

Judgment 9/2010

**Mitco Realty Limited and Develica
Deutschland Limited – Royal Court –
(Civil Action File 1240) – 11th April 2011**

Royal Court Civil Rules, 2007 – application by Mitco for security for costs, under Rule 82, in respect of counterclaim brought by Develica – relevance of Solvency Certificate under s.304 of the Companies (Guernsey) Law, 2008 – held that the Court has discretion whether to order a defendant to provide security for the cost of defending a counterclaim – application dismissed.

IN THE ROYAL COURT OF THE ISLAND OF GUERNSEY

The 11th day of April 2011 before Richard John Collas Deputy Bailiff, alone

MITCO REALTY LIMITED

Plaintiff

and

DEVLICA DEUTSCHLAND LIMITED

Defendant

Whereas on 8th April 2011 the Deputy Bailiff considered the Plaintiff's application for security for the costs of the counter claim and heard thereon Advocates P Richardson and R Shepherd counsel for the Plaintiff and Defendant respectively, the Deputy Bailiff this day handed down judgment in the terms attached hereto and DISMISSED the said application.

**S M D ROSS
H M Deputy Greffier**

IN THE ROYAL COURT OF THE ISLAND OF GUERNSEY

ORDINARY DIVISION

Between:

MITCO REALTY LIMITED

Plaintif

and

DEVLICA DEUTSCHLAND LIMITED

Defendant

PLAINTIFF'S APPLICATION FOR SECURITY FOR COSTS OF COUNTERCLAIM

Hearing date: 8th April 2011

Judgment handed down: 11th April 2011

Before: Richard John Collas Esq., Deputy Bailiff

Advocate for Plaintiff: Advocate P Richardson

Advocate for Defendant: Advocate R G Shepherd

Cases, texts & legislation referred to:

- 1) Royal Court Civil Rules 2007, Rule 82
- 2) Ashdene Consultants limited v Bachmann Group Limited [2005-6] GLR Note 22
- 3) Civil Procedure Rules, Rule 25.13 (2) (c)
- 4) Volume 1 of the 2009 White Book paragraphs 25.13.12 and 25.12.4
- 5) Jirehouse Capital v Beller [2008] EWCA Civ 908
- 6) The Companies (Guernsey) Law, 2008, sections 304, 309 and 527
- 7) Thistle Hotels Ltd v Gamma Four Ltd [2004] EWHC 322; [2004] 2 B.C.L.C. 174
- 8) C T Bowring & Co (Insurance) Ltd v Corsi & Partners Ltd [1995] 1 B.C.L.C. 148
- 9) Accidental and Marine Insurance Co v Mercati (1866) LR 3 Eq 200 at 203
- 10) Hutchison Telephone (UK) Ltd v Ultimate Response Ltd [1993] B.C.L.C. 307
- 11) Cohl (Samuel J) Co v Eastern Mediterranean Maritime Ltd, The Silver Fir [1980] 1 Lloyd's Rep 371, CA

1. I am concerned with an application by Mitco Realty Ltd ("Mitco") dated 8th March 2011 pursuant to Rule 82 of the Royal Court Civil Rules 2007 for an Order that Develica

Deutschland Ltd (“Develica”) shall lodge with H M Greffier the sum of £40,920 as security for costs in respect of a counterclaim brought by Develica in proceedings commenced by Mitco against Develica.

2. A cross-application by Develica for an order that Mitco lodge £44,000 as additional security for its costs in defending Mitco’s claim, having already lodged £38,000, has been adjourned at the request of Develica’s counsel to enable a further affidavit to be lodged.
3. Both parties accept that in applying Rule 82, the established practice of the Royal Court is to have regard to the English Civil Procedure Rules and authorities thereon (see for example Ashdene Consultants limited v Bachmann Group Limited [2005-6] GLR Note 22) although Rule 82 is not identical to the equivalent English rules and, Advocate Richardson submitted, is in fact drafted in wider terms.
4. The primary submission of Advocate Richardson, on behalf of Mitco, was that I should have regard to the ability of Develica to meet any cost order that might be made against it in the event that Mitco’s claim is successful.
5. The rule in England where there are allegations of insolvency or impecuniosity is Rule 25.13 (2) (c) and commentary thereon is to be found in Volume 1 of the 2009 White Book at page 667:

“An applicant for security for costs relying on Condition (c) must show that the company would not (as opposed to may not) be able to meet its debts when an Order for Costs was made against it. The question has to be answered at the time of the application although the Court can take into account evidence of what is to be expected in the future before any Order would be made.”

6. And:

In order to establish ground (c) the applicant must show “there is reason to believe that it [the claimant company] will be unable to pay the defendant’s costs if ordered to do so”. The opening words “there is reason to believe” have the effect of watering down the obligation which follows i.e., the obligation to prove the company’s inability to pay costs if ordered to do so”. The defendant does not have to show on a balance of probabilities that the claimant company “will be unable to pay” etc: the defendant may well be able to show that there is reason to believe that the company will not be able to pay even if the company can adduce substantial evidence to the contrary. (see generally Jirehouse Capital v Beller [2008] EWCA Civ 908).”

7. Authority for the proposition that “reason to believe” is the sufficient test is to be found in paragraph 26 of the judgment of Lady Justice Arden in Jirehouse.
8. The evidence relied upon by Advocate Richardson is in the Fourth Affidavit, sworn on 14 March 2011, of Michael James Brown, a Director of Mitco, to which he exhibited an announcement issued by Develica in connection with a circular posted to shareholders of Develica convening an EGM. The announcement was entitled “Recommended proposals for the orderly run off of the Group, cash distribution to Shareholders, changes to the Management and Administration agreements and cancellation of admission to trading on AIM”. The announcement advised that the company had breached the loan to value covenant imposed by the lenders of the company’s second largest property portfolio and that a waiver from the group’s largest lender was due to expire at the end of March 2011 “which is expected to have a significant negative impact on the Group’s cash reserves”.
9. Advocate Richardson submitted the announcement clearly demonstrated that Develica had severe liquidity problems affecting its ability to meet its day to day liabilities. As the announcement came from the directors of Develica, it was the best evidence that a plaintiff,

being a creditor, or a contingent creditor, of the defendant was likely to be able to adduce as to the financial state of the other party.

10. In reply to Mr Brown's fourth Affidavit, Develica lodged an Affidavit sworn by Andrew Duquemin on 4th April 2011. Mr Duquemin is a director of the corporate secretary of Develica. He reported the outcome of an EGM of Develica held on 25 March at which various resolutions were approved and as a result of which the Board of Develica declared an interim dividend of 1.5 Euro cents per share to be paid on 21 April 2011, totalling €3.75 million.
11. Before paying a dividend, the directors had to comply with the requirements of section 304 of The Companies (Guernsey) Law 2008 entitled 'Procedure for paying a dividend'. Pursuant to that section, they declared a Solvency Certificate Resolution on 25 March 2011, a copy of which was exhibited by Mr. Duquemin to his affidavit. The Resolution declared that the directors were satisfied that immediately after paying the interim dividend the company would satisfy the solvency test as defined in section 527 of the 2008 Law. It recorded that in reaching that determination, the directors took account of a budgeted balance sheet and income statement as at 25 March 2011, a budgeted cash flow for the next 12 months and a review and assessment by the company's external auditor of those documents. The Resolution noted that the trial of the claim by Mitco was due to be heard commencing on 11 July 2011 and provision for the claim had been included on a worst case basis in calculating the company's solvency.
12. Advocate Shepherd, on behalf of Develica, described the Solvency Resolution as a "serious document" and referred to the sanctions that could be visited on the shareholders and directors of Develica, under section 309 of the 2008 Law, if a distribution later had to be recovered. It was sufficient, he said, to demonstrate that Develica was expected to have sufficient funds available to satisfy any costs order that might be made against Develica if the Court found wholly in favour of Mitco and thus the "worst case" scenario materialised.
13. Advocate Richardson sought to discredit the Solvency Resolution on several grounds, which I summarise as follows:
 - (a) The affidavit to which it was exhibited was sworn not by a director of Develica but by a director of the corporate secretary of Develica;
 - (b) It declared the company would be solvent immediately after payment of the interim dividend, not after the trial;
 - (c) It was unsubstantiated by any supporting documentation; and
 - (d) It was self-serving.
14. Consequently, he submitted that I should attach very little weight to the Solvency Resolution and instead I should prefer the information that had been sent to shareholders of Develica in the announcement issued in connection with convening the EGM.
15. I recognise that it would have been preferable if the Affidavit had been sworn by a director of Develica because a director could have testified that in his opinion Develica did satisfy the solvency test. I therefore have no first hand sworn evidence that a director of the company is satisfied that the solvency requirements are met. Instead, the Resolution is no more than a report that at a meeting held on 25 March, the directors present were satisfied that the conditions for solvency were met.
16. I do not accept that the document is merely self-serving; it was not produced for the purpose of responding to the application for security for costs but in compliance with the director's obligations under The Companies (Guernsey) Law 2008. There is no reason to believe that

the information contained in the announcement that preceded the EGM is more reliable than the declarations in the Resolution. The directors clearly had supporting documents, including the advice of an independent auditor available to them at the date of their meeting, I do not agree that it was necessary for them to disclose some or all of the detailed financial information to Mitco or the Court.

17. I have carefully considered Advocate Richardson's submissions but I agree with Advocate Shepherd that the Solvency Resolution is a serious document and, having regard to the sanctions that could be visited upon shareholders and/or directors if it was not properly approved, I am entitled to attach weight to it. The Resolution states that the directors took account of a 12 month cash flow statement that took into consideration the Mitco claim on a worst case basis.
18. Consequently, I am persuaded that there is no basis upon which I could properly come to the conclusion that there is "reason to believe" that Develica would be unable to meet its liabilities to Mitco if the decision of the Court went wholly in favour of Mitco, or to be more precise, there is no reason to believe that Develica could not meet a costs order in respect of Mitco's costs in defending the counterclaim.
19. Advocate Richardson's second line of argument arose from the fact that the application was for security for the costs of defending a counterclaim and required consideration of the principles to be applied by the Court in that situation; a question that apparently has not previously been addressed in the Royal Court, or if it has been considered, no earlier decisions were cited to me.
20. Both counsel referred to English cases for guidance. The 2009 White Book states at paragraph 25.12.4:

"An order for security for costs can be made in favour of a claimant in respect of a counterclaim brought against him if the counterclaim raises issues which go beyond the defence of his claim. (Thistle Hotels Ltd v Gamma Four Ltd [2004] EWHC 322; [2004] 2 B.C.L.C. 174)."

21. Advocate Shepherd relied upon a passage in the judgment of Dillon LJ in C T Bowring & Co (Insurance) Ltd v Corsi & Partners Ltd [1995] 1 B.C.L.C. 148 at the foot of page 4 of 16:

"there was a strongly established rule of practice that a person who is in the position of a defendant is to be at liberty to defend himself and is not to be called on to give security. See the judgment of Sir William Page Wood V-C in Accidental and Marine Insurance Co v Mercati (1866) LR 3 Eq 200 at 203. I regard this as a rule of practice, and not a mere matter of discretion to be determined on the facts in each individual case...

..it is clear that an impecunious company which makes a counterclaim which is more than a mere formulation of its defence can be ordered to give security for the plaintiff's costs of the counterclaim."

22. The above passage was cited by Miss Sonia Proudman QC in her judgment in Thistle Hotels after she had said the following at paragraph 28:

"28. The policy behind the jurisdiction to order security for costs is to counter the prejudice suffered by a defendant who is unsuccessfully pursued by a claimant unable to meet an order for costs. It is not intended to counter prejudice to a claimant in meeting a defence that proves to be unsuccessful. It is the claimant's business if he chooses to sue a defendant who is not good for costs. An impecunious defendant is not to be prejudiced in defending the main claim by an order for security on the counterclaim."

23. In her review of the decisions, Miss Proudman QC included Hutchison Telephone (UK) Ltd v Ultimate Response Ltd [1993] B.C.L.C. 307 where, at page 316, Dillon LJ identified:

“two different types of case where a question may arise that a counterclaim put forward by a defendant is really only to be regarded as part of the defence. One is the case of equitable set-off where the defendant asserts, by his counterclaim for instance, that a sum of money is in any event due to him under some other aspect of the very agreement or transaction on which the plaintiff is suing whether the plaintiff’s claim be valid or not, and there is a plea of equitable set-off of the moneys so due and claimed by counterclaim against the moneys claimed by the plaintiff in his claim, should those be held otherwise to be payable....”

The other case, where again the counterclaim may be just the automatic counterpart of the defence, is where there is a claim to establish that the plaintiffs are entitled to something, possibly merely a declaration to that effect, and there is a counterclaim for the opposite declaration, which would be the automatic counterpart of the claim of the plaintiffs failing.”

24. In both of those cases, Dillon LJ said it would not normally be appropriate to order a defendant to give security for the costs of such a counterclaim. He continued:

“But there are other circumstances which may lead to other conclusions, as for instance where, in The Silver Fir, there were two claims on different aspects of the one event and it was a matter of chance which party happened to be the plaintiff and, on one ground or another there was jurisdiction, be it under s 726 or because of foreign residence, to order security.”

25. In the same case, Hutchison, Bingham LJ posed the question in the following terms:

“So the question may arise, as a question of substance, not formality or pleading: is the defendant simply defending himself, or is he going beyond mere self-defence and launching a cross-claim with an independent vitality of its own?”

It appears to me that Field J put his finger on the appropriate question when he pithily observed in Mapleson v Masini (1879) 5 QBD 144 at 147:

‘The substantial position of the parties must always be looked at’.

For my part, I think that no simple rule of thumb exists to determine the answer to the question. An order for security against a counterclaiming defendant is not precluded because the counterclaim arises out of the same transaction as the claim.”

26. Having reviewed the English authorities, it is to be noted that the Royal Court has a wider discretion. Under CPR 25.12, it is only a defendant who may apply for security for his costs of the proceedings. Whereas under Rule 82, any party may be ordered to give security for costs. Rule 82 (1) (b) provides that:

“(1) The Court may, in any action...

(b) order any party to give security for costs...”

27. In my judgment, counsel correctly stated that we look to the English principles for guidance and I have no doubt that we accept the *“strongly established rule of practice that a person who is in the position of a defendant is to be at liberty to defend himself and is not to be called on to give security”* described by Dillon LJ in C T Bowring. I accept that in Guernsey a similar rule of practice governs the extent of the Court’s discretion under rule 82 such that a defendant will not normally be required to give security for costs.

28. I am satisfied that the Court has a discretion to order a defendant to give security for the costs of defending a counterclaim. In deciding how to exercise that discretion, the Court is directed by Rule 1 of the Royal Court Civil Rules, 2007 to have regard to the Overriding Objective and must deal with the case justly. The English authorities provide guidance as to what is considered to be just. I accept Field J's observation that "*The substantial position of the parties must always be looked at*".
29. The main disagreement in the instant case principally involves the parties' different interpretations of the proper construction of the terms of a share sale agreement and a brokerage agreement, in particular, the formula agreed for the purpose of calculating the consideration payable thereunder to Mitco in respect of a portfolio of properties. In relation to that disagreement, the counterclaim amounts to a defence by Develica of Mitco's claim. In paragraph 28 of Develica's skeleton argument, Advocate Shepherd contended that if his client's interpretation of the formula is correct, Mitco would owe €485,251.00 to Develica and hence that if Mitco had not commenced proceedings, Develica could have done so. That element of the counterclaim is therefore the counterpart of the claim.
30. Advocate Richardson asserted that the counterclaim does raise some additional issues that will need to be investigated and considered at trial and that would not have had to be dealt with if the Court was concerned only with the claim and not the counterclaim. (The additional issues are set out in paragraph 11 of Advocate Richardson's skeleton argument of 14 March 2011).
31. Advocate Shepherd estimated that the additional costs to be incurred by Mitco in dealing with the additional issues is between 10 and 15% of the total costs. Advocate Richardson declined to speculate saying that he had not adduced any evidence on which to base an estimate but invited me to make my own guess. It is difficult for me to do so as I have not yet been told what witnesses the parties intend to call or what areas of expert testimony will be needed to deal either with the issues raised in the claim or those in the counterclaim. However I accept, without putting a figure on it, that the bulk of the costs that will be incurred on the pleadings as they now stand would be incurred even if the counterclaim had not been pleaded.
32. In doing justice between the parties, I consider it would be inconsistent with the general rule of practice to require Develica to give security for the costs that Mitco will incur in respect of dealing with that part of the counterclaim which is merely the counterpart of the claim.
33. In respect of the additional costs to be incurred in dealing with the additional issues raised in the counterclaim, I accept that I have a discretion to exercise in deciding whether to order security.
34. The main factor that Advocate Richardson asked me to take into account in exercising that discretion is the alleged insolvency of Develica but, for the reasons I have already given in this judgment, I accept the Board's Solvency Certificate Resolution of 25 March, and consequently that it will have the cash required to meet any costs order in Mitco's favour.
35. In his skeleton argument, Advocate Richardson invited me to look at the prospects of success of the counterclaim but it is not possible for me to form a view on the merits of it at this stage of the proceedings. I would add though that even if the counterclaim was wholly without merit it would not alter my decision.
36. I am not persuaded that there is any basis on which I could properly exercise my discretion to order Develica to pay security for any part of Mitco's costs. I have asked myself whether that is fair and just in circumstances where Mitco has paid security for costs. I am satisfied that it is. The main distinction between the two companies is that Mitco is registered in the British Virgin Islands and is not resident in Guernsey whereas Develica is a Guernsey registered company administered and resident in Guernsey.

37. If Develica was the plaintiff in these proceedings, there would be no basis for making a security for costs order against it; it would be treated no differently from any other solvent Guernsey company. Thus, although an unformed observer might think it is unfair that only one party is having to pay security for costs when, in substance, both parties are advancing a claim, I am satisfied that is appropriate in the circumstances.
38. For the reasons I have given, I dismiss Mitco's application dated 8th March 2011.