequately prescribes the procedure for the vast majority of cases, but makes no express provision for those exceptional cases in which the standard rule (service on and review by the liquidation committee) cannot be applied. One obvious instance where the usual rules would not apply is where all liquidation committee members were conflicted in relation to a litigation sanction application, so that service on each member or their counsel as mandated by CWR Order 11 rule 2 would not be appropriate. The present remuneration application involving work which is confidential for other reasons is another broadly similar instance where full compliance with the service and approval requirements of Regulations 12 and 13 of the IPR is not appropriate.

16. The statutory principle that official liquidators are entitled to their remuneration subject to Court approval cannot be frustrated because rules of court have prescribed liquidation committee approval without expressly providing that this approval may in special circumstances be dispensed with. A not too dissimilar conundrum of the procedural code by its express terms conflicting with the overarching legislative mandate imposed by primary legislation (again the Companies Act) occurred in Re *Oriente Group* [2022 (2) CILR 391]. In that case I observed:

> "*31. The legal effect of the unambiguous provisions of s.91G(1): 'no suit, action or other proceedings … shall be proceeded with … against the company … except with the leave of the Court' cannot be nullified because no express provision is currently made in the CWR for an application for leave to proceed with proceedings which are clearly intended by the terms of the Act to be automatically stayed when a restructuring petition is filed. Seeking to construe O.1A, r.5 in conformity with the primary legislation under which it was made, rather than with a view to undermining the primary legislative scheme, it seemed reasonable to assume that s.91G in any event confers a sufficient statutory power on the court to grant leave for pre-s.91B petition proceedings to be proceeded with against the relevant company irrespective of any governing rules under O.1A, r.5 of the CWR.*"

17. In short, those empowered to make subordinate legislation cannot validly create rules which are beyond the scope of the rule-making power. Offending subordinate legislation will be invalid under

the *ultra vires* rule. As Lord Reed observed in *R (on the application of the Public Law Project)-v-Lord Chancellor* [2015] UKSC 39 (at paragraph 13): "*Subordinate legislation will be held by a court to be invalid if it has an effect, or is made for a purpose, which is ultra vires, that is, outside the scope of the statutory power pursuant to which it was purportedly made.*" Accordingly, the Rules cannot be construed as creating a comprehensive code which the Court has no jurisdiction to depart from, even in the context of a *casus omissus* i.e. a matter not dealt with at all.

18. Where there is a gap in subordinate legislation creating procedural powers, the rules will not be construed as acting as a fetter on exercise of the power in the primary legislation which the rules are designed to facilitate. The Court will simply exercise the general power contained in the primary legislation instead. This approach was followed by the Bermudian Court of Appeal (Sir Anthony Evans, P (Acting, concurring) in *New Skies Satellite BV-v- FG Hemisphere Associates LLC* [2005] Bda LR 59 where he concluded as follows (at page 8):

> "*Ultimately, the ground for New Skies' objection is that the Rules of Court in Bermuda do not provide for the exercise of the statutory right. Mr. Woloniecki submits that the Courts cannot 'bend the rules to fix a problem' but this assumes that there are rules which create the problem, rather than an absence of rules which creates what the White Book described as a 'loophole' but we prefer counsels' word 'lacuna'. If the Appellant's submissions are correct, it is a legal black hole. Mrs. Cabot invites the Court to avoid this result by holding that the statutory right can be exercised even though the Rules are silent.*
>
> *We hold that the Court has power to hear an ex parte application under section 40(1) of the 1993 Act and to decide in the exercise of its discretion whether or not leave to enforce the award should be given, and if so, on what terms.*"

19. In my judgment, although the CWR and the IPR do make some provision for sanction application proceedings, there is a *lacuna* as regards what should happen when there is a liquidation committee, but that committee cannot be served and consulted in the usual manner because it is not legally possible for such service and consultation to occur. Even though the gap in the Rules may be likened to a legal black hole, it is a black hole which does not possess sufficient legal gravitational force to eliminate the power conferred by the primary legislation. Approving the fees without regard to the unavailable standard procedural regime is not "*bending the rules to fix a problem*". This is made clear by the *New Skies* decision. Section 109 of the Act empowers the Court to approve official liquidators' fees in accordance with rules made under section 155. But the Court is not deprived of the ability to exercise that power in circumstances which are clearly within the general scope of section 109 but which were not contemplated at all by the relevant Rules.

20. It has been necessary to fully articulate the basis of the Court's jurisdiction to adopt an approach not prescribed by the Rules because the Liquidation Committee in the present case have expressly indicated that they are relying on the Court to scrutinise the legality of the process followed by the PLs.

21. In an era when judicial decisions are typically made by reference to express statutory powers in primary and/or subordinate legislation, it is not always easy to distinguish between judge-made law grounded in sound legal principles and what Lord Collins stingingly described (in an altogether different context) as "*inconsistent with established principles governing the relationship between the judiciary and the legislature and therefore profoundly unconstitutional*" (*Singularis Holdings Limited –v-PricewaterhouseCoopers* [2015] 1 AC 1675 at paragraph 108). It is to be hoped, therefore, that the Rules Committee will at least consider adopting a suitably modernised version of rule 226 (1) of the Companies (Winding-Up) Rules 1949 (UK), which is still in force in those 'old-fashioned' jurisdictions which have not yet 'modernised' their winding-up rules.

Exercise of the section 109 jurisdiction where the usual liquidation committee approval process is not available

22. In my judgment it is self-evident that the Court should, where the usual consultation and approval mechanism cannot be followed:

(a) ensure that the usual procedure is followed to the greatest extent possible; and

(b) generally follow the same scrutinising approach it would follow in case where no liquidation committee had been appointed.

Findings: merits of application

Limits to the Liquidation Committee's involvement

23. I accepted the PLs' evidence that the present remuneration application related to matters that were subject to special confidentiality obligations under the relevant foreign law. Those confidentiality

obligations prevented them from providing un-redacted copies of the application to the Liquidation Committee, but no such impediments existed in relation to the Court.

24. The Liquidation Committee was provided with a redacted version of the application, but it was clear that the information furnished was insufficient for the any proper evaluation of the application so as to enable the Liquidation Committee to make an informed decision as to whether to grant or withhold its consent. In summary, it was obvious that the prescribed role of the Liquidation Committee under, in particular, Regulations 12 and 13 of the IPR, could not be performed without the PLs undermining their desired strategy.

25. I was satisfied that the PLs had provided the Liquidation Committee with as much information as they properly could with a view to minimising the extent to which its usual role was compromised. The Letter Application explained what transpired in the following way:

> "*14. In the unusual circumstances they faced, the Principal Liquidators appraised the current Liquidation Committee of this matter generally, while also observing their* [relevant foreign legal obligations]*, by an email from Mr Magennis to the Liquidation Committee dated 21 December 2023. The email sought the approval of the Liquidation Committee in respect of the Relevant Fees and Expenses, by providing a fee report, showing the dates and quantum of the Relevant Fees and Expenses incurred, but with the time entries and summaries of the work undertaken redacted (the 'Redacted Fee Report'). The email acknowledged that the Liquidation Committee might consider itself unable to approve the Relevant Fees and Expenses in the circumstances and confirmed that, in that event, the Principal Liquidators would make the present Application, seeking also the requisite orders to comply with their obligations of confidentiality under relevant law.*
>
> *15. Thereafter, the Liquidation Committee confirmed that it did not approve the Relevant Fees and Expenses…*"

Merits of the remuneration application

26. The Relevant Fees and Expenses were incurred some six years ago. The confidentiality conundrum may partially explain why the present application was delayed. In considering the present application, I take into account the history of previous remuneration applications.

27. Against this background, I satisfied myself of the commercial soundness and proportionality of the present remuneration application. The approach I take to the present remuneration application was

also informed by the following remarks that were made in my judgment on a previous contested remuneration application in the liquidation, in *Re Herald Fund SPC (in Official Liquidation)*, FSD 27/2013 (IKJ):

> "*47…A Fee Approval application ought not ordinarily to be the context in which the Court is retrospectively invited to approve high-level policy or operational level strategic decisions made by official liquidators. The reasonableness of fees should, in the ordinary case, be determined by reference to cost incurred in relation to work-streams the general pursuit of which has been informally approved by the Committee or formally approved by the Court. An operational strategic decision made by the liquidators within the rubric of furthering a legitimate liquidation purpose should not be impugned, in the fees context, unless the decision can fairly be said not to be a rational one. The decision to incur the fees would not be rational if the work done was either not 'reasonable in the circumstances', not 'necessary' or 'achieved [no] useful result'. Experience suggests in any event that 21st century professional liquidators have a vested commercial interest in demonstrating their ability to meet the expectations of their stakeholders and to achieve commercially palatable practical results.*
>
> *48. Applying this test, it will in appropriate cases be necessary for the Court to disallow legal fees. However, the standard practice is that liquidators approve the fees of the advisers they retain. This has a legislative basis. CWR Order 25 rule 2 provides that where the liquidator or the Committee consider that lawyers' fees are excessive, the liquidator may have them taxed. In some cases taxation might not be the appropriate remedy, for instance if a contributory or creditor was challenging the need to hire a lawyer to file a time-barred claim, or the need to hire a lawyer in Japan to advise on a claim in another jurisdiction which had no Japanese connections whatsoever. In the real world, this Court is unlikely to be often properly required to consider the reasonableness of a liquidator's lawyer's fees in the context of a Fee Approval Application…*"

28. The Relevant Fees and Expenses amount to nearly US$ 600,000 incurred over a seven months' period. What tasks were performed is rationally explained. The hours billed by any one individual on any one day are not eyebrow-raising and the disbursements (approximately 11% of the billed time) appear proportionate. The amount billed is net of a 2% discount. Remembering that the Liquidation Committee has adopted a stringent approach to remuneration applications in the past, I have looked for and been unable to find valid basis on which the application could be opposed.

Conclusion

29. For the above reasons, the Relevant Fees and Expenses are approved pursuant to section 109 (1) of the Companies Act (2023 Revision) notwithstanding the inability of the Liquidation Committee to consider properly and/or approve the application.

THE HONOURABLE JUSTICE IAN RC KAWALEY
JUDGE OF THE GRAND COURT