In The Supreme Court of Bermuda

COMPANIES (WINDING-UP)

COMMERCIAL COURT

2011: No. 369

IN THE MATTER OF GEROVA FINANCIAL GROUP LIMITED

COMPANY NO: 44558

AND IN THE MATTER OF THE COMPANIES ACT 1981

JUDGMENT

(In Court)

Date of Hearing: June 21, 2012
Date of Ruling: July 6, 2012

Mr. Cameron Hill, Sedgwick Chudleigh, for the Petitioner

Mr. Martin Ouwehand, Appleby, for the Company

Introductory

1. On March 16, 2012 I made the following findings about the status of the Petitioner (by substitution-Maxim LLC ("Maxim")):

> "53. *Mr. Ouwehand advanced no convincing reasons as to why this Court should not determine this aspect of the standing issue at a hearing set down for two hours and which lasted a full day and in relation to which copious amounts of evidence had been filed.*

54. *It is common ground that Maxim was issued a promissory note on February 19, 2010 pursuant to a Settlement Agreement under which its obligation to pay Maxim an underwriting fee was deferred ("the Promissory Note"). Although the amounts said to be due and the due dates pleaded in the draft Amended Petition do not appear to me to perfectly match the terms of the Promissory Note (the pleaded amounts appear to be rounded down), it seems clear that at least $2 million is prima facie owed under the Note. Demand for payment was made on the last date specified in the Note (December 15, 2011) and the Company failed to pay the Note.*

55. *On December 16, 2011, CAC, the Company's friendly debt-purchaser, commenced negotiations to purchase the Note from Maxim. The evidence shows that although a written agreement was almost consummated, Maxim pulled out at the last minute as a result of a better offer. On January 12, 2012, CAC filed a Complaint in the Superior Court for the State of California (County of Los Angeles) seeking to enforce an alleged oral agreement concluded by CAC and Maxim for the purchase of Maxim's Note.*

56. *On February 2, 2012 at 3.35 pm, Maxim filed its Summons seeking to be substituted as Petitioner in this Court. The same day the Company filed a Complaint against Maxim in the United States District Court for the Southern District of New York seeking, inter alia, a declaration that the Promissory Note and related release (presumably given by the Company to Maxim in the Settlement Agreement) are 'unenforceable because they are the result of a mistake on the part of Gerova'. Other complaints are made about the alleged assignment by Maxim of the Note which do not appear relevant to present concerns save to note that it is asserted that the note was not legally capable of being assigned.*

57. *The standing of Maxim as a creditor petitioning on the basis of an undisputed debt is, implicitly at least, challenged on two inconsistent grounds. Firstly that it entered into an oral agreement to assign the Note to CAC which is legally enforceable. Secondly, it is alleged that the Note is unenforceable as against the Company and cannot according to its terms be validly assigned to a third party.*

58. *The evidence before this Court clearly shows that no binding assignment agreement was reached with CAC by Maxim. It is further impossible to regard the disputes raised by the Company about the validity of the Note after attempts by CAC to purchase it failed as being either substantial or raised in good faith.*

> 59. *I find that Maxim is an actual creditor with standing to be substituted under rule 27 of the Rules as Petitioner as submitted by Mr. Hill on Maxim's behalf. However, in the exercise of my discretion under rule 157 of the Rules, I postpone any final determination of how (if at all) any agreement entered into between Aramid and Maxim impacts on its status as a creditor until the hearing of the Petition because this matter was not fully addressed either by the evidence or by way of argument.*"

2. This is a hotly contested winding-up Petition at the centre of which lies the Company's assertion that the Petition ought to be dismissed in any event. This assertion is based on the grounds that Maxim's pursuit of the present proceedings is tainted by the improper collateral motives of Aramid Entertainment Fund Ltd. ("Aramid"), allegedly the driving force behind the Petition. In addition, the Company relies heavily on the fact that the only other creditors who have participated in the present proceedings at the hearing of the Petition stage have lent their support to the Company's position that the winding-up application should be refused.

3. The Petitioner's primary grounds for seeking a winding-up order are that the Company is insolvent on a cash-flow and balance-sheet basis and that as an unpaid creditor it is entitled to a winding-up order as of right. In the course of the hearing Mr. Ouwehand indicated, to substantiate the Company's assertions of solvency (it seemed to me), that if the Court was minded to make a winding-up order a short time should be afforded to enable the Company to tender payment.

4. Based on the evidence placed before the Court and the findings made on the substitution application, the position on the controversial issues appeared to me to be as follows:

    (a) Maxim's status as a creditor had already been determined and the challenges to that standing already rejected as neither *bona fide* nor substantial, subject to a residual discretion to stay or dismiss the Petition to allow the Company's cross-claim to be determined by ordinary civil action;

    (b) if the Company was unable or unwilling to pay Maxim in the event that the Court declined to require Maxim to defeat the Company's cross-claim in the pending US litigation, the Company would be insolvent on a cash-flow basis and, *prima facie*, entitled to a winding-up order *ex debito justitiae*;

    (c) the majority of the Company's creditors appeared to be content with the Company's management as the Petitioner had been able to garner no support for a winding-up order. This discretionary factor mitigated in the Company's favour;

(d) the Court should be cautious about making positive findings about the balance sheet solvency of the Company in the absence of both expert evidence and concerns expressed by independent creditors;

(e) the Agency Agreement entered into between Maxim and Aramid was an unusual commercial document which lent credence in circumstantial terms to the Company's contentions that the Petition was being prosecuted for collateral purposes;

(f) it was nevertheless somewhat unclear precisely how any such collateral purpose actually impacted on the relief sought by the Petitioner in the present proceedings.

Findings: should the Petition be dismissed because the Company has a cross-claim based on a breach by Maxim of the non-assignment clause and/or because Maxim lacks sufficient interest in the proceedings and/or because the proceedings are being pursued for a collateral purpose?

The Agency Agreement

5. It is important to recall the findings that I reached on the hearing of the substitution application with respect to Aramid and its interest in petitioning to wind-up the Company:

> "*38.It might be said that the nature of the Petition, asserting 'real' insolvency and a positive case for winding-up would not entitle Aramid to seek payment of its debt at the expense of other creditors. However, if Aramid was acting reasonably, having regard to the only status it relied upon in presenting the Petition, that of a comparatively modest creditor with a presently due claim, it would surely have been more interested in obtaining payment than in actually winding the Company up. Aramid would have threatened to present a petition before it did so, and the Company could then have either ignored the threat or taken immediate steps to either pay the judgment debt or to apply to set it aside. It did none of these things, it is obvious, because its primary goal was to pursue its far greater interests either:*
>
> *(a) as a potential judgment creditor in relation to the tort claims being pursued before the NY Court; or*
> *(b) as a contingent creditor without having to pass through the section 163 (1)(c) filter.*
>
> *39.I say this is obvious because Aramid took an assignment of the Seal Claim on October 7, 2011, having commenced proceedings in the NY*

Court against the Company on or about July 25, 2011[1]. If it believed the Company to be insolvent, it is difficult to see what motive it would have for acquiring the Seal Claim save to enable it to petition as an actual creditor as it did exactly one month later. The chronology and the zeal with which Aramid has pursued a liquidation of the Company leads to the irresistible inference that its primary interests were motivated by its passive potential judgment creditor status rather than its active actual creditor status. I need not decide whether Aramid is in fact a contingent or prospective creditor, a point which was not fully argued and which is not easy to decipher from the evidence. At best its status as such is subject to doubt.

40.I am unable to find that its conduct constituted an abuse of process in that the 2nd Petitioner petitioned motivated by a collateral purpose in the legal sense described above. It is not presently clear what specific benefit (if any) Aramid would acquire from a winding-up which unsecured creditors generally would not also acquire. Mr.. Ouwehand was unable to effectively respond to Mr.. Hill's challenge to identify such a benefit.

41.Nevertheless, the cumulative effect of the intensive tactical manoeuvring which Aramid has deployed in relation to its prosecution of the present Petition passes a tipping point which requires this Court to find that it has acted unreasonably and should not be awarded its costs in relation to its abortive Petition."

6. Aramid took an assignment of a debt from one of the Company's judgment creditors and without making a demand for payment petitioned to wind-up the Company shortly after asserting a more substantial claim against the Company in ordinary litigation in the United States. When that debt was paid, Aramid turned to the Petitioner which had a debt based on a Promissory Note which could not be assigned. It concluded an Agency Agreement on January 13, 2012 which had the following essential elements to it:

    (a) Maxim, the Petitioner, received a non-refundable payment of $750,000;

    (b) Aramid was entitled to retain whatever was collected up to $2 million and its collection costs while Maxim was only entitled to 10% of whatever was collected in excess of $2 million (or a maximum of $25,000 net);

    (c) Aramid was exclusively entitled to control the collection proceedings.

[1] Exhibit "DLM-2/45" to the Second Molner Affidavit.

7. In practical terms, this agreement was an artful way of sidestepping the non-assignment clause in the Note which formed the basis of Maxim's claim, in circumstances where Maxim's stated reason for the agreement was its desire to collect combined with its reticence about pursuing litigation in Bermuda. Maxim received $750,000 up front for a claim against a company which might end up in liquidation and yield far less than 100 cents on the dollar by way of dividends paid. Aramid assumed the risk of a downside minimal return from such liquidation and the upside of a potential net recovery (after costs and taking into account the $750,000 paid to Maxim) as high as $2 million. Although the control clause appeared designed to ensure that Maxim could not be bought off as other Petitioners had been in the past, it was entirely consistent with the commercial risk being assumed by Aramid in pursuing the Petition on Maxim's behalf.

8. Mr. Ouwehand rightly submitted that the Agency Agreement went beyond the bounds of the sort of litigation funding agreement which would be recognised in England and Wales. He further contended that Maxim had been divested of any significant on-going commercial interest in the Note. Accordingly the Petition was now being prosecuted exclusively for the benefit of Aramid, which had its own collateral interests arising out of a suit commenced against it in California by entities connected to the Company. The Chairman of Aramid, David Molner, is said to have a long-running feud with the Company. The Company asserted that the Petition should be dismissed because:

    (a) (in addition to the cross-claims this Court has already rejected as lacking in substance) the company had a cross-claim against Maxim for breach of the non-assignment clause;

    (b) The pursuit of the Petition constituted an abuse of process because of Aramid's collateral purpose (Mr. Ouwehand recanted from the submissions set out in his Skeleton Argument to the effect that the Agency Agreement was void by reason of maintenance and champerty. He invited the Court not to consider the wider implications of the Agency Agreement beyond the confines of the unique circumstances of the present case and Aramid's improper collateral purpose).

9. Mr. Hill for the Petitioner submitted that the Court had already determined that a debt was due and owing to Maxim and, despite the Agency Agreement, only Maxim could receive payment. This was a commercial interest in the claim upon which the Petition was based. The Agreement did not operate in law or in equity as an assignment. It was suggested that having regard to the fact that Aramid's New York claim against the Company had been dismissed no specific collateral or improper purpose had been identified.

Counterclaim based on breach of non-assignment agreement

10. The Company sought to rely upon the affidavit of one its own New York lawyers to support a finding that the Petition should be dismissed to allow this dispute to be determined through ordinary civil litigation. No leave was granted for expert evidence as to foreign law, so the Court is required to proceed on the assumption that Bermudian law is the same as the relevant foreign law. The Court is also mindful of the fact that it has already concluded that the Company has raised spurious counterclaims in response to the present Petition.

11. On the facts before me I did not find this argument to be sufficiently substantial to justify the Court exercising its discretion to stay or dismiss the Petition so this counterclaim could be pursued. Firstly the Agency Agreement does not by its terms operate as an assignment. Secondly it seems to me fundamentally unjust to refuse to pay a debt the Court has already found to be due and payable in substance because the creditor has arranged to share the proceeds of the debt with a third party funder. The fact that the third party funder has entered into what seems to Bermudian legal eyes to be a somewhat unusual funding arrangement borne of collateral disputes with the Company does not negate the fact that Maxim's debt is due and owing.

Sufficient interest and improper purpose

12. I find that Maxim has sufficient interest in the present proceedings to seek a winding-up order *ex debito justitiae* as an unpaid creditor with a presently due debt. Although it seems likely that any payment it actually receives from the Company will be remitted to Aramid under the terms of the Agency Agreement, it has received $750,000 from Aramid on the express and/or implied basis that it will pursue to the fullest its rights as a creditor of the Company. This must constitute a sufficient interest to seek a winding-up order as of right as the unpaid creditor of a company which maintains that it is solvent both in balance-sheet and cash-flow terms.

13. On the other hand, if the Company tenders payment, as Mr. Ouwehand astutely offered to do if the Petition was not otherwise dismissed, it is difficult to see what legitimate interest Maxim would have in insisting that a winding-up order be made in any event in circumstances where:

    (a) there is no evidence that a liquidation is desired by any other (let alone the majority of) unsecured creditors;

    (b) there is no clear and/or independent evidence of balance-sheet insolvency;

(c) there is no credible basis on which any payment made to Maxim to defeat the present Petition and procure its dismissal could be set aside in any subsequent liquidation of the Company.

14. In these circumstances it would in my judgment be clear as a matter of inference that Aramid was using its control of the present proceedings pursuant to the Agency Agreement not for the legitimate purpose of maximizing the return achieved by Maxim but for some collateral purpose unconnected with:

    (a) Maxim's status as an unpaid unsecured creditor; and

    (b) Aramid's legitimate ancillary rights pursuant to the Agency Agreement.

15. The commercial background against which the present proceedings take place appears to me to be highly contentious and probably largely lawyer driven. All of the principal parties affected by a failed corporate venture appear willing to make damning judgments against each other and commence or threaten legal proceedings at the drop of a hat. In this very rough and tumble commercial environment, it would be a disproportionate response to the admittedly strong circumstantial evidence that Aramid's involvement in the prosecution of the present Petition is for collateral purposes of its own to find that such involvement is so unconscionable as to vitiate the legitimate unpaid petitioning creditor's rights altogether. Rather the Court should decline to grant Maxim relief which goes beyond the proper scope of the Petition and the overt standing upon which the Petitioner relies.

16. I adopt by way of analogy the approach to determining whether an applicant for discretionary injunctive relief should be declined such relief applying the "clean hands" doctrine. As I observed in *OAO "CT-Mobile"-v-IPOC International Growth Fund et al*[2006] Bda LR 69 (at paragraph 90):

> "*The present legal contest, after all, is not a mediaeval jousting contest where honour trumps all. It is more akin to a professional football match between rival teams with a history of previous grudge matches, with each side fielding players not averse to committing the occasional professional foul. The referee of such a match is required to have a sense of proportionality, waving an occasional yellow or red card, perhaps, but saving the ultimate sanction of effectively awarding the match to one side by default only for the most grave of circumstances. Although equitable rules are, historically, grounded in mediaeval notions of religious conscience, courts of equity have always sought to deliver real world justice, to saints and sinners alike.*"

17. When the Court is considering whether or not to exercise its discretion to grant a winding-up order and abuse of process is alleged, even where the grounds relied upon are insolvency rather than the "just and equitable ground" itself, the approach adopted to the grant of "purer" forms of equitable discretionary relief may be followed as a useful guide.

Findings: balance-sheet insolvency, loss of substratum and views of other creditors

18. Mr. Hill launched a powerful and persuasive attack on the balance-sheet solvency of the Company, the loss of its substratum and the status of at least two supporting creditors as unsecured creditors. I decline to make specific findings on his submissions in this regard, for the following reasons.

19. Firstly, it is usually unwise for a court to make findings as to balance-sheet solvency in a contested hearing without the benefit of independent expert evidence. But in the present case it seems to me that such findings are ultimately not necessary. Maxim has been found on the hearing of the substitution application to be an unpaid creditor with a presently due debt. As the Court has declined to dismiss or stay the Petition to allow the Company to pursue its dubious counterclaims against Maxim, the failure to pay Maxim's debt will itself provide the requisite proof of insolvency.

20. I got the distinct impression, however, that the balance-sheet insolvency case was primarily advanced to explain why, if the Company tendered payment, Maxim could not properly accept payment. Such an argument will often carry weight but only where one can credibly point to other creditors who will arguably be prejudiced by a petitioning creditor being preferred in circumstances where it seems inevitable that the company will be wound-up. In the present case all of the creditors of any significance appear to be insiders of one sort or another.

21. The case for independent management is not being advanced by any other creditors of a company which all concerned well know has not been able to fulfil its original commercial purpose and whose management is trying to wind-down operations without incurring the expense of a formal liquidation process. Moreover, it is ordinarily for shareholders not creditors to raise loss of substratum complaints.

22. Bearing in mind that the present proceedings have been advertised and that the Company has been able to successfully canvass support for its position while the Petitioner has not, Maxim has no plausible basis for seeking a winding-up order save on the grounds that it is itself an unpaid actual creditor entitled to a winding-up order as of right. The fact that the Company has arguably lost its substratum and/or is insolvent on a balance-sheet basis is neither here nor there in 'real world' commercial terms. The remedy of winding-up is a draconian one, not to be exercised on artificial or technical grounds.

23. Some creditors who oppose the petition appear to be secured; others are unsecured. Mr. Hill sought to discount the unsecured creditors as "connected" parties whose views ought not to be taken into account. As I have already observed, it is far from clear to me what creditors exist which are likely wholly unconnected. Neither Maxim nor its agent Aramid would pass any rational "unconnected" test.

24. The Court is bound to conclude that some unsecured creditors have been willing to positively support the Company's position that a winding-up would not be in the interests of the general body of unsecured creditors. In summary, there is no positive evidence that the majority of creditors favour a winding-up. There is positive evidence that at least some unsecured creditors favour an out of court "work-out" or "wind-down".

Findings: could Maxim properly decline to accept any tender of payment on the grounds that any such payment is liable to be set aside in any subsequent liquidation of the Company?

25. It is well settled that the payment under commercial or legal pressure of a valid debt will not constitute a fraudulent preference. I find no substance to the submission that Maxim could not accept any payment tendered with a view to settling the petition debt and bringing the present proceedings to an end. The Petition has been advertised and no creditors have appeared in support of the Petition.

26. It is difficult to envisage any seriously arguable basis on which any payment made in the present circumstances could be set aside (as between the Company and Maxim) in any subsequent liquidation.

Findings: the Company should be wound-up if it does not pay or secure the Petition debt within such time as may be directed by the Court or agreed

27. Andrew Keay's '*McPherson's Law of Company Liquidation*', 1st English Edition at paragraph 3.67, refers to:

> "*the rule that a petitioner who can prove that a debt is un paidand that the company is insolvent is entitled to a winding-up order ex debito justitiae, which has been taken to mean that, in accordance with settled practice, the court can exercise its discretion in only one way, namely by granting the order sought…*"[2]

28. The Company owes Maxim the sums due under the Promissory Note which forms the basis of its substitution as petitioning creditor in the present proceedings. This finding was made at the hearing of the substitution application on March 16, 2012: *Re Gerova*

[2] Second Edition, paragraph 3.033. None of the limited exceptional grounds for refusing to make an order apply to the present case.

Financial Group Ltd [2012] SC (Bda) 18 Com (19 March 2012). Maxim has sufficient interest in the Petition to seek a winding-up order as an unpaid creditor, although I would decline to exercise my discretion in favour of granting an order on any other ground.

Conclusion

29. The Petitioner is entitled to an order that the Company be wound-up, but solely on the grounds that it is unable to pay Maxim's debt which is presently due and payable. As the Company sought an unspecified period of time within which to effect payment of the Petition debt should the Court find that such debt was presently due, I will hear counsel as to how much time should be afforded for this purpose and as to costs.

Dated this 5th day of July, 2012 _____
IAN RC KAWALEY CJ