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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
Heard on the 13th April 2010

Appearances:

Mr. Thomas Lowe QC and Mr. Richard Snowden QC and Ms. Ceri Bryant instructed by 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. Stephen Atherton QC instructed by Mr. Mark Goodman of Turner & Roulstone for the Liquidation Committee of the SPhinX Group of Companies ("the LC")

Mr. Kenneth Farrow QC of Mourant for Mr. Robert Aaron, an indemnity claimant

Shelley White of Higgs Johnson for Pricewaterhouse Coopers Cayman Islands, an indemnity claimant

Ms. Bernadette Carey of Conyers Dill & Pearman for Bank für Arbeit und Wirtschaft und Österreichische Postsparkasse Aktiengesellschaft, Contrarian and Rotary, an investor

Ms. Sarah Dobbyn of Harney, Westwood & Riegels for Contrarian Capital Management LLC, an investor

Mr. Marc Kish of Maples and Calder for Rotary International

Mr. Neil Timms QC instructed by Mr. Roger Nelson of Nelson & Co. for Pricewaterhouse Coopers LLP, an indemnity

Mr. Guy Manning of Campbells for DPM Mellon, LLC and DPM Mellon Ltd, indemnity claimants

Mr. Andrew Bolton of Appleby for Messrs Kavangh and Owens, indemnity claimants

RULING

1. The issue to be resolved is whether the Court has jurisdiction to sanction a scheme of arrangement pursuant to section 86 of the Companies Law (2009 Revision) ("The Law") that includes within its terms provisions which require participants in the scheme of arrangement (here the investors/shareholders) to surrender rights that they have (or may have) against third party non-participants to the scheme of arrangement.

2. Framed in that way, the issue is one of both scope and enforceability and I will come below to address it under those separate headings. The essential background is as follows.

3. The SPhinX Group of Companies are investment fund companies now in official liquidation before this Court.

4. The SPhinX Funds had been promoted by PlusFunds Group Inc. ("PlusFunds") who had entered into an exclusive licence with Standard and Poor's ("S & P") – a division of McGraw-Hill Companies – to create and market investment products designed to achieve returns consistent with the S & P Hedge Fund Index, a corporate index measuring major hedge fund strategies. Hence the acronym "SPhinX".

5. For a number of reasons, including alleged fraud and mismanagement on the part of the Funds' former investment manager the ill-fated Refco Group and Refco's President and CEO Phillip Bennett – the SPhinX Funds collapsed and were put into liquidation in 2006 when the JOLs were appointed.

6. The JOLs subsequently instituted proceedings in the New Jersey District Court (later consolidated with other proceedings brought by PlusFunds in New York District) seeking to recover damages said to have been suffered by the SPhinX Funds and PlusFunds, the consequence of the alleged fraud and mismanagement. These proceedings also came to incorporate the claims of 16 investors in the SPhinX Funds who assigned their causes of actions to the JOLs. These multi-district litigation proceedings as consolidated in New York, have given rise to the present issue and will be referred to herein as the "NYMDL".

7. The SPhinX liquidation estate is reported by the JOLs to be solvent having recovered some US$540 million to date, with prospects of recoveries by way of net litigation proceeds from the NYMDL. Such recoveries, expected at more than $300 million, could thus significantly increase the dividends returnable to investors from the estates, in the event of success.

8. Within the SPhinX liquidations creditor claims are regarded by the JOLs as being of a potentially limited value, well within the amount of the already existing assets and so the JOLs expect, in any event, to have a sizable surplus for distribution to investors.

9. Creditors' claims are regarded by the JOLs as likely to materialize primarily on account of certain contractual indemnities which were given to the former auditors, directors and consultants engaged by the SPhinX Companies and, in that sense, are as yet only contingent claims.

10. A second class of potential creditors are those persons who were at one time investors/shareholders in the SPhinX Companies, who sought to redeem their

investments and were recognised as having redeemed, but who were not finally paid out or removed from the register of shareholders. Pursuant to the articles and the offering memoranda of the SPhinX Funds, such redeeming investors have been allocated a class of shares termed "S" shares. The S shares have been ascribed certain rights which may allow them to participate in the liquidation process either as shareholders or as creditors.

11. While S shareholders would be bound along with other participants in the proposed Scheme(s) of Arrangement now under discussion ("the Scheme(s)"); their status as potential creditors is not that which gives rise to the present issue of jurisdiction.

12. Rather, it is the status of the contingent creditors who hold indemnities that is of concern for present purposes. That concern arises in the following manner.

13. In summary, the indemnities given to the indemnity holders would entitle those claiming under them ("Indemnity Claimants" or "ICs") to indemnification against any damages for which they may be found liable based on their non-intentional wrong-doing (that is: mere negligence) in their former relationships with the SPhinX Companies or for any legal costs they might incur in successfully defending against any claims whatsoever arising from their former relationships with the SPhinX Companies. As one would expect, no indemnity was given against liability for intentional wrongdoing. Several ICs (10 of 34 indemnity holders) have already been joined by the JOLs as defendants in the NYMDL and so have potential claims under their indemnities if they succeed in their defences or are found liable only for mere negligence. One of those 10 – PWC (Cayman) –

may also be sued in Cayman (the New York Court having refused jurisdiction over it) and may so be able to claim on its indemnity in the Cayman action.

14. Of the 10 ICs who have been sued, the JOLs have received 5 proofs of debts based on their contingent claims and/or claims for legal costs actually already incurred, in responding in the NYMDL or in the Cayman action. Of the 10 ICs who have been sued, 6 of them have appeared on the indemnity reserve applications as follows:

    (1) DPM [DPM Mellon Ltd and DPM Mellon LLC]

    (2) Robert Aaron

    (3) Brian Owens

    (4) Mark Kavanagh

    (5) PWC LLP

    (6) PWC Cayman

15. And so, solvent though the SPhinX liquidation estates may be, the JOLs are obliged (in keeping with the statutory order of priority of payments) to make provisions for the actual and potential claims of all 34 ICs as contingent creditors, before any payments by way of interim distributions may be made to investors/shareholders.

16. Insofar as the ICs' potential exposure for costs in the NYMDL is concerned, that is reasonably foreseeable and so estimable and has been estimated. For those purposes, a monetary reserve has been set in the amount of US$117 million. That monetary reserve is the subject of a judgment handed down in this Cause on the 26 January 2010.

17. There are, however, other potential risks of liability for damages and costs (either in the NYMDL or in other possible actions) for which the ICs could become entitled to indemnification but which are as yet so contingent as not to be amenable to estimation.

18. These are, nonetheless, risks for which the JOLs acknowledge (and it is so declared in the Judgment of 26th January 2010), that some form of provision must be made before distribution of dividends to investors. So widespread are the allegations involving the Refco fraud that it is still regarded as capable of spawning further litigation. And, as investors reside in several different countries around the world, a further concern is whether litigation may be brought in any number of those countries as the place where the investment (and thus the putative duty of care) was engaged or where the loss was suffered.

19. Among the concerns are the risks of claims for damages which may be brought against the ICs directly by investors. Such damages ICs could conceivably be required to pay if they are sued by investors for derivative or "reflective loss" claims (that is: net losses purportedly suffered by investors of the SPhinX Funds as a result of the diminution in value of the Funds and as the result of the negligence or wrongful misconduct of the ICs in the context of the Refco debacle in relation to duties owed to the SPhinX Companies and in that sense derived from or reflective of the Companies' losses). Such claims could also be brought by Investors against third parties who could in turn seek to bring "ricochet" claims against ICs for damages for which those third parties might have been found liable to pay. Subject to concerns over the validity of such reflective loss or

ricochet claims, an example of a ricochet claim could arise as a result of a claim by an investor against, say, the former lawyers of the SPhinX funds (who were given no indemnities hence "non-indemnified contribution claimants" or "Non-ICCs") and who may in turn seek to claim contribution in damages from the ICs. If such contribution is to damages arising from a claim founded in mere negligence, the ICs would in turn be able to rely on their indemnification both as to the amount of the damages required to be contributed and as to the legal costs incurred in responding to the Non-ICC's claims.

20. As also mentioned, investors could also conceivably sue ICs directly for reflective losses and, to the extent such claims may successfully be based only on mere negligence, the ICs would be entitled to be indemnified both as to the damages they may be liable to pay and for the legal costs incurred. If unsuccessful then the indemnity would sound only in the legal costs of defending.

21. Statutory limitation periods in respect of possible investor claims have not yet fully expired and the limitation periods in respect of ricochet contribution claims would not start to run (at least in the case of the United States) until after Non-ICCs would have been found liable in damages. ICs could thus still be exposed to claims for which they could seek indemnification for upwards of six years from now.

22. The problem therefore becomes how do the JOLs make provision now for reflective loss and ricochet claims against which ICs may be entitled to indemnification in order that there may be interim distribution of the anticipated surplus as dividends to investors?

23. As there is already set aside a significant portion of the assets (US$117 million) to meet ICs' claims and as the remaining risks of liability (such as may arise from reflective loss or ricochet claims) are not presently given to estimation, the solution proposed by the JOLs is not to increase the monetary reserve, but to compromise such possible claims by way of the Scheme(s).

24. It should however be noted, that even while the JOLs recognise the risk that they represent, the JOLs do not regard such reflective loss claims as likely to materialise. Rather, they see such claims as misconceived and if brought, as doomed to fail.

25. It is the JOLs' view, based on legal advice, that investors would themselves have no contractual basis for reflective loss claims, either as against ICs or as against Non-ICCs. Privity of contract in respect of their professional services, would have existed only as between the SPhinX Companies on the one hand and the ICs or Non-ICCs on the other. Yet, it would be an alleged breach of such contractual relationships by ICs or Non-ICCs that would purportedly give rise to reflective loss claims for damages.

26. Reflective loss claims by investors would therefore have to be brought in tort premised on some notion of economic loss suffered as the foreseeable consequence of the negligence or wrongful misconduct of the ICs and/or Non-ICCs as the case may be, in the context of their respective relationships with the SPhinX Companies and on the basis that such relationships gave rise to a putative duty of care owed to the investors and which duty was breached resulting in loss sounding in damages.

27. The prevailing view among not only the JOLs but also the members of the Liquidation Committee ("the LC") before me, is that the courts in the jurisdictions in which such reflective loss claims could be brought against ICs or Non-ICCs, would not entertain such claims.

28. Already, in the NYMDL purported derivative or reflective loss claims sought to be brought by the JOLs as the assignees of the 16 investors already mentioned, have been struck out by the Court (decision of Judge Rakoff given on 31 March 2010, the judge in charge of the NYMDL).

29. In another relevant jurisdiction, the Irish Republic, there is high judicial authority to the effect that a claim by a shareholder which is attributable solely to the diminution in value of the company's assets and which is "merely a reflection of the loss suffered by the company" is thus a reflective loss claim and gives no right of action by a shareholder ***Madden v Anglo Irish Bank Corporation PLC and Lacey [2004] IESC 108.***

30. As to those relevant jurisdictions in respect of which it remains unclear whether reflective loss claims may be maintainable, an issue that remains to be resolved is whether the JOLs should first obtain recognition of the proposed Scheme (or Schemes), including the compulsory releases by investors of their reflective loss claims, before the Scheme(s) may finally be approved by this Court.

31. In any event, it is only on the assumption that the Scheme(s) would be recognised and enforced in relevant jurisdictions so as to block reflective loss claims, that it would be permissible now to make no further monetary reserve to meet the ICs' claims for indemnification which could arise from such claims.

The Scheme(s)

32. The Scheme(s) would seek to address the risks to ICs arising from reflective loss claims, by means of the compulsory and consensual release of such claims by investors/shareholders, that is: "Scheme Claimants". Once effectively released, such claims could not be brought either directly against ICs or against Non-ICCs resulting in ricochet contribution claims against ICs, and so there would be no need to make further provision for them, monetary or otherwise.

33. The issue as first framed above finally devolves therefore into whether or not the Court has jurisdiction to sanction a scheme of arrangement which purports, among other things, to require a Scheme Claimant to surrender any right to sue an IC or to sue a Non-ICC (that is: a non-scheme participant) so as to ensure that ricochet claims may not be brought by a Non-ICC against an IC; and so as further to ensure, that there will be no consequential claims from ICs for indemnification.

34. Before turning to address the issue, I must explain in a bit more detail how the releases under the Scheme(s) would be proposed to work.

35. Having regard to the foregoing narrative, it will be apparent that the objectives of the Scheme(s) will be threefold:

    (i) To provide a method of establishing and compromising claims against the SPhinX Scheme Companies arising in respect of a Redemption Request purportedly satisfied by the issue of the S Shares, or arising out of an outstanding Redemption Request against a Scheme Company, or arising out of holding shares in a Scheme Company (excluding S Shares) which were not the subject of any Redemption Request ("Scheme Claims").

(ii) To distribute to investors bound by the Scheme(s) (the "Scheme Claimants"), in a more cost-efficient and expeditious distribution than may be available through a winding up, a significant part of the cash held by SPhinX Companies and any net proceeds of litigation brought by or on behalf of the SPhinX Companies in the wake of the events leading to their collapse.

(iii) To put in place a permanent stay of proceedings preventing the Scheme Claimants from enforcing Scheme Claims – the deemed reflective loss claims – except as provided for in the Scheme(s).

It is in respect of this third objective that the present issue arises for resolution.

36. The Scheme(s) documentation will provide that claims against ICs are "to be treated as released".

37. It will do so in a number of ways.

38. *First*, it will require that every Scheme Claimant who has not effected a consensual release to the JOLs of any claim a Scheme Claimant might have against an IC, shall agree not to sue the IC in respect of any such claim arising from or by virtue of any act or omissions of the IC in connection with the SPhinX Companies or PlusFunds.

39. *Secondly*, the Scheme(s) will require that a Scheme Claimant authorise the JOLs (acting jointly or singly) to enter into, execute and deliver on behalf of such Scheme Claimant and any person to whom a Scheme Claimant has transferred a Scheme Claim one or more deeds of release whereby, for the consideration therein stated and to the extent permitted by law, each and every claim which

such Scheme Claimant may have against any of the ICs, arising from or by virtue of any act or omission of such IC in connection with the SPhinX Companies or PlusFunds, is agreed by the parties *to be treated as released* by the Scheme Claimant and the Scheme Claimant agrees not to sue the IC in respect of the same.

40. Claims by Scheme Claimants against third party "Non-Indemnified Contribution Claimants" (that is: Non-ICCs) are also to be treated as released. As mentioned above, these potential claimants are those third parties who are not covered by indemnities and who may be sued by Scheme Claimants and in turn seek contribution in damages from ICs. These are therefore those releases of claims which arise most acutely for consideration now as a matter of the jurisdiction of the Court to sanction, and as the means by which to prevent the monetary indemnity reserve having to be increased to take into account the reflective loss or ricochet claims.

41. These releases of Non-ICCs will be sought to be effected by the requirement that each of the Scheme Claimants who has not effected an assignment of claims to the JOLs, agrees that the Non-ICCs are to be treated as if they were released from, and agrees not to sue the Non-ICCs in respect of, each and every claim whatsoever that such Scheme Claimant may have against such Non-ICCs arising from or by virtue of any act or omissions of such Non-ICCs in connection with the SPhinX Companies or PlusFunds.

42. *And finally*, in this regard, the Scheme will require that each Scheme Claimant authorizes the JOLs (jointly or singly) to enter into, execute and deliver on behalf

of such Scheme Claimant and any person to whom a Scheme Claimant has transferred a Scheme Claim after the effective date of the Scheme(s), one or more deeds in relation to Non-ICCs whereby for the consideration stated therein and to the extent permitted as a matter of law, each and every claim which such Scheme Claimant may have against any Non-ICC in connection with the SPhinX Companies or PlusFunds, is agreed by the parties thereto to be treated as released by the Scheme Claimant and the Scheme Claimant agrees not to sue the Non-ICC in respect of the same.

43. Thus the Deeds of Release would prevent claims which have been agreed not to be brought from being brought by Scheme Claimants against Non-ICCs which could result in "ricochet" contribution claims being brought against ICs; such claims being "treated as released".

44. In each instance, the respective Deed (that is: the Deed of Compulsory Release, Deed of Consensual Release, Deed of Release of Non-Indemnified Claims and Deed of Assignees' Releases as the case might be; or a Consolidated Deed of Release combining all of such Deeds) would be the means by which the non-party to the Scheme(s) (here for practical purposes only the ICs, as the Non-ICCs are not presently identifiable) would enforce the releases.

45. The overall object of the Scheme(s) is therefore to compromise several issues standing in the way of the distribution of assets, which include the unresolved issues over the extent of the reserve for the contingent liability that may yet be found to be owed to ICs. It is an important premise of the Scheme(s) and of the JOLs' contention for the jurisdiction of the Court to sanction it, that as it presents

an alternative to the litigation of those issues and to others which along with them have been identified in a summons issued as long ago as June 2007, there will be a compromise of the rights of the Investors as Scheme Claimants against the SPhinX Companies which founds the jurisdiction of the Court. The alternative to the Scheme(s) would be extremely costly litigation in which each of the issues taken up in the summons of June 2007 would have to be litigated.

46. In accordance with an order made on 28 January 2010 by the Court at a directions hearing for the issue of jurisdiction to be considered and at which this hearing deemed "the Releases Convening Hearing" – was set, all affected parties have been given due notice.

47. The order made on 28 January 2010 directed that at the Releases Convening Hearing the Court would consider the issue as framed in these terms:

> *"Whether the Court has jurisdiction under the Companies Law to sanction Schemes of Arrangements under section 86 of the Companies Law (the "Schemes") which include releases by the Scheme Claimants (as defined in the Schemes) of the Indemnity Claimants and of certain third parties whose claims are not proposed to be compromised by the Schemes."*

48. As indicated above, there are two aspects to this releases jurisdiction issue:

(a) The scope issue: Is a scheme which incorporates the release of a non-party a scheme which is within the scope of section 86?

(b) The enforceability issue: Is a scheme which confers a benefit upon a non-party one which the Court can sanction under section 86, notwithstanding that a scheme sanctioned under section 86 does not

bind, and cannot be enforced by, a non-party?

49. I have concluded, in agreement with the submissions by Mr. Snowden QC for the JOLs and Mr. Atherton QC for the LC and for the reasons which follow, that the answer to each of those aspects of the issue is "Yes".

The Statutory jurisdiction of the Court

50. This is provided in section 86 of the Law as follows:

> *"(1) Where a compromise or arrangement is proposed between a company and its creditors or any class of them, or between the company and its members or any class of them, the Court may, on the application of the company or of any creditor or member of the company, or where a company is being wound up, of the liquidator, order a meeting of the creditors or class of creditors, or of the members or class of members, as the case may be, to be summoned in such manner as the Court directs.*
>
> *(2) If a majority in number representing seventy-five per cent in value of the creditors or class of creditors or members or class of members, as the case may be, present and voting either in person or by proxy at the meeting, agree to any compromise, or arrangement, the compromise or arrangement shall, if sanctioned by the Court, be binding on all the creditors or the class of creditors, or on the members or class of members, as the case may be, and also on the company or, where a company is in the course of being wound up, on the liquidators and contributories of the company."*

51. It is to be presumed, for the present purposes, that the Scheme(s) meetings of creditors and members, as the case may be, will have been directed by the Court, summoned and convened as contemplated by section 86(1).

52. It is also to be presumed, that the necessary majorities in number representing at least seventy-five percent in value of the creditors or class of creditors, or

members or class of members as the case may be, will have agreed to the terms of the compromise or arrangement as proposed in the Scheme(s).

53. Indeed, while the terms of the proposed Scheme(s) are not yet in their final form, the purpose of seeking the Court's ruling on the question of jurisdiction now is to confirm that the Scheme(s) have a sound juridical basis for going forward to the Scheme meeting(s) and thereafter for sanction by the Court. There would be no point in the Court directing the convening of meetings to consider the Scheme(s) if it were to determine now that it lacks the jurisdiction to sanction the Scheme(s) later.

The Scope issue

54. As proposed, the Scheme(s) would embody a compromise or arrangement as between the SPhinX Companies and its investors/members, the Scheme Claimants.

55. The Scheme(s) would nonetheless involve third parties in the persons of those ICs for whom the releases would be provided as against direct investor claims or as against ricochet claims by Non-ICCs.

56. There is now well-established case authority in both England and Australia of high persuasive value, to the effect that a compromise or arrangement between a company and its creditors (or members) can involve a third party provided that there is a reasonable element of "accommodation" or "give and take", as between the Scheme participants which redounds in such manner as to involve an element of accommodation or give and take, on the part of the third party as well.

57. In ***Re T & N Ltd. and Others (No. 3) [2007] 1 All E.R. 851***, one of six questions posed to the Court (per David Richards J) was whether a Scheme between T & N Ltd. (in Administration) and its creditors (at that stage former employees who sued for asbestos related diseases and conditions acquired while employed to T & N) was a scheme within the meaning of Section 425 of the UK Companies Act 1985 (similar to section 86 here) – as being a compromise or arrangement proposed between T & N and its creditors. The question arose because the claims against T & N to be compromised were claims for which T & N was obliged to and had obtained employer's liability insurance and T & N and its Insurer wished to ensure that a specific sum of money agreed to be paid in escrow by the Insurer (in settlement of litigation T & N had instituted to enforce the policy of insurance against the Insurer) would fully cover all claims which employees (or those claiming through them) might bring under the policies.

58. It was a term of the heads of agreement of the settlement of litigation between T & N and the Insurer, that the proposed scheme of arrangement as between T & N and its employees should be sanctioned by the Court in order to give effect to the proposals for settlement and to make them binding on those who could then or might in future be able to claim under the insurance policies.

59. The essential features of the scheme were that, by way of compromise of the claims in the litigation (as between T& N and the Insurer) the Scheme companies (T & N and its affiliates) and the actual or potential employee claimants could not assert claims against the Insurers; and the sum paid into escrow would be held by trustees to pay a dividend on such claims as and when they were made and

established. Thus, the fund would be available to meet both present and future claims. An important further factor in this regard was that by operation of the Third Parties (Rights Against Insurers) Act 1930; on entering into Administration, the rights of T & N and its affiliates under the insurance policies which had by then been incurred to employee claimants, were deemed to be transferred to those employee claimants whether or not they had yet in fact made a claim.

60. It was submitted by an outside creditor of T & N's who opposed the scheme, that the scheme between T & N and its employees did not fall within the meaning of section 425 of the 1985 Act as being a compromise or arrangement. It was argued that this was because the Scheme did not purport to affect the rights between T & N and its employee claimants as it was the employee claimants' rights against the Insurer vested in them by operation of the 1930 Act which were to be compromised by the scheme and, however broadly "arrangement" in section 425 of the 1985 Act was construed, a proposal which left the relationship between a company and its creditors (here the employees or those claiming under them against T & N itself) unaltered, could not fall within that section. In other words, what was objected to as sought to be compromised was not the claims which the employees had against T & N but their rights which had accrued by operation of the 1930 Act as against the Insurer.

61. Emphasis was placed in the arguments upon the statutory requirement in section 425, that a scheme could not involve third parties within its scope because the compromise or arrangement must be one which is "between" a company and its creditors or a class of them, or "between" a company and its members or a class

of them or "between a company and its creditors and members" (or a class or classes of its creditors and/or members, as the case may be)".

62. At paragraph 45 (page 869) David Richards J. recognised that it is an essential element of a scheme that it comprises a compromise or arrangement which is one between a company and/or its members or creditors, expressing himself in these terms:

> *"The first and obvious point to make is that, whatever the precise meaning of a compromise or arrangement, it must be proposed with creditors or members of a company. It is implicit that it must be made with them in their capacity as creditors or members and that it must at least concern their position as creditors or members of the company."*

63. However, he went on clearly to recognise that schemes of arrangement can and do involve third parties. At paragraphs 46–47 he observed that the word "arrangement" has a very broad meaning and is not defined in the Companies Act itself. Adopting the views of the Court of Appeal in ***Re Guardian Assurance Co. [1917] 1 Ch. 431***, he also noted that compromise and arrangement are different concepts and that an arrangement need not involve a compromise or be confined to a case of dispute or difficulty. He then stated, apropos the question then before him as to the involvement of the Insurers (and, in my view, of equal relevance to the present question of the involvement of third parties in the Scheme proposed here) (at paragraphs 49 – 59):

> *"It is fair to say that the great majority of schemes of arrangement involving members do not involve a compromise. For example, schemes providing for the acquisition of companies by a third party, whether by way of transfer of existing shares or the cancellation of existing shares and the issue of new shares to the acquiring third party, on terms that the third party provides consideration, are not compromises. But they are arrangements*

> *between the company and its members, because they involve a change in the membership of the company (see, for example* ***Re Savoy Hotel Ltd.*** *(1981) 3 All E.R. 646; (1981) Ch. 351).*
>
> *...As members' schemes such as that in* ***Re Savoy Hotel Ltd.*** *show, the give and take need not be between the members and the company, but may be between the members and a third party purchaser, with the company's only function being to register the transfer of shares and thereby terminate the existing member's status as members."*

64. Following that line of reasoning David Richards J went on to hold in ***Re T & N (No. 3)*** that notwithstanding the fact that the effect of the settlement of funds in escrow was to bring about a change in relationship, not as between T & N and its affiliates on the one hand and the employee claimants on the other, but as between the employee claimants and the Insurer, it was not possible to divorce the escrow arrangements from the schemes, because the schemes were an integral part of a single proposition affecting all the parties; that is: the compromise of asbestos related claims which had or could incur liability under the insurance policies.

65. As Mr. Snowden submitted, in the instant case, the release by the Scheme Claimants of claims which could give rise to ricochet claims against ICs is proposed to be effected through the execution, under the terms of the Scheme(s), of the Deeds of Releases. Based on the reasoning and conclusion reached in ***T & N Ltd. (No. 3)*** as already noted, Mr. Justice David Richards' view was that it was not a necessary element of an arrangement that it should alter the rights existing as between the company and its creditors or members, and that, provided the context and content of the scheme were such as properly to constitute an arrangement between the company and members or creditors, the Court had

jurisdiction to sanction the scheme. He did, however note (at paragraph 54 page 872) that:

> *"...the looser the connection between the subject matter of the scheme and the relationship between the company and creditors concerned, the more substantial might be the objection on discretionary grounds to sanctioning the scheme."*

66. Such difficulties do not appear to me to be presented by this case. The connections here would be in no sense "loose". If the SPhinX Companies enter into the Scheme(s) with their Scheme Claimants as an alternative to litigating the complex issues identified in the June 2007 summons, there will undoubtedly be a compromise of the rights of the Scheme Claimants against the SPhinX Companies. That compromise of rights is in no sense diminished by the fact that releases are to be given to the ICs which would prevent Scheme Claimants from bringing claims which might result in ricochet claims against them.

67. Moreover, I accept that the releases proposed to be given by the Scheme Claimants to the ICs pursuant to the Schemes, are within the scope of the Court's jurisdiction because they contain the element of accommodation or give and take by all concerned, required to be contained in schemes under section 86 of the Law.

68. If the Scheme(s) are successfully promoted, they could also serve in the long run to increase the amount of money ultimately to become available to the Scheme Claimants by avoiding the costly litigation mentioned above.

69. Moreover, the releases will be of benefit to the Scheme Claimants because they will serve to delimit the amount of the monetary reserve that may be required to

be set aside to meet ICs' claims and thus increase the amount available for distribution now.

70. To the extent that cash would be required for the indemnities reserve, it would not be available for distribution to Scheme Claimants until after ICs' claims against the SPhinX Companies have been fully resolved. As 'time is money', the sooner and larger the distributions made to Scheme Claimants, the better from their point of view.

71. For their part, ICs will also be giving an accommodation to the Scheme Claimants and to the SPhinX Companies, because the releases to be given by the Scheme Claimants and to be accepted by them, will serve to reduce the amount of the monetary reserve required to protect the ICs' interests under their indemnities.

72. As the ICs get the benefit, in turn, of the releases of claims (both claims directly from Scheme Claimants and ricochet claims by Non-ICCs who may be sued by Scheme Claimants) – there will clearly be give and take on all three sides of the compromise – the SPhinX Companies, the Scheme Claimants and the ICs.

73. That such a scheme of arrangement involving a company, its members and a third party will come within the ambit of section 86, appears already to be recognized by this Court.

74. ***In the SIIC Medical Science and Technology (Group) Limited, 2003 CILR 355***, this Court sanctioned a scheme in which the proposed exchange of rights involved shareholders in the scheme company SIIC, exchanging their shares for cash to be paid by the proposed purchaser (another company SIHL, whose wholly-owned subsidiary SIIC would thus become and, on the other hand, SIIC extinguishing its

liability to its shareholders in respect of their equity in SIIC by cancelling their shares).

75. The Court held that the proposed exchange of rights would be a compromise or arrangement within the meaning of section 86 because the term "arrangement" was to be construed broadly and in order for the scheme to be so classified, it was necessary for it to involve an element of 'give and take' and to have the approval of the company, either by its board or by a resolution of its members.

76. That dictum echoes the words of Brightman J in ***In Re N.F.U. Development Trust Ltd. [1972] 1 W.L.R 1548*** and indeed reflects what must by now be accepted to be settled principle. As Nourse J. later observed in ***In re Savoy Hotel Ltd.*** at ***[1981] Ch 351 at p359, E-F***:

> *"... there can be no doubt that the word "arrangement" [(in what was then the equivalent section 206 of the Companies Act 1948] has for many years been treated as being one of very wide import. Statements to that effect can be found in the judgments of Plowman J. in In re National Bank Ltd [1966] 1 W.L.R. 819, 829, and of Megarry J. in In re Calgary and Edmonton Land Co. Ltd. (in Liquidation) [1975] 1 W.L.R. 355, 363. That is indeed a proposition for which any judge who has sat in this Court in recent years would not require authority, and its validity is by no means diminished by what was said by Brightman J. in In re N.F.U. Development Trust Ltd. [1972] 1 W.L.R. 1548. All that that case shows is that there must be some element of give and take. Beyond that it is neither necessary nor desirable to attempt a definition of "arrangement"."*

77. Indeed, going even further back to the early 20th century during what was still the relative infancy of the concept of legal corporate personality, an arrangement between a company and its relevant creditors or members, was found not to be outside the scope of the statutory provisions governing schemes of compromise

and arrangement, merely because the arrangement was part of a wider scheme involving outsiders, or an outsider was a necessary party to its implementation. See, for instance ***Shaw v Royce [1911] 1 Ch. 138*** and ***Re Guardian Assurance Co. [1917] 1 Ch. 431*** and the analysis of those and other cases on point by McLelland J. in ***Re Glendale Land Development Ltd. (In Liquidation) (1982) 7 ACLR 171 at 173.***

78. In a recent case containing elements of compromise involving releases of potential third party liability and so analogous to the present case, the Federal High Court of Australia also identified the element of give and take as being the prerequisite for a scheme to be sanctioned by that Court as coming within the statutory meaning of compromise or arrangement. I adopt and adapt Mr. Snowden's summary of the case as follows.

79. In ***Fowler v Lindholm, In the matter of Opes Prime Stockbroking Limited (2009) FCAFC 125,*** a creditor (Mr. Fowler) argued that the Court did not have power to approve schemes of arrangement under section 411 of the Australian Corporation Acts (which is substantially the same as section 86 of the Law) because the Scheme contained provisions which would require himself and other creditors of the scheme companies to release claims they had against various financiers, including Merrill Lynch International and Merrill Lynch International (Australia) Limited (together "Merrill Lynch") and Australia and New Zealand Banking Group Limited and AWZ Nominees (together "ANZ"). Pursuant to securities lending arrangements with two of the four scheme companies, the two companies had transferred securities received from their clients to Merrill Lynch

and ANZ and had been provided in return with cash, collateral and other securities.

80. Creditors of the scheme companies had begun proceedings against Merrill Lynch, ANZ and the scheme companies. Mediation resulted in schemes of arrangement settling all claims and proceedings against Merrill Lynch, ANZ and others in exchange for Merrill Lynch and ANZ paying Aus$226 million in cash; and the scheme companies' receivers and Merrill Lynch releasing cash and assets of the scheme companies (of about Aus $27 million), for distribution to the scheme creditors.

81. Under the schemes (as is proposed in relation to the SPhinX Companies here) the liquidators of the scheme companies, as attorneys for the scheme creditors, would execute the documentation under which the scheme creditors would release all their claims - including their claims against Merrill Lynch and ANZ - a form of compulsory release from the point of view of minority scheme creditors who did not approve. That was the category in which Mr. Fowler found himself.

82. The scheme was (after obtaining the necessary majority approvals in number and value) approved by order of the Court on 4 August 2009, and became effective on that day, the necessary documentation having been executed by the liquidators as attorney of each of the scheme creditors under the power conferred by the schemes. The sum of Aus$226 million was deposited by Merrill Lynch and ANZ to be held by the liquidators in escrow pending release to scheme creditors. The proceedings against Merrill Lynch and ANZ and others were discontinued, and the liquidators were anticipating paying an interim dividend by the end of

December 2009. Then Mr. Fowler was given leave to appeal from the order of the 4 August 2009.

83. As eventually argued before the Federal Court Mr. Fowler's appeal was summarized as follows by the Federal Court:

> *"57. **Mr. Fowler contends that** the effect of the Schemes is to confiscate the property of certain creditors, being claims that those creditors have against Merrill Lynch and ANZ, which are solvent and would be well able to meet such claims. He contends that releases of and indemnities in favour of, Merrill Lynch and ANZ, insofar as they are effected by the Schemes, do not fall within s.411 of the Corporation Act. He says that a Scheme may not bind a person who is a creditor of a company on account of that person's claim against a third party other than as a creditor of the Company. All parties agreed that there was no binding authority that determined this issue, although there are a number of cases that have expressed views one way or the other that may cast some light on the resolution of the question."*

84. This concern of Mr. Fowler's – that a dissentient creditor should not, in effect, have a claim that he has against a third party confiscated as a condition of participating in a scheme of arrangement with his debtor company, could be transposed to the present case; at least from the point of view of dissentient Scheme Claimants who may wish to bring reflective loss claims against ICs or against Non-ICCs who could seek contribution against ICs by ricochet claims.

85. Before returning to the narrative in ***Fowler v Lindholm***, it is just as well to note that the essential premise of a scheme, in answer to such concerns as raised by Mr. Fowler, lies in the notion of fairness involved in the "give and take" – the compromise or accommodation – that underlies a scheme and which derives its essential acceptability from the consent of the majorities in number and in value of those participants who vote for a scheme. As was said by Chadwick LJ in

Johnson v Davies *[1998] 2 BCLC 252 at 261-262,* the effect of a scheme is to create *"a statutory hypothesis...that the person who has notice of and was entitled to vote at the meeting is party to an arrangement to which he has given his consent".*

86. If, by that process, it is deemed to be in the interest of the investors or creditors (or classes of them) as a whole, that a third party who provides benefit to them through the scheme of arrangement between them and their company should in turn be released from liability arising in respect of his dealings with the company, the statute then gives the Court the jurisdiction to sanction the scheme notwithstanding that a right which a dissentient investor or creditor might in the minority wish to retain relative to the same or related dealings, would also be compromised as a part of the scheme.

87. That reasoning is, I think, all implicitly recognised in the Federal Court's comprehensive and careful analysis and rejection of Mr. Fowler's arguments in the following terms which is worth quoting *in extenso:*

> ***"66.*** *Doubtless there are limitations on the extent to which a scheme of arrangement purporting to be between a company and its creditors or a class of its creditors can purport to affect property of the creditor that has no connection with the company or the relationship of creditor and debtor between the creditor and the company. The mere fact that a person or entity is a creditor of a company would not, of itself, justify an arrangement between that person or entity on the one hand and the company on the other whereby property of the person or entity were confiscated without any benefit to the person or entity. Such an arrangement would not be approved by the Court pursuant to s.411 (4) (b.*
>
> *A purported scheme of arrangement must involve some arrangement in a sense that is to be construed liberally.*

No narrow interpretation should be given to the expressions "compromise" or "arrangements". An arrangement within the meaning of s.411 connotes some element of give and take. A proposal that conferred no benefit to creditors and constituted the mere confiscation of interests would not be an arrangement within the meaning of s.411. An arrangement must involve some bargain giving benefit to both sides. However, there is no reason to construe the terms in s.411 as restricting in any way the nature of the bargain that might be made between company and creditors (Re Sonodyne International Ltd. (1994) 15 ASCR 494 at 497-8), subject only to the additional requirement that the arrangement must be within the power of the company and not in contravention of the Corporations Act.

67. *A scheme of arrangement between a company and its creditors or a class of creditors is no more than a proposal to vary or modify the company's obligations in relation to its debts and liabilities owed to the creditors or class of creditors. There is nothing to prevent the company from posing, as part of the arrangement, a term to the effect that, in consideration of what the company has provided under the scheme, the creditors will discharge not only the debt and liabilities of the company, but also the liabilities of, for example, sureties for the same debts and liabilities of the company.*

It is permissible to incorporate in a scheme of arrangement an involvement or participation by an outsider, being a person or entity who is not a party to the scheme as a company or creditor (see Re Glendale Law Development Ltd. (In Liquidation) (1982) 1 ACLC 540 and as above). Such arrangements are commonplace in relation to the schemes involving takeovers. A scheme of arrangement made between a company and its creditors under s.411 binds only the company and the creditors.

Nevertheless, there is no reason why a bargain might not be struck between a company and creditors whereby the creditors are bound to enter into an arrangement with third parties. So long as there is some element of give and take, such that the creditors receive something in return for the benefit conferred on a third party, there is no reason in principle why that in turn could not be part of a scheme of arrangement as contemplated by s.411".

88. I adopt fully that dictum as being applicable to the present case. For the sake of completeness, I should note that there is of course, no requirement of "fairness", in the absolute sense, as a prerequisite to the exercise of the jurisdiction of the Court. The Court will recognise that the commercial realities which could give rise to a rational and principled basis for a scheme, and so for the approval of the statutory majorities, are legion. And, as was observed in ***Prudential Ass. Co. Ltd. and Others v PRG Powerhouse Ltd. and Others*** *[2007] EWHC 1002 (Ch)* – a useful starting point would be to compare a scheme claimant's position under a scheme with what his position would have been on a winding up. In the present case, the former is to be even more starkly contrasted with the latter, because of the prospect of expensive and time consuming litigation of the several complex and difficult issues sought to be compromised by the Scheme(s).

89. In this regard, the Federal Court in ***Fowler v Lindholm*** declared further in terms which I also regard as analogous to the present case:

> *"There is also no principled basis for a restrictive approach. Provisions of s.411 are intended to provide a flexible mechanism to facilitate compromises and arrangements between insolvent companies and their creditors as an alternative to liquidation [or as in this case, between solvent companies and their shareholders and/or creditors].*
>
> *If there is an adequate nexus between a release or indemnity, on the one hand, and the relationship between the creditor and the company, as creditor and debtor on the other hand, there is no reason in principle why a scheme could not validly incorporate a release and indemnity such as is provided for in the Schemes. The claims against Merrill Lynch and ANZ that are released and are the subject of the indemnity arise out of dealings with the Scheme Companies. Thus the claims of creditors against the Scheme Companies and the claims against Merrill Lynch and ANZ substantially overlap. The arrangement involves a settlement of*

claims that are significantly interrelated. Without the release, there could be no compromise or arrangement."

90. Here, in the context of the proposed Scheme(s), the release of direct claims against ICs and of indirect reflective loss claims against Non-ICCs by Scheme Claimants that could otherwise lead to ricochet claims – like the release of scheme creditors' claims against Merrill Lynch and ANZ – offers an immediate and tangible benefit to Scheme Claimants. As the Scheme(s) would involve the settlement of claims which are interrelated in that way, there would be a compromise or arrangement which includes the releases.

91. The English Court of Appeal also recently expressed views on the validity of schemes which incorporate releases against third parties.

92. In ***Lehman Brothers International (Europe) (in administration) ("LBIE") (2009) EWCA 1161,*** the administrator of LBIE appealed from a determination that a scheme, which required scheme creditors to release proprietary rights in assets held for their benefit as beneficiaries under a trust by which securities were held by LBIE as trustee, was not a compromise or arrangement within the meaning of section 899 of the Companies Act 2006.

93. The Court of Appeal, while upholding the decision of the lower court concluded that the court had no jurisdiction to sanction a scheme which required creditors to release their proprietary rights in assets held in trust for them by LBIE, nonetheless recognised that a scheme could incorporate the release of rights of action held by scheme creditors or members against third parties (a proposition that was helpful to the administrators of LBIE who sought to include such a

release in the scheme and so compromise monetary claims as against third parties).

94. Among the case authorities cited by the Court of Appeal and approved by them in support of that proposition were ***RE T & N (No. 3)*** and ***Fowler v Lindholm*** (both above) .

95. At paragraph 63 of his judgment on behalf of the Court of Appeal, Patten L.J. said of relevance to the proposed Scheme(s) here:

> *"Although the decision in **Re T & N Ltd. (No. 3)** has not been the subject of any judicial criticism in this country, the principle it establishes has proved controversial at least in Australia. It seems to me entirely logical to regard the court's jurisdiction as extending to approving a scheme which varies or releases creditors' claims against the company on terms which require them to bring into account and release rights of action against third parties designed to recover the same loss. The release of such third party claims is merely ancillary to the arrangement between the company and its own creditors."*

96. All claims against the SPhinX liquidation estate under contemplation here would be personal, not proprietary trust claims and so on the authority of the LBIE case, may be regarded as claims which the Schemes may encompass and which may be required to be compromised under the Scheme(s) without falling foul of the limitations imposed by the Court of Appeal in that case.

97. I should note in passing, that the controversy surrounding the ***T & N (No. 3)*** principle mentioned by Patton L.J. as having arisen in Australia, is now resolved by a very recent decision there of the High Court.

98. Indeed, that controversy was deservedly short-lived because it was based on a concern which was misconceived: that because creditors may be bound by a Scheme of Arrangement under Part 5.1 S.411 of the Australian Corporations Act

to give up claims against others, creditors who are parties to Deeds of Company Arrangements under S.444 D(1) Part 5.3 of the Act, may be equally bound to do so.

99. In ***City of Swan v Lehman Bros. Australia Ltd. (2009) FCAFC 130,*** the Full Federal Court of Australia had been cautious about endorsing the decision in ***Fowler v Lindholm*** (above) out of the misconceived concern identified above.

100. In its recent reasons for decision (handed down on 14 April 2010 in respect of its decision reached on 30 March 2010), the High Court of Australia expressed itself in this regard as follows (paragraphs 53 and 54):

> *"**53.** Because creditors are bound under S.444 D(1) only to the limited extent identified in that provision, the assent of some creditors (even a majority by number and value of those who vote) to giving up claims against another does not bind other creditors to do so. No creditor is bound to give up such claims because the Act does not bind them beyond the limit prescribed by s.444 D(1) where, particularly, the Act does not bind creditors to give up a claim against a person other than the subject company – here Lehman Australia.*
>
> ***54.** In this respect, Pt. 5.3A (and in particular, S.444 D(1) stands in sharp contrast with Pt. 5.1 of Ch. 5 of the Act[including S.411], which regulates arrangements and reconstructions. The provisions of Pt. 5.1 (which derives ultimately from the Joint Stock Companies Arrangement Act 1875 (UK)) make a compromise or arrangement binding on creditors (or on a class of creditors)if agreed by a majority in number of the creditors (or class) whose debts or claims aggregate at least 75 per cent of the total amount of the debts and claims of the creditors (or class of creditors) present and voting, and if approved by order of the Court.*
>
> *Unlike S.444 D(1), the provision of Pt. 5.1 which makes certain compromises or arrangements*

binding on creditors (S.411(4)) does not qualify the extent to which creditors are bound."

101. It follows that, as authority for which it stands, the decision in ***Fowler v Lindholm*** (above) has not in any way been put in doubt by this later decision of the High Court of Australia.

102. And so to conclude on the issue of the scope of the jurisdiction, I find as follows.

103. The question as posited involves the surrender of putative rights of action by the Scheme Claimants which they may have against ICs and against Non-ICCs who may be regarded as being in no way connected to the SPhinX companies apart from the potential claims which they may in turn bring against ICs as persons who are indemnified by the SPhinX Companies. Viewed in that way, the possible connection to the SPhinX Companies of the rights to be relinquished may be regarded as being at the outer reaches of the limits of the Scheme(s). It is, nonetheless, because the Scheme(s) would provide for the releases of such possible claims that their release may properly be regarded as ancillary to and beneficial to the Scheme(s) and so within the scope of the jurisdiction of the Court to sanction.

Enforceability

104. It is axiomatic and settled principle that a scheme of arrangement is directly binding only upon the parties to it.

105. As McLelland J. in the Supreme Court of New South Wales said of an arrangement between a company and its creditors under S.315 of the Companies (NSW) Code:

> *"...the contractual status of any outsider vis-a-vis the company or any creditor or member must have some other basis than the court's approval of the arrangement between the company and its relevant creditors or members."* ***Re Glendale Land Development Limited (In Liquidation) (1982) 7 ACLR 171, 173.***

106. As Jacob J also said in ***R.A. Securities Ltd. v Mercantile Credit Co. Ltd. [1994] 2 BCLC 721 at 724*** (reflecting upon the liability of an original tenant ("T1") owed to a landlord after the lease between them had been assigned and the assignee had entered into a Companies Voluntary Arrangement under Section 5 of the Insolvency Act):

> *"Turning back to section 5 (of the Insolvency Act) – [the equivalent to S.86(2) as read with the notice provisions under the local Companies Winding-up Rules 2008)], does "bind every person" have any effect outside the voluntary arrangement? I think not. The effect of the binding is solely as between the parties bound – those entitled to vote, whether they did or not. An outsider, such as T1 can get no assistance from the terms of the voluntary arrangement as such. Of course, if something is actually done as a result of the arrangement (e.g. property transferred, or as might have been but did not happen here, surrender of the lease) then an outsider can rely upon that. But his right to rely upon it must result from the actual act done, not the arrangement."*

107. The "actual act" proposed to be done upon which the ICs can rely in the Scheme(s) here, will be the entering into the Deeds of Releases with them as parties to them and by which the potential claims by Scheme Claimants will be "treated as released".

108. This is regarded as necessary because the other provisions which the Scheme(s) will contain, by which Scheme claimants will merely agree "not to sue ICs" (and by extension Non-ICCs) will not be, on the basis of the foregoing case law,

sufficient to enable ICs (and by extension Non-ICCs) to enforce their intended benefits under the Scheme(s).

109. In this regard also, there is very helpful dicta to be further found in the decided cases.

110. While it was accepted in the arguments in ***T & N Ltd. (No. 3)*** (above); that it was only the scheme companies and the employees that were bound by virtue of the Court's order sanctioning the schemes, it was also accepted that a compromise of the rights of the employees against the Insurers could nevertheless be achieved by schemes between the scheme companies and the employees. At page 872 paragraph 55, David Richards J said in this regard:

> *"**55** ...There are mechanisms regularly used whereby a third party can be bound by and obtain the benefit of a scheme.*
>
> *In a typical scheme to effect a merger or takeover, the members' obligation to transfer their shares will be enforceable through the appointment of an attorney to sign the share transfers, and for its part the acquirer will undertake to the court to be bound by the scheme and can therefore be obliged to give effect to it. Likewise, in this case the EL Claimants [the employees] are obliged to assign to the trustee the benefit of their claims against the EL Insurers and the fruits of any action and authority to effect the assignment, if necessary, conferred by the Scheme on an attorney. Their covenant not to make claims against the EL Insurers is enforceable by ([the Scheme Companies])."*

111. Of even more direct relevance to the situation here is the analysis of Etherton J. given in ***Prudential Assurance Co. Ltd. v PRG Powerhouse Ltd.*** [2008] 1 BCLC 289.

112. In that case, one of the issues presented to the learned judge was whether the guarantees or indemnities given by PRG Powerhouse – the parent of other companies including "Powerhouse Ltd." – to former landlords of premises which some Powerhouse Ltd. stores had occupied but which had been relinquished, were released by Powerhouse Ltd's company voluntary arrangement ("the CVA") under the Insolvency Act 1986. This was raised by virtue of the Clause 3.12 under the CVA that provided that payment of dividends to the landlords as creditors of Powerhouse Ltd. would immediately and automatically operate to release all liability of PRG under its guarantees to the landlords. Thus the CVA of Powerhouse Ltd. purported to have a direct binding effect on the substantive rights and obligations of the guaranteed landlords and of PRG under the guarantees.

113. On the question whether clause 3.12 of the CVA was binding and enforceable as between PRG and the guaranteed landlords, Etherton J decided that it was not enforceable as between them, because PRG had the contractual status of an outsider vis-à-vis the guaranteed landlords:

> *"44. In my judgment, broad and facilitative as the statutory language may be, it does not enable Clause 3.12 to operate directly to release PRG's liability under the guarantees.*

[He then cited the dictum of McLelland J from ***Re Glendale Land Development Limited (In Liquidation)*** (above, ibid) and continued]:

> ***"51.*** *...In relation to the guarantees PRG's obligations are those of a debtor arising out of a contract made by itself as principal on its own behalf. There is nothing in the [Insolvency Act] or [the Insolvency Rules] which makes the CVA binding and*

enforceable as between PRG and the guaranteed landlords in respect of such obligations."

[The Learned Judge then cited by way of further authority for the foregoing proposition, the dictum of Jacob J. from ***R A Securities Ltd. v Mercantile Credit Co. Ltd.*** (above, ibid)].

114. By analogy with that analysis of Etherton J's by which Clause 3.12 of the CVA did not serve to release PRG's obligations under the guarantees, here Scheme Claimants agreement within the Scheme(s) "not to sue" ICs (and by extension Non-ICCs) would not serve directly to release such claims in a manner that would be enforceable by ICs as non-participants to the Scheme(s).

115. However, as will appear from further discussion of the PRG case below, the problem of enforceability can, in my view, be overcome by the inclusion of the words in the Deeds of Release by which claims against ICs and Non-ICCs are "to be treated as released"; as that mechanism will allow for enforcement, not only by the JOLs and other scheme participants, but also by ICs who become parties to and by their reliance on the Deeds of Release. This is on the further basis, of course, that if sanctioned by the Court, even compulsory Deeds of Releases executed by the JOLs as part of the Scheme(s), will be binding upon dissentient investors by way of the "statutory hypothesis" of contract embodied in the Scheme(s) (see ***Johnson v Davies*** above) and so enforceable by the parties to the Deeds, including ICs.

116. As to enforceability by scheme participants Etherton J went on in relation to a different clause – Clause 3.14 of the CVA in which it was provided that the PRG

guarantees "shall…be treated as having been released" – to state at paragraphs 60-62:

> *"**60.** The claimants accept that it is legally possible for the CVA to provide that a creditor cannot take steps to enforce an obligation of a third party to the creditor which would give rise to a right of recourse by the third party against the debtor company, such as payment by a guarantor who can then claim repayment from the debtor. That concession is plainly right. Such a provision falls within the broad term "scheme of arrangement of its affairs" in S. 1(1) of [the Insolvency Act]. It is consistent with **Shaw v Royce** and **Re Glendale Land Development** [(both above)]. The validity of such a prohibition on action by the creditor against a third party was expressly recognised by Judge Roger Cooke, sitting as a High Court Judge, in **Burford Midland Properties Ltd. v Marley Extrusions Ltd. [1995] 1 BCLC 102 at 113-114**, and **262** and, **[1999] Ch. 117 at 128 and 130.***
>
> ***61.** In terms of what legitimately may be encompassed within a CVA, there is no difference in substance between an obligation of a creditor not to enforce a contract with a third party, on the one hand, and an obligation of the creditor to deal with the third party as if the creditor's contract with the third party did not exist on the other hand. If the former is enforceable by the debtor company against the creditor, there is no legitimate policy reason, nor anything in the relevant legislation, for holding the latter to be unenforceable by the debtor company.*
>
> ***62.** Accordingly, clause 3.14 is, in principle, enforceable by Powerhouse as an obligation of the guaranteed landlords [qua creditors under the scheme] not to claim against PRG under the guarantees"*

117. On the basis of the foregoing analysis, I accept that the Deeds of Release treating claims against ICs and Non-ICCs "as released" for the purposes of the Scheme(s) will be enforceable. The obligation on the part of Scheme Claimants not to sue

will be enforceable both by other scheme participants (including the JOLs) and by the ICs, on the basis of the *"actual act done"* (per Jacob J. above) of entering into the respective Deeds and by virtue of the provisions of the Deeds to the effect that claims that may be brought by such suits are to be treated as released.

118. I conclude that the court has jurisdiction to sanction the Scheme(s) as proposed.

Hon. Anthony Smellie
Chief Justice

May 5, 2010