IN THE SUPREME COURT OF BERMUDA

CIVIL JURISDICTION

2004: 51

BETWEEN:

FIRST ATLANTIC COMMERCE LIMITED

Plaintiff

-and-

THE BANK OF BERMUDA LIMITED

Defendant

RULING

Date of hearing: November 5, 2007
Date of Ruling: November 8, 2007

Mr. Victor Lyon Q.C. and Mr. Jan Woloniecki, Attride-Stirling & Woloniecki, for the Plaintiff
Ms. Barbara Dohmann Q.C. and Mr. Andrew Martin, Mello Jones & Martin, for the Defendant

Introductory

1. The present action was scheduled to be tried over four weeks commencing on November 5, 2007. But Guy Fawkes Day, as far as this potentially explosive trial was concerned, turned out to be a damp squib. The parties agreed that there would be no fireworks display, and the trial was de-listed. But the purpose of civil litigation is not entertainment. It is to resolve disputes in as cost-effective a manner as possible. Both parties are to be commended for keeping this goal in view. The parties agreed that, in light of the Bank's offer (without admission of liability) to relinquish certain common and preference shares in the Plaintiff, that the Plaintiff's remaining claims were not worth pursuing. The parties also agreed that the only issues for this Court to determine were (a) the mechanism whereby the Bank's shares in the Plaintiff ("FAC") would be relinquished and (b) costs.

2. Counsel sensibly agreed to work together to agree the terms on which this Court would approve a process whereby the preference and common shares held by the Bank could be cancelled or otherwise relinquished by the Bank. Understandably, in light of the length and obvious complexity of this action, as well as the amounts of money in dispute, the burden of costs is obviously a significant one to both parties. So counsel can be forgiven for the enthusiasm with which they advanced their respective cases on costs, each insisting that the other side had capitulated, but both agreeing that I should look at the real result and not speculate as to how the un-litigated claims and defences would have been resolved.

3. Mr. Lyon contended that the Bank had agreed to give his clients "*exactly what they wanted*" and Mr. Woloniecki insisted that there had been a "*complete capitulation*". Ms. Dohmann contended that FAC's restitutionary claim was "*legally illiterate*", the recent mutual mistake plea was "*stunningly hopeless*" and that the shares they had agreed to return were worthless in real terms. In correspondence it has been suggested that the Plaintiff's costs are in the region of $3 million, so the present application is no trifling matter.

4. It is against this highly contentious background that I must determine what order to make with respect to the costs of the action, it being essentially common ground that the crucial question is which party (if any) may fairly be said to have succeeded in an action it is agreed no longer needs to be tried.

Applicable legal principles

5. Order 62 rule 3 of the Rules of the Supreme Court provides as follows:

   "*(3) If the Court in the exercise of its discretion sees fit to make any order as to the costs of any proceedings, the Court shall order the costs to follow the event, except when it appears to the Court that in the circumstances of the case some other order should be made as to the whole or any part of the costs.*"

6. This fundamental guiding principle is simple to apply in cases where there is no factual dispute as to what the relevant "*event*" is. In the present case FAC contends that the without liability share offer is the relevant event, while the Bank contends that the application to discontinue the Plaintiff's claim is the relevant event. In preparing for the hearing in advance of receiving counsel's fulsome written submissions, my provisional view was that the governing principles in the present context where to be found in <u>*Brawley-v- Marczynski*</u> [2003] 1 WLR 813 (CA). However, this case in fact suggests that the Court should award costs based on an assessment of how the dispute would have been determined, had it gone to trial, but only where it is obvious what the result would have been. In cases of doubt, there should be no order as to costs.

7. Both parties are agreed that it would be inappropriate for me to determine how the unresolved liability issues would have been determined if the trial had proceeded. I agree that in general terms it is far from obvious what the result would have been. If required to follow <u>*Brawley-v- Marczynski*</u>, I would simply make no order as to costs. However, in my view counsel are correct that a more just approach is to consider in more broad terms which party (if any) may be said to have substantially won.

8. Ms. Dohmann is correct that the usual rule on discontinuance is that the claimant pays the defendant's costs, but it is always open to the claimant to show that the normal rule should be departed from. One relevant circumstance, upon which FAC relied, would be where "*the claimant's claim had become worthless as a result of something the defendant had done of his own initiative*": *In* <u>*re Walker Wingsail Systems plc*</u> [2006 1 WLR 2194 (per Chadwick LJ at 2205 D). It is, for reasons that I shall come to, clear beyond sensible argument that this is a case where the normal rule may, potentially be departed from. The Bank's offer to return the shares was clearly the trigger for FAC's discontinuance application.

9. Bearing in mind that the costs of the Defendant's counterclaim are insignificant because of a costs order made in respect of all costs incurred prior to September 26 , 2007[1], the crucial question is as follows. How should the substantial costs burden of the present action be borne in circumstances where a voluntary act by the Bank has substantially reduced FAC's recoverable loss making the further pursuit of its claim un-commercial, and prompting its application to discontinue?

10. In seeking to answer this practical question, I find most helpful the following dictum of my brother judge Bell J in SCAL Ltd.-v- Beach Capital Management Ltd. [2006] Bda LR 93 at page 9. Although this authority was relied upon by Mr. Lyon, the first sentence of the following passage was endorsed by Ms. Dohmann as well:

> "*In BCCI –v- Ali (#4) [1999] NLJ 1734, Lightman J. said that for the purpose of the Civil Procedure Rules 1998, operative in the UK, "success is not in my view a technical term but a result in real life, and the question as to who succeeded is a matter for the exercise of common sense." I respectfully agree, and there is no doubt whatsoever in my mind that the successful parties in this litigation were BCM and Mr. Beach. Looking at the issue as Sunfish did at the outset of its submission on costs, BCM and Mr. Beach were the winners. Whilst it is true that Sunfish was successful on a number of minor issues (the March 2003 compromise in respect of the treatment of interest income and Mr. Parfit's costs, the treatment of pre-trading income, and the rejection of BCM's claim for recovery of the fees of certain of its professional advisors), these issues took a miniscule amount of time, and certainly the amount of time spent on those issues pales into insignificance, when compared to the time necessarily taken by the principal issues at trial, in respect of which BCM and Mr. Beach were successful. I accept the contention put forward on behalf of BCM and Mr. Beach that they are plainly properly to be described as the successful parties, and Sunfish as the unsuccessful party. Those minor successes enjoyed by Sunfish are in my view so minor that it would be inappropriate to make any percentage adjustment which would deprive BCM and Mr. Beach of their full costs. In this regard, I entirely accept the submission made by Sunfish that where a party succeeds only partially, it may recover only a proportionate amount of its costs, and in these circumstances it is preferable to award the partially successful party a percentage of its costs, rather than to make orders on an issue by issue basis.*"

Findings: the circumstances under which the Plaintiff's claim is being discontinued

11. The present litigation has been vigorously contested for three years. FAC has employed three firms of attorneys, the Bank has made an unsuccessful strike-out application[2], and final pre-trial directions were ordered on September 26, 2007. A

[1] On this date I awarded the costs occasioned by the Plaintiff's abandonment of its claim that the refinancing agreement was voidable by reason of economic duress to the Defendant in any event. This by necessary implication included all the Plaintiff's costs relating to the Counterclaim up to this date.
[2] It is only fair to point out that FAC was required to give further and better particulars of the way in which it quantified its loss in its original Statement of Claim, which was found to be inadequately pleaded by

four week trial with expert evidence and numerous live witnesses was scheduled to commence on November 5, 2007.

12. Throughout various interlocutory skirmishes, the Bank insisted that FAC's claims were unmeritorious, but FAC rightly contended that they had not been struck out. Concerns about costs were manifested in two principal ways. Firstly, attempts were made by both parties (at the Bank's initiative[3]) to agree the trial of preliminary issues which might avoid the need for a full trial, but the complexities of the case made this impossible. Secondly, the Bank procured an undertaking from FAC's parent to meet any costs order that might be obtained against FAC because the Plaintiff's ability to continue as a going concern was dependent on financial support from its parent company[4].

13. Issue has therefore been joined from the outset as to both liability (is the Bank liable for negligent breach of contract in relation to the losses incurred in relation to the credit card processing business operated by FAC through the Bank?) and damage (if any breach of contract occurred, are any losses recoverable by FAC from the Bank?). From the beginning of the action, FAC has asserted that it is entitled to approximately $5.8 million, being the total amount that various sub-merchants' accounts were in overdraft. The complaint from the outset was that the Bank had contractually agreed to bear the risk of such losses, which were higher than expected because of underlying frauds.

14. Bearing mind that these losses were in fact paid out of funds recovered from certain Nevis proceedings and monies advanced by the Bank in the refinancing transaction, it was unclear how it could be contended that FAC had suffered any recoverable loss. This complaint was made by the Bank in its strike-out application, and resulted in Further and Better Particulars of this aspect of the case being furnished by FAC on November 4, 2004. From paragraphs 26 of those Particulars, it is clear that FAC acknowledged that the "*purchase of the common shares and the class A preference shares was used to reduce the …overdraft…in the amount of US$4,000,000.00*". From paragraph 28 of the Particulars, it is apparent that FAC complained (somewhat absurdly) that its loss included that part of the overdraft which was paid out of the funds it recovered through the Nevis proceedings ($1,642,162.30). The balance of the $5,828,236.65 claimed in respect of so-called "offset losses" was alleged to be the sum of $186, 074.35 paid to the Bank out of FAC's operating account. In paragraph 29 of the Particulars, it is stated that:

> "*The Plaintiff will aver that its need for the Debt Conversion and the Facility Agreement was as a direct result of the Defendant's gross negligence which resulted in the overdrawn status of its Merchant Client Account Accounts and was specifically required by the Defendant to resolve the said overdrawn Merchant Client Accounts.*"

15. Looked at, admittedly with the benefit of hindsight, these Particulars cannot sensibly be read as further elucidating the Plaintiff's case on causation of loss unless given the following interpretation. Although the Bank had indeed funded the losses complained off, FAC had actually suffered loss by reason of the liabilities it incurred by virtue of the Debt Conversion Agreement and the Facility Agreement. For convenience, FAC was treating the sums paid by the Bank as in fact paid by FAC. Absent this sort of liberal and purposive construction, it is difficult to see why the Bank would not have immediately complained that FAC's case on loss was as lacking in coherence as the Court had found it to be on the strike-out application.

Riihiluoma (AJ) in his Ruling dated August 26, 2004. The Further and Better Particulars were supplied on November 4, 2004.

[3] Summons dated September 15, 2006. I ordered a two-phased trial on September 20, 2006, but this Order was subsequently discharged.

[4] Ruling dated May 15, 2007.

16. On the contrary, the Bank consented on January 11, 2005 to FAC filing Amended Further and Better Particulars, which did not add complete clarity to this delicate aspect of its claim. The position remained that FAC claimed, in addition to other smaller sums, $5.8 million in respect of "offset losses" which it admitted were paid mostly by monies recovered from Nevis and, principally, provided by the Bank in return for the common and preference shares. It was, by necessary implication, asserted, that FAC's loss was (a) the liability it was forced to assume in respect of the shares (which approximated to the $4 million actually paid by the Bank for the shares) and (b) the Nevis recoveries (which it is implied could otherwise have been kept by FAC when, but for FAC being liable for them, it would never have made the recoveries at all!). The Further and Better Particulars also claimed legal fees reference the Nevis Action and arrangement, foreign currency and legal fees reference the refinancing. They also refer to the fact that the preference shares were redeemable and had a 10% coupon after three years.

17. While nowhere is it explicitly stated that FAC's loss is computed by reference to the liability assumed in respect of the preference shares, explicit claims for losses flowing from the refinancing agreement were made in November 2004. And the Particulars are incomprehensible (as regards at least $4 million out of the $5.8 million claimed) unless the liability in respect of the preference shares is taken into account. FAC did expressly complain that it was required to enter into the refinancing agreement to meet losses for which the Bank was legally liable.

18. The Bank appears to have taken this somewhat pragmatic view of the case FAC was advancing. Because in its initial Defence and Counterclaim dated February 4, 2005, the Bank (a) responded to the Further and Better Particulars of Statement of Claim by, broadly speaking, asserting that the refinancing agreement was validly entered into by FAC after receiving legal advice, so that it was estopped from denying its liability under the agreement, and (b) asserted a Counterclaim for dividends due under the preference shares. Thereafter FAC attempted to refine the legal basis on which it was contending that it was not bound by the refinancing agreement. The duress plea was eventually abandoned and replaced by the mutual mistake plea combined with an application for a declaration that the shares issued to the Bank be cancelled (Consolidated and Re-Amended Reply and Defence to Counterclaim, September 17, 2007). Although Ms. Dohmann characterised this plea as "stunningly hopeless", the Bank did not apply to strike it out. On the liability front, FAC had attempted to bolster its case by an estoppel by convention plea and by a plea that the Bank was in breach of an agreement to place the relevant sub-merchants' accounts into segregated cells, but these claims related to the same financial losses.

19. On September 28, 2007, James L. Gibbons on behalf of FAC wrote (without prejudice save as to costs) Philip Butterfield of the Bank and stated that FAC expected at trial " *to win damages in the region of US$6 million as claimed, succeed in having the preference and common share transaction set aside and have its costs (which are now over $3 million including those more recently incurred and not yet claimed) paid by the Bank…*" To save time and costs, Mr. Gibbons made the following proposal:

> "*(i) the Bank pays FAC $6.0 million; (ii) the Bank cancels the preference and common shares which it holds in FAC; (ii) each party bears its own costs…*"

20. By letter dated October 4, 2007, also without prejudice save as to costs, Mr. Butterfield made the following counter proposal:

> " *In order to resolve this matter before a lengthy and expensive trial, on behalf of the Bank, I offer FAC the return of all common and preference shares held by the Bank. This reduces FAC's claim by $4 million, the Bank having absorbed that part of the loss permanently…*"

21. Again, without prejudice save as to costs, FAC sought to extract a cash payment of $3 million on top of the shares, by letter dated October 9, 2007. By open letter dated October 10, 2007 to FAC's attorneys, the Bank's attorneys wrote that it was "*self-evident*" that FAC had suffered no loss. Further:

> "*We are instructed that in order to try and end this lengthy and extremely expensive litigation, our client will forthwith return to FAC the 500,000 common shares (for which it paid US$1 million on October 31st 2000) together with the 3 million class A convertible preference shares (for which it had paid US$3 million on the same date). Our client has no liability to return these shares, but no longer wishes to be a shareholder in FAC. The shares had and have no value, and our client has absorbed US$4 million of the losses claimed in any event, although it had and has no liability for those losses..*"

22. FAC's attorneys replied by open letter dated October 15, 2007 describing the offer as a capitulation, and indicating that apart from the $41.64 million recovered from the Nevis proceedings, FAC's additional losses were $792,135:

> "*In light of the Bank making good approximately 70% of FAC's losses…it is no longer sensible to incur the costs of a four week trial.*"

23. Having regard to the pleadings and the general course of this litigation, it seems clear that (a) FAC's claim has always been for damages in the region of $6 million, and (b) that the Bank's offer to return the preference shares and common shares (even though they obviously have no market value) substantially reduces the quantum of FAC's claim. But on October 10, 2007, FAC's pleaded case sought both nearly $6 million and cancellation of the shares. The suggestion that FAC was given all they had always been asking for is clearly bordering on absurd; but so is the suggestion that the Bank in returning the shares has given FAC absolutely nothing of value to the Plaintiff company.

24. I accept Ms. Dohmann's submission, that the issuance of the common shares created no liability for the issuing company, even though it doubtless diluted the value of the existing shareholders' shares: <u>Pilmer –v-Duke Group Ltd. (in liquidation) and others</u> [2001] 2 BCLC 773. So it is only the value of the liability assumed by FAC on the preference shares which falls to be taken into account. The best evidence of that value is FAC's own latest audited financial statements for the financial year ending January 31, 2006[5].

25. These financials suggest that 10% per annum dividends on the $3 million preference shares were due commencing November 1, 2003, which means that the liability on October 10, 2007 would have been over $1 million. The balance sheet shows a $3 million long term liability, and the notes explain that redemption is possible after November 1, 2010. Note 6 expressed management's hope that the preference shares would be cancelled by the Company "*as part of certain legal claims it has against the class A preferred shareholder.*" This emphasises the reality that, irrespective of how fuzzy the pleadings and Particulars were on this issue, cancellation of the shares formed part of FAC's intended relief long before the recent formal pleas were added in September 2007. And the Bank as a shareholder had actual or constructive knowledge of this.

26. Mr. Lyon suggested that because the Bank in correspondence had valued the impact of the return of the shares at $4 million, the Court was bound to accept this valuation. Much was said in the without prejudice save as to costs correspondence on both sides, that had more to do with tactical posturing than with an objective assessment of the real value of FAC's claim. However, when that claim is properly analysed, the bulk of the loss claimed was from the outset only potentially recoverable on the premise that FAC had incurred some liability through the debt for equity transaction. If the Bank had simply advanced the funds

[5] Affidavit of Venous Memari, Exhibit "VM-1", TAB 33.

to pay the offset charges, then FAC could only have claimed for losses over and above the $4 million loss “absorbed” by the Bank. Being sympathetic (it seems to me) to FAC’s plight, the Bank lent $4 million to FAC and converted that debt into equity. So FAC did legally pay the relevant offset losses with monies advanced by the Bank, but assumed roughly corresponding liabilities under the redeemable preference shares.

27. As long as the Bank held these shares, it was potentially open to this Court to hold that FAC had suffered loss by reason of the Bank’s breach of contract. Throughout most of the litigation, FAC’s claim for damages was based on the implicit premise that it had suffered substantial loss because the Bank was properly liable for the offset losses but had extracted the preference shares from FAC as consideration for funding those losses. This is necessarily the case irrespective of how the case was explicitly pleaded. Because the Bank’s suggestion in the October 10, 2007 open letter that it was “self-evident” that FAC had suffered no recoverable loss only in fact became self-evident when the Bank offered to relinquish the preference shares and for the first time “*absorbed the US$4 million losses, in any event.*” This ingeniously simple stratagem on the Bank’s part was seemingly only conjured up when, with the full financial and public relations implications of a four week trial coming into sharper focus, a high-level executive decision was reached to make FAC an offer it could not rationally refuse. The Bank could have assumed the risks of going to trial, and hopefully winning and gaining an automatic award of its costs of the action. Instead, at a comparatively late stage, it made an open offer (which could have been made at any earlier point in the action) which in practical terms made it un-commercial for the Plaintiff to pursue its remaining claims.

28. It would, with respect to Ms. Dohmann, be highly artificial to assess the value to FAC of what the Bank has offered as amounting to precisely the same value of what the Bank considers it has given up. The preference shares have no market value, and (without deciding this issue) appear to have no value for stamp duty purposes. But the parties have essentially been litigating over whether FAC or the Bank was legally responsible for paying the approximately $5.8 million of losses which was partially funded by a refinancing scheme consummated seven years ago. FAC contended that the Bank was liable, and the Bank contended FAC was liable. The Bank, without admission of liability, has agreed to accept responsibility for $4 million of those losses by returning to FAC, *in specie,* the principal consideration given by FAC in return for the Bank funding payments to the tune of $4 million made on FAC’s part. Recalling the wise words of Lightman J, “*success is not in my view a technical term but a result in real life, and the question as to who succeeded is a matter for the exercise of common sense*”, FAC has clearly achieved substantial success.

29. The ticklish question is to what extent has FAC succeeded, and how should the recovery made be assessed as a proportion of FAC’s total claim? It may be that in purely numerical terms that the shares represent 70% of FAC’s dollar-value claim. In this context, the merits of the claims which have not been adjudicated ought not to be taken into account. This analysis, even if it has some support in the company’s balance-sheet, seems to be far-divorced from a “real life” analysis of the extent of FAC’s success. I find the judgment of Bell J in *SCAL Ltd.-v-Beach Capital Management Ltd.* [2006] Bda LR 93 to be most illuminating on how the Court should approach apportioning costs in cases of partial success. The relevant question is not so much what percentage of the claim has been recovered (this may be more significant in determining who has “won”), but what percentage of the total costs have been expended on the issues which were decided in favour of the successful party. In the present case, the Bank has in substance conceded the very issue of recoverable loss which formed the subject of the successful aspect of its strike-out application.

30. This issue was an important issue, but in my judgment was less significant overall (in terms of the time and resources spent on it) than the various manifestations of the contractual liability issue. As a matter of first impression, I

felt that one-third of the parties' costs could fairly be attributed to the recoverable loss issue, at the highest. The Specially Endorsed Writ is predominantly concerned with liability issues rather than damage, but the Further and Better Particulars, which were later amended and which are as extensive as the original Statement of Claim, is devoted exclusively to the loss issue. Later amendments of the Statement of Claim deal with loss issues in more detail, and sometimes liability and loss issues are merged. But, as in the case of the Defence and Counterclaim, more attention is devoted to liability rather than quantum of loss issues.

31. At the pre-trial directions hearing on September 26, 2007, FAC's counsel submitted the Plaintiff's pre-trial timetable. This suggests that in terms of expert evidence, accounting evidence relevant to quantum was expected to occupy two days, the same amount of time as the credit card practice expert evidence relevant to liability. The Plaintiff's case was estimated to last two weeks, and most of the witnesses identified appeared clearly to be primarily witnesses as to liability. It seems more likely than not that no more than one-third of trial time would focus on the loss issue.

32. Using these informal tools as a rough and ready guide to the extent to which the loss issue contributed to the overall costs of the action, it seems to me that it is generous to the Plaintiff to assess the importance of this issue at one-third of the total costs.

33. When grappling with the challenges of defining a preliminary issue which might be determinative of the entire action, not only did my September 20, 2006 Order, essentially by consent, directing a Phase 1 and Phase 2 trial have to be discharged. Following a contested hearing, I directed a trial of certain other issues on January 12, 2007, and the parties subsequently agreed that these issues could not be isolated from other issues. This Order was later discharged. Mr. Martin raised the "no recoverable loss issue" as a possible discrete issue which might be tried in advance of a full trial, but both counsel agreed that this would not necessarily avoid the need for a trial on other issues altogether. This adds powerful support for the view that the loss issue has never in reality been the largest issue in this litigation; rather, it has always been a significant minor issue.

34. For the above reasons, I conclude that FAC has succeeded in part and should be awarded one-third of its costs of the action, to be taxed if not agreed. Leave to discontinue is granted on these terms. The Bank is granted leave to discontinue its Counterclaim, but I make no order as to the costs of the Counterclaim.[6].

Indemnity costs

35. FAC sought indemnity costs, an application which in my view was not warranted. This action arose out of a commercial relationship which seemingly went sour because of frauds committed by third parties who, at least arguably, the Bank was not primarily responsible for vetting. When the losses occurred, the parties worked together to manage the crisis but without (it appears) FAC formally releasing the Bank from any further liability.

36. FAC was bordering on insolvency, and clearly need the Bank's assistance to fund the losses. A loan might not have been repayable by FAC. The Bank accommodated by extending credit but converting its debt into equity. FAC belated decided that grounds to sue the Bank existed. The Bank no doubt felt aggrieved that what from its perspective was generosity was not appreciated. The litigation was fought vigorously, but in no sense improperly on the Bank's part. The Bank's offer came late, but in my judgment it was not an offer which clearly should have been made earlier.

[6] FAC's costs of dealing with the Counterclaim, if any, may be claimed as part of its costs of the action.

37. Both parties were in effect playing “chicken”, and the Bank blinked first. It is a major multinational institution with a reputation to protect. FAC is a comparatively small local company with, comparatively speaking, little to lose. Both parties have, one suspects, in their own way snatched victory from the jaws of defeat by avoiding what would have been an extremely costly trial. There is no basis for believing that the share transfer agreement which has brought these proceedings to a close could have been consummated earlier; with hindsight it is easy to speculate that the offer made could have been made and might have been accepted years ago, but indemnity costs are not to be awarded on such hypothetical grounds. Every case has its own settlement “tipping point”, and this one came at a late stage but not to late to enable an obviously significant savings of costs.

Summary

38. The Plaintiff is granted leave to discontinue its action, and is awarded one-third of its costs, to be taxed if not agreed, on the standard basis. The Defendant is granted leave to discontinue its Counterclaim, but no order is made with respect to the costs of the Counterclaim.

39. The Plaintiff has effectively succeeded because it was prompted to discontinue after the Defendant voluntarily assumed responsibility for roughly 70% of the loss which formed the basis of the Plaintiff’s claim. However, the Plaintiff, having succeeded in part, it became necessary to assess what proportion of the total costs the loss issue fairly represented. In my judgment the loss issue on which the Plaintiff succeeded represented no more than one-third of the entire case, based on a generous view (in the Plaintiff’s favour) of its actual importance to the case. Most of the costs, in terms of pleadings, legal analysis and evidence, were heavily loaded towards the liability side of this complex case.

Dated this 8th day of November, 2007

KAWALEY J.