

UPDATE

Cayman Court considers the *Berkeley Applegate* principle and clarifies grounds for refusing a liquidator's costs

Update prepared by Hector Robinson QC, Christopher Harlowe and Laura Stone (Cayman Islands)

A recent decision of the Cayman Islands Grand Court is an important reminder that a liquidator's costs claimed from trust assets must be proportionate and reasonable, and will be refused on certain grounds.

Background

The Decision¹ arose from an application for the payment of fees and expenses of joint provisional liquidators (JPLs) out of the trust assets held by OneTradex Limited (the **Company**) pursuant to a *Berkeley Applegate* Order. The JPLs, Mr Kenneth Kryss and Ms Angela Barkhouse, were originally appointed by the Cayman Islands Monetary Authority (CIMA) as controllers over the Company following suspected regulatory breaches by the Company. Following investigations, CIMA filed a petition to wind up the Company pursuant to which the Court subsequently appointed the controllers as JPLs. Ms Barkhouse later resigned as one of the JPLs and the application was made by Mr Kryss as the sole provisional liquidator (PL). An ad hoc committee of clients and creditors (the **Committee**) was established during the provisional liquidation to represent the interests of the Company's clients and creditors.

The Company was a licensed broker/dealer offering online discount trading services to individual investors, traders, hedge fund managers and family offices. The Company's own assets were insufficient to meet the costs of the controllership and provisional liquidation. Consequently, the Court granted the JPL's application for a *Berkeley Applegate* Order,² allowing the Controllers' and JPLs' fees and expenses incurred in the administration of the client funds that it held on trust (the **Trust Assets**) to be paid out of the Trust Assets.

The PL applied to the Court for approval of US\$3,583,720 in fees and expenses, to be paid out of the Trust Assets and claimed a further US\$120,883.67 in fees and expenses from the Company's assets. The Committee objected on the basis that the fees and expenses claimed were unreasonable, incorrectly allocated to the Trust Assets and disproportionately high relative to the US\$5million in liabilities to which the Trust Assets were exposed. In light of these objections, the Court gave detailed consideration to the scope of the *Berkeley Applegate* principle and in the process identified several grounds upon which a significant proportion of the PLs' costs were ultimately refused and reallocated to the Company.

A *Berkeley Applegate* order

Ordinarily, an officeholder can only recover fees for work in respect of the insolvent estate, out of the insolvent estate's assets. Assets that are controlled by the officeholder, but which are beneficially owned by a third party, do not fall within the insolvent estate's pool of assets from which the officeholder's fees and

¹ *In the Matter of OneTradex Ltd (In Provisional Liquidation)* (unreported, 17 June 2022), FSD 166 of 2019.

² The Court, granted the order in an earlier decision, *In the matter of OneTradex Ltd* [2020 (2) CILR Note 20] (1 October 2020).

expenses would ordinarily be paid. A *Berkeley Applegate* order allows an officeholder to recover costs incurred in the administration of assets for the benefit of a third party, from the third party's assets. As identified in *Re Berkeley Applegate*,³ there are two factors which will operate in favour of the Court exercising its discretion to grant such an order. The first is whether the work, if not done by the officeholder would have to be done either by the person claiming an equitable interest in the property or by a receiver appointed by the Court, whose fees would have been borne out of the trust property. The second, is whether the work done has been of substantial benefit to the trust property and the beneficiaries of that property.

The scope of the *Berkeley Applegate* principle

In considering the PL's costs application, the Court confirmed that an officeholder needs to clearly distinguish between the costs incurred in respect of trust assets (*Berkeley Applegate* costs) and the costs incurred in the winding up of the company. The Court also identified the following circumstances where an officeholder would not be permitted to recover costs from trust assets:

- where the JPLs have carried out work which is inevitable in the administration of the company, such as costs that will arise in a winding up process. The JPLs are not entitled to recover the costs of doing this work from trust assets, even if the work confers a benefit to the beneficial owners of the trust assets;
- where the officeholder's costs relate to work which is not of '*substantial benefit*' to the beneficiaries of the trust assets;
- where the beneficial owners do not need the Court's assistance in the administration of the trust assets;
- where the officeholder's costs have been incurred without the beneficial owner's consent or the Court's approval. An officeholder does not have the right to the benefit of the doubt or the Court's reliance on their commercial judgment where they carry out the work, and where the beneficiaries have opposed the work being done, in which circumstances an officeholder should apply to the Court for directions before incurring costs; and
- where the officeholder incurred costs in advancing a position adverse to the beneficial owners' interest.

Reasonableness

In addition to considering whether the costs fell within the scope of the *Berkeley Applegate* Order, the Court confirmed that a determination also needs to be made as to whether the costs claimed are reasonable and proportionate. If fees are payable out of the Trust Assets as being properly incurred for the purpose of identifying, protecting and distributing those assets, the Court will assess the reasonableness of those fees in the usual way. In considering each cost claimed, the Court outlined the following factors to be taken into account when assessing reasonableness and which have previously been applied by the Court in *Re Caledonian*⁴ and *Re SphinX Group*⁵:

- the time properly given by the liquidator and the liquidator's staff in attending to the company's affairs;
- the complexity (or otherwise) of the case;
- any respects in which, in connection with the company's affairs, there falls on the liquidator any responsibility of an exceptional degree or kind;
- the effectiveness with which the liquidator appears to be carrying out, or to have carried out his duties; and
- the value and nature of the property with which he has had to deal.

In applying the above analysis, the Court considered each of the cost categories claimed by the PL as payable out of the Trust Assets and concluded that a total of US\$861,692.74 in fees and expenses were to be allocated to the liquidation estate as being primarily, costs relating to the Company's provisional liquidation, rather than out of the Trust Assets. This was despite the fact that the liquidation estate would likely have insufficient assets to cover such costs.

³ *Re Berkeley Applegate (Investment Consultants) Ltd* [1989] BCLC 28.

⁴ *In re Caledonian Securities Limited* [2016 (1) CILR 309].

⁵ *In re SPhinX Group* [2012 (2) CILR Note 11].

Additional considerations

As confirmed by the Court in the Decision, the burden remains on the officeholder to demonstrate that its costs are properly allocated to the trust assets and are reasonable. The Decision also confirms that the Court should carefully consider whether the fees charged are fair and reasonable in all the circumstances. If, in undertaking such an assessment, the Court is not satisfied that the costs of the work done, when looked at as a whole, are proportionate to the value of the work to the trust estate (or the beneficiaries), the Court may disallow a percentage of the costs.

Costs disallowed as not recoverable under the *Berkeley Applegate* principles

Applying the principles set out above, the Court disallowed the following categories of costs and reallocated them as costs recoverable from the Company:

- communications on an ongoing basis with the directors on cash reconciliations - the Company was required to perform this pursuant to section 7 of the Financial Requirements Regulations made under the Securities Investment Business Act and therefore, this work was not undertaken for the benefit of the Trust Assets and was considered Company costs;
- half of the costs incurred by the PL in engaging external US counsel - these were disallowed and reallocated to the Company on the basis that part of these costs were incurred in relation to the Company's regulatory breaches;
- part of the JPL's costs associated with communications with the Company's directors with respect to the sale of the Company's book of business - these were disallowed as costs related to the Company and fell outside the scope of the *Berkeley Applegate* Order;
- communications with stakeholders during the controllership period - these were disallowed as they were an ordinary incident of the controllers' statutory obligations and were not payable out of the Trust Assets;
- a significant proportion of the costs claimed by the JPLs in respect to the company's books and records and the ongoing operation of the company's business;
- the costs claimed by the JPLs in relation to reporting to CIMA - these were entirely reallocated to the Company as being part of the costs of the controllership;
- the JPLs' costs associated with putting the Company into provisional liquidation and any legal costs associated with that process;
- the JPLs' costs incurred in relation to an attempted sale of the Company's book of business - these were disallowed as being properly costs of the liquidation; and all of the JPLs' costs incurred in making a US Chapter 15 application; and
- the JPLs' costs incurred instructing attorneys in relation to potential litigation were disallowed and reallocated to the Company.

Conclusion

In light of the significant portion of costs claimed by the PL that the Court reallocated to be paid out of the insolvent estate, the Decision is an important reminder to officeholders that they need to carefully consider how they record and allocate their fees and expenses when a *Berkeley Applegate* Order is in place and to ensure that all costs claimed against assets held on trust are necessarily incurred for the purpose of the proper administration of the trust assets and are reasonable in amount and proportionate to the scope of the work actually undertaken. A *Berkeley Applegate* order does not automatically grant officeholders an unfettered right of recovery for their fees against third party assets held on trust.

Hector Robinson QC, Christopher Harlowe and Laurence Aiolfi of Mourant appeared for the Committee.

Contacts



Christopher Harlowe
Partner
Mourant Ozannes (Cayman) LLP
+1 345 814 9232
christopher.harlowe@mourant.com



Hector Robinson QC
Partner
Mourant Ozannes (Cayman) LLP
+1 345 814 9114
hector.robinson@mourant.com



Laura Stone
Associate
Mourant Ozannes (Cayman) LLP
+1 345 814 9121
laura.stone@mourant.com

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