FEBRUARY 2022

UPDATE

The Grand Court clarifies the correct test to challenge official liquidators' remuneration

Update prepared by Nicholas Fox and David Ramsaran (Cayman Islands)

In a recent decision,[1] the Grand Court of the Cayman Islands considered the approach the Court will take when reviewing official liquidators' fees, the extent to which the *Wednesbury* reasonableness test is relevant and the need to file sufficient evidence in advance of the fee approval application hearing.

The joint official liquidators (the JOLs) of Direct Lending Income Feeder Fund, Ltd (in liquidation) brought an application seeking the Court's approval of their fees. Certain parts of the application were opposed by the liquidation committee (the LC) on the basis that the fees were unreasonable, which the JOLs refuted.

The Parties' Submissions

The parties agreed that in circumstances where the LC did not approve the JOL's remuneration, the burden of proof was on the JOLs to satisfy the test found in *Re Sphinx*, namely, '*...whether a reasonably prudent man faced with the same circumstances in relation to his own affairs, would layout or hazard his own money on doing what the office-holders have done*'.[2]

There was also some argument regarding the extent to which, following the judgment of Kawaley J in *Re Herald Fund*,[3] in order to successfully challenge liquidators' fees, the LC needed to meet a test analogous to the public law test of *Wednesbury* unreasonableness,[4] that is, *'that the JOLs decisions and actions were so unreasonable that no reasonable person acting reasonably could have decided or acted as the JOLs did*.'[5]

The Test

The Grand Court, by Segal J, distinguished between two different types of challenge:

1. a challenge to the JOLs core (commercial or business) decisions relating to how to exercise their powers (and conduct the liquidation) – (ie any time was spent on a task which should not have been undertaken because it was done pursuant to a particular workstream that was not reasonably necessary); and
2. a challenge to the level of resources deployed, and/or time spent in implementing the JOLs' decisions – (ie too much time or expense was spent on a particular task that was undertaken pursuant to a workstream that was reasonably and properly required).[6]

---

[1] *In the matter of Direct Lending Income Feeder Fund Inc* (unreported, 3 February 2022) (***Direct Lending***).

[2] *Re Sphinx* (unreported, 13 November 2012) at para 18. Affirmed in *Caledonian Securities Limited (In Official Liquidation)* [2016 (1) CILR 309] (***Caledonian***), at paras 77 – 81.

NB, the Cayman Islands approach to such issues differs from the BVI approach – see the BVI case of *Rich Victory v Sino Union* - 9 October 2009, in which Bannister J rejected the *reasonably prudent man* test, on the basis that '*.... Insolvency practitioners, while obviously they must act responsibly and prudently, are not in the position of an ordinary man of business. They are subject to fiduciary responsibilities which often require them to take steps and to carry out activities which no ordinary person would think spending his own money on...* '.

[3] *Herald Fund* (unreported, 1 April 2021) at paras 21 - 22.

[4] *Associated Provincial Picture Houses v Wednesbury Corporation* [1948] 1 KB 223.

[5] *Direct Lending* at para 36(g).

[6] *Direct Lending* at paras 40 and 44.

A challenge that a task should not have been done

As to the first ground, Segal J warned that where a stakeholder wants in substance to challenge a liquidator's commercial or business decision, by saying that an activity should not have been done because it was not justified, then an objection to the liquidators' fee approval application will generally not be the proper forum in which to do this. By that stage, it is too late – because the task will have already been carried out. Instead, the LC should object at an earlier stage, either by intervening in the JOLs' application to the Court for sanction of the exercise of their powers, or by applying to the Court for directions relating to the proposed decision to carry out a particular task.

If a stakeholder waits until the task has been completed and then seeks to challenge a liquidator's fees on the former ground, then the Court will only disallow those fees if persuaded that the JOLs should not have acted as they did, applying a test akin to the *Wednesbury* unreasonableness standard, ie that the '*decision is such that no reasonable liquidator could, properly instructed and advised, in the circumstances arrive at it…*'.[7] This is a very high threshold.

A challenge that a task should have been done more efficiently

By contrast, if a challenge to liquidators' fees is made on the latter ground, then the Court will seek to identify whether the resources used, and the subsequent costs, were proportionate to what was needed and the benefits that resulted from the work, and on what is the fair value of the liquidator's work in the circumstances (ie the *Sphinx* test, set out above). This is a much lower threshold.

Application of the principles

Segal J held that the LC was not challenging the JOLs' strategic decision making, save in one case, namely the JOLs' decision to reserve to themselves the responsibility for conducting and taking decisions about the Company's own litigation claims, rather than delegating these to the US Receiver, who was also investigating and managing litigation claims. The LC complained that the JOLs' approach resulted in duplication and additional expense. However, the Grand Court rejected this challenge, finding that the JOLs' decision was not unreasonable (either in the ordinary or, more stringent *Wednesbury* sense).

On considering the LC's other challenges, all of which related to the amount of expenses incurred, the Grand Court found that the JOLs had discharged their burden of proof and established that the amounts on which approval was sought were fair, reasonable, and commensurate with the nature and extent of the tasks which the JOLs had undertaken, and the work which the JOLs had charged resulted in significant and proportionate benefits to the estate. The Grand Court accordingly dismissed all of the LC's challenges.

Other significant points

Segal J also made a number of other significant observations, which liquidators and liquidation stakeholders would do well to bear in mind:

- He observed that the Cayman Court can treat the English Court's *Practice Statement: The Fixing and Approval of the Remuneration of Appointees* [2004] BCC 912 (UKPS) as providing helpful guidance regarding the remuneration of liquidators. Thus, for example, the statement in paragraph 21.1 of the UKPS provides a useful indication, in summary form, of the approach to be followed on a remuneration application in the Cayman Islands:

  '*The objective in any remuneration application is to ensure that the amount and/or basis of any remuneration fixed by the Court is fair, reasonable and commensurate with the nature and extent of the work properly undertaken or to be undertaken by the office-holder in any given case and is fixed and approved by a process which is consistent and predictable.*'

- He cautioned insolvency officeholders against taking a 'light-touch' approach in relation to the filing of evidence for the purposes of a fee-approval application.

  '*All requisite evidence should be filed in advance of the hearing, and it should not be assumed that the Court will allow the officeholder more time and the opportunity to file further evidence in every case or indeed in most cases. As I have mentioned above, there will be cases where this is justified, particularly where, as in Perry, issues arose during the hearing that justified giving the receivers*

[7] *Direct Lending* at para 44.

more time. But this will not always be the case and officeholders who limit the evidence they file and fail to put in sufficient evidence to justify their fees, may find that the Court declines to approve some or all of those fees.'

- He observed what amounted to sufficient information provided to the LC in the present case.

  '*As David Richards J said in Brook v Reed it is for the officeholder to provide a sufficient and proportionate level of information to explain the remuneration and to enable the LC (objector) to identify with reasonable precision its points of dispute. It seems to me that the information and data provided in the Second Fee Report and the Third Fee Report allowed the LC to understand the type of work done on each workstream, the fee earners who had worked on the workstream, the amount of time spent and the charge out rates used and to have an outline of each time entry recorded by the relevant fee earner. This allowed the LC to assess the reasonableness and basis of the charges and to identify further information that they needed…*'

- Finally, he observed that a LC's role in reviewing the remuneration of JOLs is an important role and the Court relies upon the LC's independent and commercial judgment. Accordingly, a LC should not hesitate to challenge and oppose the approval of a JOLs' remuneration application.

  '*… But if it is dissatisfied with the official liquidators' remuneration, before it opposes such an application it must ensure that not only has it identified with reasonable precision its points of dispute (with a suitably detailed explanation and reference to the evidence) but also that if it wishes to challenge the official liquidator's professional judgment on resource allocation and case management, it is supported in its view by another professional, at least in any case where the challenge relates to a substantial part of the JOLs' activities and remuneration claimed.*'

The final observation, about a challenge benefitting from supporting evidence from another professional, is an interesting one and it remains to be seen how stakeholders will seek to adopt such observations in future remuneration challenges.

Conclusion

Segal J's decision clarifies the approach the Cayman Court will take when liquidators' fees are challenged by stakeholders. As such, it is worth reading closely by both liquidators and liquidation stakeholder alike.

Contacts

Nicholas Fox
Partner
Mourant Ozannes (Cayman) LLP
+1 345 814 9268
nicholas.fox@mourant.com

Simon Dickson
Partner
Mourant Ozannes (Cayman) LLP
+1 345 814 9110
simon.dickson@mourant.com

David Ramsaran
Associate
Mourant Ozannes (Cayman) LLP
+1 345 814 9133
david.ramsaran@mourant.com