In The Supreme Court of Bermuda

(COMMERCIAL COURT)

CIVIL JURISDICTION 2009: 178
AND
CIVIL JURISDICTION 2009: 374

(Consolidated by Order of the Court dated 26 November 2009)

IN THE MATTER OF CLASSES B, C, H, I AND L OF NEW STREAM CAPITAL FUND LIMITED
AND IN THE MATTER OF SECTION 19 AND 20 OF THE SEGREGATED ACCOUNTS ACT 2000

BETWEEN:

(1) BNY AIS NOMINEES LIMITED (as nominees for each of the 2nd to 6th Plaintiffs)
(2) GOTTEX ABL (CAYMAN) LIMITED
(3) GOTTEX ABI MASTER FUND LIMITED
(4) GOTTEX MATRIX ASSET FOCUSED MASTER FUND LIMITED
(5) HUDSON ABL FUND LIMITED
(6) GVA ABL PORTFOLIO LIMITED

Plaintiffs

-And-

NEW STREAM CAPITAL FUND LIMITED

Defendant

RULING ON COSTS
(in Chambers)

Date of hearing: November 8, 2012

Date of Ruling: November 15, 2012

Mr Jan Woloniecki and Ms Kehinde George, Attride-Stirling and Woloniecki, for the Plaintiffs
Ms Kiernan Bell, Appleby (Bermuda)Ltd, for the Joint Receiver of the Defendant's Classes B, H, L, E, K, N and O (the "NSSC Classes")
Ms Nicole Tovey, Trott and Duncan Ltd, for the Receiver of the Defendant's Classes C, I and F ("the NSI Classes")

Background

1. The Defendant ("the Company") is a segregated accounts company. On May 27, 2010, I delivered a Judgment in favour of the Plaintiffs and determined that it was just and equitable that a Receiver be appointed in respect of Classes C and I which they owned 100%[1]. Mr John McKenna was appointed Receiver of C and I Classes on the same date. The final paragraph of the Judgment reads as follows:

> "*208. I will hear counsel as to the terms of the formal order to be drawn up to give effect to this Judgment. Unless either party applies by letter to the Registrar within 21 days to be heard as to costs, I would award the costs of the consolidated action to the Plaintiffs to be taxed if not agreed on the standard basis.*"

2. However when an 'Interim Declaratory Order' was signed on June 18, 2010, paragraph 3 provided: "*Costs reserved, with liberty to the Plaintiffs to apply for costs in their favour, in the event that these are not agreed with the Defendant*". Thereafter, as far as the Company and its original management are concerned, the sky fell in.

3. On July 10, 2010, Mr McKenna was appointed Receiver of the third insurance-related share class, Class F. On the same date Mr Michael Morrison and Mr. Charles Thresh were appointed Joint Receiver of the NSSC Classes. On September 13, 2010, Messrs Morrison and McKenna, together with Mr Charles Thresh, were appointed Joint Provisional Liquidators of the Company.

4. The Plaintiffs did not issue their Summons for costs until June 21, 2012. It is not seriously arguable that they waived their right to make the present application. Nor is

[1] [2010] Bda LR 34 ; [2010] SC (Bda) Com (27 May, 2010).

it seriously arguable that as successful litigants they ought not to be awarded their costs. Controversy substantially centres on against whom the costs order should be made having regard to the fact that the Company is a segregated accounts company. Looked at most broadly, the choices are between the Company's (presumably illiquid) general account and all or some of the Company's segregated accounts in which all of the Company's real value lies.

5. This is a point that has not seemingly been addressed by this Court, or indeed by any other court. The point was not addressed prior to Judgment. It calls for an analysis of the central question of whether the liability for costs in relation to the litigation unsuccessfully contested by the Company may be said to be linked to one or more of the Company's segregated accounts.

6. If this question is answered in the negative, it seems clear that the Plaintiffs are only entitled to enforce the costs order to which they are entitled against the Company's general account. If the costs liability is linked to one or more segregated accounts, a subsidiary (and more knotty) question is whether the Plaintiffs' own accounts are liable to contribute to paying their own costs.

7. These questions do not simply engage the provisions of the governing legislation. Regard must also be had to the Company's governing instruments, the nature of the litigation and the available evidence of how the Company funded its defence of the Plaintiffs' claims.

Relevant provisions of the Segregated Accounts Companies Act 2000 ('the Act")

8. Section 17 of the Act provides in material part as follows:

> "*17 (1) Notwithstanding any other provision of this Act, the establishment of a segregated account does not create a legal person distinct from the segregated accounts company.*
>
> *(2) Notwithstanding any enactment or rule of law to the contrary, but subject to this Act, any liability linked to a segregated account shall be a liability only of that account and not the liability of any other account and the rights of creditors in respect of such liabilities shall be rights only in respect of the relevant account and not of any other account, and, for the avoidance of doubt, any asset which is linked by a segregated accounts company to a segregated account—*

> *(a) shall be held by the segregated accounts company as a separate fund which is—*
>
> > *(i) not part of the general account and shall be held exclusively for the benefit of the account owners of the segregated account and any counterparty to a transaction linked to that segregated account, and*
> >
> > *(ii) available only to meet liabilities to the account owners and creditors of that segregated account; and*
>
> *(b) shall not be available or used to meet liabilities to, and shall be absolutely and for all purposes protected from, the general shareholders and from the creditors of the company who are not creditors with claims linked to segregated accounts.*
>
> *(3) For the purposes of this Act, the Companies Act 1981 and otherwise at law, the assets recorded in the general account shall be the only assets of a segregated accounts company available to meet liabilities of the segregated accounts company that are not linked to a segregated account....*"

9. This provision lies at the heart of the segregated accounts company legal framework. The assets of segregated accounts "*shall be absolutely and for all purposes protected from, the general shareholders and from the creditors of the company who are not creditors with claims linked to segregated accounts*" (section 17(2) (b)). "*Linked*" is defined as follows in section 2 as follows:

> "*'linked' means referable by means of—*
>
> *(a) an instrument in writing including a governing instrument or contract;*
>
> *(b) an entry or other notation made in respect of a transaction in the records of a segregated accounts company; or*
>
> *(c) an unwritten but conclusive indication,*
>
> *which identifies an asset, right, contribution, liability or obligation as belonging or pertaining to a segregated account...*"

10. Section 18 of the Act, so far as is material, provides as follows:

> "*(7) A segregated accounts company may—*
>
> > *(a) sue and be sued in respect of a particular segregated account, and service of process upon the company in accordance with subsection (9) shall be sufficient;*
> >
> > *(b) be sued for debts and other obligations or liabilities contracted or incurred by the company in respect of a particular segregated account, and for any damages to persons or property resulting from the negligence of the company*

> *acting in the performance of duties with respect to that account;*
>
> *(c) exercise the same rights of set-off (if any) as between accounts as apply under the general law in respect of companies, including, on an insolvent liquidation of the company, the same rights of set-off which arise in an insolvent liquidation of a company.*
>
> *(8) The property of a segregated account is subject to orders of the court as it would have been if the segregated account were a separate legal person (and notwithstanding that it is not a separate legal person).*
> *(9) A segregated accounts company may be served with process in the manner prescribed in section 62A of the Companies Act 1981 in all civil actions or proceedings involving or relating to the activities of a segregated account or a breach by the company of a duty to the segregated account, or to any account owner thereof or to a counterparty to a transaction linked thereto.*
>
> *(10) Except to the extent it may be agreed otherwise by virtue of the governing instrument or contract, as the case may be, an account owner of a segregated account and any counterparty who is a creditor in respect of a transaction linked to that segregated account shall have an undivided beneficial interest in the assets linked to a segregated account, and, after satisfying in full the claims of creditors of the segregated account, account owners shall share in the profits and losses of the segregated account in such proportions of the residual undivided beneficial interest in the segregated account owned by that account owner as may be specified in any governing instrument relating to such segregated account....*"

11. The quoted provisions from section 18 are very much subsidiary to the previously quoted provisions of section 17. The dominant principle is that the assets of segregated accounts are protected from liabilities which are not linked to the relevant account. As Ms Bell and Ms Tovey both pointed out, any doubts must be resolved in favour of restricting the liability of the segregated accounts. Subservient to this dominant principle, however, are the facilitative provisions of section 18 (7)-(9). A segregated accounts company may be sued in respect of a particular segregated account, in respective of liabilities linked to such account.

12. Further, the starting statutory presumption is that account owners (and creditors in respect of linked transactions) have "*an undivided beneficial interest in the assets linked to a segregated account*" (section 18(10)).

13. Counsel for each Receiver rightly pointed to this provision as demonstrating that there was no legal basis for costs to be awarded against only such portion of the assets in accounts in which the Plaintiffs were interested which were attributable to the ownership interest of other account owners.

The governing instruments

14. Mr Woloniecki submitted that the following provision in the Company's Prospectus provided a sufficient basis for linking the costs liability in relation to the present action to the various segregated accounts:

> "*The Company will bear all administrative fees and expenses relating to the operation of the Company, including, but not limited to, costs related to the purchase, holding, or sale of notes, consulting fees, brokerage fees, investment expenses, legal, accounting, third party administrative and other direct expenses, expenses incurred in connection with the continuing offering of the Shares after the Initial Closing and any extraordinary expenses. Such operating expenses will be pro rated between each of the Segregated Accounts.*
>
> *Joint expenses will be allocated on a pro rata basis between the Segregated Accounts. Expenses unique to one Class will be allocated solely to its linked Segregated Account.*" [emphasis added]

15. Ms Bell answered that although the directors were empowered by the Bye-laws to allocate litigation expenses, this had never occurred. Bye-law 4 (6) (f) provides as follows:

> "*the Directors shall (for the avoidance of doubt, without further requirement to obtain the consent of the Account Owners) have power and discretion (and, where applicable in accordance with sub-sections 11(4) and 17(5) of SACA) (i) to allocate any liability among the Funds and the general account of the Company and to determine the basis of such allocation...and to vary any such allocation from time to time...*"

16. Although the Directors[2] never appear to have formally exercised their discretion in relation to allocating the expenses of the Company in respect of defending the present litigation, it was conceded that the Managers in fact allocated the expenses on a *pro rata* basis across all accounts including the Plaintiffs accounts. This was consistent with what was contemplated by the Prospectus and the Bye-laws, assuming that the litigation itself was in fact linked to all segregated accounts.

17. The litigation was clearly brought with the consent of the directors, one of whom appeared as a witness at the trial. If the directors expressly or impliedly approved the litigation and the Managers administratively allocated the defence costs to each segregated account, it seems more likely that the directors approved this allocation than it does that they did not. I can find no rational basis for the inference that the Company embarked upon contesting litigation of such commercial significance, in relation to which they retained London Leading Counsel, without the Company's guiding minds consciously considering who would foot the bill.

[2] Bye-law 58(1) permits the directors to delegate "*any of the duties, powers and discretions exercisable by the Directors*" to the Manager. It was not suggested that formal Board approval would have been required for each and every expense allocation. The litigation was clearly brought with the consent of the directors, one of whom appeared as a witness at the trial.

18. In summary, the governing instruments of the Company contemplated:

    (a) that expenses incurred by the Company would be shared *pro rata* by all account owners unless the relevant expenses were only linked to one or more specific account; and

    (b) that the directors were empowered, without being required to obtain account owner (ie shareholder) consent in each case, to allocate liabilities among the various segregated accounts.

19. Whether the costs liability in respect of the present action was in fact linked to all, some or none of the segregated accounts ultimately turns on an analysis of the nature of the claims asserted in the litigation in question.

Were the Plaintiffs' claims linked to one or more or none of the segregated accounts?

20. It is self-evident that the Company's defence of the Plaintiffs' claims was based on the following key facts and matters:
    (a) the validity of the Plan which was purportedly entered into by the Company's management in relation to all share classes; and

    (b) the commercial premise that the Plan was in the best interests of all share classes/segregated accounts as a whole.

21. In my Judgment, I declined to grant a declaration that the entire Plan was of no legal effect because this relief appeared to be beyond the necessary scope of the Plaintiffs' case as C and I class shareholders (paragraphs 171, 205). However, on November 26, 2011 on the application of the Joint Receivers themselves, this Court ordered that:

> "*1. the purported plan of restructuring proposed and purportedly implemented on an amended basis in May 2009 by New Stream Capital Fund Limited...to investors in the segregated account classes is void and has no effect in respect of any of the segregated account classes or their creditors or account owners either inter se or at all...*"

22. The Plaintiffs' action was formally brought against the Company without specifying in the action title that the claims were asserted not simply against the Company (and, by implication, only in respect of its general account); not simply against the Company in respect of the Plaintiffs' own accounts; but rather against the Company in respect of all share classes and segregated accounts. Having granted substantive relief based on the premise that that Plaintiffs' action was brought against the Company to challenge the validity of an out of court restructuring plan involving all of the company's segregated accounts, it is now too late to contend for the purposes of costs that the claims were asserted against the general account alone. Such a contention is, in any event, wholly unsupportable having regard to the true character of the present proceedings.

23. I find that the claims asserted by the Plaintiffs in the present action were linked to all of the Company's segregated accounts because:

(a) the claims sought to impugn and successfully impugned the validity of a restructuring purportedly implemented by the Company's management on behalf of all of its segregated accounts; and

(b) the Company's management allocated the costs of defending the action on a *pro rata* basis against all segregated accounts in a manner which was consistent with both the governing instruments and the basis on which the liabilities were incurred.

Findings: appropriate costs order

Should the Plaintiffs be awarded their costs?

24. The Plaintiffs contended that any costs order should achieve the result that no costs should be levied against any interest owned by the Plaintiffs in a segregated account. The Joint Receivers submitted that if it were held that any costs order was enforceable against the assets in a segregated account, the costs should be payable on a *pro rata* basis by all accounts (including the Plaintiffs' own segregated accounts). In particular, it was argued (by reference to section 18(10) of the Act) that the Court had no jurisdiction to apportion liability within a segregated account.

25. It is easy to conclude that the Plaintiffs should be entitled to an award of costs in relation to an action they have successfully pursued against the Company and that such costs should be treated, to some extent at least, as a liability of the segregated accounts.

Should the Plaintiffs' interests in any jointly owned segregated accounts be exempted from making any contribution to the Plaintiffs' costs?

26. It is comparatively straightforward to conclude that this Court has no jurisdiction, on the facts of the present case at least, to award costs in favour of the Plaintiffs by imposing a liability only on that portion of the accounts which they do not own outright. The Plaintiffs only succeeded based on their status as 100% owners of Class C and I.

Should Classes C and I be exempted from contributing to the Plaintiffs' costs?

27. It is rather more difficult to analyse whether the cost burden should be borne by all classes save for C and I (along the lines of how the Managers told the Company's former Bermudian attorneys defence costs were being allocated) or whether C and I should bear a *pro rata* share of the expense as a legal expense (as contemplated by the Prospectus and as allocated in fact by the Managers during the litigation).

28. Ms Bell drew the interesting analogy of a shareholder claim against a traditional company seeking to invalidate a restructuring. If the shareholder succeeded and obtained a costs order, such order would be payable by the company out of its assets and with the indirect commercial effect of the costs order on the company's shareholders being borne equally by all shareholders- including the successful litigant. This was entirely logical because the successful litigant shareholder would enjoy

equally alongside other shareholders any future benefits flowing from the relevant proceedings which the company 'lost'. In the segregated accounts company context, she argued, there was no reason why the Plaintiffs-*qua* account owners- should not share in funding the costs to the Company of their successful proceedings.

29. The attribution of expenses in the segregated accounts company context must in my judgment always be informed by the dominant principle that while all account owners must expect to share equally the ordinary operating expenses of the corporate vehicle which all investors are using, where any expense is incurred by that shared vehicle in respect of one or more particular accounts only, no liabilities incurred in respect such specific accounts should be attributed to unconnected accounts. This principle, derived from the Act and the governing instruments of the Company, may be illustrated most clearly in the following scenarios where one assumes that governing instruments similar to those in the present case also exist.

30. **Scenario A**: a Bermudian segregated accounts company has three classes of shares. Class A invests in shares in a Delaware company; Class B invests in shares in a UK company; and Class C invests in shares in a Hong Kong company. The Class A investment fails because fraudulent misrepresentations in the prospectus of the Delaware company. The Bermudian company sues the promoters of the Delaware company. Which share classes would be liable to pay the costs incurred by the company in pursuing this litigation? It seems quite obvious that the liability in respect of the company's litigation costs could only be allocated to Class A account owners. An express agreement that all shareholders would share litigation expenses irrespective of which specific account the litigation related to would be required to justify a contrary result;

31. **Scenario B**: Modifying Scenario A somewhat, Class A shareholders sue the segregated accounts company, its directors and the managers for conspiring with themselves and the promoters of the Delaware company to defraud the Class A shareholders of their investment monies. The company's managers invite Classes B and C to contribute to a fighting fund to defend 'these outrageous claims' and 'protect the good name of the company'. Classes B and C refuse to make any contribution on the grounds that the liabilities in question are not linked to their accounts and it makes no difference to their commercial interests what position the company adopts in the litigation in question. In this scenario as well it seems fairly clear that Classes B and C ought not in principle to be held liable to contribute to expenses incurred by the company in relation to transactions which are exclusively linked to Class A accounts;

32. **Scenario C**: modifying Scenario B somewhat, Class A shareholders win their suit against the Company and its management and are awarded, *inter alia*, costs. The general account being virtually empty, the successful plaintiffs seek to enforce their judgment against the assets of the Class B and C accounts. The company would surely succeed in establishing that any Class A judgment against it was not enforceable against Class B and C assets. Its costs of defending such enforcement action would be an expense which could clearly be allocated to Classes B and C as it was incurred for the benefit of those investor classes. But would Class A be required to share *pro rata* in those expenses as well, even though their interests were engaged in an adversarial manner in the relevant litigation? This question does not yield such a ready answer.

33. If one returns to Ms Bell's helpful analogy of a traditional company, however, it is instructive to recall that the shareholders contribute capital which is pooled to provide the initial operating capital of the company. If a shareholder has a dispute with the company in his capacity as a shareholder, he cannot complain that funds he contributed to the company are being utilised by the company to fund the company's defence costs. Moreover, if our notional shareholder obtains a costs order against the company, he can hardly complain if that costs order is satisfied by the company directly or indirectly out of operating capital invested by the successful plaintiff himself into the company.

34. The company must fund its operating expenses somehow; it is not for the company's management to fund operating expenses out of their own pockets. Such expenses must be paid out of capital invested by the shareholders or generated on the platform of such initial capital as income from the company's business operations.

35. These principles in my judgment must apply with equal practical force to the sphere of segregated accounts companies, subject to the modification that some expenses will clearly be linked to all accounts while others will be linked solely to some accounts (and subject, of course, to the terms of any *sui generis* governing instruments) . Only where liabilities are incurred which are not linked to any segregated account at all will the claim be enforceable solely against the company's general account. Such claims would probably include most liabilities incurred by the segregated accounts company to third parties in relation to its basic operations (as opposed to its primary business activities), under transactions such as:

    (a) a lease for the company's commercial premises;

    (b) contracts of employment;

    (c) management contracts.

36. In the present case the Plaintiff owners of Classes C and I are entitled to recover costs in relation to an action brought to challenge the validity of a transaction purportedly entered into by the Company on behalf of all of the Company's share classes, including Classes C and I. The costs liabilities attached to the litigation (both defence costs and adverse costs orders) were accordingly linked to all segregated accounts. It accordingly follows that these costs are expenses, perhaps extraordinary expenses, which the Prospectus contemplated would be allocated across <u>all</u> accounts on a *pro rata* basis.

37. It may at first blush seem odd that the result should be that Classes C and I must contribute to the Company's costs of defending litigation brought by their owners against the Company in which the account owners have succeeded in establishing the invalidity of the Company's impugned conduct. But on closer scrutiny, this result is entirely consistent with the implicit bargain which was consummated when the Plaintiffs invested in the Company; and this conclusion follows logically from the analysis advanced by Mr Woloniecki in rebuttal of the proposition that any costs order was only enforceable against the Company's general account.

38. While the traditional corporate model helps to support this conclusion, it is also necessary to take note of an equally important legal distinction between a shareholder in a traditional company and an account owner of a segregated account. A traditional shareholder is a legal person who can sue in his own name to assert his share rights. The traditional company has no right to sue or be sued on behalf of its shareholders, and has a legal personality entirely separate and distinct from them. Segregated accounts do not have a separate legal personality (section 17(1)). Moreover, section 18(7) (a) of the Act expressly provides that a segregated accounts company may "*sue and be sued in respect of a particular segregated account*". The right to sue and be sued on behalf of a segregated account is vested in the company, not the owners of the relevant accounts. In the litigation context therefore, even where an account owner is suing the company in respect of the company's management of its own account, the segregated account is wholly or substantially an extension of the company's own legal personality.

39. It is entirely rational within this distinctive legal framework for an account owner which sues a segregated accounts company in respect of its own account and is awarded costs to find that the account it invested in is liable to contribute to the account owner's costs award. The position would perhaps be different if the relevant claim was wholly unconnected with the account owner's own segregated account, and consisted of:

    (a) claims against other segregated accounts in which the plaintiff investor had no interest *qua* account owner but only an interest *qua* counterparty;

    (b) claims against the Company otherwise than in respect of any segregated account, in other words, against the Company and its general account; and/or

    (c) the starting assumption that litigation costs incurred by a segregated accounts company which are linked to particular segregated accounts should be borne by such accounts had been displaced through express funding agreements or some other course of dealing pointing clearly to agreement on a different allocation approach.

40. It is also important not to exclude the possibility that, in appropriate circumstances, it may be open to an account owner to contend that litigation costs which were charged to the relevant account were improperly charged and ought to be recoverable by the account owner by way of compensatory or restitutionary damages. This sort of claim would generally only arise, it seems to me, in the context of proceedings brought by an account owner against the directors or managers of a segregated accounts company.

41. The above analysis will of course be subject to refinement in future cases with the benefit of greater experience of how these issues impact on the relevant actors in the segregated account legal context in practice. Indeed, governing instruments may come to address the issue in a more fulsome way. For the time being, the Court is compelled

to engage in an exercise not wholly dissimilar to that of a scientist exploring a newly discovered planet for the first time.

Has the costs discretion in Bye-law 4(6)(f) survived the making of the Receivership Order and the appointment of the Joint Receivers as Joint Provisional Liquidators?

42. Ms Tovey for the Receiver of the NSI Classes explained that her client had a conflict as the Receiver of Classes C and I (which were wholly owned by the Plaintiffs) and Class F (which had third party ownership). Not only was he compelled to adopt a neutral position to the present costs application, merely assisting the Court to reach a sound conclusion on the applicable legal principles, he sought directions from the Court as to how he should allocate any costs award made against the Company and linked to the NSI Classes across the various segregated accounts.

43. I have found that:

    (a) the starting assumption by virtue of the Prospectus is that all expenses including legal expenses should be shared on a pro rata basis by all share classes;

    (b) the Company applied this standard rule, implicitly exercising the directors' discretion under Bye-law 4(6)(f) in the course of the litigation;

    (c) the same allocation principle accordingly applies to the liability incurred by the Company in respect of the costs awarded to the Plaintiffs herein because there are no grounds for properly displacing the starting assumption referred to in (a);

    (d) each of the NSI classes (including all accounts in which the Plaintiffs have an ownership interest) and NSSC classes are liable to contribute on a *pro rata* basis to the Plaintiffs' costs.

44. These findings applicable to all classes would appear to me to obviate the need for any further special directions to be given in respect to the allocation amongst the NSI classes of the costs payable to the Plaintiffs in relation to the present litigation.

45. Is the discretionary power conferred on directors to allocate costs contained in Bye-law 4(6)(f) available to the NSI Receiver? In my judgment, the discretion contained in Bye-law 4(6)(f) must survive the Receivership Orders as regards the accounts to which each Order relates. Section 21 (1) of the Act provides that a receiver:

    > "*(b) shall have all the functions and powers of the directors and managers of the segregated accounts company in respect of the business and assets linked to the segregated account.*"

46. The Receiver can deploy this Bye-law power with respect to allocating all receivership costs.

Conclusion

47. For the above reasons, the Plaintiffs are awarded the costs of the present action up to and including Judgment and the filing of the Orders granted in their favour. Those costs are to be payable by the Company out of the assets of all segregated accounts on a *pro rata* basis, including (without any diminution) those accounts in which the Plaintiffs are beneficially interested.

48. I will hear the parties, if necessary, as to costs. To assist the parties to agree costs, I will merely note that it seems obvious (without regard to any without prejudice offers which may have been made in this respect) that the Plaintiffs have only achieved partial success. This would suggest that any sum to which they would otherwise be entitled in respect of the costs of their present application perhaps ought to be reduced to a commensurate extent.

Dated this 15th day of November, 2012 _____
IAN RC KAWALEY CJ