Protected cell company. Business in insolvent liquidation. Scheme for appropriate distribution of monies coming to company as "core assets" amongst creditors of protected cells.

[2024]GRC042

IN THE ROYAL COURT OF GUERNSEY
(Ordinary Division)

IN THE MATTER OF

(1) PROVIDENCE INVESTMENT FUNDS PCC LIMITED (in Liquidation ("PIF")); and

(2) PROVIDENCE INVESTMENT MANAGEMENT INTERNATIONAL LIMITED (in Liquidation) ("PIMIL")

AND

IN THE MATTER OF THE COMPANIES (Guernsey) Law, 2008
(as amended)

AND

IN THE MATTER OF AN APPLICATION
by Mr Andrew Wood and Mr Ian Wormleighton
(in their capacities as Joint Liquidators of PIF and PIMIL)

Before:

Her Honour Lieutenant Bailiff Hazel Marshall KC, sitting alone

Date of Hearing: **4 September 2023**

Judgment given: **4 September 2023**

Judgment handed down: **17 June 2024**

Counsel for the Applicants: Advocate H M Sandy

Cases, Legislation and texts referred to:

Guernsey
Protection of Investors (Bailiwick of Guernsey) Law 1987 s 6
Companies (Guernsey) Law 2008 ss 419, 426
Financial Services Business (Enforcement Powers) (Bailiwick of Guernsey) Law 2020 s 89
Protection of Investors (Administration and Intervention)) (Bailiwick of Guernsey) Ordinance 2008

JUDGMENT

1. This is an application by the Joint Liquidators of the above companies for directions, pursuant to section 426 of the *Companies (Guernsey) Law 2008* ("**the Companies Law**"). It is made *ex parte* as the nature of the application is such that there is no obviously affected party who/which ought immediately to be convened.

2. The original hearing was held *in camera*, owing to the potentially commercially sensitive nature of the information which would be disclosed to the Court in the application hearing. However, once the order which was made was put into effect, the need for such confidentiality has largely fallen away, and since the judgment itself concerned the administration of Guernsey registered companies in an insolvency context on a point as to which there is no recorded Guernsey authority, I have been asked to produce an appropriate written judgment indicating the Court's reasons for making the order which it did, for the assistance of those concerned with the insolvent administration of companies. I do so in terms which I consider adequate to protect the confidentiality of the material for which the original *in camera* hearing was permitted.

3. In the interests of succinctness, and because they are not material, I do not recite the measures taken to preserve confidentiality, or the applications made and considered by the Court in that regard.

The Facts

4. The above captioned companies were registered and carried on business in Guernsey in the financial services sector. In June and July 2016, the Guernsey Financial Services Commission imposed conditions on the business being carried on by PIF under the *Protection of Investors (Bailiwick of Guernsey) Law 1987* ("**The PoI Law"**), for the protection of the public, of investors in PIF and of the reputation of the Bailiwick as a financial centre. Almost immediately, in July 2016, PIF found itself unable to make certain required payments out of its assets as scheduled, and PIF's directors therefore decided to suspend activities.

5. In August 2016, plans for a restructuring of the Providence Group which was supposed to save the situation foundered. PIMIL's Board resigned, and an application was made to the Court for Administration Management of the two companies. This application was made on the basis that there were no directors of the companies, that the situation posed a significant risk to their investors and that the appointment of professional administrators was therefore needed in the best interests of investors. The application was duly granted.

6. Mr Philip Bowers, Mr Andrew Isham and Mr Alexander Adam were then appointed Joint Administration Managers of the companies on 11th August 2016. The administration was lengthy. Mr Isham and Mr Bowers resigned during 2019 on ceasing to be partners in Deloitte, and Mr Ian Wormleighton was sworn into office on 22 November 2019 to replace them.

7. It is not necessary to recite the detail of the administration, but in essence the Joint Administration Managers first investigated Providence's business and concluded that there was no realisable value in its business activities. In investigating the reasons for the companies' insolvency they identified potential claims in negligence against the auditors of PIF, for having negligently failed to uncover frauds being committed by the principal executive(s) of the company. They obtained third party litigation funding to pursue this claim against the auditors, and commenced proceedings on 21 December 2018.

The Actions

8. The claim in this first action averred negligence by the auditors in the conduct of the audits of PIF for the years ending 31 December 2013 and 2014. Damages were claimed in a large sum, calculated by reference to "new money" subscriptions which investors had made subsequent to the point at which (it was alleged) the auditors were in possession of sufficient documentation that could have led them to take action that could have led to the suspension of PIF's shares (alleged to have been on 11 May 2015) and which subscriptions had then been paid out and lost to the company, as part of the fraudulent conduct of its management.

9. With the above action proceeding, in June 2020 the Joint Administration Managers commenced a second action against the same auditors, alleging negligence in respect of the audit of PIMIL's accounts for similar reasons. In this second action, PIMIL's claim against the auditors was made in respect of claims being made in turn against it, as contractual or de facto investment manager, by two insolvent Providence subsidiaries, Providence Investments PCC Ltd ("**PIP**") and Providence Fixed Income Fund SPC ("**SPC**"). Again, the damages claim was quantified on the basis of the amount of "new money" subscriptions paid into those companies after 11 May 2015, and later fraudulently paid away. This further claim increased the amount of the damages claimed against the auditors in the combined actions by about 50%.

10. After various interlocutory applications, the two proceedings, raising essentially the same issues of negligence and breach of contract, were consolidated, and the combined action was set down for a four week trial commencing in May 2022.

11. However, in April 2022, the Joint Administration Managers reached a Settlement Agreement with the auditors to settle the claims on a confidential basis, and the trial dates were vacated. The settlement involved payment of a significant sum of money, to be paid to the Joint Administration Managers on behalf of the companies.

12. The Joint Administration Managers then set about preparing their final accounts, and considering the appropriate way forward. Having concluded by this time that they had achieved all worthwhile recoveries on behalf of PIF and PIMIL, and thus that the purpose of the administration had been achieved, they considered that it was now time that the companies should be wound up and appropriate distributions of monies held by them should be made between creditors of, and investors in, the companies. They therefore set about applying for their discharge, under ss 6 (1) and (2) of the *Protection of Investors (Administration and Intervention) (Bailiwick of Guernsey) Ordinance* 2008 ("**the 2008 Ordinance**") in force at the time of their appointment and/or the re-enactment of that provision in ss 89 (1) and (2) of the *Financial Services Business (Enforcement Powers) (Bailiwick of Guernsey) Law 2020* ("**the 2020 Law"**) which came into force on 1 November 2021, and to obtain

consequent appropriate releases from liability under s 9 of the 2008 Ordinance and s 92 of the 2020 Law.

13. As the Joint Administration Managers had no power as such, to make distributions and wind up the companies, arrangements were made whereby the sole voting shareholder of PIF and PIMIL, Providence Global Limited ("**PGL**") (already itself in compulsory liquidation) applied to have PIF and PIMIL placed in compulsory liquidation pursuant to s 408 of the Companies Law. This order was made by the Royal Court on 23rd March 2023, and Mr Andrew Wood and Mr Wormleighton were duly appointed as Joint Liquidators of PIF and PIMIL.

This Application

14. The Joint Liquidators' application to the Court seeks the Court's approval to the scheme which the Joint Liquidators have decided upon as being the most appropriate for the final distribution of the funds under their control. This arises as follows.

15. Whilst PIMIL is an ordinary, non-cellular Guernsey registered company, PIF is a protected cell company ("**PCC**") under Guernsey legislation. The characteristics of such a PCC are that its business is authorised to be carried on in "cells" each of which is operated separately and discretely, with its assets (and liabilities) being segregated entirely from those of other cells, and also from any assets of the overarching company itself, the latter being usually referred to as the PCC's "core assets".

16. In the normal situation, the cells' respective businesses are simply conducted separately and relations with the overarching company will be conducted under any governing agreements, no doubt allocating expenses and any income.

17. However, the effect of the Settlement Agreement in this case provided for receipt of the settlement sum by the Joint Administration Managers as a global sum, not allocated between the two actions, or the two companies, or to any underlying individual cell or investors. The Joint Liquidators were therefore required to decide how the funds thus recovered by them, and available for distribution to creditors and investors of the companies, should be distributed.

18. Having decided on a scheme of (in their view) fair distribution, they now apply to the Court for approval of their proposed actions. Their proposed scheme of distribution is explained as follow.

The available net sum

19. The Joint Liquidators first explained how a net sum available for distributions in the two liquidations had been arrived at. This was by taking the settlement sum received, and deducting first, the total costs of the proceedings (being the litigation funders' entitlement under their agreements, and the legal costs incurred) and second the costs of the Joint Administration Managers, thus arriving at the sum standing to credit of the account at the time of the application for compulsory liquidation). They then deducted, further the costs of the liquidation itself, but added back bank interest received on sums held to the credit of the liquidations in the interim. This exercise produced the sum available for allocation between PIF and PIMIL.

The allocation between PIF and PIMIL

20. As the Settlement Agreement had not itself distinguished any allocation between PIF's claim and PIMIL's claim, the Joint Liquidators needed to assess this for themselves. They had looked at their own assessments and calculations of losses, used within the mediation negotiations which had taken place. They had then used the final offers received from the Auditors, which had provided their figures related to gross claims in respect of PIF and PIMIL (also distinguishing between the PIP and SPC elements in respect of PIMIL's claim). They used these as a basis to assess the approximate relative strength and therefore value, of each claim, and thus derived a working ratio between the PIF and PIMIL claims.

21. They had then allocated further legal costs incurred in the same proportions except for a small element of costs which were clearly attributable directly to one estate or the other, and which were allocated accordingly.

22. This exercise therefore divided the net proceeds of the Settlement Agreement between PIF and PIMIL and gave separate sums for distribution in their respective liquidations.

Distributions in the PIF Liquidation

23. The complication in respect of PIF lies in the fact that PIF received the settlement sum allocated to it at "core asset" level, while the investor/creditors' claims lie against the net assets of individual Protected Cells. The investors/creditors had made their investments by way of subscriptions for preference shares issued by those individual Protected Cells.

24. PIF itself (ie the core of the PCC) had no creditors and was therefore solvent. However, its assets would still require to be distributed in accordance with the principles laid down by s 419 of the Companies Law, and as applied to the claims of investors against the assets of the Protected Cells.

25. There was, though, no mechanism in PIF's own articles of incorporation governing the allocations of assets of PIF between the Protected Cells. The Joint Liquidators therefore considered various approaches by which an appropriate allocation of the settlement sum between Protected Cells might be made.

26. They first considered Article 13.4 of PIF's Articles of Association, which provides that liabilities incurred by PIF which do not directly relate to any specific Protected Cell are to be allocated between the Protected Cells pro rata to each Protected Cell according to the Cells' net asset values. They considered whether this would provide an equitable basis for allocation.

27. In principle, allocating assets made available from the overarching PCC between individual cells on a basis pro-rated to the value of those Cells would appear to be reasonable. However, on examining how this would work in practice, the Joint Liquidators concluded that this was not the case.

28. The net asset value of a Cell would be calculated as the difference in value between its assets and its liabilities. The Joint Liquidators noted that any redemptions approved by directors of a Cell but not yet actually paid out to investors, ("redemption creditors") would count as a liability of the Cell, rather than as equity, thus reducing the Cell's net asset value. Also, any returns to investors in the form

of dividends which were approved but unpaid, or any accrued preferred returns on accumulation investments, would, in the normal course of business, have been off-set by equal value assets coming in to the relevant Cell (being returns from the underlying foreign businesses) but such returns were now non-existent. Those dividends or accruals would therefore stand as a liability of that Cell, but without a corresponding asset to restore value, thus, again, reducing the net asset value of such a Cell. Importantly also, the relative incidence of such liabilities among Cells, in particular as to redemption creditors, would not be uniform, and indeed was potentially quite arbitrary.

29. The Joint Liquidators therefore concluded that using, by analogy, the mechanism applicable to allocating overarching liabilities between Cells, as the principle for allocation of the settlement sum as an asset between the Cells, was not equitable. It would unfairly disadvantage the creditors and investors in Cells which happened to have relatively larger creditor balances for reasons unconnected with any equitable considerations.

30. The Joint Liquidators therefore then looked at three other possible bases or methods by which the PIF sum might be allocated between Cells, namely

    (1) Pro rata to shareholder equity only,

    (2) Pro rata to shareholder equity plus redemption creditors, and

    (3) Pro rata to shareholder equity plus all creditors.

31. They concluded that method (1) (allocation pro rata to shareholder equity only), would again disadvantage investors in Cells where there were redemption creditors as contrasted with those where there were not, for the similar reasons to those mentioned above.

32. They concluded that method (2) (allocation pro rata to shareholder equity plus redemption creditors) would give a more intuitively "normal" equity value to Cells, but would make no allowance or adjustment for the difference between "accumulation" Cells, (where investors had elected to take all the value of their investments at maturity and had not received periodic income distributions prior to PIF's suspension) and "distribution" Cells, (where they had received such distributions). They concluded that this would also operate potentially unfairly.

33. They had ultimately concluded that method (3) (allocation pro rata to equity plus all creditors, which would take account not only of the value of redemption creditors but also of creditor claims in respect of unpaid dividends and/or preferred returns) would best give an even-handed approximation of gross investor claims on any particular Cell. They therefore considered that this third mechanism would deliver the fairest result to PIF's stakeholders.

34. They therefore commended, and sought the Court's approval for, allocation of the settlement sum between individual Cells of PIF based on this third approach, given that there was no prescribed mechanism to be found in the constitution of PIF and its Cells for the allocation of assets held at "core" level.

35. The Joint Liquidators also sought the Court's approval to then pay out distributions from the Cells to those Cells' investors/creditors. For the avoidance of doubt the Joint Liquidators confirmed that they would follow the usual order of priority as between creditors and shareholders, as set out in the Companies Law.

Distributions in the PIMIL liquidation

36. The question in the PIMIL liquidation was how the net settlement sums received in respect of the PIMIL claim should be allocated between the only two creditors of PIMIL, namely PIP and SPC.

37. As to this, the Joint Liquidators proposed to allocate these on the basis of the percentages which had apparently been allocated by the Defendants to the value of their respective claims against the auditors in the PIMIL proceedings, as derived from the offers made in respect of their claims in the mediation, mentioned above.

Decision

38. I have recited arguments and reasoning presented on behalf of the Joint Liquidators, which were supported by evidence and supporting documents from Mr Oliver Lythgoe of Teneo Financial Advisory Limited, the Joint Liquidators' firm. Mr Lythgoe has worked as the day to day case manager for the administrations of PIF and PIMIL, and the liquidations of PGL and PIP.

39. The Joint Liquidators are plainly required, as part of their function, to determine how the funds held by them as the proceeds of the litigation ought to be allocated and distributed in the course of the two liquidations. Where neither statute nor contractual documents lay down any regime for this, in the particular circumstances, then they would have to exercise their discretion. They would have to make a judgment, taking into account the competing interests of the various stakeholders with calls on the funds, and seek to devise a scheme which operated even-handedly between those competing interests, in the manner which they considered to be the fairest and most equitable, having regard to the nature of the claims arising in the particular circumstances of the failure of these two Providence companies.

40. As regards the allocation of the net realised settlement proceeds between the two claims made respectively by PIMIL and PIF, this was, in effect, a matter of valuing the claims made, although the valuation was necessarily a matter of relativity. As to that the Joint Liquidators have adopted, in my judgment, a reasonable and rational approach to the split of the net proceeds, looking at the only source of evidence available to guide an assessment, namely the inferences which could be drawn from the attitude of the opposing parties in the settlement negotiations. Indeed no other source of evidence or any other potential method of evaluating an appropriate split was suggested, nor could I see one. In my judgment this process has been similar to the function of liquidators in assessing and accepting the valuation of claims advanced by creditors. I am therefore content to approve the general split of the net settlement proceeds between the two claims which the Joint Liquidators have calculated.

41. As regards the division of the sum thus allocated to the PIMIL claim between the two constituent elements, namely the PIP claim and the SPC claim, a similar approach to the evaluation was adopted. The percentage division was arrived at, again, by reflecting the apparent strength and quantum of the claims as assessed by those facing them, and, in my judgment, it provided a proper and reasonable basis for allocating the total PIMIL sum received. The allocated sums would then fall to be distributed in the respective liquidations of PIP and SPC, according to the scheme applicable in their own individual liquidations.

42. As regards the distribution of the sum allocated to PIF and the methodology for distributing this amongst the Protected Cells of PIF, neither statute nor PIF's constitution documents provide any stipulated basis for making such an allocation. Plainly some equitable basis for assessing the relative values of the Cells is called for. A distribution based upon the relative values of the Cells in question is both logical, obvious and prima facie fair and reasonable in principle but the question is then as to the fair basis of calculating such values.

43. The Joint Liquidators have arrived at a preferred methodology for such calculations as set out above, and have explained their reasons for preferring Option (3) to Options (1) or (2), in the light of their knowledge of the way subscriptions were made by various investors, and were dealt with, and their assessment of the effects of purely fortuitous circumstances, on the way such Options would operate.

44. Whilst it would be possible for the Court to appoint representatives of the various groups of creditors/investors whose interests would lie in arguing in support of each of the different Options, so as to receive competing arguments and make a decision between them, in my judgment that is neither necessary nor desirable. It is undesirable because of the cumbersome nature of any such exercise, and the additional costs which would be imposed upon these funds if it were taken. It is not necessary either, in my judgment, because the Joint Liquidators are charged with the function of making decisions (subject, of course, to the requirement to comply with statute or any governing provisions of the company's constitution documents) as to the appropriate distribution of the company's assets available, to satisfy recognised claims upon them. This is what they have done, and they have explained their reasons.

45. It follows therefore that unless I can see some flaw in their reasoning, or some other matter which I consider has not, or may not have, been taken into account, I can, in my judgment, properly approve their decision as being apparently in accordance with their duties upon the evidence presented to the Court. I cannot see any such flaw and I therefore do so.

Conclusion

46. In conclusion, therefore, I grant the Joint Liquidators' application as asked, and I approve the Joint Liquidators' proposals in respect of

    (i) the allocation of the settlement funds received pursuant to the Settlement Agreement between each of the Companies as further detailed in the Second Affidavit of Oliver Lythgoe sworn on 1 September 2023, including

    (ii) the mechanisms and the distribution of the settlement funds between the Companies' investors as further therein detailed.

Hazel Marshall KC
Lieutenant Bailiff