IN THE GRAND COURT OF THE CAYMAN ISLANDS

FINANCIAL SERVICES DIVISION

CAUSE NO: FSD 9 OF 2019 (IKJ)

IN THE MATTER OF THE COMPANIES LAW (2018 REVISION)

AND

IN THE MATTER OF OAKRUN PRECIOUS METALS FUND, LTD

IN COURT

Appearances:	Mr Guy Cowan, Campbells, on behalf of the Petitioner, Bejoy International Ltd. ("Bejoy" and/or "Petitioner")
	Mr Scott Rhodenizer, a former director of the Company and the principal of Oakrun Capital LLC (the "Manager") appeared in person on behalf of the Company
	The Company (the "Fund") did not formally appear
	Mr Jeremy Snead and Mr David Jin, Appleby, on behalf of Echelon Wealth Partners Inc ("Echelon")
Before:	**The Hon. Justice Kawaley**
Heard:	**22 March 2019**
Date of decision:	**22 March 2019**
Draft Judgment Circulated:	**23 April 2019**
Judgment Delivered:	**30 April 2019**

HEADNOTE

Petition presented as creditor and shareholder to wind-up Fund on insolvency and/or just and equitable grounds- principal of the Manager appearing in person to seek adjournment of petition in order for Fund to obtain legal advice-custodian of Fund's assets seeking validation order to enable Company to pay for legal advice-principles governing applications for validation order-principles applicable to costs of an unsuccessful application for a validation order

REASONS FOR MAKING WINDING-UP ORDER AND DISMISSING APPLICATION FOR VALIDATION ORDER AND RULING ON COSTS

Background

1. The Petitioner, legally domiciled in the British Virgin Islands and commercially based in Malaysia, is the sole participating shareholder of the locally incorporated Fund. The Fund was incorporated on April 25, 2008 and was registered as a regulated mutual fund under the Mutual Funds Law on October 20, 2010. On November 1, 2010, Bejoy subscribed for 5000 Class A Participating Shares for $1,000 per share, investing a total of $5 million in the Fund. It is unaware of any other subscriptions before or since. The Manager is the sole holder of the voting Management Shares.

2. The Fund's Articles conferred redemption rights which were exercised by Bejoy on June 30, 2016. The Fund admitted an obligation to pay $5million. $1 million was paid as of July 31, 2016. The balance was never paid. Before the present proceedings were commenced, Bejoy agreed to postpone payment until August and then December 2018. The Independent Directors (provided by International Management Services Ltd.) notified Bejoy on December 11, 2018 that the Manager had withdrawn funds in respect of expenses which the Independent Directors had been unwilling to approve. The Manager reportedly removed the Independent Directors on January 1, 2019 with effect from December 31, 2018.

3. It was against this background that the Petition was presented on January 24, 2019. The principal grounds for winding –up were:

    (a) the Petitioner was an unpaid creditor in the amount of $4 million;

    (b) it was just and equitable that the Fund be wound-up in light of:

        (i) the Manager's improper expenses claim,

        (ii) the improper removal of the Independent Directors,

        (iii) the loss of substratum flowing from the redemption of the sole investor's shares,

(iv) breaches of the Directors Registration and Licensing Law and the Articles flowing from the removal of the Independent Directors.

4. The Petition was verified by the First Affidavit of Sherrine Hart, Bejoy's attorney-in-fact pursuant to Powers of Attorney dated June 30, 2016 and January 17, 2019. This Affidavit also exhibited various supporting documents including correspondence from the Independent Directors expressing concerns about, *inter alia*, the regulatory implications of their removal. The Petition and the Verifying Affidavit were served on the Fund at its registered office on January 25, 2019, just short of two months before the Petition was listed for hearing. At this juncture, the Manager as the controlling voting shareholder of the Fund had just over 8 weeks to appoint new directors to consider how the Fund should respond to the Petition. In the event, the Fund did not appear in opposition of the Petition on March 22, 2019 and the Petitioner's strong *prima facie* case for a winding-up Order was not challenged by any contrary evidence.

The Hearing of the Petition

5. Order 5 rule 6 of the Grand Court Rules provides as follows:

> "*(2) Except as expressly provided by or under any Law, a body corporate may not begin or carry on or defend any such proceedings otherwise than by an attorney.*"

6. The spectre of Mr Rhodenizer, principal of the Manager, appearing in person to seek an adjournment on behalf of the Company provided vivid support for the Petitioner's case that the Fund was insolvent and, *inter alia*, had lost its substratum. I heard him to ensure that there were no unusual extenuating circumstances which might justify the Court granting the adjournment he sought to enable the Fund to obtain legal representation deploying funds held by Echelon for the Fund's account. Echelon was unwilling to release the funds without a Validation Order from the Court.

7. Mr Rhodenizer claimed to be oblivious of the Fund's legal position in light of the Petition and had seemingly, notwithstanding his apparently undisputed pivotal position as the directing mind of the Manager, studiously avoided educating himself on the position. He was unable to identify any arguable basis on which the Petition might successfully be opposed. Nor could he satisfactorily explain why the Manager had not been willing to obtain legal advice for the Fund at its own expense. When he was pressed by the Court, Mr Rhodenizer's main concerns appeared to be, unsurprisingly, his own personal commercial position. He had devoted years to the Fund and had seemingly spent most of the time after the Petition was served seeking to find a last-ditch commercial solution to the underlying liquidity problems. This apparently involved making an *in specie* distribution of the underlying investments and winding-up the Fund in any event. He was convinced of the justness of the Manager's disputed

expense claims and wished to ensure that they would be fairly adjudicated. I assured him that Official Liquidators would guarantee a fair adjudication of the Manager's claims.

8. The appearance of Echelon, represented by counsel, added to the other-worldly air of the hearing. Echelon was a custodian of certain of the Fund's cash assets. Its position was, quite properly, neutral on whether or not an adjournment should be granted. If an adjournment was granted it sought a Validation Order blessing the release of $25,000 from monies it held for the Fund for its proposed legal defence costs in relation to the Petition. Late on March 21, 2019, on the eve of the hearing of the Petition, Echelon filed a Summons seeking a validation Order under section 99 of the Companies Law ("Validation Summons" and "Validation Order")[1]. This application raised a number of obvious questions. Why was Echelon taking such an active step in the proceedings? Why did Echelon not leave it to the Fund to seek an adjournment, postponing any application to Court for a Validation Order until it was clearly necessary? What understandably enraged the Petitioner was that the main substantive position adopted by Echelon, supported by a Skeleton Argument and authorities, was to advance a positive case that it should be awarded its costs of participating in the hearing of the Petition in any event, on a priority basis. To rub salt in the Petitioner's wounds (as the sole economic stakeholder in the insolvent Fund), Echelon implied that it would ultimately rely upon contractual rights of indemnity against the Fund in respect of its costs.

9. The case for an immediate winding-up Order was compelling and the case for an adjournment was wholly insubstantial. I accordingly granted the relief the Petitioner sought. In the final analysis no need to consider the March 21, 2019 Echelon Summons for a Validation Order arose. The costs application made by Echelon in relation to its Summons arose in an unusual factual context. The competing written submissions and authorities were only filed shortly before the hearing. I accordingly reserved judgment on the costs of the Validation Summons.

10. I set out below my reasons for making the winding-up Order and dismissing the Validation Summons. As the Petition was not opposed and the need to consider the Validation Summons on its merits fell away once the winding-up Order was granted, the reasons for that decision are in large part articulated as part of my reserved judgment on the costs of Echelon's application for a validation Order.

The Validation Summons and the related costs

The factual context

11. The Summons was supported by the First Affidavit of Carmen Diges, a Director of Legal Affairs for the Toronto-based Echelon. She deposed that Echelon provided broker-dealer services to the Fund as a successor to a prior service provider. However, it is clear that at all material times Echelon received directions from the Manager. The

[1] Electronic copies of the application were emailed to the Court at 6.46pm on March 21, 2019. The Clerk of the Court forwarded the materials to me at 8.22pm. The Petitioner's response materials were filed the following morning and reached me shortly before the hearing.

implication is that the Fund had authorised Echelon to act on the instructions of the Manager.

12. From correspondence the deponent exhibits, it appears that Echelon initially approached the Petitioner in February 2019 having been instructed to arrange to transfer the shares Echelon held in the Fund's account to the Petitioner. The Petitioner's attorneys responded by email dated February 11, 2019 advising that the Petition had been presented, supplying a copy of the Petition and warning Echelon not to transfer any of the Fund's assets without a Validation Order by this Court. Far from inviting Echelon to make an application for a Validation Order, Campbells' response clearly disavowed any interest of receiving the proposed distribution.

13. It is deposed that Echelon subsequently received instructions from the Manager to release funds in respect of (a) management fees, and (b) legal advice in relation to the Petition. Echelon took the view that it was "*appropriate for the Fund*" to expend funds on legal advice and instructed Appleby to seek to agree a Validation Order for this purpose. Appleby made the request on March 19, 2019, just three days before the hearing of the Petition. Campbells responded as follows:

> "*Thank you for your email. In circumstances where:*
>
> *a) there is no evidence (let alone credible evidence) that the Fund is solvent, and Bejoy is an undisputed creditor of the Fund;*
> *b) a validation order would not be in the interest of the Fund or its only independent stakeholder, Bejoy;*
> *c) there are no bona fide grounds upon which the Petition could properly be opposed in the circumstances;*
> *d) any validation application, if made, would be made at an unreasonably late stage of the proceedings; and*
> *e) Echelon has no legitimate interest in the validation of the Fund's proposed legal expenses*
>
> *Bejoy is not prepared to consent to a validation order.*
>
> *In the event that you proceed to issue an application for a validation order, Bejoy expressly reserves all of its rights including, without limitation, its right to seek an order for costs against Echelon.*"

14. The gauntlet was thrown down. The Petitioner contended that there was no justification for Echelon making its proposed application and warned that it would seek an adverse costs order if it did. Echelon persisted in pursuing its proposed application. According to the First Diges Affidavit, the decision to proceed with the application for a Validation Order was made in the following circumstances:

> (a) "*Mr Rhodenizer*...[prior to the decision to make the application] *indicated that he would support the application, and may seek further validation orders himself*" (paragraph 14);

(b) "*Echelon is left in the invidious choice of refusing to release funds to its client to enable it to pay for legal advice or facing the threat from Campbells that any such payment would be void pursuant to Cayman law*" (paragraph 16);

(c) "*the need to make an application is not of Echelon's making, and Echelon is making this application only to be of assistance*" (paragraph 17).

15. Closely examined, the rationale for the application was an internally inconsistent and not entirely convincing one. The "invidious choice" seems somewhat contrived. If Mr Rhodenizer was willing to support the application and possibly make applications of his own, why was it necessary for Echelon to file its Summons at all? Why could Echelon not simply have declined to file its Summons until Mr Rhodenizer had obtained an adjournment of the Petition, leaving it to the Court to decide whether the Fund required legal advice?

The respective submissions

16. The main thrust of Echelon's submissions is reflected in the concluding paragraph of its Skeleton Argument:

> "*21. Accordingly, Echelon respectfully requests this Honourable Court to determine whether Echelon should make a payment in respect of legal fees in the event that a winding up order is not made on 22 March 2019.*"

17. Its substantive application was clearly contingent upon the Court deciding not to make an immediate winding-up Order, a contingency which Echelon's submissions did not formally seek to evaluate or even influence. It was submitted that Echelon had standing to apply for a Validation Order under section 99 of the Companies Law, which did not restrict who could apply: *Argentum Reductions (UK) Ltd* [1975] 1 WLR 186. It was then submitted, after reciting the explanations set out in the First Diges Affidavit, that "*Echelon has only taken the step of making the application itself given that Oakrun is apparently unable to obtain legal advice*".

18. Mr Snead in his oral argument made it clear that Echelon adopted a neutral position in relation to the adjournment of the Petition (orally requested by Mr Rhodenizer). However, Echelon's Skeleton Argument contained the following beguiling submission which was clearly designed to provide 'soft' support for the adjournment application:

> "*13. The Court must determine whether it can at the hearing of the Petition resolve questions relating to the solvency of Oakrun and the interests of its creditors without Oakrun having had the benefit of legal advice.*"

19. The submission perhaps reflects a morally laudable sympathy for the rules of natural justice and the Fund's fair hearing rights. But it also betrays a failure to appreciate the breadth and scope of the allegations made in the Petition supplied to Echelon on February 11, 2019. Firstly, it was or ought to have been obvious that the Fund was in no position to dispute that it was insolvent on a cash flow basis. Secondly it was or ought to have been obvious that, insolvency apart, there were compelling 'public interest' grounds for making a winding-up order based on apparently undisputed allegations of serious regulatory defaults. These grounds seriously undermined the case for the Manager to be afforded the opportunity (at the Fund's expense) to obtain legal advice for the Fund. If (as the Petition alleged and the supporting evidence strongly supported) the Manager had improperly removed the Independent Directors, who was capable of validly instructing lawyers on behalf of the Fund under Cayman Islands law?

20. As regards the costs of its Summons, primary reliance was placed on Companies Winding-Up Rules Order 20 rule 1(1) (a) which provides that the "*costs of the petitioner and any person appearing on the petition whose costs are allowed by the Court*" are payable on a priority basis. It was then submitted:

> "*17. Echelon's position is that it is caught between complying with obligations to its client in making payment of legal fees and falling foul of an avoidance provision that has retrospective effect upon the making of a winding up order. Echelon is an agent of Oakrun, and therefore a contingent creditor of Oakrun to the extent that its actions give rise to liabilities in relation to which the standard indemnity principles of agent and principal apply.*
>
> *18. In the recent case of Abraaj Holdings (unreported decision of McMillan J , 4 January 2019, enclosed) McMillan J accepted that in the absence of a specific rule the Court 'applies a general standard ...as to whether a relevant party has acted unreasonably in determining that party's liability for costs' and the fact that the petitioning creditor did not prevail in its argument is in no way an adverse conclusion as to whether the arguments in the first place should have been placed before the Court.' The same judge in the matter of CAMAC International Limited (order enclosed) allowed for the recovery of some of the Company's costs in responding to the petition, demonstrating that the Court has a broad discretion to allow costs orders in favour of those appearing on the petition.*
>
> *19. Echelon has sought to act reasonably in proposing a solution to the situation it faces and has made this application at its own expense because (A) Oakrun is apparently unable to do so; and (B) the Petitioner has refused consent.*
>
> *20.<u>If the Court determines whether or not Echelon should make a payment of legal fees then Echelon's application was reasonable</u> because it was, pending the making of a winding up* [order], *left in a position for which only the Court could determine whether a payment was appropriate or not.*" [Emphasis added]

21. Echelon's Skeleton apparently advanced an application for its costs to be awarded on a priority basis in any event "if" the Court determined the merits of its Summons. Mr Snead was eager to move his application for a Validation Order before the adjournment application was made, perhaps to avoid any suggestion that the Court did not consider it. But this merely added to the incongruity surrounding an application the need for which was wholly contingent on the Court being persuaded to adjourn the Petition. In all but an entirely artificial and wholly technical sense, Echelon's Summons was summarily dismissed because with the grant of a winding-up Order the need for the Validation Order sought fell away.

22. It is important nonetheless to briefly record what I regard as the highlights of the Petitioner's case as set out in its Skeleton Argument on the merits of the application for a Validation Order. It was argued that:

(a) Echelon had no legitimate interest in having the payment validated and had taken six weeks to make the application, which should be struck-out;

(b) the application was unmeritorious because it was unsupported by any evidence supporting the requisite finding that "*the validation order is likely to benefit creditors as a class*": *Re Fairway Graphics Ltd.* [1991] BCLC 468 at 469C (Harman J). Further, "[i]*n considering whether to make a validation order the court must always…do its best to ensure that the interests of unsecured creditors will not be prejudiced*": *Re Gray's Inn Construction Co Ltd.*[1980] 1 WLR 711 at 717 (Buckley LJ);

(c) when a validation order is sought to pay legal fees for defending a petition, the merits of any potential defence will be a key consideration. In *RC Brewery Limited –v-HMRC* [2013] EWHC 1184 (Ch), Warren J opined as follows:

> *"8. As a general rule, validation orders will only be made where there is no serious risk to creditors or where the court is satisfied that the company is likely to improve the position of creditors by trading at a profit: see for instance Harman J in Re McGuinness Bros (UK) Ltd (1987) 3 BCC 571 at p74 col 1. In the case of a petition to which the company has a genuine defence which it wishes to raise, for instance where there is a bona fide dispute about the debt, it may be right to grant a validation order to enable the payment of lawyers to raise the defence. As Hoffmann J put it in the Crossmore case:*
>
> *'In the case of an ordinary petition by some wholly unrelated creditor it would I think be in the ordinary course of the company's business for it to pay solicitors to defend itself against such a petition and therefore such*

payments should fall within the scope of a validation order under sec. 127.'

9. In the present case, there is no dispute about the petition debt. HMRC have a clear right to payment and were entitled to present the Petition. Had there been time for the Company to seek a validation order before incurring costs in relation to the application for the order to restrain advertisement, the Court would have wanted to know the outline of the case which was eventually presented to me. I would not have granted an order because I would have seen the arguments as very weak (as I did on the first hearing). I do not think that it would be right to make such an order now. That is so in relation to the fees which have already been paid. It is even more the case where the fees relate to an appeal for which I see no prospect of success (which is why I refused permission to appeal). Further, it must be very doubtful that such fees would be incurred in the ordinary course of business.

10. Of course, some cost would have had to be incurred in investigating whether there was an argument at all which the Company could present in support of the making a validation order. It might be said, therefore, that the Company should be entitled to an order at least to the extent of the cost of obtaining the necessary preliminary advice. I do not agree with that suggestion. It is one thing to allow a company to fund a genuine defence to a petition which, if successful, would show that the petition should never have been brought in the first place. It is quite another to allow the Company to fund an application designed to buy time to pay off its liability to HMRC";

(d) "*there is an overwhelming case for a winding-up order to be made…such that the Summons is moot*" (paragraph 19(d)).

23. After I granted the winding-up Order, Mr Cowan for the Petitioner orally sought an Order requiring Echelon to pay the Petitioner's costs of the validation application on the grounds that it had been unreasonable to make the application. Because Echelon had contractual indemnity rights in any event, an express direction was sought that the Fund's assets could not be used to pay the Petitioner's costs. Those assets were "*our money*".

24. Mr Snead responded that the ordinary costs rules applicable to *inter partes* hearings were displaced in winding-up matters by CWR Order 24 rule 8. However, this rule merely provides as follows:

"***General Rules as to Costs (O. 24, r. 8)***

8. *(1) The general rule is that the costs incurred by a person who successfully presents a creditor's winding up petition under Order 3, Part II or creditor's petition for a supervision order under Order 15, rule 3 should have his costs paid out of the assets of the company, such costs to be taxed on an indemnity basis unless agreed with the official liquidator.*

(2) In the case of a contributory's winding up petition under Order 3, Part III, the general rules are that –

(a) if the Court has directed that the company itself is properly able to participate in the proceeding, the general rule is that the costs of a successful petitioner be paid out of the assets of the company; or

(b) if the Court has directed that the winding up petition be treated as an inter partes proceeding between one or more members of the other members or members of the company as respondents, the general rule is that none of the costs should be paid out of the assets of the company and the unsuccessful parties should pay the costs of the successful party, such costs to be taxed on the standard basis unless agreed.

(2A) An order for security for costs may only be made if the petitioner is a nominal petitioner who has presented the petition for the benefit of another person and who would be unable to pay the costs of the company or other respondent, as the case may be, if ordered to do so.

(3) In the case of an Authority's petition under Order 3, Part IV, the general rule is that –

(a) the Authority's costs of successfully presenting a petition should be paid out of the assets of the company, such costs to be taxed on the indemnity basis if not agreed with the official liquidator; or

(b) the company's costs of successfully resisting the petition should be paid by the Authority, such costs to be taxed on the indemnity basis if not agreed.

(4) The Court shall make orders for costs in accordance with these general rules unless it is satisfied that there are exceptional and special circumstances which justify making some other order or no order for costs."

25. In the Petitioner's Skeleton Argument, it was submitted that GCR Order 62 applied to winding-up proceedings by virtue of CWR Order 1 rule 2(4). Costs on the indemnity basis were sought against Echelon applying the principles enunciated by Jones J in *Al*

Sadiq-v-Investcorp Bank BSC and Five Others [2012(2)CILR 33] (at paragraphs 14-15). Indemnity costs under Order 62 rule 4(11) might potentially be awarded because:

> "*14...A party who asserts a cause of action when he knows that he has no legitimate basis for so doing is acting improperly...*
>
> *15. Unreasonable conduct falling short of impropriety usually leads to a wasted costs order...but it can also lead to an indemnity costs order under r.4 (11) if it can be characterized as substantive misconduct. For example, one can envisage a case in which it was not improper to have asserted a particular cause of action, but the court might nevertheless conclude that it was unreasonable to have pursued it beyond the point at which the party must have realized that it was bound to fail.*"

The Merits of the adjournment application and the need to consider the Validation Summons

26. I also accept the submission of Mr Cowan for the Petitioner that it was or ought to have been obvious that an immediate winding-up Order would be made because there were no cogent reasons ever identified for granting the adjournment sought by Mr Rhodenizer. The adjournment application faced two main obstacles:

    (a) the fact that no evidence was filed on behalf of the Manager (or the Fund) by Mr Rhodenizer to contest the central allegations in the Petition; and

    (b) the fact that, as a result, no material was placed before the Court which supported (or was capable of supporting) a finding that paying the $25,000 retainer would potentially enable the Fund to persuade the Court that a winding-up Order should not be made.

27. When petitions are presented on the grounds of insolvency and key stakeholders wish to defend the proceedings, it is not uncommon for the respondent to have no ready cash. Where it is desired to seriously contest the winding-up proceedings, the controlling shareholders will typically advance funds to retain counsel to ensure that the petition can be effectively opposed. When regulated companies have been accused of regulatory non-compliance and lack the statutory directors, the responsible managers are usually keen to explain to the Court either why the accusations are unfounded or what steps are being taken to bring a temporary state of non-compliance to an end. Against this background, Mr Rhodenizer's approach in seeking an adjournment on behalf of the Fund was surprisingly shambolic. For instance:

(a) he was unable to convincingly explain why the Manager had not elected to financially support the defence of the Petition or engage its own counsel to appear at the hearing;

(b) he was unable to identify any potential defences to the Petition or to provide any practical justification for adjourning the Petition and permitting the Fund to obtain legal advice;

(c) he professed complete unfamiliarity with Cayman Islands law, despite having been in charge of a regulated Cayman Islands mutual fund for over 10 years;

(d) the Manager's principal still appeared to hope that he could 'wind-up' the Fund out of Court to the Petitioner's satisfaction, despite the Petitioner's determination to obtain a winding-up Order;

(e) however, Mr Rhodenizer ultimately articulated his primary concern as being to procure a fair adjudication for his disputed fees claim, having spent many years of his life devoted to the Fund.

28. The surprisingly vivid picture painted by these 'submissions' only served to fortify the case for an immediate winding-up of the Fund because there was an obvious need for independent management to be placed in charge of an entity whose former Independent Directors had expressed concerns in writing to the Petitioner about (a) the conduct of the Manager and (b) the circumstances of their removal. Although I had considerable sympathy for Mr Rhodenizer's predicament, no amount of 'milk of human kindness' could alter the toxic chemistry of the Fund's legal condition. The Validation Summons was accordingly not merely unsustainable in its own right. It was filed in circumstances where it was or ought to have been obvious to Echelon that, absent grounds for believing that a coherent case for adjourning the Petition would be advanced by Mr Rhodenizer, the Court would not in any event need to consider the Validation Summons on its merits.

29. For these reasons I refused the request for an adjournment, granted a winding-up Order and summarily dismissed the Validation Summons on the grounds that it had become otiose.

Findings: the merits of the Validation Summons

30. As a matter of general principle, I consider that Echelon as a party concerned to know whether a payment it wished to make out of funds held for the respondent to a winding-up petition had in general terms standing to seek relief under section 99 of the Companies Law. Section 99 provides as follows:

> "*99. When a winding up order has been made, any disposition of the company's property and any transfer of shares or alteration in the status of the company's members made after the commencement of the winding up is, unless the Court otherwise orders, void.*"

31. Ordinarily, the relevant application would be made by a company or its liquidators as the most logical parties to seek approval of post-petition payments on a company's part. Circumstances where a company has no effective management or available funds so as to be able to make a validation application will be rare. Management typically either abandons the company altogether or marshals resources from shareholders or affiliates if a serious defence of a petition is proposed. Nonetheless it is impossible to read into the section any limitation on who may seek relief under section 99. *Argentum Reductions (UK) Ltd* [1975] 1 WLR 186, upon which Echelon relied, was just such a case. A minority shareholder petitioned to wind-up a company on the grounds that a deadlock existed on the Board. The majority shareholders applied to validate the payment, post-petition, of certain debts owed by the company in circumstances where there was no allegation of insolvency. Megarry J held (at page 190):

> "*The affairs of companies are almost infinitely various, and where the legislature has refrained from putting any express limit on those who may seek an order form the court, I would be slow to attempt to spell out any implied limit which reaches beyond the ordinary limits imposed by the courts on almost any application, namely, that the applicant must have some discernible interest in the matter. The courts are not places for those who wish to meddle in things which are of no concern of theirs, just for the pleasure of interfering, or of proclaiming abroad some favourite doctrine of theirs, or of indulging a taste for forensic display.*"

32. That Echelon was in a very general sense a person with "*some discernible interest in the matter*" was of marginal relevance in the context of the present case. It was not necessary for me to dispose of the application by making any formal findings on the standing issue. The critical issue here was (and is for costs purposes) whether, in all the circumstances of the present case, it was reasonable for the Validation Order to be sought at all. The relevant factors which appertained were arguably the following:

(a) no or no coherent basis was identified by Echelon (nor, apparently the Manager when requesting the release of the monies to obtain legal advice for the Fund) for believing that any arguable defence to the Petition existed;

(b) it was or ought to have been obvious that an adjournment application on behalf of the admittedly insolvent Fund made in person by the principal of the Manager which had been accused of, *inter alia*, regulatory misconduct and the misapplication of funds was bound to fail; and

(c) no or no coherent reason was identified for the Summons being filed before rather than after an adjournment of the Petition (in the event that an adjournment was, against all the odds, obtained by Mr Rhodenizer).

33. I accept the Petitioner's submissions as to the legal principles governing an application for a Validation Order in relation to an apparently insolvent respondent to a winding-up petition. The relevant payment must be in the interests of the general body of unsecured creditors: *Re Fairway Graphics Ltd.* [1991] BCLC 468 at 469C (Harman J); *Re Gray's Inn Construction Co Ltd.* [1980] 1 WLR 711 at 717 (Buckley LJ). Where the proposed payment relates to legal advice with a view to defending the petition, the Court must be provided some basis for concluding that a potentially successful defence exists: *RC Brewery Limited –v-HMRC* [2013] EWHC 1184 (Ch) (Warren J, at paragraphs 8-10). Identifying a potentially valid complete defence to a petition is, in a practical sense, a necessary precondition for engaging the company's fair hearing rights. In the civil litigation context, the right to a full hearing or trial almost invariably presupposes the existence of an arguable defence to the merits of the claim.

34. The legally logical starting point for the present application ought to have been an assessment by Echelon of the extent to which legal advice was likely to assist the Fund to advance a defence to the Petition. Despite Campbells warning that there was, *inter alia*, no basis on which the Petition could be successfully resisted, Echelon doggedly insisted on pursuing its application without attempting to identify, in its evidence or its Skeleton Argument, how it considered the expenditure on legal advice would potentially undermine the allegations in the Petition. Instead, Echelon appears to have attempted to elevate the Fund's right to obtain legal advice in relation to the Petition to a far more rarefied, abstract and legally unprecedented sphere. Only in the criminal context is the right to counsel generally recognised as an absolute right, wholly independent of the merits of the accused's defence[2].

35. The central rational for Echelon's application appears to have been the view that its own commercial interests made it desirable to assist the Manager at all costs. The reasons for this view were opaque. It placed before the Court (without comment) its own statements which implied that the Fund was solvent in balance sheet terms based on the value assigned to the various shares. It did not put before the Court any correspondence with the Manager relating to the present application. It is possible that the Manager threatened legal action if Echelon did not release any funds and that the Validation Summons was a way of mitigating that threat. Unless something of this nature occurred it is difficult to make sense of its assertion that it was, in effect, on the horns of a dilemma.

36. Be that as it may the commentary on the communications with the Manager in Echelon's Affidavit evidence, and indeed the Affidavit generally, made no allusions to the practical impact of the proposed legal advice on the defence of the Petition. The core allegations in the Petition were:

(a) admitted insolvency of the Fund in cash flow terms;

[2] The right to representation is a minimum right conferred on persons charged with criminal offences under section 7(2) (d) of the Cayman Islands Constitution Order 2009. No corresponding right is conferred on civil litigants by section 7.

(b) improper payment of expenses by the Manager out of the assets of the Fund;

(c) improper removal of the Independent Directors by the Manager;

(d) the Manager allowing the Fund to be in breach of regulatory requirements because it lacked the requisite management.

37. If there was a coherent answer to this catalogue of serious complaints against the Manager in relation to its management of the Fund, one might have expected the Manager to instruct counsel to appear on behalf of the Manager, which was a key stakeholder in the Fund, and file evidence (a) refuting the allegations, and (b) justifying an adjournment in order to retain counsel to defend the Petition. Had an intervention of this substance been anticipated when Echelon filed its Summons, its decision to do so might have been legally comprehensible. Instead, for reasons that are ultimately unclear, it elected to provide logistical support to the attempts of an allegedly 'rogue' Manager to forestall the sole investor's attempts to wind-up the Fund. Most importantly of all, for present purposes, its application failed to advance any legally valid grounds for granting a Validation Order.

38. The Validation Summons was on its merits bound to fail and the supporting evidence did not disclose an arguable basis for granting a Validation Order. Had it been necessary to consider the application on its merits, I would have dismissed it for the above reasons.

Costs: governing principles

39. CWR Order 24 rule 8 provides as follows:

> "*(1) The general rule is that the costs incurred by a person who successfully presents a creditor's winding up petition under Order 3, Part II or creditor's petition for a supervision order under Order 15, rule 3 should have his costs paid out of the assets of the company, such costs to be taxed on an indemnity basis unless agreed with the official liquidator.*"

40. This is the general rule upon which Echelon relied and I was initially inclined to accept that this rule is at least potentially engaged by the present Petition which (a) primarily relied upon the Petitioner's status as a creditor, and (b) resulted in a winding-up Order being granted on an unopposed basis. However, on more careful analysis, rule 8(1) is concerned with the petitioner's costs of the successful petition as against the respondent company. It is not concerned with the costs of a freestanding application made by a 'third party' to the proceedings in relation to which the company takes no position.

41. To the extent that the Order was also granted on the basis that the Petitioner was a member, the following paragraph of Order 24 rule 8 does not appear to be even potentially engaged:

"*(2) In the case of a contributory's winding up petition under Order 3, Part III, the general rules are that –*

(a) if the Court has directed that the company itself is properly able to participate in the proceeding, the general rule is that the costs of a successful petitioner be paid out of the assets of the company; or

(b) if the Court has directed that the winding up petition be treated as an inter partes proceeding between one or more members of the other members or members of the company as respondents, the general rule is that none of the costs should be paid out of the assets of the company and the unsuccessful parties should pay the costs of the successful party, such costs to be taxed on the standard basis unless agreed.

42. Rule 8 (2) (a) is concerned with the costs of a successful petitioner as against the company; rule 8(2) (b) is concerned with the costs as between disputing members. The present costs dispute is between the Petitioner and a stranger to the Fund.

43. Intuitively it seems to amount to little more than wishful thinking to believe that a party such as Echelon can interpose itself into winding-up proceedings in which it has a negligible interest, make a misconceived application which is summarily dismissed and then escape the usual consequences in terms of legal costs. And Mr Cowan's straightforward primary submission was that CWR Order 24 rule 8(1), (2) only reflected general rules. Rule 8 (4) goes on to provide:

"*(4) The Court shall make orders for costs in accordance with these general rules unless it is satisfied that there are exceptional and special circumstances which justify making some other order or no order for costs.*"

44. I have little difficulty in concluding that that the general costs rules are displaced as regards the exceptional and special circumstances presented by Echelon's unnecessary and unmeritorious Validation Summons. What principles then apply? Mr Cowan submitted that the general costs rules under GCR Order 62 applied by virtue of "*GCR Order 1, rule 2(4)*" (Skeleton Argument, paragraph 23 note 11). I accept this submission. GCR Order 1 rule 2(4) provides as follows:

"*(4) Except for Orders 3 (Time), 4 (Assignment, Transfer and Consolidation of Proceedings), 5 (Mode of Beginning Proceedings), 38 Part II (Writs of Subpoena), 39 (Evidence by Deposition), 62 (Costs), 67 (Change of Attorney), 45-51 (Enforcement) and 52 (Committal) these Rules shall not apply to any proceedings which are –*

(a) governed by the Matrimonial Causes Rules (2005 Revision),
(b) governed by the Grand Court (Bankruptcy) Rules 1977, as amended,

(c) governed by the Companies Winding Up Rules 2008; or
(d) on appeal from civil proceedings in the Summary Court." [Emphasis added]

45. The effect of these parallel provisions is that GCR Order 62 applies to winding-up proceedings save to the extent that special costs rules under the CWR are engaged. Even where Order 62 does apply, the way in which the Court's discretion is exercised may be shaped by any distinctive characteristics of the winding-up context. This view finds support in the valuable recent decision of McMillan J in *Re Abraaj Holdings*, FSD 95 of 2018 (RMJ), Judgment dated January 4, 2019 (unreported), which I consider further below.

46. As regards Echelon's Summons, therefore, the starting assumption in favour of applying the usual 'costs follow the event' rule (Order 62 rule 4(5)) is properly engaged.

Findings: should Echelon pay the costs of its unsuccessful Summons?

47. To the extent that Echelon seriously pursued its application for its costs after its application was dismissed at all, I would summarily refuse this application. Mr Snead valiantly sought to contend that an adverse costs order was inappropriate in all the circumstances of the present case. He placed reliance upon *Re Abraaj Holdings*, FSD 95 of 2018 (RMJ), Judgment dated January 4, 2019 (unreported). An adjournment was granted of a winding-up petition for restructuring efforts to be further pursued over the objections of the petitioning creditor. The adjournment was supported by a creditor and director/shareholder/founder of the company who sought an adverse costs order against the petitioner in respect of the unsuccessful adjournment application. The joint provisional liquidators submitted that the petitioner had not acted unreasonably in opposing the adjournment that they considered was merited.

48. It was essentially common ground that no adverse costs order should be made against the petitioner unless it had acted unreasonably. In *Re Abraaj Holdings*, there had apparently been several contested previous hearings at which no adverse costs orders had been made. It was also unclear whether or not the petitioner would ultimately succeed on its petition engaging the general rule that it should recover its petition costs. The submission that the unsuccessful petitioner had acted unreasonably was firmly rejected. McMillan J, clearly placing primary emphasis on the distinctive character of the petitioner's rejected application in the winding-up context, crucially held as follows:

"*35. The fact that PIFSS did not prevail in its arguments is in no way an adverse conclusion as to whether the arguments in the first place should have been placed before the Court.*

36. In matters of so complex a nature the Court must be fully receptive to weighing such arguments as a relevant party may wish to put forward.

37. To impose upon an unsuccessful creditor a costs order where its arguments have failed in these circumstances could be perceived as limiting or discouraging the expression of entirely legitimate differences of opinion."

49. I wholeheartedly endorse this analysis and find difficulty in seeing how it supports Echelon's brave efforts to extricate itself from liability for an adverse costs Order in the present case. McMillan J was clearly vindicating the rights of a petitioning creditor assessed by reference to (a) the application made and (b) the relevant principles applicable to the winding-up process as a whole. The Court had a broad discretion as to whether or not to adjourn the winding-up petition in circumstances where it seems implicit that the requirements for granting a winding-up order had also been validly met by the petitioner. The petitioner in *Abraaj* was clearly one of the leading characters in the cast. In stark contrast, in the present proceedings, Echelon's intervention resembled that of a member of the audience clambering onto the stage to interrupt the show.

50. Moreover, Echelon's Summons was premature, filed in circumstances in which there was no objectively reasonable basis for believing that the need to consider the application would arise. This was because there was no objectively reasonable grounds for believing the Petition would be adjourned to enable the Fund to obtain legal advice. The Validation Order was only needed if a winding-up Order was not made on March 22, 2019. Echelon's Summons was, for overlapping reasons, unsustainable on its merits because it failed to advance any arguable grounds for the relief sought being granted. It needed to demonstrate that the proposed expenditure for legal advice would potentially enable the Fund to defend the Petition. It failed to do so. In short the application was, properly analysed, a misuse of the winding-up jurisdiction of this Court.

51. It follows that Echelon should pay the Petitioner's costs of the misconceived application for a Validation Order.

Findings: should the Petitioner be awarded costs on the indemnity basis?

52. Applying the principles articulated by Jones J in *Al Sadiq-v-Investcorp Bank BSC and Five Others* [2012(2)CILR 33] (at paragraphs 14-15) upon which Mr Cowan relied, I find that this a very clear case for an indemnity costs award. Order 62 rule 34 provides:

> "*(11) The Court may make an inter partes order for costs to be taxed on the indemnity basis only if it is satisfied that the paying party has conducted the proceedings, or that part of the proceedings to which the order relates, improperly, unreasonably or negligently.*"

53. The application was an abuse of process because it was premature and wholly unmeritorious and made for reasons which are legally unintelligible. It matters not that Echelon had legitimate commercial reasons of its own for pursuing the present application, albeit that those reasons were in evidential terms almost completely undecipherable. The Petitioner is entitled to its costs on an indemnity basis.

Findings: should the Court make directions to ensure that Echelon is not able to fund the costs out of the Fund's assets?

54. On the face of it justice would not be served if Echelon was able to enforce a contractual indemnity against the Fund and pay the Petitioner's costs out of monies which would otherwise be distributed to the Petitioner in any event. That is merely an instinctive provisional view made without the benefit of argument or evidence about the nature and scope of the relevant indemnity rights. I only express that view to demonstrate that I have considered and understood why the Petitioner invited the Court to grant directions designed to avoid such an outcome.

55. In my judgment the winding-up scheme contemplates that any persons asserting claims against a company which is being wound-up should, *prima facie*, submit their claims to proof. It is for the Official Liquidators, in the first instance, to adjudicate all such claims. It was premature for the Validation Summons to be filed before it was known whether or not the need for it would actually arise. It is even more premature for this Court to adjudicate whether or not Echelon should be able to rely upon its contractual indemnity rights against the Fund. It has hinted at such a claim, but has not yet formally asserted it. I decline to make the directions sought by the Petitioner in this regard.

Summary

56. For the above reasons the Petitioner was granted a winding-Up Order and Echelon's application for a Validation Order was refused on March 22, 2019. Echelon shall pay the Petitioner's costs of the Validation Summons to be taxed if not agreed on the indemnity basis. The Court declines to deal with any questions relating to Echelon's potential rights of indemnity against the Fund as the relevant issues are not properly before the Court at this stage.

THE HONOURABLE MR JUSTICE IAN RC KAWALEY
JUDGE OF THE GRAND COURT