IN THE GRAND COURT OF THE CAYMAN ISLANDS

CAUSE NO. 258 OF 2006

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 THIS COURT DATED 6TH JUNE 2007

IN CHAMBERS
BEFORE THE HON. CHIEF JUSTICE
Heard on the 30th November 2009 to 4th December 2009

Appearances:

Mr. Thomas Lowe QC 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. Mark Phillips QC instructed by Mr. Alan Turner of Turner & Roulstone for the Liquidation Committee of the SPhinX Group of Companies (in liquidation)

Mr. Richard Sheldon QC instructed by Mr. Alistair Walters and Mr. Guy Manning of Campbells for DPM Mellon LLC and DPM Mellon Ltd. (together "DPM")

Mr. Richard Gillis QC instructed by Mr. Andrew Bolton of Appleby for Messrs. Owens and Kavanagh

Mr. Neil Timms QC instructed by Mr. Roger Nelson of Nelson & Co., for PriceWaterhouseCoopers LLP

Mr. Kenneth Farrow QC of Mourant for Mr. Robert Aaron

Mr. Raymond Davern of Higgs Johnson for Pricewaterhouse Coopers Cayman Islands

(Indemnity Claimants Patricia Farquharson and Andrew Feighery not represented)

RULING

1. The SPhinX Group of Companies are investment fund entities now in official liquidation under the aegis of this Court. The Joint Official Liquidators ("the JOLs") have applied to the Court for the setting of a monetary reserve to meet the contingent liabilities of the SPhinX Companies, as such contingent liabilities may arise from certain indemnities given by them. These are contractual indemnities given to persons in respect of various fiduciary relationships formerly held as between those persons and the SPhinX Companies and in respect of which those persons have filed or may yet file claims in the liquidations.

2. There are potentially 34 such Indemnity Claimants, 9 of whom have participated in the hearing of this, the JOLs' application. It is however accepted by the JOLs that the monetary reserve must also cover the contingent liabilities of the other 25.

3. The Indemnity Claimants are individuals who were in various capacities engaged as auditors, directors or other professional service providers to the SPhinX Companies and whose contracts of engagement contained the indemnities which are contemplated by this application.

4. Subject to their proper construction and to the admission by the JOLs of the contingent proofs of debts submitted by reliance on them, the contractual indemnities would protect the Indemnity Claimants from liability arising from their relationships with the SPhinX Companies and with related third parties; except for liability arising from gross negligence, fraud or other intentional wrong-doing. Thus, liability for negligence – non-intentional wrong-doing –

would be covered by the indemnities, as well as liability for the legal costs of successfully defending against any claim whatsoever – whether of non-intentional or intentional wrong-doing. This contingent liability for the legal costs of the Indemnity Claimants became, in the course of these proceedings, the subject for which the JOLs, with the support of the Liquidation Committee ("the LC"), pressed most urgently for the setting of the reserve. However, legal costs aside, the Indemnity Claimants have identified at least three other heads of potential contingent liabilities for which they say provision must be made now and object to the monetary reserve being set for legal costs alone, unless some arrangement (monetary or otherwise) is made to provide for those other heads of contingent liabilities .

5. For their part, the JOLs and the LC contend that the reserve for legal costs should now be set so that a distribution of surplus assets can be made to the investors/shareholders of the SPhinX Companies.

6. The JOLs have reported that the SPhinX Funds are solvent, with some 535 million dollars' worth of assets realised over the course of the past three years of the liquidation and available for distribution.

7. While the Indemnity Claimants who are present on this application ("the ICs") and the other 25 ICs, may properly be regarded as contingent creditors to the extent of their potential indemnity claims, the JOLs believe that indemnity claims could - even if they were all realised - come to represent but a fraction of the assets and so should not stand in the way of a timely distribution to the investors/shareholders now. In this the LC naturally joins in support. However,

in the view of the JOLs, no distribution scheme can be finally agreed or is likely to be appealing to the various classes of investors/shareholders, until the reserve for the contingent indemnity claims has been quantified. It is to resolve this issue that the JOLs apply now to the Court and in order to meet the contingent liabilities other than for legal costs (for which they seek the immediate setting of the reserve) they make other proposals about which more below.

8. By way of background, it is to be noted that the JOLs have been engaged for some time in two sets of proceedings being heard together in the Southern District of New York against, amongst others, the ICs who are present in these proceedings. The New York proceedings are complex consolidated proceedings in which the JOLs also seek to recover some 300 million dollars in damages, not only as against the ICs, but also as against others who had been closely involved in the management of the SPhinX Companies and of its fund managers – the ill-fated Refco Group of Companies – in claims of gross negligence and fraudulent mismanagement. These consolidated proceedings will be referred to as "the New York proceedings" or "the Refco MDL", as the context requires. There are also on foot, proceedings brought by four of the ICs (Messrs. Kavanagh, Owens, DPM and Aaron) here in Cayman by way of appeals against the JOLs' rejection of their proofs of debt based on their indemnities, for legal costs already incurred in the New York proceedings.

9. If the JOLs are successful in the New York proceedings on grounds of intentional wrong-doing, they would also expect to establish that the exclusionary provisions of the indemnities apply. But if the JOLs fail to establish such liability against the

ICs or succeed only on grounds of negligence, then the ICs (and potentially the other 25 ICs who may yet be joined in the New York proceedings) will seek to rely on the indemnities for the recovery of all their costs.

10. It is therefore accepted by the JOLs, that the reserve for costs must be calculated on the footing that the JOLs lose; both in the New York and the Cayman proceedings.

PRIORITIES

11. The directions and orders which the JOLs seek are, against the background of the contingent liabilities which may arise on the indemnities, of personal importance to them as well. Were it not for the protection which the sanction of the Court will afford them, the JOLs - being on notice of the full extent of the potential contingent liabilities - would be at risk of themselves having to meet any shortfall which might arise from keeping too small a reserve.

12. The Court must therefore be alive to the risk of prejudice to the ICs and the other 25 ICs, which may arise from it setting too small a reserve to meet the costs which may be indemnified. The same risk of prejudice would arise from too small a reserve for meeting any other liabilities which may be owed arising under the indemnities.

13. It is in this respect that the ICs assert correctly that as contingent creditors of the SPhinX liquidation estate, they are entitled to priority over the investors/shareholders. The Companies Law (2009 Revision) ("the Law") in section 140 (1) provides that in a winding-up *"…the property of the company shall be applied in satisfaction of its liabilities pari passu and subject thereto*

shall be distributed amongst the members according to their rights and interests in the company."

14. The statutory priority and *pari passu* principles are reflected in the winding up rules and for present purposes the important rule is Companies Winding-up Rules ("CWR"*)* O.18 R.4 which provides:

> *"In the calculation and distribution of the dividend the official liquidator shall make provisions for –*
>
> *(a) any debts which appear to him to be due to persons who for whatever reason, may not have had sufficient time in which to tender or establish their proofs;*
>
> *(b) any debts which are the subject of claims which have not yet been determined;*
>
> *(c) disputed proofs and claims; and*
>
> *(d) expenses of the liquidation which are anticipated but not yet incurred."*

15. The contingent liabilities here contemplated would come within sub rule (d) and the disputed proofs of ICs Kavanagh, Owens, DPM and Aaron already the subject of appeals before this Court; within sub rule (c).

16. The purpose of CWR O.18 R.4 is clear: provision must be made by a liquidator for the matters there identified in order that the priority of creditors over shareholders and the pari passu principle can be honoured, before a liquidator calculates and distributes a dividend. If no or inadequate provision is made for the matters identified in Rule 4, claimants whose proofs have been admitted may

receive a greater dividend than they should at the expense and to the prejudice of claimants (including contingent creditors) who subsequently establish their claims. In this case, a failure to make provision as required would allow investors/shareholders to receive assets which may turn out not to be surplus assets and so to which they have no entitlement.

17. The amount of the provision which is required to be made for the types of claim identified in CWR O.18 R.4 is the full amount of the potential liability: ***Gooch v London Banking Association [1885] 32 Ch. 41***; ***Oppenheimer v British and Foreign Exchange and Investment Bank [1886] 6 Ch.D. 744 at 747***; and ***Midland Coal, Coke and Iron Company [1895] 1 Ch. 267.*** The principle that full provision must be made for the contingent liabilities of companies in liquidation is well established also in the local case law (See: ***In Re Transnational Ins. Co. Ltd. 2001 CILR 34*** and ***In Re Bristol Fund 2008 CILR 317.)***

18. If the Court errs in setting a reserve that is too small, the ICs will suffer irremediable prejudice because - absent some provisions for "claw back" from recipients or insurance provision to cover any shortfall – once a distribution has been made, a creditor who could have proved his debt in the liquidation has no claim against those to whom a distribution has been made and the distribution cannot be reopened to let in such a creditor. In the words of Sir Robert Megarry VC in ***Re R-R Realisations Ltd. [1980] 1 All E.R. 1019 at 1024A:***

"What has gone has gone".

19. Thus, an outcome in which the ICs receive less than their entitlement in the liquidation would be unacceptable: the statutory order of priority – the requirement that all liabilities to creditors shall be discharged in full before returns to shareholders – the principle mandated by section 140 of the Companies Law mentioned above and which lies at the heart of the regime for the compulsory winding-up of companies – would not have been applied.

20. This risk of prejudice – the wrongful subordination of creditors to shareholders – is therefore that of which I must be acutely aware in my approach to the exercise at hand.

21. For this reason, not only must I seek to set the appropriate reserve for the legal costs of the ICs relative to the New York proceedings and Cayman proceedings; I must also address their concerns about the other three heads of contingent liability claims. This is especially against the background of some of the ICs having objected from the outset to any distributions at all being made to investors/shareholders pending the determination of the New York proceedings and their reluctant acceptance that the Court might now proceed as requested by the JOLs, only because of the JOLs' assertion that the SPhinX Funds are solvent vis-à-vis creditor claims.

NATURE OF THE CONTINGENT CLAIMS

22. While the contingent claims for legal costs are by their very nature dependent on what may happen in the future course of complex litigation and thus not given to precise estimation; the contingent claims which may arise under the other three heads are entirely within the realm of the unknown. For that reason, it was

eventually accepted that the Court might not sensibly be asked at this stage to embark upon the setting of a monetary reserve for them. Some other mechanism must be found to provide for them, if the JOLs' proposed scheme for distribution is to proceed now, rather than much later when those claims may be estimated or actually evaluated.

23. I am therefore called upon to make it expressly clear that the monetary reserve, which I now set for meeting the legal costs of the New York and Cayman proceedings, provides no basis for the JOLs proceeding with their proposed Scheme of Arrangement for distribution unless and until arrangements, to the satisfaction of the Court, for meeting the other heads of contingent indemnity claims, are in place. I now do so.

24. Those other heads of contingent indemnity claims I describe as follows, largely adopting the summary of them as they were addressed in these proceedings:

(i) **Claims for indemnification by the ICs arising from awards made in favour of the JOLs based on non-intentional wrong-doing.**

In the event the JOLs recovered damages from the ICs on the basis of non-intentional wrong-doing (eg. negligence); the ICs would be entitled to indemnification from the estate. As the liabilities would thus cancel each other out, the JOLs have proposed that there is no need for a reserve to meet the ICs' claim in this regard. The JOLs propose instead, that this head of contingent liability be addressed through set-off agreements.

(ii) **Contribution claims which may be brought against the ICs.**

In the event a third party who is successfully sued by the JOLs for non-intentional wrong-doing obtains a contribution to the damages awarded from the ICs, based also on non-intentional wrong-doing; the ICs would be entitled to indemnification from the estate. The JOLs propose to avoid the need for a reserve for this aspect (as it may arise in the New York proceedings) by undertaking to hold any monies paid by a third party judgment debtor until the period for issuing contribution claims against the ICs had expired or any such contribution claim had been determined.

The time for holding such payments became an obvious question. It was however agreed by the experts on New York law who testified in these proceedings (Attorney Mr. William Reid and Attorney and retired United States Bankruptcy Judge Melanie Cyganowski) that contribution could not be demanded until after payment of a judgment award. Thus, this undertaking as expressed by the JOLs not to pay out such recoveries from the estate, appeared to obviate the need to reserve for any liabilities of the ICs for damages under contribution claims in the New York proceedings. That then left the question of the reserve as it relates to potential legal costs of the ICs in defending contribution claims in the New York proceedings. The ICs would be entitled to indemnity for their legal costs in successfully defending against contribution claims in those proceedings, or of unsuccessfully defending against contribution claims which are based only on non-intentional wrong-doing. It was accepted by the JOLs that the monetary reserve which they invite the Court to set now must

include these heads of potential costs in relation to contribution claims, even if their undertaking is accepted for dealing with contribution damages awards. I will therefore approach the setting of the reserve on that basis.

(iii) **Separate or "Rogue" Investor claims.**

The JOLs' proposal that the monetary reserve need only cover the contingent liability to ICs for legal costs, is crucially dependent upon the acceptance by the SPhinX investors generally that they should not seek to bring their own claims against the ICs (or other 25 ICs), but should allow any claims which may properly be brought to be brought by the JOLs on behalf of the SPhinX liquidation estate. For these among other purposes, the JOLs intend to propose a Scheme of Arrangement for the distribution of the assets which would bind all shareholders/investors. As part of that Scheme, the JOLs propose that Investors provide releases of any such separate claims as they might otherwise seek to bring against the ICs (or other 25 ICs).

25. Thus, it is of pivotal importance to the workability of the proposed Scheme that the JOLs are able to bring all claims which the estate may have against the ICs within the realm of the liquidation.

26. While in the absence of orders of the Court which personally enjoin them, investors are not precluded by liquidation proceedings from suing third parties in their own right; by participating in the liquidation they are expected to be confined to the collective enforcement procedure that results in the *pari passu*

distribution of a company's assets which is itself aimed at achieving fairness between creditors (and/or ultimately, shareholders/investors): ***Wight v Eckhardt Marine 2003 CILR 211 at 220 (paras. 26, 27).*** There are obvious good reasons why shareholders/investors would be well advised to adhere to this principle in the circumstances of this case.

27. For instance, to the extent that their separate claims might succeed against the ICs on grounds other than intentional wrong-doing, the ICs would be entitled to indemnification from the estate for any damages they must pay. To the extent the ICs incur costs in successfully defending against any such separate claims, they would also be entitled to rely on their indemnity. In such circumstances, the returns from the estate to shareholders/investors would be pro tanto stultified.

28. Such potential indemnity liabilities as may arise from separate investor claims are at present entirely unknown and unquantifiable; and are thus obviously not given to the setting of a monetary reserve.

29. To address this problem, the JOLs initially proposed that the Scheme of Arrangement would obtain consensual releases from or impose compulsory releases upon investors of all their potential rogue claims, as a condition of participating in the distributions under the Scheme.

30. However, as such claims would likely be brought not in the Cayman Islands (where the law would govern the Scheme) but in the United States or other foreign jurisdiction where investors might reside, questions of the enforceability of compulsory releases as part of the enforceability of the Scheme, immediately arose.

31. In the case of the United States, the JOLs' expert Attorney William Reid opined (in his evidence in these proceedings before me), that the Scheme would be automatically enforced by the United States Courts whose discretion in such matters had become curtailed by Title 18 USC. This was on the basis, as he argued, that the JOLs had already obtained "foreign non-main proceedings recognition" in the New York Bankruptcy Court under Title 18 USC, in respect of the SPhinX liquidation proceedings.

32. But Judge Melanie Cyganowski, on behalf of the ICs, opined otherwise; to the effect that although recognition and enforcement of the releases may be obtainable in New York (or elsewhere in the United States), it remained a matter for the exercise of judicial discretion likely to involve considerations such as whether the enforcement of compulsory releases might operate so as unconstitutionally to deprive potential claimants of such rights to property as they might have in their causes of action.

33. In the end, Judge Cyganowski's patently more plausible opinion led the JOLs to the concession that this Court, in being now asked to set a limited monetary reserve; could not proceed on the certain basis that the proposed compulsory releases would be automatically recognised and enforced by the United States (or for that matter other foreign) Courts.

34. Accordingly, the JOLs conceded that they would need to obtain recognition of the Scheme in the relevant jurisdictions as a condition of seeking this Court's sanction of the Scheme. On the basis of precedent for this procedure – (see ***In the Matter of Telewest Communications Plc, Cause 2528 of 2004 in the High Court***

of Justice, Chancery Division, Companies Court, England and Wales; order delivered on 21st June 2004 and Permanent Injunction (para. E) and Order entered on 1st July 2004 pursuant to section 304 of the Bankruptcy Code giving effect to Scheme of Arrangement in the United States in ***RE Telewest Communication Plc et al; Case No. 04-12916 (ALG); United States Bankruptcy Court District of New York***) – it was accepted that I might proceed to set the monetary reserve limited as to legal costs, without reserving for the indemnity claims which may arise as the result of damages which may be awarded on rogue investor claims.

THE LAW FOR SETTING A COSTS RESERVE

35. Having thus explained the other three heads of potential IC claims and the proposals for dealing with them, I may now turn to the detailed treatment of the monetary reserve for meeting the legal costs.

36. Here, too, there was early debate over the correct principles to be applied.

37. In the end, however, there was general agreement about the principles, save for the question of the standard of proof; that is: the degree of assurance I should have about the appropriateness of the amount of the reserve that I set.

38. What was agreed was that I should set such a reserve as I determine will be sufficient to satisfy the maximum sum that might reasonably be incurred by the ICs (and, for that matter, the other 25 ICs) in defending against claims. Equally, it was accepted that I am not required to make provision for costs which I conclude are merely fanciful. It was accepted and recognised, in any event on high authority, that unreasonable costs do not generally form part of an indemnity

(see ***Gomba Holdings (UK) Ltd. et al v Minories Finance Ltd. and others (No. 2) C.A. [1993] Ch 171; 187 F-H-188A***). For instance, an indemnity for legal costs is usually taken to refer to the basis of taxation known as, "attorney and own client". But what is reasonable as between an attorney and his own client may depend on the scope of instructions and will not necessarily be the same as what is reasonable as between opposing parties to litigation. (See ***EMI Records Ltd v Ian Cameron Wallace Ltd***. ***[1983] Ch 59 at 71 C-E***).

39. As a simple matter also of logic, I accept that the forgoing must be the correct general formulation of the approach to be taken to the basis upon which costs to be indemnified here might be incurred. I can see no reason why this Court should accept that costs which might be incurred other than reasonably should be indemnified; for instance: by engaging in processes of interlocutory skirmishing in the New York proceedings having no better than a fanciful chance of success or by the charging and payment of legal or related fees which bear no relationship to market realities.

40. Conversely, this Court should not put the ICs in a position where costs which they reasonably incur in defending against claims cannot be recovered from the estate.

41. I accept the constant reminder of Counsel for the ICs that, after all, the object of the present exercise is to minimize the risk of irremediable prejudice – contrary to the statutory order of priorities mandated by section 140(1) of the Law – that would be caused to the ICs were the reserve to be under-funded.

42. But the foregoing statement of the principle is easier than its application in the exercise of the setting of a reserve, which, at best, still remains an extremely

difficult exercise of seeking to anticipate the future costs of complex litigation and even the future costs of possible future complex litigation – described during the arguments respectively as the "known unknowns" and the "unknown unknowns".

43. Such uncertainties behove the Court to proceed with extreme caution if the risk of irremediable prejudice to the ICs who must at this juncture be viewed as ranking in priority to the shareholders/investors; is to be avoided.

44. For that reason, I felt compelled to accept the submissions of Counsel for the ICs also as to the standard of proof to be applied; that is: that the Court should set such reserve as it can be satisfied to a high degree of assurance – and not just on a balance of probabilities – will be sufficient to satisfy the maximum sum that might reasonably be incurred by the ICs by way of legal costs.

45. The JOLs and the LC did not accept this proposition but I think they must be wrong.

46. If the Court were to conclude, as they proposed, on the ordinary civil standard of the balance of probabilities (sometimes expressed mathematically as 51/49) that a reserve would be adequate; there would clearly be an appreciable risk (that is, 49%) that the reserve would prove to be inadequate. Acknowledgment of the uncertainties which are inherent in the exercise reveals the foibles of the mere balance of probabilities and suggests that the Court is better advised to look for a higher degree of assurance, if it is to avoid the risk of irremediable prejudice.

47. Nor, moreover, would the requirement of a "high degree of assurance" on an exercise of this kind be illegitimately to import a criminal standard into civil

proceedings, as Counsel for the JOLs and LC further argued. There are established precedents in this regard.

48. In strike out proceedings, it is well established that the Court must feel certain (not just satisfied on the balance of probabilities) that the claim sought to be struck is bound to fail. See, for instance: ***Hughes v Richards*** [2004] EWCA civ 266, per Peter Gibson LJ at para 22.

49. On applications for mandatory interlocutory injunctions, the courts have long required to be satisfied to a "high degree of assurance" exactly because of the increased risk of irremediable prejudice such injunctions pose to defendants. In ***National Commercial Bank of Jamaica v _Olint Corporation*** [2009] UK PC 16; [2009] 1 WLR 1405, Lord Hoffmann, in giving the advice of the Privy Council, said at para 19:

> "If it appears that the injunction is likely to cause irremediable prejudice to the defendant, a court may be reluctant to grant it unless satisfied that the chances that it will turn out to have been wrongly granted are low; that is to say, that the Court will feel, as Megarry J said in ***Shephard Homes Ltd. v Sandham [1971] Ch 340, at 351***, "a high degree of assurance" that at the trial it will appear that the injunction was rightly granted." (Emphasis added)

50. The analogy with the approach taken on applications for mandatory interlocutory injunctions is apposite. Here, as with those types of applications, the court is being asked to make a decision which future events may prove to have been wrongly made. Equally, as in the case of some mandatory interlocutory

injunction applications, irremediable prejudice may be caused (in this case to the ICs) if the decision proves to be wrong. That is the rationale for the Court requiring a high degree of assurance – the minimalisation of the risk of causing irremediable prejudice.

THE EXPERTS' ESTIMATES OF LEGAL COSTS

51. The JOLs engaged Professor Eric Green to advise on the assessment of legal costs "that are likely" to be incurred by the ICs in the New York proceedings. His initial report, given before the ICs Kavanagh and Owens had presented their expert's report (presented by Mr. Martin Karlinsky), was that a reserve of between USD27.5 and USD49 million should be set. Having seen Mr. Karlinsky's report, Professor Green advised an increase to the outer limit of his estimate to USD56 million.

52. Mr. Karlinsky, guided by his instructions (given on behalf of ICs Kavanagh and Owens) that he should assess "the maximum costs that might reasonably be incurred"; arrived at the initially much higher sum of approximately $90 million.

53. While, for reasons to be explained, Mr. Karlinsky's methodology is to be preferred, this sum was, in my view, arrived at in a rather tortuous way.

54. Having concluded that Professor Green, in arriving at an estimate of USD6 to USD10 million for the costs of Kavanagh and Owens in the New York proceedings – approximately one-half (at the outer limit of USD10 million) of the sum of USD20 million at which he had himself arrived; Mr. Karlinsky then determined that it would be appropriate simply to double all the other estimates at which Professor Green had arrived for the other 7 of the 9 ICs.

55. His rationale was simply that as Professor Green had underestimated by 50% the reserve for Kavanagh and Owens, that approach was likely to hold true for the others and so it should suffice simply to double those other estimates of Professor Green's.

56. Thus, by doubling the maximum fees estimated by Professor Green for each of those 7 ICs (that is, the PWC defendants and the DPM defendants (collectively) and Mr. Aaron) the estimates for them would be USD30 million, USD20 million and USD20 million, respectively. Adding those sums to the amount of USD20 million Mr. Karlinsky assessed for Kavanagh and Owens, Mr. Karlinsky arrived at his initial sum of USD90 million.

57. I describe this method as "tortuous" for the reason that Professor Green's methodology and some of his assumptions were roundly criticised by Mr. Karlinsky, and for reasons to be discussed below, I concluded, criticised for good reasons.

58. I therefore do not consider it a sound proposition to interpolate and to extrapolate the findings in the way proposed by Mr. Karlinsky.

59. Rather, having decided on a figure as proper to set the reserve for Kavanagh and Owens (based on Mr. Karlinsky's approach and as to be explained) I consider it a safer approach simply to apply that figure rateably across the board to all of the 9 ICs.

60. Much depended on the nature of the instructions given to the experts by those instructing them, as the assumptions taken from those instructions carried through into the quanta at which they arrived.

61. In the end, I was satisfied that the assumptions taken by Professor Green were flawed in so many important respects as, when taken with other considerations also to be identified, were such as to make his estimations far less reliable than those of Mr. Karlinsky. This did not result however, in a wholesale adoption of the Karlinsky figures, as the following discussion will show.

62. I should note, however, my acceptance that both experts are eminent in their fields, in so far as any form of real expertise can be claimed in this field of assessing the future costs of complex litigation.

63. Both are very experienced lawyers with Professor Green's current field of specialism being, apart from in academia, in alternative dispute resolution – arbitration and mediation; although many years ago (in the mid to late 1970s) he was an active litigator before the California Courts. Mr. Karlinsky, by virtue of his consistent practice before the New York Courts over the past 32 years; has considerably more current experience as a trial and appellate lawyer. Both gentlemen have very wide experience in the field of complex commercial dispute resolution, with Professor Green claiming to have been involved in the mediation or arbitration of many complex and large commercial disputes and Mr. Karlinsky in the actual litigation of many such cases; albeit not on so large a scale as Professor Green.

64. The difference in their approaches to their assignments was what mattered in the end.

65. Apart from their differing assumptions, the experts also differed as to the appropriate methodology to be adopted. Professor Green adopted what he

termed his "holistic" approach based on comparing the overall litigation as has developed in the New York proceedings with comparable litigation – measuring the comparables by means of his (and of others whom he consulted but did not name) experience and understanding of the factors which typically drive and determine litigation costs in such types of litigation. He also explained that he then applied a "sanity check" against his results, by using what may be described as the more conventional approach of seeking to measure the hours likely to be taken for each major phase of the litigation and multiplying that by the likely charge out rates for the lawyers involved (by reference to known typical charge out rates for the caliber of lawyer involved). This latter – "the Lodestar or time/activity method" was that which was clearly applied from beginning to end by Mr. Karlinsky. But unlike Professor Green, Mr. Karlinsky demonstrated his conclusions by showing his workings; and insisted that the Lodestar is the only reliable methodology to be applied.

66. Indeed, not only did Mr. Karlinsky explain his application of the Lodestar time/activity method; he did so by reference to the distinct phases of the extant litigation as he, based on experience, expected it to unfold in the New York proceedings. These are phases which all sides came to accept as fairly accurately describing what steps are likely to be taken or stages likely to unfold in the New York proceedings and came to be adopted in the Schedules submitted by the parties with their closing submissions. I adopt these phases for the purposes of my conclusions.

67. Mr. Karlinsky expressed his preference for the time/activity method over Professor Green's holistic approach in these words which are plainly sensible: *"In my…view, the estimated fees and costs to be incurred (by Kavanagh and Owens) must be estimated by considering the particular facts of the New York Action itself, and not by categorizing it generically and comparing it in a general sense to other generically categorized actions."*

68. Those considerations aside, the holistic approach was eventually admitted by Professor Green to be very much his invention, and unheralded anywhere in the literature (such as there is) in the field of litigation costs estimation.

69. That being so, one would think that Professor Green would have been most anxious to support his methodology by full disclosure of his workings, in particular of the comparables which he adopted. But that was not to be as he cited "confidentiality" and "privilege" as preventing him from disclosing details even of a single comparable.

70. This meant that I was not to be afforded, as the judge trying this matter, even sufficient understanding of the comparables to be able to accept that they are suitable comparables, let alone to decide for myself whether Professor Green had appropriately used them in arriving at his figures.

71. This failure or even refusal by Professor Green to give any details of his workings was, by itself in my view, fatal to the acceptance of his evidence, which was in effect presented to the Court to be accepted virtually as an article of faith.

72. This approach of Professor Green would undermine the fundamental purpose of expert evidence which is to assist the Court in arriving at its own conclusion. The

principle is fully explained in the following dicta from ***Davie v Edinburgh Magistrates (1953) S.C. 34 at 40*** and heavily relied upon by Counsel for the ICs:

> "Expert witnesses, however skilled or eminent, can give no more than evidence. They cannot usurp the function of the jury or the judge sitting as a jury, any more than a technical assessor can substitute his advice for the judgment of the Court…
>
> Their duty is to furnish the Judge or jury with the scientific criteria for testing the accuracy of their conclusions so as to enable the Judge or jury to form their own independent judgment by the application of these criteria to the facts proved in evidence. The scientific opinion evidence, if intelligible, convincing and tested, becomes a factor (and often an important factor) for consideration along with the whole of the other evidence in the case, but the decision is for the Judge or jury. In particular the bare *ipse dixit* of a scientist, however eminent, upon the issue in controversy will normally carry little weight, for it cannot be tested by cross-examination nor independently appraised, and the parties have invoked the decision of a judicial tribunal and not an oracular pronouncement by an expert."

73. The absence of any information as regards the comparables he used or of the analytical techniques he applied, afforded me no opportunity to form my own

independent opinion about the reliability of Professor Green's holistic approach. The same criticism must fairly be made in general about his "time/activity based analysis" which he said he applied as a "sanity check".

74. Here too, apart from in one instance (the calculation of deposition costs to be incurred by ICs Owens and Kavanagh); Professor Green provided no information to show how he arrived at his cost estimates.

75. Finally in this regard, it must be noted that these short-comings did not even accord with the basic instructions given to Professor Green on behalf of the JOLs; as those instructions clearly required him to set out (i) as much detail as possible to show how he had arrived at his figures and (ii) the facts relied upon in forming his opinions. This left with me the unfortunate impression that Professor Green was quite deliberate in not providing the Court with the means by which it could question and decide for itself whether his methodology was sound.

76. His refusal or failure to share the information he had gleaned from others with whom he said he had discussed his brief and relied upon in coming to his conclusions was a further short-coming.

77. The failure to disclose extrinsic materials relied upon in arriving at an expert's opinion is a fundamental failing. ***Hodgkinson*** on ***Expert Evidence: Law and Practice*** (2007) Sweet & Maxwell Chapter 8, provides a comprehensive analysis of the circumstances under which and the conditions under which expert witnesses may be allowed to draw upon extrinsic materials in arriving at their opinions which they present to the Court.

78. The author, in so doing relies upon a thorough analysis of the leading case: ***R v Abadom*** [1983] 1 W.L.R. 126. While this was a criminal case, the central principles are equally applicable to civil proceedings and indeed, ***Abadom*** itself followed and applied earlier dicta of Megarry J from the civil case of ***English Exporters (London) Ltd v Eldonwall Ltd [1973] 1 Ch. 415, at 420E.*** The following passage from ***Abadom*** in the judgment given on behalf of the Court of Appeal by Kerr LJ (at p131) is most on point:

"Once the primary facts on which their opinion is based have been proved by admissible evidence, they [(experts)] are entitled to draw on the work of others as part of the process of arriving at their conclusion. However, where they have done so, they should refer to this material in their evidence so that the cogency and probative value of their conclusions can be tested and evaluated by reference to it." (Emphasis supplied)

79. The forgoing catalogue of failings on the part of Professor Green which could not fairly be leveled also against Mr. Karlinsky, might well be sufficient basis for rejecting the former's evidence and preferring the latter's.

80. There were however, also specific other criticisms going to the reliability of Professor Green's evidence which would heighten the concerns. I do not think I need to catalogue those here, as those already identified, when taken with further wrong assumptions taken by him which I will discuss; were in my view conclusive in leading to my rejection of his evidence. Of the further specific criticisms I make mention of only one: that which was described by Counsel for the ICs in their joint closing submissions as Professor Green's "unprincipled

pragmatism". This became moot (from his second report and from cross-examination in response to Mr. Karlinsky's report) in his apparent willingness, without reasoned explanation, to jettison his own estimates and adopt Mr. Karlinsky's, whenever Mr. Karlinsky's estimates would provide a lower figure than his own.

81. The starkest example of this related to the question of what costs should be reserved for any appeal that the ICs may be advised to take against an adverse outcome of the trial of the New York proceedings. Here, unusually, Professor Green's initial estimate was significantly higher than Mr. Karlinsky's with a range of 1-2 million dollars as against 1 million dollars. (This latter figure was derived from the figure of $250,000 which Mr. Karlinsky had estimated for appeals by Kavanagh and Owens as he then used the sum of $250,000 (increased at the hearing to $262,000) as a typical figure for each of the four sets of ICs contemplated in his report.)

82. Despite his much higher estimate, in his second report as well as under cross-examination Professor Green readily adopted Mr. Karlinsky's estimate of 1 million dollars, explaining only that this was because he recognised his own "tendency (in the past) to over-estimate the costs of appeals" and that when he saw Mr. Karlinsky's estimate he realised that he "had done it again".

83. Yet, nothing about that response explained why Mr. Karlinsky's estimate of $1,000,000 was necessarily correct and why his own of $1-2 million, necessarily incorrect. I was left with the unfortunate impression that Professor Green was, indeed, resorting only to an unprincipled excuse for adopting the lower figure.

84. Apart from the wrong assumption given in his report for approaching his task (that is, seeking "the likely costs to be incurred" rather than "the maximum costs that might reasonably be incurred" discussed above); there were at least two further flawed assumptions under-pinning Professor Green's methodology. These related to the costs estimates for dealing with (i) disclosure materials and (ii) the taking of depositions.

85. As to (i) disclosure costs; Professor Green stated in his first report that he had been instructed on behalf of the JOLs to assume that "several million documents" would comprise the disclosure material in the New York proceedings. These instructions informed his assessment of the time which would be required by the lawyers and others (including document custodians who would digitize, manage and safeguard the documents) to analyze and deploy them in the litigation. That time then informed the costs to be involved in dealing with disclosure material.

86. It turned out that Professor Green's instructions and assumptions about disclosure were grossly wrong. Instead of "several million documents", there are already some 96 to 106 million pages of documents disclosed in the New York proceedings.

87. Given that Professor Green himself acknowledged that "the costs of the discovery phase (of the litigation) can be enormous" it was hardly surprising that he was compelled under cross examination to also acknowledge that the information which he had been given and ex hypothesi the assumptions which he had taken from it, were "significantly inaccurate."

88. As to (ii) deposition costs; Professor Green had been instructed on 24th August 2009 as he acknowledges in his report and evidence, that the ICs Owens and Kavanagh should be expected to marshall some 10 to 15 depositions of witnesses. However, many months before, in February 2009, the JOLs had been informed that Messrs Owens and Kavanagh intended to marshall 49 depositions. In his first report Professor Green also mistakenly assumed that the ICs DPM would conduct 10 – 20 deposition hearings, whereas DPM's Associate General Counsel (Mr. Leonard Heinz) explained in his affidavit in these proceedings that DPM intends to participate in all of the more than 100 deposition hearings likely to be convened in the New York proceedings.

89. It is plain that the correction of such errors in setting this reserve, would have a significant impact on the sum required. This was nonetheless and surprisingly not accepted by Professor Green, who insisted instead that the range of figures arrived at by his holistic approach for meeting deposition costs, was in any event sufficiently broad to have accommodated even such unanticipated increases in the number of depositions.

90. While not giving further basis for criticism of the methodology of his "holistic" approach; Professor Green's exclusion of other factors from his initial report (it seems by agreement with those who instructed him) nonetheless further contributed to its unreliability for setting the final sum of the reserve:

(i) He addressed only the likely costs of the ICs in respect of the New York proceedings, excluding any other legal costs, including those arising from the Cayman proceedings.

(ii) He excluded any estimate for expert fees and costs.

(iii) He excluded any legal costs for the ICs' defence against (i) contribution claims, (ii) Independent Damages claims or (iii) for civil claims which may be brought by the United States Securities Exchange Commission ("the SEC") against ICs for breach of security regulations. This last omission, notwithstanding that the SEC will not be barred from bringing such claims until October 2010. The kind of independent damages claims contemplated here (at (ii) above) could include such as may be brought under New York law against an IC by those persons who had enjoyed a special relationship with a SPhinX company for the tort of negligent interference with business relationships. See (according to Mr. Karlinsky) ***Glaubs Jewelers Inc v New York Daily News 535 N.Y.S. 2d 532 (N.Y. Civ. Ct 1988).***

Loss of profit damages can be recovered (again according to Mr. Karlinsky) if such damages can be calculated with reasonable certainty and are the natural consequence of a defendant's interfering conduct – citing ***Levine v American Federal Group Ltd. 580 N.Y.S. 2d 287 (1st Dept 1992).***

While there was disagreement between the experts on this issue (Mr. Karlinsky on the one side and Mr. William Reid on the other) it is clearly at least arguable that such a tort exists and could found a cause of action in the circumstances of the collapse of the SPhinX Companies; and so a costs reserve needs to be set.

As to contribution claims (item (i)), the JOLs' instructions to Professor Green reflected their recognition that such claims could be brought by other defendants to the New York proceedings or by third parties in other actions, against the ICs. Such claims are not time-barred until six years after the payment of the judgment damages to which contribution may be sought from other ICs.

Mr. Reid's opinion on behalf of the JOLs that such claims are only ever rarely brought is not a view therefore, upon which I can reasonably rely for denying the ICs' request for a reserve for the legal costs of defending against possible contribution claims.

It is to be emphasized, for reasons already explained, that even such a costs reserve would not address the further need for a reserve against substantive awards of contribution damages which may be made against the ICs and for which they would be entitled to be indemnified.

(iv) The need for the reserve for the costs of the other 25 ICs who may yet be joined in the New York proceedings was also overlooked by Professor Green. While at paragraph 62 of his initial report Professor Green gave a vague estimate of what the costs of the other ICs could be, it is clear that there and in his second report, he made no real attempt to assess those costs because (as stated in his second report): "I cannot estimate any defence costs for theoretical proceedings that have not yet been brought or articulated. Therefore I make no allowance for them."

I accept however that an allowance, albeit not in the order of magnitude of the $14 million proposed by Mr. Karlinsky, should be allowed for the potential legal costs of the other ICs in the New York proceedings..

I state my primary reasons for this conclusion here although further observations will be made below: First, that the other 25 ICs (not 35 as Mr. Karlinsky calculated) are in the main former or current employees of DPM, PwC Firms, Plus Funds or SPhinX personnel, several of whom have already entered into "tolling agreements" with the JOLs. This signifies a recognition of the possibility of suit against them and thus the need for a reserve. On the other hand however, it seems to me that any cause of action against them must already by now have been identified and contemplated and if not yet taken, not very likely to be taken.

Finally, the figures used by Mr. Karlinsky in this regard are acknowledged to be wrong. He estimated $400,000 per IC multiplying that by 35 to arrive at $14,000,000 but there are only 25 other ICs.

For the foregoing reasons, , there has to be significant discount from the amount of $14,000,000 proposed by Mr. Karlinsky as a reserve for the legal costs of the other ICs and this will be reflected in the figures I arrive at.

(v) Retrial. Professor Green's evidence is that as only 5% of actions of the kind of the New York proceedings are eventually tried, there is very little chance of the New York proceedings having to be retried (say following an appeal) and so he saw no need to set a reserve for the costs of retrial.

While Mr. Karlinsky made no initial allowance for this either, in the end he agreed it should be allowed. I accept that there is clearly a risk of a retrial which has to be provided for in the reserve.

The ICs argue for a sum of $9,713,936 which would contain a 30% discount to reflect the reduction in trial preparation the second time around. I accept that approach, taking into account also that in the end Professor Green and Mr. Karlinsky both accepted that if there were to be a retrial, the costs would be considerable.

91. Those five heads,s well as those for documentary disclosure (discovery) and deposition hearings, represented the main heads of divergence, if not to say outright disagreement, between Professor Green and Mr. Karlinsky.

92. Before turning to my final conclusions on the various heads and the actual sums of the reserve, I think it should suffice for me to note further my general preference for and acceptance of Mr. Karlinsky's opinions. Not only did he crucially adopt the proper "maximum costs which might reasonably be incurred" test, I am satisfied that the application by him of the Lodestar method was both fair and sound. Importantly, in this regard and by marked contrast with Professor Green's approach, Mr. Karlinsky presented his report in such a way as to have afforded me the ability to assess for myself the exact basis upon which he had arrived at his conclusions. Indeed the Lodestar ("time and activity based") approach, relying as it does upon estimates and multiples of time and hourly rates, is amenable to being presented in a readily understandable arithmetic format.

93. As already noted, this exercise of estimating future legal costs in complex litigations is fraught with uncertainty. Assumptions must be taken often without concrete basis and nothing can be calculated with anything approaching scientific certainty. Much depends upon the experience and judgment of the assessor.

94. Nevertheless, as the task had to be undertaken I am satisfied, as the ICs argued, that it is best approached in the manner taken by Mr. Karlinsky; both as set out in his report and in response to questions during the proceedings. In the end, it was not an insignificant consideration that he has vastly more current litigation experience than Professor Green, although this must be qualified by the consideration that neither he nor his firm can claim past experience in cases where the costs generated were in the order of magnitude of $90 to $100 million. Mr. Karlinsky said that in most of his cases the costs involved were in the range of $2 or $5 to $6 million. However, given the application of his time/activity method to the different and fairly well defined stages of the litigation, there appeared no reason why he ought not to have been able to arrive, based on his experience, at a reliable conclusion in relation to these very large and complex proceedings. The difference in experience to be brought to the exercise would have been a matter of scale rather than principle.

95. A final word on the importance in principle of the different instructions given to the experts and which informed the methods they applied.

96. A quest to identify the "costs likely to be incurred" can produce results vastly different from that to identify the "maximum costs that might reasonably be incurred".

97. Two common scenarios can serve to illustrate.

98. In the first, a party who is concerned at the ultimate risks of having to pay the costs of complex litigation for lack of any indemnity for such costs may be likely to be very conservative in his choice of lawyers. He may, for instance, opt to go for lawyers of only competent repute whose charge out rates are more modest than his preferred more expensive lawyers of highest repute.

99. Thus, he may likely seek to balance the risks of the outcome of the merits of his case, as against the risks of costs at the end.

100. However, being assured of a full indemnity for his costs, the same party might reasonably decide not to take the risks of the outcome by engaging any but the best lawyers, irrespective of the costs.

101. In the second scenario, without assurance of a full indemnity, a party might likely try to share costs with other parties by engaging the same lawyers. However, with a full indemnity, the same party might reasonably prefer and decide to engage his own lawyers with the initial costs being a secondary concern.

102. In either scenario, the impact on the overall costs could be very significant depending on the choices made, but without any proper criticism that the higher costs resulting from the preferred positions would have been unreasonably incurred.

THE RESERVE

103. I turn now finally, to the separate heads of reserve and to the sums to be respectively allocated. I adopt the same 15 heads or "phases" (the first 10 of which were presented by Mr. Karlinsky) used by the JOLs in the Scott Schedule

proposed jointly on theirs and the LC's behalf at the end of this hearing; the same 15 heads further adopted by the ICs in their final submissions. The initial figures which the first 10 heads yield are those which would be applicable to Kavanagh and Owens (Mr. Karlinsky's clients) but which, for reasons already explained, form the basis for the overall figures for all 9 ICs.

1. Indemnity expenses already incurred

Indemnity expenses incurred to date by the ICs Kavanagh and Owens in connection with the New York proceedings. In the end this was not disputed by either the JOLs or the LC	2,536,597

2. Amendments and motions to dismiss

Possible costs of amendments to the pleadings in the New York proceedings (including drafting of an Answer (Defence)) and possible costs to be incurred by the ICs in bringing a motion(s) to dismiss the New York proceedings. I accept the ICs Kavanagh's and Owens' estimates as reasonable.	$331,000

3. Documents Discovery

There was significant debate over the number of documents or pages of documents to be involved in the discovery exercise in the New York proceedings. As noted above, figures as high as 106 million pages were mentioned. In the end however, Mr. Karlinsky accepted that this could be reduced by 41.5% for the purposes of assessing the costs of review of the documents by the trial lawyers and similarly for the required cost of initial document review by outside contract lawyers. This latter cost being recognized as necessary for the purpose of sifting out the truly relevant material for review; i.e.: inspection and deployment by the trial lawyers. This discount of 41.5% was arrived at by reference to the percentage of the 106 million pages which had already been

disclosed from the Refco database which itself had already undergone those two processes of review.

In Mr. Karlinsky's assessment this 41.5% reduced number of pages (from 106m to 62m) would incur $7,970,000 worth of legal costs for the full documentary discovery process in the New York proceedings by Kavanagh and Owens.

The JOLs submitted however, that even if Mr. Karlinsky's assessment is correct, there should be applied a further discount of 24% from $7,970,000 to $6,082,050. I do not accept the rationale for that further reduction. 7,970,000

4. Depositions

While there was considerable debate about this head of reserve, in the end the issues were fairly narrowed when it was acknowledged that there is a deposition protocol in the Refco MDL which limits the possible number of depositions to 100; 50 of which have already been marshalled.

Mr. Karlinsky proceeds by allowing an average of 2 days for Kavanagh and Owens for each of the remaining 50 while Professor Green assumed 1.5 days. In this I think Professor Green's view is to be preferred. It is supported empirically by there having been taken an average of 1.4 days for the 50 depositions already marshalled. I do, however, accept Mr. Karlinsky's estimates of hourly rates for professional time to be involved. This means that his overall estimate of $3,543,000 for the remaining depositions should be reduced by 25% to reflect the lower average of 1.5 days per deposition. 2,657,250

5. Experts' Fees and Costs

Mr. Karlinsky in his initial report assumed that 4 non-legal experts per group of ICs would be needed at $125,000 each, for a total of $500,000 for each group (mistakenly calculated in his report at US$600,000). To this he added $216,800 for legal fees to be incurred in instructing the experts for a total of USD$716,800 (for Kavanagh and Owens).

For this head Professor Green who had initially omitted it, came to allow the lower sum of USD$600,000.

I could find no basis for concluding that the additional sum (USD$216,800 approx) advised by Mr. Karlinsky fell outside the bounds of reasonableness. [(Moreover, having seen the closing submissions for PWC LLP in particular, I consider that a further global sum of $1,500,000 should be added to the total in the event experts are required for defence to contributions claims, etc. This will be added in below.)] 716,800

6. Motions for Summary Judgment

It was acknowledged (but deemed highly unlikely by Professor Green) that the IC's could move for summary judgment in dismissal of the New York proceedings, once discovery and pleadings are closed. Professor Green's skepticism in this regard arose from the not unreasonable proposition that in a fact intensive case such as the New York proceedings, a summary judgment application is unlikely to succeed and so should be now regarded as unlikely to be brought by the ICs.

On the basis that a reserve should nonetheless be set, Professor Green advised US$300,000 but acknowledged under cross-examination that Mr. Karlinsky's figure of USD$484,000 for Kavanagh and Owens (and each group of ICs) was not unreasonable. 484,000

7. Kavanagh's and Owens' Motion for separate trials

Far from accepting that they should be expected to share costs with some of the other 25 ICs (in particular Gibson Dunn who are their lawyers of choice for the New York proceedings while themselves being the former New York lawyers to the SPhinX Companies and so potential defendants in the New York proceedings) Kavanagh and Owens have evinced their intention to apply for separate trials.

Although said by the JOL's as unlikely to be successful in such an application, it was accepted that their proposed reserve was reasonable and that similar applications could be brought by other ICs. 57,000

8. Interlocutory proceedings before the Special Master

The presiding judge in the New York proceedings has appointed two "Special Masters" to hear substantive interlocutory motions and to issue reports to him on them. He might review these motions *de novo*, if necessary. The parties must bear the costs of Special Masters, who are private attorneys.

There is no dispute over Mr. Karlinsky's figure of USD$171,000 for this item for the ICs Special Master costs and, in keeping with my preference for his time/activity method, I accept that a specific reserve needs to be made for this as for other heads of activity for each of the ICs. 171,000

9. Trial preparation, Trial and Post Trial Motions

In the end there was no disagreement here either. Mr. Karlinsky's estimates of $3,315,000 ($1,739,000 for post trial motions) fell well within Professor Green's holistic range of between $2 and $4 million. I am satisfied with Mr. Karlinsky's figure of USD$3,315,000 for Kavanagh and Owens (as typical for each set of ICs). 3,315,000

10. Appeal

This is an aspect already commented on as above in paragraphs 80-82 and in which context Professor Green's "unprincipled pragmatism" was mentioned for his apparent willingness to abandon his own much higher estimate for Mr. Karlinsky's lower estimate of $250,000 (increased at the hearing to $262,000) for Kavanagh and Owens (as typical for each set of ICs).

Mr. Karlinsky's demonstrated willingness to stand by his lower estimate even when presented with Professor Green's higher estimate, was identified by Counsel for the ICs as a further reason for my reliance on his evidence and for rejecting what was

termed the "adjectival" criticism of his evidence by the JOLs and the LC. I agree.	262,000
Total for Kavanagh and Owens	**18,500,647**
[Total for Kavanagh and Owens uplifted from 2/9th to 9/9th to set the reserve for the legal costs of the 9 ICs].	83,252,912
Add 1.5 million as extra expert costs (to cover contribution claims, etc.) as proposed by PWC LLP	1,500,000

11. <u>Contribution and indemnity rights from other sources</u>

This head is already discussed and explained above in paragraph 89 (iii) as to the need for setting a reserve. Thus, the items to be provided for under this head are (i) costs which the ICs might reasonably incur defending contribution claims (ii) costs of defending independent damages claims and (iii) costs of defending possible SEC claims.

Mr. Karlinsky suggested a global reserve of $10 million for these three heads of costs.

There was, in my view, only one point made by Counsel for the JOLs in arguing for a reduction in Mr. Karlinsky's estimate which I need mention. (Professor Green refusing to proffer an estimate). This was that a reduction from the amount was necessary "to take account of the fact that some defendants will drop out of the case or settle and it was Professor Green's evidence that less than 5% of these cases end up at trial." But these are obviously, as the ICs argued, not matters that should be taken into account. The purpose of the reserve is to protect the ICs' position in the event the matter does go to trial and may therefore not be discounted from what may be required in that event.

There is, however, a further factor which I consider should be borne in mind as properly going towards a reduction of this global sum, a large portion of which would be set aside against possible costs of defending contribution claims.

This factor goes to the very nature of a contribution claim which, as already explained can only arise after payment of primary judgment debts for damages. Where such a judgment debt is already clearly established and paid, one would expect that the liability of an IC to make a contribution would also be prima facie established. If the fulfillment of that liability is one for which the IC can call for indemnification, one would expect that that would also be fairly and readily established.

That being, in my view, the likely scenario, one might reasonably conclude now that full-blown litigation over that very question of liability to contribute, will not likely occur as between contribution claimants and ICs in many instances. Nor, for that matter, as between ICs and the JOLs over whether the right to indemnity applies.

For those reasons, I do not think Mr. Karlinsky's suggested reserve of $10 million for these three heads (of which costs of defending contribution claims would be a large component) is entirely reasonable. I would reduce the costs reserve by a quarter and still feel comfortably within the bounds of what might reasonably be incurred. 7,500,000

12. Other Indemnity Claimants

This is already discussed in some detail above at paragraph 89 (iv). As explained the number of other ICs being 25 and not the 35 contemplated by Mr. Karlinsky, his figure under the head would be reduced from $14 million to $10 million; that is $400,000 x 25 instead of x 35. I make further observations now. The issue here is what allowance should be made for costs that may be incurred by the other 25 ICs – persons who hold rights of indemnity but who have not yet been joined as parties to the New York proceedings or sued by others for possible damages or contribution claims. These other possible suits could be brought, inter alia, by any of the 50 or so other defendants to the New York proceedings and the ICs say that there is clearly a significant risk that some at least of the other 25 ICs could yet be joined as

defendants to the New York proceedings; let alone possibly being sued in other proceedings by, for example, rogue investors.

Professor Green would make allowance using his holistic approach. This is although a significant part of the risk here would relate to the costs of contribution claims against the other 25 ICs and potential rogue investors claims; costs for which type of claims he had refused to provide in his report because, as he stated, "I cannot estimate any defence costs for theoretical proceedings that have not yet been brought or articulated."

On the other hand, the ICs (per Mr. Karlinsky) seek a significant reserve citing among other reasons, the fact that the JOLs have entered into tolling agreements already with at least 11 of the other 25 ICs signifying that those 11 and the JOLs must all contemplate that there are potential claims that could be brought against the 11.

The converse of this argument of course, would be that in the absence of a tolling agreement with the remaining 14 other ICs and with the limitation period thus being allowed to continue to run as against them, the JOLs do not consider that there are viable claims to be brought against them.

This same reasoning might apply in respect of possible claims by rogue investors against the other 25 ICs and as between other defendants to the New York proceedings and the other 25 ICs.

There is, I think, a further relevant consideration even though tolling agreements already apply to 11 ICs. It is that the nature of such agreements implies that a claim would eventually be brought only in the event of a successful claim by the JOLs against others, which would suggest a clear claim against the tolled defendants.

In that way, both sides to the tolling agreement can avoid the costs and other risks of litigation by not embarking upon it unless and until it becomes plainly necessary and unavoidable.

Looked at from the JOLs' point of view as intended plaintiffs; the risk of paying the additional costs of those 11 other ICs would be deferred pending the outcome of the extant New York proceedings and ultimately avoided in the event the JOLs do not succeed on grounds of intentional wrong-doing against the ICs. If the JOLs succeed, then that should be a clear indication to the other ICs of the likely outcome and which would likely advise the stance they take.

With all of the foregoing factors in mind, I think Mr. Karlinsky's figure of $14 million is too high and can quite reasonably be reduced by one-third. 9,380,000

13. Retrials

I have already discussed this issue above at paragraph 89(v) and for the reasons set out there, will adopt Mr. Karlinsky's estimate 9,700,000

14. Investors Suits

This is discussed above (at paragraphs 23 (iii) – 33) and for the reasons set out there, no monetary reserve will be made now for possible substantive damages awards against the ICs arising from rogue investor suits. I repeat that the issue of what reserve should ultimately be set is subject to the Court being satisfied about the proposed Scheme of Arrangement for distribution of assets as it may relate to the consensual and compulsory releases. 00

15. Cayman Legal Proceedings

These are the Proof of Debt proceedings including pending appeals against rejection of some proofs, already mentioned above at paragraph 8.

The JOLs and the LCs assert that a reserve of $3.6 million would be sufficient for these Cayman Legal proceedings. While they did not have Professor Green's assistance on this (he frankly admitted he had no basis for estimating Cayman Islands litigation costs) they argued that the main issue – that is, that

the JOLs' liability under the indemnities (which are governed by New York law) – will be resolved in the New York proceedings. Thus there should be only narrow scope for litigation on the issue of liability under the indemnities (as distinct from the quanta that must be paid) in the Cayman Proof of Debt proceedings.

The ICs recognise this but nonetheless point to a number of other circumstances under which the issue of liability under the indemnities could arise, even if the JOLs succeed in the New York proceedings on the basis of intentional wrong-doing. These could include where the ICs have to defend against contribution claims based on non-intentional wrong-doing some time in the future, bearing in mind that the limitation period for such claims would not expire until after 6 years after the main judgment is paid.

Moreover, say the ICs, the amount of $3.6 million that the JOLs would offer for reserve now is already exceeded by indemnifiable claims which have already materialised. For instance, the evidence of Mr. Karlan of Gibson Dunn, who act for ICs Owens and Kavanagh, is that their indemnifiable fees and costs have already exceeded $3,389,000. DPM, for their part, assert that they have already incurred $1,467,500 in costs in respect of the Cayman proceedings. Thus the historic costs alone show that the JOLs' proposed reserve is inadequate.

I find this to be compelling enough to require a significantly larger reserve than the $3.6 million proposed by the JOLs but not such as to justify the amount of $9 million proposed by the ICs.

I consider that their concerns about potential other claims, and actions (apart from the New York proceedings) and from which a different view of the operation of the indemnities could arise, are too widely cast.

I think it is well within the bounds of reasonable expectation that the New York proceedings will largely serve to define the meaning of the indemnity

provisions so as largely to determine the extent of their application in the Cayman proceedings.	
I consider that a reserve for the Cayman proceedings should be safe if set at	6,000,000
Total costs reserve	US$117,332,912

104. I conclude on the basis of the foregoing discussion, that the reserve to be set for the maximum costs that might reasonably be incurred by the Indemnity Claimants is the total amount of US$117,332,912, which is itemized also in the schedule attached to this ruling.

105. Large though this amount is, I am assured to the extent that it turns out to be an over-estimation of what is required, there would be little, if any risk of prejudice to shareholders/investors, as the assets will no doubt be invested in the meantime.

Hon. Anthony Smellie
Chief Justice

THE RESERVE

	ISSUE	RESERVED AMOUNT (USD)
1.	Indemnity expenses to date	2,536,597
2.	Possible Amendments and Motions to Dismiss	331,000
3.	Document Discovery	7,970,000
4.	Depositions	2,657,250
5.	Expert Fees and Costs	716,800
6.	Motions for Summary Judgment	484,000
7.	K.O. Motion for Separate Trials	57,000
8.	Objections and Other Proceedings	171,000
9.	Trial preparation, Trial and Post Trial Motion	3,315,000
10.	Appeals	262,0000
	Total for Kavanagh and Owens	**18,500,647**
	Uplift (to include all ICs including PwC Firms, DPM and Aaron) from 2/9^{ths} to 9/9^{ths}	**83,252,912**
	Additional amount for PwC LLP experts as proposed by PWC LLP	1,500,000
	Sub-total	**84,752,912**
11.	Contribution, Independent Damages and SEC claims	7,500,000
12.	Other ICs	9,380,000
13.	Retrial	9,700,000
14.	Investor Suits [to be otherwise provisioned]	00
15.	Cayman Legal Proceedings	6,000,000
	TOTAL	117,332,912