CAUSE NO FSD: 0016 OF 2009 - ASCJ
(ORIGINALLY CAUSE NO. 258 OF 2006)

IN THE GRAND COURT OF THE CAYMAN ISLANDS

FINANCIAL SERVICES DIVISION

THE HONOURABLE CHIEF JUSTICE

IN THE MATTER OF THE COMPANIES LAW

AND IN THE MATTER OF THE SPHINX GROUP OF COMPANIES (IN OFFICIAL LIQUIDATION) AS CONSOLIDATED BY THE ORDER OF THE GRAND COURT DATED 6TH JUNE 2007

SKELETON ARGUMENT OF THE JOINT OFFICIAL LIQUIDATORS IN RELATION TO THE CONVENING HEARING ON 12/13 OCTOBER 2011

Introduction

1. This is the hearing of an application (the "**Convening Application**") by Kenneth Krys and Margot MacInnis, the Joint Official Liquidators (the "**JOLs**") of the companies in the SPhinX group (the "**SPhinX Companies**"), for an order convening Court Meetings to consider schemes of arrangement (the "**new Scheme**") proposed to be made between certain of the SPhinX Companies (the "**Scheme Companies**") and certain of their respective members and creditors ("**Investors**").

2. The Convening Application is made pursuant to an *ex parte* summons by the JOLs but on notice to all potentially interested parties in accordance with the Practice Direction No.2 of 2010 and the Order made by the Court on 31 August 2011.

3. The application is supported by the 99th (Open) and 100th (Confidential) affidavits of Mr. Krys. That evidence contained a draft of the new Scheme and, for reasons that will be elaborated below, an "Open" and a "Confidential" version of the Explanatory Memorandum required by the Companies Law (the "**Explan**"). Except where otherwise indicated, the same abbreviations are used in this document as in the Explan.

4. Confidential evidence in response was filed on 30th September 2011 by Deutsche Bank ("**DB**") and hfc Limited ("**hfc**"), the two architects of the new Scheme.

5. An amended set of draft documents including the new Scheme and Explan, taking into account some points made in correspondence and in evidence by various parties, and resolving a number of issues that had been outstanding on the earlier drafts, were exhibited to two affidavits in reply (one confidential and one open) of Ms. MacInnis dated 7 October 2011.

6. In very brief outline, the issues to be addressed at the Convening Hearing fall into four categories (which it is suggested should be resolved in the following sequence so that after the issue relating to the Indemnity Claimants, confidential matters can be discussed in their absence):

   (1) Jurisdictional issues, and "quasi-jurisdictional" questions, including in particular the question of whether the new Scheme affects or prejudices the rights of the Indemnity Claimants such that it could not proceed without them being made parties to it.

   (2) The constitution of classes for the Court Meetings.

   (3) The adequacy of the Explan and the proposals for circulation of two forms of that document.

   (4) Arrangements for the holding of the Court Meetings, including arrangements for voting.

7. DB and hfc, together with the Liquidation Committee ("**LC**") and some of the Indemnity Claimants have given notice that they intend to attend the hearing of the Convening Application. It is expected that the following parties will be present (in person or by videolink).

Counsel/Attorney Appearing	**Law Firm Appearing**	**Representing**
Richard Snowden QC Ceri Bryant Tom Lowe QC Cherry Bridges Adam Zoubir Cora Joscelyn <u>The JOLs</u> Margot MacInnis John Skeleton Alyson Reilly	Counsel Ritch & Conolly	The Joint Official Liquidators of the SPhinX Group of Companies
Mark Phillips QC (by videolink from London) Mark Goodman Andrea Dunsby	Counsel Turner & Roulstone	Liquidation Committee
William Trower QC (by videolink from London at the offices of Linklaters) Graham Ritchie QC David Collier	Counsel CARD	Deutsche Bank
Sarah Dobbyn (by videolink from London) Anthony Akiwumi Chris Levers	Stuarts	hfc Limited
Simon Dickson	Mourant	Robert Aaron (Indemnity Claimant)
Guy Manning	Campbells	DPM (Indemnity Claimant)
Alexia Adda	Higgs & Johnson	PWC Cayman (Indemnity Claimant)
Stephen Leontsinis	Conyers Dill & Pearman	BAWAG

Counsel/Attorney Appearing	**Law Firm Appearing**	**Representing**
Marc Kish	Maples and Calder	Refco Offshore Managed Futures Fund Ltd and Refco Public Commodity Pool LP

Background to the SPhinX liquidations and the Schemes

8. The Court is assumed to be broadly familiar with the SPhinX liquidations and the various issues which have arisen. As the Court will be aware, the conduct of the liquidations of the SPhinX Companies has been exceptionally challenging. Section 1 of the Explan provides a summary of the history of events.

9. As things now stand, the liquidations have progressed to the point that the assets of the SPhinX Companies now consist of about US$500 million in cash, together with claims against various third parties in respect of the losses to the group companies and the PlusFunds companies.

10. The primary claims of the SPhinX Companies are being pursued in substantial litigation in the US (the "**US Litigation**"): the claims are for basic losses of US$263 million, plus loss of business enterprise value and deepening insolvency losses of US$243 million. With pre-judgment interest but without possible punitive damages, the claims amount to at least US$750 million. The prospect of substantial recoveries from that litigation would enable a second distribution to be made to Investors who would otherwise suffer a significant loss on the perceived value of their investments.

11. Recently, writs have also been issued by the SPhinX Companies in the Cayman Islands in respect of potential restitutionary claims against redeeming Investors who appear to have been overpaid due to the overstatement of NAVs in the months before the commencement of the liquidations (the "**Restitutionary Claims**").

12. As well as unresolved litigation to recover damages for the SPhinX Companies, there are also substantial unresolved issues between the Investors arising out of the complex structure of the SPhinX group and the way in which its affairs were conducted. Many

of those issues arose out of events following the grant by a court in the US of a Temporary Restraining Order ("**TRO**") in 2005 freezing the assets of one of the segregated portfolio companies ("**spc**"), SPhinX Managed Futures Fund SPC ("**SMFF**"). In particular, when the SPhinX Companies found that they had insufficient funds to redeem Investors' shares because of the TRO freezing the assets of SMFF, the SPhinX Companies put in place a plan for the issue, or purported issue, of "Special Situation Shares", or "S" Shares. The S Shares were issued in SMFF, SPhinX Managed Futures Limited ("**SMFL**"), the Master Fund which had invested in SMFF, and in SPhinX Ltd, the Feeder Fund which had invested in SMFL. Investors in the four Feeder Funds, SMFL and SMFF are exposed in varying degrees to SMFF.

13. These events gave rise to several different issues which would be relevant to how Investors' Claims would be treated in the liquidations, and which would require to be resolved before a distribution could be made in the liquidations:

(1) First, there are uncertainties as to whether the S Shares were validly issued, as to the rights attached to them, and as to their value.

(2) Second, there are uncertainties as to whether Investors who had submitted requests for redemption of shares rank as unsecured creditors, should be paid in priority to the claims of Investors who had not submitted redemption requests, or should rank *pari passu* with such Investors, in the light of section 37(7) of the Companies Law.

(3) Third, there are uncertainties as to whether a resolution passed on 14 June 2006 to suspend redemptions was effective, and if it was, as to the effect of the resolution on the rights of Investors in the light of section 37(7) of the Companies Law.

(4) Fourth, there are uncertainties arising out of the records of share subscriptions, redemptions, and inter-company transactions having been poorly maintained and being difficult to reconcile.

14. These uncertainties affect Investors who had invested in the four Feeder Funds or were issued with S Shares in SMFL and SMFF. These four Feeder Funds, SMFL and SMFF are the main proposed Scheme Companies.

15. There are also five other Scheme Companies which are spcs. Apart from (relatively small) trade creditors and the holding of shares by the relevant master fund, the only creditors and shareholders of those companies are portfolio managers (the "**Portfolio Managers**") who are creditors by virtue of unpaid management fees and incentive fees and who are shareholders because they were issued with "M" and "N" shares in the spcs which may (depending upon determination of their rights, which are not clearly defined) carry some right to share in surplus funds.

16. It has been recognised for some time that the promotion of schemes of arrangement under the Companies Law might provide the most appropriate means to resolve a large number of these issues between the different groups of Investors. To that end, in 2007 the Court directed the JOLs to work together with the LC to produce a scheme or schemes and/or a pooling agreement or pooling agreements to put to Investors. The JOLs and the LC worked together throughout 2007 - 2009 to put together terms for schemes of arrangement for the Scheme Companies (the "**previous Scheme**").

17. In January 2010 the JOLs made an application seeking a direction from the Court that the JOLs should apply for orders convening Court Meetings to approve the previous Scheme and directions for the hearing of that application. The Court directed the JOLs to make an application for directions in relation to the convening of Court Meetings to approve the previous Scheme.

18. As a precursor to the previous Scheme, it was also considered necessary for the JOLs to make provision by way of a reserve from the assets of the SPhinX Companies for the contingent liabilities of those companies to various entities and individuals who might have a claim against a SPhinX Company in respect of a contractual indemnities which those entities or individuals claimed to have been given by a SPhinX Company (the "**Indemnity Claimants**"). Some of those Indemnity Claimants are defendants to the US Litigation but (in broad terms) claim that they are entitled to indemnification

against any damages for which they might be found liable based on their non-intentional wrongdoing (i.e. mere negligence) in their former relationships with the SPhinX Companies or for any legal costs that they might incur in successfully defending themselves against any claims arising from their former relationships with the SPhinX Companies.[1]

19. The JOLs proposed that the indemnity reserve be US$45 million, but in a judgment delivered on 12 February 2010 (the "**Indemnity Reserve Judgment**") the Court determined that the JOLs should make a provision of US$117,332,912 for the future legal costs of the Indemnity Claimants. There also remained further contingent indemnity claims in respect of which no protective mechanisms to protect the interests of the Indemnity Claimants had been agreed by the Indemnity Claimants or accepted by the Court and which might accordingly have given rise to the need for an increase in the indemnity reserve required (the "**Extant Indemnity Reserve Issues**").

20. In addition, and prior to finalising the terms of the previous Scheme, the JOLs also requested that the Court determine an essential issue of jurisdiction – namely whether it could sanction a scheme under section 86 of the Companies Law that contained mandatory releases of causes of action which Scheme Claimants might have against third parties including the Indemnity Claimants. The importance of that issue was that the grant of effective releases by the Scheme Claimants would reduce the prospect of "ricochet" claims against the Scheme Companies by the Indemnity Claimants and hence reduce provide a mechanism for addressing one of the heads of potential claim advanced by the Indemnity Claimants. If effective, this mechanism would have increased the likely level of the initial cash distribution under the previous Scheme. Following a hearing on 13 April 2010, in a judgment delivered on 5 May 2010, the Court held that such releases could be included in a scheme as a matter of jurisdiction (the "**Releases Judgment**").

[1] See para. 13 of the Releases Judgment of 5 May 2010.

21. In the meantime, however, progress on the finalisation of the terms of the previous Scheme between the LC and other Investors reached an impasse. That scheme proposal foundered for two main reasons:

(1) the LC members could not agree among themselves how to allocate the indemnity reserve of US$117 million for legal costs (which had turned out to be significantly more than had been anticipated and had not been finally quantified because of the Extant Indemnity Reserve Issues) between the different groups of Investors; and

(2) there were objections from some Investors and from hfc (which had bought an interest in a significant number of Investor claims) whose positions gave them the ability to block affirmative votes in some of the necessary class meetings ("**blocking Investors**"). Those blocking Investors indicated that they would vote against the previous Scheme on the terms put forward.

22. On 27 April 2010 the JOLs made a final attempt to see if a compromise could be reached among the blocking Investors and the LC, but this was unsuccessful. Accordingly, the previous Scheme proposal was discontinued and the JOLs reinstated the summons of June 2006 and began litigating the various issues that had arisen in the liquidations (the "**Liquidation Issues**") that needed to be resolved before there could be a distribution to Investors in the liquidations in the ordinary way.

23. As the Court will recall, arrangements were made for the Liquidation Issues to be litigated with representative parties. On almost all of the Liquidation Issues, DB and (recognising its economic interest) hfc were representative parties for Investors with differing interests. DPM was the representative party for the Indemnity Claimants on three of the Liquidation Issues which primarily related to whether assets and liabilities of the SPhinX Companies ought to be pooled.

24. DB and hfc have subsequently indicated that in the course of the proceedings to determine the Liquidation Issues, they became concerned about the costs, delay and uncertainty involved. They have stated that the preparations for a hearing in May 2011 of two of the Liquidation Issues relating to pooling acted as a catalyst for

negotiations. Days before the May hearing was to occur, the JOLs were notified that DB and hfc were negotiating a possible proposal to put to Investors.

25. Heads of Terms were executed by DB and hfc on 9 May 2011, the first day of the May hearing. It was a condition of the Heads of Terms that the hearing of the Litigation Issues be adjourned, and at a hearing on 11 May 2011, they were adjourned, following a joint application by DB and hfc, to a date to be fixed in January 2012. The Heads of Terms also stipulated that they would lapse unless the new Scheme was made effective by the end of this year.

26. Notwithstanding that, for reasons that are elaborated upon below, the JOLs had considerable reservations about the terms that had been reached between DB and hfc, the JOLs took the view that they should attempt to gauge whether a new scheme on those terms might have support from sufficient Investors to justify proceeding to develop the terms into a formal scheme proposal. To that end, an outline of the terms agreed by DB and hfc was presented to Investors at a meeting in New York with video link to London on 18 July 2011 attended by the JOLs, their Cayman Counsel (Mr. Lowe QC) and Leo Beus of the JOLs' US Counsel (Beus Gilbert). Presentations were made by each of the JOLs, DB, hfc and Leo Beus (on a confidential basis) and following those presentations Investors had an opportunity to ask questions and to express their views on the proposals.

27. 27 investors, representing approximately 32% by number and 94% by value of notional claims, attended the Investors' meeting in person or by teleconference. Those attending included most of the potential blocking Investors. All attendees were asked to confirm whether they were in support of the proposals for a scheme at the end of the meeting, and the JOLs undertook to follow up with each of them so as to confirm the level of support.

28. The JOLs received indications of support from 21 Investors representing 25% in number and 90% in value of all investors. The proposals also had the support of the LC. In light of this support, the JOLs took the view that the proposals should be developed into a draft scheme that could be put formally to Investors at Court

Meetings convened under section 86 of the Companies Law. The new Scheme is the product of that process, which has been undertaken by the JOLs and their Counsel in conjunction with lawyers acting for DB and hfc.

The new Scheme (in outline)

29. The Court will be taken through the new Scheme in detail at the hearing. In broad terms, the main features of the new Scheme proposal are as follows:-

    a. Immediately upon the new Scheme becoming effective,

        (i) DB and BAWAG will receive full releases from the claims made against them in the US Litigation without any payment being made in return to the SPhinX Companies;

        (ii) the Investors will have full releases from the Restitutionary claims (and any rectification of the SPhinX Companies' registers) without any payment being made in return to the SPhinX Companies;

        (iii) the Investors will grant releases to the Indemnity Claimants and any others who might make claims for contribution against the Indemnity Claimants which might result in "ricochet" claims against the SPhinX Companies by the Indemnity Claimants;

        (iv) the Investors will release the JOLs, the SPhinX Trustee and the Scheme Supervisors from all claims and liabilities (known or unknown) in connection with the formulation etc of the new Scheme and the conduct of the liquidation in so far as it affects the amounts to be distributed under the new Scheme; and

        (v) DB and hfc will be able to recover their costs in connection with the negotiation and preparation of the new Scheme up to a maximum of US$1 million each.

    b. Within a specified period of the Scheme becoming effective (the "Bar Date"), all Scheme Claims of Investors must be lodged with "Scheme Supervisors"

who will agree or determine the notional amount of the Scheme Claims of Investors. [2]

c. After the new Scheme has become effective, hearings will be held to determine protective mechanisms and the level of consequential reserves required to be established in the liquidations for the benefit of the Indemnity Claimants (the "**Indemnity Reserve**"), for the creditor claims of the Portfolio Managers and trade creditors (the "**Portfolio Managers and Trade Creditors Reserve**"), and for the future costs and expenses of the liquidations (the "**General Expenses Reserve**"). Unless the Court otherwise orders, no distribution will be made to Investors until after all of issues affecting the quantum of these reserves have been finally resolved by the Court if not agreed.

d. As and when the Indemnity Reserve, the Portfolio Managers and Trade Creditors Reserve and the General Expenses Reserve have been set, the remaining cash assets of all the SPhinX Companies will be pooled and distributed to Investors according to a pre-determined formula based upon a notional claim value as at 31 March 2006.

e. On and with effect the date of the first and each subsequent distribution of funds by the JOLs, the Investors will grant releases to the JOLs, the SPhinX Trustee and the Scheme Supervisors of claims and liabilities (known or unknown) in connection with the formation and operation of the new Scheme and the liquidations in so far as affects the amounts to be distributed under the new Scheme.

f. The JOLs will continue to pursue the US Litigation and will consult with a "Scheme Committee" of Investors. Any recoveries from the balance of the US Litigation (net of the contingency fees of Beus Gilbert) will be credited to the Indemnity Reserve. Any reductions in the Indemnity Reserve that may be

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[2] Claims that have already been notified to the JOLs in the liquidation or in connection with the previous Scheme proposals will not need to be lodged again.

ordered by the Court from time to time will form the basis of a further distribution by the JOLs to the Scheme Supervisors for onwards transmission to Investors.

Of these features, the following points should be noted.

The DB and BAWAG Releases

30. As indicated above, following the discontinuance of the previous Scheme, the JOLs lodged claims for breaches of fiduciary duty, breaches of contract, conversion, and fraud against DB in the US litigation. BAWAG, which is an Austrian bank and part-owner of Refco, had already been sued.

31. DB, which is a large Investor in the Sphinx Companies and a blocking Investor, has consistently indicated that it will not support any scheme without obtaining a release from all claims against it by the JOLs, each of the SPhinX Companies and PlusFunds. The new Scheme contains a release which will be provided to DB in return for a release by DB of any indemnity claims that it might have, but without DB being required to make any payment to the SPhinX Companies in return, and which will become effective immediately upon the new Scheme becoming effective. A similar release was required by BAWAG which is also a blocking Investor.[3]

32. Because of the time that may be taken to deal with the Extant Indemnity Reserve Issues, the JOLs consider that there is a substantial risk that these releases will become effective long before any distribution is capable of being made to Investors under the new Scheme.

[3] Although BAWAG admitted it had been fraudulent, the US Court has, subject to an appeal, dismissed a significant part of the SPhinX claims against BAWAG on the basis that BAWAG had reached a settlement with the US Attorney's Office under which BAWAG contributed US$400 million to the Refco estate and abandoned an additional US$400 million claim against the Refco estate.

The Release of the Restitutionary Claims

33. The JOLs have received advice from an independent accounting expert that to accord with US GAAP (as required by the articles), an accrual in the amount of US$312 million should have been made in SMFF's financial and accounting records, with a corresponding downward adjustment to SMFF's NAV, on or about 17 October 2005 (the date of the market becoming aware of the bankruptcy petitions of Refco and RCM).

34. Subsequently, the JOLs received legal advice from their Cayman counsel that notwithstanding that the relevant articles stated that any valuations made pursuant to the articles were to be conclusive and binding, the NAVs could be challenged on the basis that the failure to determine the NAVs in accordance with US GAAP meant that the valuations were not made pursuant to the articles, and that it is arguable that the JOLs are required to rectify the register of members of the relevant SPhinX Companies on the footing that the NAV calculations could be overturned. The JOLs have also been advised by Cayman counsel that to the extent that overpayments cannot be adjusted for by rectification of the register in respect of remaining shareholdings, it may be possible to recover overpayments by claims in restitution based on unjust enrichment.

35. The JOLs have begun proceedings in the Cayman Court seeking to recover US$88 million through the Restitutionary Claims. The defendants to those proceedings could raise defences, including various forms of estoppel, denial of unjust enrichment, good consideration or change of position.

36. From the JOLs' preliminary review of the redemption payments that took effect during the relevant period, the JOLs identified that some Investors would be significantly affected by the reduction of their holdings of shares in the liquidation and are therefore receiving a great benefit from the new Scheme proceeding upon the footing that there is no rectification of the register of members and that all the Restitutionary Claims are released. Those Investors who sought to redeem their shares after 17th October 2005, and were therefore most directly affected if NAVs have been overstated, tended to be those Investors with SMFF-exposed shares who

were mostly given S Shares in respect of such redemptions. In some cases, it appears that Investors with significant holdings of shares might, on rectification, have their holdings reduced to a very small amount or even nil. Moreover, just as there are claims that are significantly reduced or eliminated as a result of rectification, so there are other Investors who would receive a higher than anticipated payout if the Restitutionary Claims were to be pursued and/or if the shares register was to be rectified.

37. The scope for adjustment, either upwards or downwards, may create a tension between those that are benefiting from the proposed release of the Restitutionary Claims, and the remaining Investors, who may receive a better recovery in a liquidation in which the Restitutionary Claims were pursued. There may also be a tension between, on the one hand, those who would be disadvantaged if there were to be rectification, whether that is because they lose the benefit of any payment out of the estate or because recoveries will be significantly reduced, and those that would benefit if there were to be rectification because they would be shown as having a bigger interest, quite apart from the prospect of sharing in a bigger estate to the extent that the SPhinX Companies were successful in bringing Restitutionary Claims.

38. The JOLs are aware that hfc is economically interested in several of the claims that are shown in the JOLs' records as held by other entities. The JOLs are conscious that hfc may actually be economically interested in other claims in relation to which no assignment has been provided to the JOLs. The JOLs understand that the interests that hfc has been purchasing are primarily S Share Claims and SMFF Redemption Claims,[4] which are those that are most acutely affected by the questions arising out of the existence of the Restitutionary Claims and the possibility of rectification.

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[4] Not least because hfc acted as representative party for these interests in the hearings to determine the Liquidation Issues.

The Indemnity Reserve

39. As with the previous Scheme, the Indemnity Claimants are not intended to be parties to the new Scheme. It is therefore necessary that the rights of the Indemnity Claimants in the liquidations must be fully respected by the new Scheme. As indicated above, the new Scheme seeks to achieve this by the establishment of an Indemnity Reserve in the liquidations to provide for the contingent claims of the Indemnity Claimants. The Indemnity Reserve will be of such amount as is agreed with the Indemnity Claimants or as the Court determines is appropriate following the final resolution of the Extant Indemnity Reserve Issues.

40. The new Scheme envisages that the Extant Indemnity Reserve Issues will be addressed after the new Scheme has become effective, and that in the meantime the new Scheme will provide that (unless the Court otherwise orders) no distribution will be made by the JOLs to the Scheme Supervisors for distribution to Investors until after the amount of Indemnity Reserve is finally determined.

41. The potential jurisdictional issues to which it might be said that this mechanism gives rise are discussed further in paragraphs 77-85 below.

42. It should also be noted that one of the mechanisms previously discussed between the JOLs, the LC and the Indemnity Claimants in relation to the previous Scheme was the question of recognition of the scheme and in particular the releases by Investors of third-party claims likely to give rise to claims against the Indemnity Claimants in other jurisdictions such as the US, the UK and Ireland. The proposal for the previous Scheme was conditional upon such recognition being achieved. The new Scheme proposal is not so conditional. It is instead intended that recognition will be sought in major jurisdictions after the new Scheme has been made effective. This may give rise to delay and could affect the level of the Indemnity Reserve if recognition cannot be obtained or is only obtained on terms.

The Compromises of the Liquidation Issues

43. As was the case with the previous Scheme, the new Scheme is intended to effect a compromise of the claims and issues between the Investors and the Scheme Companies. The Investor claims proposed to be compromised by the new Scheme are the claims arising from:

    (1) Being a holder of S Shares ("**S Share Claim**");

    (2) Having an outstanding Redemption Request with exposure to SMFF (to the extent of such exposure, an **"SMFF Redemption Claim**");

    (3) Having an outstanding Redemption Request with a Redemption Date prior to the Redemption Requests potentially affected by the suspension of redemptions on 14 June 2006 no part of which had exposure to SMFF (a "**pre-14 June non-SMFF Redemption Claim**");

    (4) Having an outstanding Redemption Request with a Redemption Date such that it is potentially affected by the suspension of redemptions on 14 June 2006, no part of which had exposure to SMFF (a "**post-14 June non-SMFF Redemption Claim**");

    (5) Holding shares (other than S Shares) which were not the subject of a Redemption Request (a "**Non-Redeeming Investor Claim**").

44. So far as Investors are concerned, the terms of the new Scheme upon which the Liquidation Issues are compromised are very much simpler than the previous Scheme:

    (1) First, whereas under the previous Scheme Investors were required to claim against the correct Scheme Company, under the new Scheme they rank alongside one another irrespective of which Scheme Company their claim was against. There is no attempt to simulate the liquidation distribution process by having SMFF make payments to Investors with claims against SMFF and then distribute any surplus to SMFL; then have SMFL make payments to Investors

with claims against SMFL and then distribute any surplus to the Feeder Fund; and then have the Feeder Funds make payments to Investors with claims against the Feeder Funds;

(2) Secondly, payments will be based upon Notional Amounts based upon the net asset values of the shares in the respective SPhinX Companies (**"NAVs"**) at a single date, i.e. 31 March 2006;

(3) Thirdly, there is a less elaborate method of dealing with claims that have exposure to SMFF;

(4) Fourthly, Investors will receive the same treatment whether or not they sought to redeem before the 14 June 2006, when the directors sought to suspend redemptions in an action of questionable validity;

(5) Fifthly, Investors that did not seek to redeem will receive the same treatment as those that did, provided the latter were not exposed to SMFF, even though the Investors that did not seek to redeem may have been partially exposed to SMFF.

45. The new Scheme provides that any Cash Distribution from Released Funds (after making reservations for Disputed Non-SMFF Redemption Claims) shall be made first to the Non-SMFF Redemption Claimants until they have received an amount which is equal to 4% of the Notional Amount of their Non-SMFF Redemption Claims.

46. Thereafter, any remaining Released Funds, together with all other Pooled Net Assets (after making reservations for any Disputed Scheme Claims) shall be distributed as follows:

(i) first, *pari passu* between Non-SMFF Claimants (in an amount equal to the Notional Amount of their Non-SMFF Claims) and SMFF Claimants (in an amount equal to 80% of the Notional Amount of their SMFF Claims);

(ii) second, if and when each Non-SMFF Claimant has been paid in full, then the next distribution will be *pari passu* between SMFF Claimants until they have received 100% of the Notional Amount of their SMFF Claims;

(iii) finally, when all Scheme Claimants have been paid in full, any remaining Released Funds or Pooled Net Assets shall be distributed to Scheme Claimants pro-rata to the Notional Amount of their Scheme Claims.

The new Scheme also provides that any Net Litigation Proceeds or other assets received by any SPhinX Company will be pooled, transferred and distributed in the same way.

Law and Practice relating to Schemes of Arrangement

47. The scheme jurisdiction under section 86 of the Companies Law will be familiar to the Court. Any company, whether or not in liquidation, and whether or not solvent, can propose a scheme between:-

(a) the company and its members; or

(b) the company and its creditors; or

(c) the company and its creditors and members; or

(d) the company and persons whose status (whether they are members or creditors) is currently unclear but who are on any basis either members, or creditors, or both.

48. The Cayman Islands approach to the process under section 86 follows the three stage process under the equivalent legislation in England which was summarised in Re Hawk Insurance Co Limited [2001] 2 BCLC 480 by Chadwick LJ,

> "11. There are … three stages in the process by which a compromise or arrangement becomes binding on the company and all its creditors (or all those creditors within the class of creditors with which the compromise or arrangement is made). First, there must be an application to the court under section 425(1) of the Act for an order that a meeting or meetings be summoned. It is at that stage that a decision needs to be taken as to whether or not to summon more than one meeting; and, if so, who should be summoned to which meeting. Second, the scheme proposals are put to the meeting or meetings held in accordance with the order that has been made; and are approved (or not) by the requisite majority in number and value of those present and voting in person or by proxy. Third, if approved at the meeting or meetings, there must be a further application to the court under section 425(2) of the Act to obtain the court's sanction to the compromise or arrangement.
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> 12. It can be seen that each of those stages serves a distinct purpose. At the first stage the court directs how the meeting or meetings are to be summoned. It is concerned, at that stage, to ensure that those who

are to be affected by the compromise or arrangement proposed have a proper opportunity of being present (in person or by proxy) at the meeting or meetings at which the proposals are to be considered and voted upon. The second stage ensures that the proposals are acceptable to at least a majority in number, representing three-fourths in value, of those who take the opportunity of being present (in person or by proxy) at the meeting or meetings. At the third stage the court is concerned (i) to ensure that the meeting or meetings have been summoned and held in accordance with its previous order, (ii) to ensure that the proposals have been approved by the requisite majority of those present at the meeting or meetings and (iii) to ensure that the views and interests of those who have not approved the proposals at the meeting or meetings (either because they were not present or, being present, did not vote in favour of the proposals) receive impartial consideration. As it was put in the BTR case, [2000] 1 BCLC 740, at page 747g-h:

> ". . . the court is not bound by the decision of the meeting. A favourable resolution of the meeting represents a threshold which must be surmounted before the sanction of the court can be sought. But if the court is satisfied that the meeting is unrepresentative, or that those voting at the meeting have done so with a special interest to promote which differs from the interest of the ordinary independent and objective shareholder, then the vote in favour of the resolution is not to be given effect by the sanction of the court."

49. The procedure to be followed in relation to the first stage is governed in the Cayman Islands by the Practice Direction: Schemes of Arrangement and Compromise under Section 86 of the Companies Law (No. 2 of 2010). The Court will recall that the current Practice Direction replaced an earlier Practice Direction (No.1 of 2002), taking into account amendments suggested in light of some of the issues raised at the hearing in relation to the previous Scheme.

50. The Practice Direction is in similar, but not identical terms to the English Practice Statement (Companies: Schemes of Arrangement) [2002] 1 WLR 1345. The rationale for the English Practice Statement was described by David Richards J. in re T&N Limited (No.3) [2007] 1 BCLC 563,

> "18. Following the decision of the Court of Appeal in Re Hawk Insurance Co Ltd [2001] 2 BCLC 480, the practice as regards applications under section 425 to convene meetings was changed. So far as possible, issues arising on the composition of classes should be decided at that stage, rather than on the later application to sanction the

> scheme of arrangement if approved at the meeting(s). The revised practice is set out in the Practice Statement (Companies: Schemes of Arrangement) [2002] 1 WLR 1345. The responsibility as to the constitution of classes and as to the number of meetings lies with the applicant, but paragraph 4 of the Practice Statement requires the applicant to draw the attention of the court as soon as possible to any issues which may arise as to the constitution of the meetings or which may otherwise affect the conduct of the meetings. Unless there are good reasons for not doing so, the applicant must also take all steps reasonably open to it to notify any person affected by the scheme of the intention to promote the scheme and of its purpose and of the proposed composition of classes. The court will, if necessary, give directions for the resolution of any such issues and in particular will hear interested parties. The Practice Statement concludes by stating that the court will expect any creditor who raises any such issue at the hearing to sanction the scheme to show good cause why they did not raise it at an earlier stage.
>
> 19. This practice is to avoid the waste of costs and court time which results if it is not until the sanction hearing that it is determined that the classes were wrongly constituted. If the classes have been wrongly constituted, the court has no jurisdiction to sanction the scheme. The purpose underlying this revised practice shows also that if there are known to be other issues which would go to the jurisdiction of the court to sanction the scheme, they too are best raised at the stage of the application to convene the meetings: see In re Savoy Hotel Ltd [1981] Ch 351 and In re MyTravel Group Plc [2005] 2 BCLC 123. The same is true also of issues which, although not strictly going to jurisdiction, are such that they would unquestionably lead the court to refuse to sanction the scheme…"

51. That rationale is reflected in the following provisions of the Cayman Islands Practice Direction:

> "3 Matters to be determined at the first Hearing
>
> 3.1 The first hearing (on the interlocutory summons for an order to convene the Court meeting) will normally be heard ex parte, but practitioners should consider giving notice to persons affected by the scheme in cases where class or other issues as referred to in paragraph 3.3 below arise, and where it is practical to do so. Such notice should include a statement of the intention to promote the scheme and of its purpose, and also of the proposed composition of classes and of the intention to raise any issue as referred to in paragraph 3.3 below.
>
> 3.2 In every case the Court will consider whether it is appropriate to convene class meetings and, if so, the composition of the classes so as

> to ensure that each meeting consists of shareholders or creditors whose rights against the company which are to be released or varied under the scheme, or the new rights which the scheme gives in their place, are not so dissimilar as to make it impossible for them to consult together with a view to their common interest. It follows that the supporting affidavit must contain all such information as may be necessary to enable the Court to make this determination. The applicant should also raise at the first hearing any other matter which may affect the conduct of the meeting(s).
>
> 3.3 At the first hearing, the Court will also consider any other issue which is relevant to the jurisdiction of the Court to sanction the scheme, and any other issue which, although not strictly going to jurisdiction, is such that it would unquestionably lead the Court to refuse to sanction the scheme.
>
> 3.4 It is the responsibility of the applicant by evidence in support of the application or otherwise to draw the attention of the Court to any issue in relation to the meeting(s) or any issue in paragraph 3.3 above. Unless the applicant's case in relation to the meeting(s) or any issue in paragraph 3.3 above is a plain and obvious one, the applicant's counsel should provide the Court with a skeleton argument addressing the relevant issues.
>
> 3.5 The Court will, if necessary, give directions for the resolution of any such issues including, if necessary, directions for the postponement of meeting(s) until that resolution has been achieved, and will hear interested parties. The Court will expect any person who raises any such issue at the hearing to sanction the scheme to show good cause why they did not raise it at an earlier stage."

52. The Practice Statement procedure has been used in England on numerous occasions to resolve issues going to the jurisdiction of the Court as well as "quasi-jurisdictional" issues of the type referred to by David Richards J. A recent example in England was the decision by Blackburne J. and the Court of Appeal that the English court had no jurisdiction to sanction a scheme of arrangement in relation to beneficial interests under trusts in Re Lehman Brothers International (Europe) [2010] 1 BCLC 496. A similar example in the Cayman Islands, (though it preceded the amended Practice Direction) was the decision by this Court in relation to the previous Scheme that it had jurisdiction under section 86 to sanction a scheme containing third party releases: see Re The Sphinx Group of Companies, 5 May 2010.

53. It is, however, worth repeating the point made by David Richards J. in re Telewest Communications [2005] 1 BCLC 752 that,

> "14. ….it is important to keep in mind the function of the court at this stage. This is an application by the companies for leave to convene meetings to consider the schemes. It is emphatically not a hearing to consider the merits and fairness of the schemes. Those aspects are among the principal matters for decision at the later hearing to sanction the schemes, if they are approved by the statutory majorities of creditors. The matters for consideration at this stage concern the jurisdiction of the court to sanction the scheme if it proceeds. There is no point in the court convening meetings to consider the scheme if it can be seen now that it will lack the jurisdiction to sanction it later."

54. One important and material difference between the practice in England and in the Cayman Islands in relation to the issues to be addressed at the first (convening) hearing is contained in paragraph 3.7 of the Practice Direction:

> "3.7 The applicant must satisfy the Court that the scheme documentation will provide the shareholder/creditor (which for this purpose means the person having the ultimate economic interest) with all the information reasonably necessary to enable them to make an informed decision about the merits of the proposed scheme. Since this application will typically be made ex parte, the applicant's counsel must draw the Court's attention to any aspects of the explanatory memorandum or proxy statement which might arguably depart from best practice."

55. At the third stage of the process (the sanction hearing), the role of the Court is limited. Although it is often referred to as the stage at which the court will rule upon the "fairness" of the proposed scheme, the task of the Court is not to pass its own subjective judgment on the merits of the scheme. The Court takes the view that in commercial matters, members or creditors are much better judges of their own interests than the Court. The position was explained (again by David Richards J.) in giving judgment at the sanction hearing in Re Telewest Communications [2005] BCC 36,

> "20. The classic formulation of the principles which guide the court in considering whether to sanction a scheme was set out by Plowman J in Re National Bank Ltd [1966] 1 WLR 819 by reference to a passage in *Buckley on the Companies Acts*, which has been approved and applied by the courts on many subsequent occasions:

> "In exercising its power of sanction the court will see, first, that the provisions of the statute have been complied with, second that the class was fairly represented by those who attended the meeting and that the statutory majority are acting bona fide and are not coercing the minority in order to promote interests adverse to those of the class whom they purport to represent, and thirdly, that the arrangement is such as an intelligent and honest man, a member of the class concerned and acting in respect of his interest, might reasonably approve.
>
> The court does not sit merely to see that the majority are acting bona fide and thereupon to register the decision of the meeting, but, at the same time, the court will be slow to differ from the meeting, unless either the class has not been properly consulted, or the meeting has not considered the matter with a view to the interests of the class which it is empowered to bind, or some blot is found in the scheme."

21. This formulation in particular recognises and balances two important factors. First, in deciding to sanction a scheme under section 425, which has the effect of binding members or creditors who have voted against the scheme or abstained as well as those who voted in its favour, the court must be satisfied that it is a fair scheme. It must be a scheme that "an intelligent and honest man, a member of the class concerned and acting in respect of his interest, might reasonably approve." That test also makes clear that the scheme proposed need not be the only fair scheme or even, in the court's view, the best scheme. Necessarily there may be reasonable differences of view on these issues.

22. The second factor recognised by the above-cited passage is that in commercial matters members or creditors are much better judges of their own interests than the courts. Subject to the qualifications set out in the second paragraph, the court "will be slow to differ from the meeting"."

The Approach of the JOLs to the new Scheme proposals

56. As indicated above, the new Scheme is not a proposal which the JOLs devised. It has certain features which the JOLs consider are material disadvantages to Investors and others interested in the SPhinX estates. These reservations are sufficiently serious that the JOLs cannot recommend the new Scheme to Investors.

57. The JOLs are particularly concerned that because of the need to resolve the Extant Indemnity Reserve Issues before any distribution can be made by the JOLs from the liquidation, there is a very real risk that the new Scheme may not in fact deliver a cash distribution to the Investors in anything like the timescale or anything like the amounts advocated by the proponents of the new Scheme. There is a very real risk that the new Scheme will not, therefore, deliver the "cost-effective and expeditious distribution" of the cash assets of the SPhinX Companies which has been promoted by DB and hfc as one of the main benefits of the new Scheme.

58. Additionally, the JOLs are particularly concerned about the potential consequences for Investors arising from the fact that long before Investors might see any cash distribution, DB will be released from the substantial claims against it in the US Litigation in return for no payment in return to the assets of the SPhinX group. This would mean an irreversible loss to the estate of the substantial value of what the JOLs have been advised by their US attorneys is a good claim against DB, with no guarantee as to the timing or amount of any cash distribution to Investors under the new Scheme. The same point applies to the release of the Restitutionary Claims on the effective date of the new Scheme.

59. The DB Release is also an acutely sensitive issue because of its potential effect upon the remaining US Litigation to which some of the Indemnity Claimants are defendants. It is therefore the subject of a separate confidential Supplemental Skeleton Argument.

60. As indicated above, however, DB has always maintained that the inclusion of a release for itself is a non-negotiable feature of any scheme in relation to the SPhinX Companies. Moreover, and in spite of the JOLs' reservations, the JOLs have been

placed under intense pressure from DB, hfc and the LC to permit Investors to vote upon the new Scheme. The JOLs are also mindful of the views of the Investors who expressed indicative support for the basics of the new Scheme at and following the Investors' meeting in July 2011.

61. In the end, the JOLs recognize that the timing and likely outcome of the Extant Indemnity Reserve Issues and the DB Release and the implications of it for the future of the US Litigation are matters upon which the commercial views of Investors may differ. It is right to say, for example, that DB (supported by hfc) expound a very different view of the merits of the claims against it in the US Litigation, and DB and hfc are more optimistic than the JOLs about the possibility and likely time required to deal with the Extant Indemnity Reserve Issues with the Indemnity Claimants.

62. In these circumstances, the JOLs have carefully considered the observations of David Richards J. in the Telewest case referred to above. Though the new Scheme is not a deal that the JOLs would have done or which they recommend because of the DB Release, the JOLs cannot say that the new Scheme is not a scheme that "an intelligent and honest man, a member of the class concerned and acting in respect of his interest, might reasonably approve."

63. Accordingly, subject to any jurisdictional points, and provided that the Investors are given, via the Explan, a very clear warning of the substantial risks that the JOLs believe that Investors would be taking if they were to approve the new Scheme, the JOLs recognize that ultimately the Investors should be permitted to decide for themselves what is in their commercial interests.

64. That view is, however, subject to there being no blocking Investors who credibly express a firm intention to vote against the new Scheme. As illustrated by the demise of the previous Scheme, such an intention would make it a waste of further time and resources to proceed to convene the Court Meetings. Although various concerns and potential objections to the new Scheme have been voiced by Investors,[5] at the date of

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[5] The Court will be provided with a confidential affidavit from Ms MacInnis exhibiting the communications between the JOLs and the Investors.

this Skeleton Argument no blocking Investor has clearly indicated any firm intention to vote against the new Scheme.

65. As indicated above, given the inherent complexities and risks of the new Scheme and the tendency for even sophisticated commercial parties to take an impressionistic view of matters, it is particularly important that the Explan provides a clear view of the new Scheme and the risks that it entails. This requirement is made more difficult than normal in this case because of the requirements to keep confidential the views of the JOLs and the other interested parties in the effect of the DB Release on the US Litigation. The Court will therefore be taken at some length through the draft Explan (both open and confidential) at the hearing in discharge of the requirements of paragraph 3.7 of the Practice Direction.

66. At the time of preparation of this Skeleton Argument there are also still a number of issues on the precise formulation of the terms of the new Scheme which have to be resolved between the JOLs and DB. Some of those points are more than mere drafting (though they do not go to the jurisdiction of the Court or class issues). Though the Court is invited to hear argument on all other relevant matters, the JOLs do not intend finally to seek an order for the convening of Court Meetings unless and until those points are resolved to the satisfaction of the JOLs.

Issues for determination at the Convening Hearing

67. As indicated above, the following issues fall to be addressed at the hearing.

<u>Jurisdictional matters, including the Position of the Indemnity Claimants</u>

The Position of the Indemnity Claimants

68. It should not be forgotten that the JOLs contend that the Indemnity Claimants who are defendants to the US Litigation are, for the most part, debtors or persons liable to the SPhinX Companies, and not creditors of the SPhinX Companies of any description. Nevertheless, for the purposes of this analysis, it is assumed that the Indemnity Claimants are contingent creditors of the SPhinX Companies. As such they are entitled to whatever rights contingent creditors have under the statutory scheme which came into effect when the Sphinx Companies went into liquidation.

69. As indicated above, it is not intended that the Indemnity Claimants be parties to the new Scheme or that they be given the opportunity to vote upon it. But there is no jurisdiction to alter or prejudice the Indemnity Claimants' rights as contingent creditors of the Scheme Companies without their consent. This means that the rights of the Indemnity Claimants in the liquidations must be fully respected by the proposed arrangements under the new Scheme in relation to the finalisation and dealings with the Indemnity Reserve.

70. As this is a matter which goes to jurisdiction, it is essential that the Court examine the issue closely and be satisfied that it is so. As the Court will be aware, the Indemnity Claimants have been notified of this hearing and have been sent copies of the draft new Scheme documents to enable them to consider for themselves whether this is in fact so.

71. For the avoidance of doubt, the JOLs wish to make it clear that whilst they will fulfil their obligation to draw to the attention of the Court any matters which they believe might be said to affect the Indemnity Claimants, the JOLs and their legal advisors do not act for the Indemnity Claimants, with whom they have obvious conflicts in the US

Litigation and in the litigation over the Indemnity Reserve. Accordingly, the Indemnity Claimants and their advisors must look after their own interests and not rely upon the JOLs or any of their advisors.

The Scope of the Convening Hearing as regards the Indemnity Claimants

72. The jurisdictional question of whether the rights of the Indemnity Claimants against the Scheme Companies are affected by the new Scheme is to be distinguished from two other questions, one of which is a proper subject for consideration by the Court at this Convening Hearing, and one of which is not.

73. As the Practice Direction makes clear, one of the purposes of a convening hearing such as the present hearing is to identify whether, in addition to "pure" jurisdictional issues there are also issues which, though not strictly going to the jurisdiction of the court under section 86 of the Companies Law, are such that would inevitably cause the court, in its discretion, to refuse to sanction the scheme. An example might be whether the scheme contravened some statutory or regulatory provision or amounted to a breach of a contract between the company and a third party. If such issues exist, there is an obvious reason to require them to be identified at an early stage to avoid a waste of time and costs. Accordingly, persons notified of a convening hearing are required to raise such matters at the convening hearing rather than keep their cards up their sleeves until the sanction hearing, and the Practice Direction indicates that the court might refuse to entertain such arguments at sanction unless provided with a good reason why they were not raised at the earlier stage. The JOLs are not aware of any such issues in this case, but if any of the parties notified of the new Scheme proposals are aware of such matters, they should raise them now and not keep them back in an attempt to disrupt the sanction hearing.

74. Apart from such jurisdictional and other matters that would inevitably cause the Court to refuse to sanction the new Scheme, there are matters which could not be relied upon by the Indemnity Claimants as a reason why the Court either cannot or should not sanction the new Scheme, but which merely go to the level of the Indemnity Reserve (whether by resolution of the Extant Indemnity Reserve Issues or otherwise). As indicated above, the new Scheme envisages that such matters will be addressed in

a separate application or applications in the liquidations between the JOLs and the Indemnity Claimants after the new Scheme has become effective.

75. Specifically, if the Indemnity Claimants contend (as they do) that various aspects of the design of the new Scheme by hfc and DB might have the result that the Indemnity Reserve ultimately turns out to be larger than anticipated or than it could otherwise have been had the new Scheme been structured differently, then that is not a matter which the Indemnity Claimants are required to raise at this hearing.

76. So, to take an important example, the Indemnity Claimants have drawn attention to the fact that (unlike the previous Scheme) DB and hfc have designed the new Scheme on the basis that it should become effective <u>before</u> recognition is sought in other jurisdictions for the scheme and the releases of Investor claims contained in it. The Indemnity Claimants have contended that this means that if recognition is not obtained (or not obtained on satisfactory terms) the Indemnity Reserve may have to be set at a higher level than might otherwise have been anticipated. Though this is undoubtedly a risk that the design of the new Scheme places upon the Investors, this is not a matter which the Indemnity Claimants are or can be required to raise for decision at this stage.

Analysis of the effect of the new Scheme on the Indemnity Claimants

77. As contingent creditors, the Indemnity Claimants have no present right under the statutory scheme created by the Companies Law to receive any share of the assets of the SPhinX Companies in payment of their debts in priority to distributions to members. The Indemnity Claimants are not current creditors.

78. At present, the rights of the Indemnity Claimants are limited to seeking compliance by the JOLs with those rights which are set out in Order 18 rule 4 of the CWR 2008, namely:-

> "(1) In the calculation and distribution of a dividend the official liquidator shall make provision 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 and 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."

79. It is submitted that the only way in which such rights of the Indemnity Claimants might conceptually be affected by a scheme between the SPhinX Companies and their Investors were if assets of the SPhinX Companies which would otherwise be required to form the reserve set under Order 18 rule 4 were to have been (i) distributed to members or (ii) otherwise disposed of at the instigation of the members prior to the reserve being set, so that the JOLs would be unable to comply with the terms of Order 18 rule 4.

80. The first of those two possibilities is catered for by the terms of the new Scheme which provide that unless the Court otherwise orders,[6] there shall be no distribution of cash or assets by the JOLs to the Scheme Supervisors unless and until the Court has finally determined the level of the Indemnity Reserve (and any other reserves which might arguably rank ahead or *pari passu* with the Indemnity Reserve). Once such determination has taken place, it is then only the net balance of cash available in the liquidations which can be distributed.[7] The new Scheme also provides for any Net Litigation Recoveries (e.g. from the US Litigation) to be credited to the Indemnity Reserve.

[6] The possibility of a distribution with the permission of the Court prior to the final determination of the Indemnity Reserve is to cater for possibilities such as a situation in which the bulk of a distribution should not be held up simply because there may be a minor point outstanding or a limited point which is being taken on appeal. This possibility is not an alteration of the rights of the Indemnity Claimants in the liquidations, because the Court always has the right to control the JOLs' operation of Order 18 rule 4 and to permit a distribution in such circumstances.

[7] The fact that the Indemnity Reserve is to be set and established on a pooled basis across all SPhinX Companies cannot be anything other than an additional benefit to the Indemnity Claimants. In reality, however, this reflects the claim of many of the Indemnity Claimants that they have indemnities from all SPhinX Companies on a joint and several basis.

81. The second possibility would only arise if the amount of the Indemnity Reserve were to be set by the Court at a level which, when taken together with other reserves which might arguably rank ahead or *pari passu* with the Indemnity Reserve, would exhaust the then available cash assets of the SPhinX Companies. If that were to occur, then the Indemnity Claimants would arguably have been affected by the terms of the new Scheme that provide for the immediate release of the claims against DB and BAWAG and the immediate release of the Restitutionary Claims (in each case for no payment to the SPhinX Companies) before the Indemnity Reserve can be finally determined. Such releases amount to the disposal, at the behest of members and for no payment in return, of assets of the SPhinX Companies which (on this hypothesis) should be available to provide for contingent creditors.

82. In determining this issue, there is a clear analogy with scheme cases in which the Court has held that when considering a reconstruction scheme under which the assets of an insolvent company are to be disposed of to a new company formed by certain of its secured creditors, it is not necessary to seek class consents from shareholders of the scheme company if, on a realistic appraisal of the financial position of the company and the value of the assets, the shareholders are significantly "out of the money" so that their shares give them no real economic interest in the assets to be disposed of. The basic principles were set out by Mann J. in Re Bluebrook Limited [2010] 1 BCLC 338 at [24]-[25];

> "24. A company is free to select the creditors with whom it wishes to enter into an arrangement and need not include creditors whose rights are not altered by the scheme. This appears from Sea Assets Ltd v Pereroan etc Garuda Indonesia [2001] EWCA Civ 1696 and In re British & Commonwealth Holdings plc [1992] 1 WLR 672. Prima facie, therefore, the company is entitled to select the Senior Lenders as being those with whom it wishes to enter into a scheme and not enter into a scheme with the Mezzanine Lenders as well. Of course, whether that scheme can ultimately be effected, or will be sanctioned, is another matter. At this stage the question is one of choice of counterparty.
>
> 25. Next, in promoting and entering into a scheme, it is not necessary for the company to consult any class of creditors (or contributories) who are not affected, either because their rights are untouched or because they have no economic interest in the company. This is apparent from In re Tea Corporation Ltd [1904] 1 Ch 12, where the Court of Appeal held that the dissent of ordinary shareholders

would not stop a scheme being sanctioned, because although those shareholders had a technical interest as shareholders, they in fact had no economic interest in the company because the assets were insufficient to generate a return to them in the liquidation that was then on foot. As Vaughan Williams LJ said (at page 23):

> "It would be very unfortunate if a different view had to be taken, for if there were ordinary shareholders who had really no interest in the company's assets, and a scheme had been approved by the creditors, and all those were really interested in the assets, the ordinary shareholders would be able to say that it should not be carried into effect unless some terms were made with them."

If there is a dispute about this, then the court is entitled to ascertain whether a purported class actually has an economic interest in a real, as opposed to a theoretical or merely fanciful, sense, and act accordingly - see the reasoning in In re MyTravel Group plc [2005] 2 BCLC 123 at first instance. Where things have to be proved, the normal civil standard applies. The same case indicates that the mere fact that the possibility of establishing a negotiating position and extracting a benefit from a deal is not the same as having a real economic interest (though obversely a real economic interest may establish, or enhance, a negotiating position). The basis on which the assessment of that interest is to be carried out will vary from case to case."

83. The approach of Mann J. can be compared with the following principles set out by this Court in the Indemnity Reserve Judgment of 12 February 2010:

> "37. In the end, however, there was general agreement about the principles, save for the question of the standard or 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 to 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."

84. The Court went on to set the Indemnity Reserve in respect of legal costs at US$117 million. As indicated above, the current cash assets of the SPhinX Companies are some US$500 million. Although there are plainly issues still to be resolved with the Indemnity Claimants concerning the Extant Indemnity Reserve Issues, the Indemnity

Claimants have not articulated any concerns that the amount of the likely future Indemnity Reserve will be so great as to mean that they are prejudiced in any realistic (as opposed to fanciful) basis by the releases intended to be granted under the new Scheme to DB and BAWAG and in respect of the Restitutionary Claims.

85. On this basis the Court is asked to confirm that the Indemnity Claimants do not need to be parties to, or given a vote upon the new Scheme.

Section 86 and the releases in the new Scheme

86. There is plainly no jurisdictional issue under section 86 of the Companies Law over the inclusion in the new Scheme of releases as between the Scheme Companies and any of the Investors (i.e. the DB and BAWAG releases and the releases of the Restitutionary Claims).

87. Moreover, since the Court has already decided in the Releases Judgment that there is jurisdiction under section 86 of the Companies Law to sanction a scheme of arrangement which incorporates the releases proposed to be given by Scheme Claimants in favour of third parties (which will then benefit the Indemnity Claimants), it is not proposed to reargue that point again. For the purposes of the application of the principles set out in the Releases Judgment, the third party releases proposed to be included in the new Scheme are not materially different to those which were the subject of the previous Scheme.

88. The new Scheme also includes releases for the JOLs, the Scheme Supervisors and the SPhinX Trustee. Such releases of office-holders are increasingly commonplace in modern schemes. The proposal is that the JOLs, the Scheme Supervisors and the SPhinX Trustee be released upon and with effect from the date upon which the new Scheme becomes effective and, separately, upon and with effect from each successive Cash Distribution Date including the First Cash Distribution Date (as defined) from any claims (known and unknown) by any Investor in respect of any loss or liability relating to or arising out of any act done or omitted to be done in relation to the Scheme (including but not limited to its negotiation, formulation, preparation,

presentation and implementation), or in relation to the conduct of the liquidations of the SPhinX Companies insofar as the same might affect either the implementation of the Scheme or the availability of assets to be distributed under the Scheme, or the exercise by the JOLs or either of them of any power, right, duty or obligation conferred upon the JOLs under the Scheme and whether or not any such claims are attributable to his or her negligence, default, breach of duty or breach of trust (but not fraud or dishonesty). The releases proposed to be given to the Scheme Supervisors and the SPhinX Trustee are in more limited terms reflecting the more limited scope of their roles.

89. The reason for the inclusion of these releases in the new Scheme is obvious. The new Scheme will require the JOLs to make a distribution from the liquidations for the benefit of Investors. In the ordinary way, the JOLs would, before deciding to make a distribution to shareholders in the liquidations, establish reserves for the payment of actual creditors and contingent creditors (such as the Indemnity Claimants) who rank or might rank ahead of the Investors. Such creditors or contingent creditors would, however, not be confined to the Indemnity Claimants, but would, as indicated in CWR Order 18 rule 4, include the JOLs themselves in relation to their liquidation expenses, which include a right to an indemnity from the company's assets in respect of any liabilities properly incurred by them to third parties: see e.g. Lewis v IRC [2001] 2 BCLC 392 and the cases cited therein.

90. In order to enable the maximum assets to be distributed, one of two possible approaches could be adopted. Either there needs to be a release of the JOLs from all claims against them (save where such claims are in respect of fraud or dishonesty) so obviating the need for them to seek a reserve. Alternatively, if a claim has been notified and is not to be released, provision should be made in the new Scheme for the JOLs to seek a provision to be made in respect of it by the Court as part of the General Expenses Reserve.

91. The same reasoning applies to the SPhinX Trustee who is a co-plaintiff with the JOLs in the US Litigation for the benefit of the SPhinX Companies. The SPhinX Trustee requires a release to the extent that it might otherwise be exposed to claims which arise through the SPhinX Trustee's efforts to bring in assets for the estate, but in

respect of which the SPhinX Trustee is unable to recover against the estate because it is to be distributed.

92. The Scheme Supervisors are in a different position. As creations of the new Scheme, the Scheme Supervisors would not have rights of indemnity against the assets in the liquidations. They are, however, required to perform functions under the new Scheme (such as adjudicating claims) prior to any distribution being made, and might claim a right of indemnity and retention against the assets passed to them for distribution unless granted a similar release under the new Scheme.

93. All such releases (for the JOLs, the SPhinX Trustee and the Scheme Supervisors) are essential for the operation of the new Scheme and, specifically, to reduce the amounts that might be required to be set aside to meet Indemnity Claims, so increasing the amounts available for distribution to Investors. As a matter of jurisdiction, such releases are plainly closely connected with the subject matter of the new Scheme and hence fall within the permissible scope of section 86: see the Releases Judgment at paragraphs 66 ff, especially 66-73.

94. Further, if releases in such terms for the JOLs and the SPhinX Trustee are not incorporated into the Scheme, the JOLs will not put forward the Scheme, and the JOLs anticipate that if a release in the proposed terms is not to be given to the Scheme Supervisors, it may well not be possible to find independent persons willing to be Scheme Supervisors.

Classes

95. The second matter to be determined at this hearing is the composition of classes for the Court Meetings.

96. The very structure of the SPhinX Companies, and the variety of claims against the Scheme Companies in the liquidations by persons holding shares, persons claiming to have exercised rights to redeem shares and to have attained the status of creditors, and

persons who were purportedly issued with S Shares inevitably leads to the conclusion that the new Scheme will require approval at Court Meetings of a number of different classes of Investors.

97. Moreover, although the distribution of rights and benefits to Investors under the new Scheme draws fewer distinctions between Investors with different rights in the liquidations, the JOLs anticipate that they will need to have a similar number of Court Meetings as was proposed under the previous Scheme.

The Law

98. In Hawk [2001] 2 BCLC 480 at para. 13ff, Chadwick LJ set out and explained the classic formulation of the test as to the correct constitution of classes derived from the judgment of Bowen LJ in Sovereign Life Assurance Company v Dodd [1892] 2 QB 573. The approach to classes was also crisply summarised by Lord Millett in a judgment of the Court of Final Appeal in Hong Kong, UDL Holdings Ltd [2002] 1 HKC 172 at 184-5:

> "(2) Persons whose rights are so dissimilar that they cannot sensibly consult together with a view to their common interest must be given separate meetings. Persons whose rights are sufficiently similar that they can consult together with a view to their common interest should be summoned to a single meeting.
>
> (3) The test is based on similarity or dissimilarity of legal rights against the company, not on similarity or dissimilarity of interests not derived from such legal rights. The fact that individuals may hold divergent views based on their private interests not derived from their legal rights against the company is not a ground for calling separate meetings.
>
> (4) The question is whether the rights which are to be released or varied under the scheme or the new rights which the scheme gives in their place are so different that the scheme must be treated as a compromise or arrangement with more than one class."

99. This formulation is reflected in the Practice Direction which, it will be recalled, indicates that,

> "3.2 In every case the Court will consider whether it is appropriate to convene class meetings and, if so, the composition of the classes so as to ensure that each meeting consists of shareholders or creditors whose rights against the company which are to be released or varied under the scheme, or the new rights which the scheme gives in their place, are not so dissimilar as to make it impossible for them to consult together with a view to their common interest."

100. In short, it is necessary to compare the rights of a creditor or investor prior to the scheme and the rights of a creditor or investor after the scheme with those rights, before and after the scheme, of other creditors or investors. If they are sufficiently similar that they can consult together, then they should be in the same class. If they are not sufficiently similar, then they must be in different classes.

101. That requirement is subject to a proviso which was explained by Chadwick LJ in Hawk at paras [31]-[32]:

> "[32] Nevertheless, it is important to keep in mind that the underlying question, to which Lord Justice Bowen's test must be directed, is that posed by the statutory language: with whom is the compromise or arrangement to be made? Or, as I have put it earlier in this judgment: "are the rights of those who are to be affected by the scheme proposed such that the scheme can be seen as a single arrangement; or ought it to be regarded, on a true analysis, as a number of linked arrangements?" If I may say so, there is much force in the observations of Mr Justice Lush, when giving the judgment of the full court in Nordic Bank plc v International Harvester Australia Ltd and anor [1982] 2 VR 298. He said this, at page 301, lines 36-46:
>
>> "The general plan of section 315 [the equivalent statutory provision in the Companies (Victoria) Code] is that when a scheme is proposed it is first put to meetings to test whether those affected by it substantially support it. If they do, it is still open to any one or more persons affected to oppose its final approval. A separated class of creditors can only be bound by the scheme if the meeting of that class approves it by the necessary majority. It is appropriate that creditors who share an interest vis-à-vis the company which places them in a position distinct from that of other creditors and so dissimilar as to make it impossible for them to consult together with a view to

their common interest should be allowed to make a separate decision. To break creditors up into classes, however, will give each class an opportunity to veto the scheme, a process which undermines the basic approach of decision by a large majority, and one which should only be permitted if there are dissimilar interests related to the company and its scheme to be protected. The fact that two views may be expressed at a meeting because one group may for extraneous reasons prefer one course, while another group prefers another is not a reason for calling two separate meetings."

[33] When applying Lord Justice Bowen's test to the question "are the rights of those who are to be affected by the scheme proposed such that the scheme can be seen as a single arrangement; or ought it to be regarded, on a true analysis, as a number of linked arrangements?" it is necessary to ensure not only that those whose rights really are so dissimilar that they cannot consult together with a view to a common interest should be treated as parties to distinct arrangements – so that they should have their own separate meetings – but also that those whose rights are sufficiently similar to the rights of others that they can properly consult together should be required to do; lest by ordering separate meetings the court gives a veto to a minority group. The safeguard against majority oppression, as I sought to point out in the BTR case, [2000] 1 BCLC 740, at page 747g-h, is that the court is not bound by the decision of the meeting. It is important Lord Justice Bowen's test should not be applied in such a way that it becomes an instrument of oppression by a minority."

102. Or, as it was put more shortly by Neuberger J. in Anglo-American Insurance [2001] 1 BCLC 755 at 764,

> "Practical considerations are not irrelevant. In that connection, they obviously play a part, as they do in relation to the implementation of any principle of law in a commercial context. That point is well illustrated by the point made by Jonathan Parker J in the BTR case, and indeed by myself in Osiris, to the effect that if one gets too picky about potential different classes, one could end up with virtually as many classes as there are members of a particular group."

103. To similar practical effect was the comment of David Richards J. in Telewest Communications plc [2004] BCC 342 at 354D, to the effect that when considering how to resolve the class question, the court ought not to constitute scheme claimants in different classes if it considers, having regard to the main purpose and features of the scheme, that *"there is a great deal more to unite [them] than divides them".*

Analysis

104. It is a basic principle that the new Scheme needs to be separately approved by the Investors who are the Scheme Claimants of each of the 11 Scheme Companies, constituted in the correct classes to vote upon the new Scheme.

105. Under the new Scheme, Scheme Claimants' rights under the Scheme depend upon whether they hold S Shares or have Redemption Claims, and in the case of Redemption Claims, but not Non-Redeeming Investor Claims, whether they are SMFF-exposed. However, there are other elements in the new Scheme which result in Scheme Claimants having different rights under the Scheme. For example, the grant of the DB Release and the BAWAG Release gives DB and BAWAG certain rights under the Scheme that other Scheme Claimants will not have. The proposal to grant releases of the Scheme Companies' Restitutionary Claims provides another instance of the Scheme affecting the rights of certain Scheme Claimants but not others, since Restitutionary Claims can be brought against some but not all Scheme Claimants.

106. In formulating their proposals for the constitution of classes to vote upon the Scheme, the JOLs have considered the following 9 questions:

    (1) Should DB and BAWAG be voting separately upon the Scheme because of the DB and BAWAG Releases?

    (2) Should Scheme Claimants who will benefit from the release of the Restitutionary Claims be voting separately upon the Scheme?

    (3) Should Redemption Claimants who were issued with S Shares be voting separately from those Redemption Claimants who were not issued with S Shares?

    (4) Should Scheme Claimants who were issued with S Shares (S Share Claimants) vote separately <u>as creditors</u> from other S Share Claimants according to which Scheme Company issued them with S Shares?

    (5) Should Scheme Claimants who were issued with S Shares in a particular company be sub-divided according to the identity of the Scheme Company against which the Redemption Request was made?

(6) Should Scheme Claimants with Redemption Claims be sub-divided according to whether they had a Redemption Date of 30 June 2006, and therefore were subject to redemption after 14 June 2006 and consequently potentially affected by the suspension, or purported suspension, of redemptions on 14 June 2006?

(7) Should Redemption Claimants be sub-divided because the cash distributed under the Scheme depends upon their SMFF-exposure?

(8) Should Scheme Claimants with Non-Redeeming Investor Claims be sub-divided according to their exposure to SMFF?

(9) Should Portfolio Managers be constituted as separate classes according to the SPC in which they held M&N Shares, or according to the specific portfolio in relation to which they were issued with S Shares, because such shares were linked to a specific portfolio?

Question 1 - Should DB and BAWAG be voting separately upon the Scheme because of the DB and BAWAG Releases?

107. The JOLs regard it as obvious that the DB and BAWAG Releases are such as to make it impossible for DB or BAWAG to be placed in the same class with Scheme Claimants that are not being given a release from any claims brought against them in the US Litigation, or that might be brought against them in any other Third Party Litigation.

Question 2 - Should Scheme Claimants who will benefit from the release of the Restitutionary Claims be voting separately upon the Scheme?

108. The JOLs propose that those Scheme Claimants who will benefit from the release of the Restitutionary Claims do not vote separately from those Scheme Claimants who will not benefit from such release. The reasons are two-fold:

(1) First, because Scheme Claimants stand to benefit from such releases to such differing degrees, depending upon their individual positions in S Share Claims and SMFF Redemption Claims, and also to benefit from other elements of the Scheme to such different degrees, depending upon their individual positions in the various other classes, that is not practical to see to draw firm conclusions

about the extent to which they might be unable to consult with others that have S Shares Claims and SMFF Redemption Claims; and

(2) Secondly, because it would be highly undesirable to fragment the classes any more than is absolutely necessary, if individual Scheme Claimants are not to be given a disproportionate right of veto.

Question 3 - Should Redemption Claimants who were issued with S Shares be voting separately from those Redemption Claimants who were not issued with S Shares?

109. The JOLs consider that it would not be appropriate for Scheme Claimants with S Share Redemption Claims to vote with those with Redemption Claims, because it is a premise of the Scheme that the rights in a liquidation of those holding S Shares are arguably different to the liquidation rights of those that sought to redeem but did not receive S Shares, so that they are treated differently under the Scheme.

Question 4 - Should Scheme Claimants who were issued with S Shares (S Share Claimants) vote separately as creditors from other S Share Claimants according to which Scheme Company issued them with S Shares?

110. The JOLs consider that it is not appropriate to divide S Share Claimants according to the identity of the Scheme Company that issued them with their S Shares, in light of the following matters:

(1) First, there is a very real likelihood of there being no material distinction in a liquidation between S Shares in one Scheme Company and S Shares in another Scheme Company in light of the progress made in relation to Issues 1 to 5 (the “”**Pooling Issues**”) as to the possibility of the SPhinX Companies’ assets being found to have been commingled and/or the possibility of the Court directing that the outcome of the Pooling Issues is that there should be pooling of assets and liabilities in the liquidations;

(2) Second, those S Shareholder Redemption Claimants, regardless of which Scheme Company issued their shares, are likely to be able to consult together on the Scheme by virtue of the fact that all S Shares, regardless of which

Scheme Company issued them, are subject to the same uncertainties concerning the validity of their issue outlined in the Explan.

(3) Third, since there are Scheme Companies where only an insignificant number of S Share Redemption Claimants were issued with S Shares in one Scheme Company, and the bulk of the S Share Redemption Claimants were issued with S Shares in another Scheme Company, sub-division of the S Shareholder Redemption Claimants according to which Scheme Company issued the S Shares would result in undue fragmentation of the class of S Shareholder Redemption Claimants (and hence the creation of inappropriate veto rights).

Question 5 - Should Scheme Claimants who were issued with S Shares in a particular company be sub-divided according to the identity of the Scheme Company against which the Redemption Request was made?

111. In a liquidation, all S Shares issued by any particular Scheme Company would be treated identically, regardless of which Scheme Company issued them. Under the Scheme, all S Shares are discounted to 80% irrespective of the Redeeming Company against which the Redemption Request had been made. The JOLs therefore consider that no distinction should be made.

Question 6 - Should Scheme Claimants with Redemption Claims be sub-divided according to whether they had a Redemption Date of 30 June 2006, and therefore were subject to redemption after 14 June 2006 and consequently potentially affected by the suspension, or purported suspension, of redemptions on 14 June 2006?

112. Under the Scheme, Redemption Claimants are treated in the same manner irrespective of Redemption Date. But arguably, the rights of Redemption Claimants would differ on liquidation according to whether they had a Redemption Date of 30June 2006, and therefore were subject to redemption after 14 June 2006, in light of the argument that the directors of the SPhinX Companies suspended redemptions on 14 June 2006. The possibility that rights in a liquidation would differ, depending upon the validity of the suspension, means that the rights of Redemption Claimants with a Redemption Date after 14 June 2006 (e.g. 30 June 2006) are too different from the rights of Redemption Claimants with a Redemption Date before 14 June 2006 so as to enable them to consult together.

Question 7 - Should Redemption Claimants be sub-divided because the cash distributed under the Scheme depends upon their SMFF-exposure?

113. The JOLs consider that there should be no sub-division according to SMFF-exposure in the light of the following matters:

(1) First, all of the Redemption Claimants are all of the same quality; they are all claims *qua* creditor, which in a liquidation would be entitled to payment in priority to any payment to shareholder.

(2) Second, the treatment of Redemption Requests has been inconsistent. Following part payment (in cash or in S Shares), the extent of exposure to SMFF is not necessarily related to the extent of exposure to SMFF according to the type of share held by the Redemption Claimant. Consequently, a sub-division of Redemption Claimants by reference to exposure predicated upon the type of share held (0%, 11% or 33% exposed) would be unrelated to the treatment of Redemption Claimants either under the Scheme or in the liquidations. So Redemption Claimants are likely to consider the merits of the Scheme, and the impact of a discount of 80% on the SMFF-exposed portion of their claim, by reference to the extent of their SMFF-exposure on their outstanding balance following part payment rather than according to the type of share held. But there would be no obvious point at which a line could be drawn making a distinction between Redemption Claims with exposure to SMFF and Redemption Claims without exposure to SMFF, because of the random way in which requests for redemption were sometimes treated by Scheme Companies.

(3) Third, sub-division to reflect the fact that Redemption Claimants held shares of different classes (or types) and that, following part payment, Redemption Claimants were SMFF-exposed to different degrees, would sub-divide Redemption Claimants into smaller and smaller groups, giving a disproportionate right of veto.

Question 8 - Should Scheme Claimants with Non-Redeeming Investor Claims be sub-divided according to their exposure to SMFF?

114. None of the Non-Redeeming Investors had an exposure to SMFF greater than 50%, so the predominant interest of all Non-Redeeming Investors would be in the treatment of the Non-SMFF-exposed claims. All of the Non-Redeeming Investor claims are of the same quality; they are all claims *qua* member, which in a liquidation would be entitled to participate in a surplus after payment of creditors. Whilst there is a spectrum of exposure, even the most exposed (33%) has a greater exposure to SPhinX Companies that are not in the SMFF-exposed SPhinX Companies. Because all Non-Redeeming Investors are dealt with in the same way under the Scheme, they have an important common interest in the treatment of non-SMFF-exposure, in addition to their common interest in the Scheme more generally.

Question 9 - Should Portfolio Managers be constituted as separate classes according to the SPC in which they held M&N Shares, or according to the specific portfolio in relation to which they were issued with S Shares, because such shares were linked to a specific portfolio?

115. The JOLs have considered the argument that each Portfolio Manager should have their own class because each held M Shares or N Shares, or was issued with S Shares, in relation to a specific portfolio. The argument is grounded on the fact that, under Cayman law, there would on a liquidation be a separate distribution in relation to the assets of each separate portfolio. However, as matters stand in relation to the Liquidation Issues, there would be a good argument that if the liquidations were to continue, the JOLs would obtain an order for a *pari passu* distribution of the entirety of SMFF's assets rather than on a portfolio-by-portfolio basis, since it would be impracticable, or at least prohibitively time-consuming and expensive, for the inter-portfolio transactions to be reconstructed.

116. The JOLs propose that the classes at the Court Meetings to approve the new Scheme be constituted according to the analysis set out above.

The Adequacy and Form of the Explanatory Memorandum

117. The third issue to be resolved at the Convening Hearing is the adequacy and form of the Explan.

118. As indicated above, the Practice Direction contains the following requirement:

> "3.7 The applicant must satisfy the Court that the scheme documentation will provide the shareholder/creditor (which for this purpose means the person having the ultimate economic interest) with all the information reasonably necessary to enable them to make an informed decision about the merits of the proposed scheme. Since this application will typically be made ex parte, the applicant's counsel must draw the Court's attention to any aspects of the explanatory memorandum or proxy statement which might arguably depart from best practice."

Although there are no specific requirements for the content of scheme documentation in the Companies Law, it must be implicit that the information to be provided in accordance with paragraph 3.7 of the Practice Direction has to be accurate, and presented in an intelligible and fair manner.

119. Though the new Scheme is complex, substantial efforts have therefore been made to ensure that the Explan is easily readable and as comprehensible as reasonably possible. However, the proposals in the new Scheme for a release of DB (and BAWAG) from the claims made against them in the US Litigation present a particular problem in this regard. By its very nature, an explanation of the potential effect of such releases upon the US Litigation will involve a discussion of confidential and privileged matters, disclosure of which in the Explan may itself prejudice the US Litigation. Accordingly, the question of the arrangements for circulation of the Explan in two different forms and the content thereof is dealt with in a confidential Supplemental Skeleton Argument.

Directions for the holding of the Scheme Meetings (including voting)

120. The final issue for determination at this Convening Hearing relates to the mechanics for the holding of the Court Meetings.

121. The JOLs propose that the Court Meetings are convened by notice set out in Section 20, and that the arrangements for disseminating the Open Explan should be the same as the arrangements for disseminating the evidence for the Convening Hearing, save that the JOLs consider that should be unnecessary, and regard it as undesirable, for the Open Explan and the Scheme to be posted on the Scheme Website. The JOLs consider it unlikely in the extreme that doing so would reach any Investor who would not otherwise be reached by email. The JOLs are concerned that even in relation to the Explan, it is undesirable that so much commercially-sensitive information should be put on the Scheme Website.

122. The JOLs' proposals for the arrangements for holding the Court Meetings are set out in Sections 19 and 20 of the Open and Confidential Explans, and the Court is referred to the latest versions of these documents. As permitted by paragraph 6.1 of the Practice Direction, it is proposed that the meetings should be in London.

123. The proposals for voting at the Court Meetings are explained in Sections 19 and 20 of the Open and Confidential Explans, as supplemented by the draft Voting Form and Proxy Form which was exhibit "KK163"to the JOls' 99TH affidavit and the Court is referred to the latest versions of these documents.

124. The JOLs have considered the difficult question of the extent to which, if at all, the Court could give directions for voting which would reflect the possibility that the claims of some Scheme Claimants are possibly subject to rectification by virtue of the matters founding the Restitutionary Claims. The scale of the potential changes to individual Scheme Claimants' positions is explained in Section 1.13.7 to 1.13.9 of the Open Explan and Annex 4 to the Open and Confidential Explans.

125. The JOLs consider that the only practical solution is for the JOLs to review the voting figures and, if and to the extent that voting outcomes might have been different had voting arrangements reflected the possibility of rectification, to present the Court with information as to how it might have been different. At that point, any interested parties can make submissions as to whether the information should have a bearing on the Court's approach to sanction.

Conclusion

126. Subject to resolution of the issues as described above, the JOLs seek an order convening the Court Meetings to consider the new Scheme.

DATED this 10th day of October 2011

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Ceri Bryant

Counsel instructed by the JOLs of the SPhinX Group of Companies

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