63rd Affidavit: Kenneth M. Krys
21st May 2010
Exhibit "KK101-Tabs 1 to 3"

FSD: 0016 of 2009 - ASCJ
(FORMERLY CAUSE NO: 258 OF 2006)

IN THE GRAND COURT OF THE CAYMAN ISLANDS

FINANCIAL SERVICES DIVISION

IN THE MATTER OF THE COMPANIES LAW

AND IN THE MATTER OF THE SPHINX GROUP OF COMPANIES (IN OFFICIAL LIQUIDATION) AS CONSOLIDATED BY THE ORDER OF THE GRAND COURT DATED 6TH JUNE 2007

SIXTY-THIRD AFFIDAVIT OF KENNETH M. KRYS

I, KENNETH M. KRYS of Krys & Associates, Governors Square, Building 6, 2nd Floor, 23 Lime Tree Bay Avenue, P.O. Box 31233, Grand Cayman KY1-1205, Cayman Islands **MAKE OATH** and **SAY AS FOLLOWS**:-

1. I am the Founder and Chief Executive Officer of Krys & Associates Cayman Ltd and one of the Joint Official Liquidators (JOLs) and the same Kenneth M. Krys who has already made 62 previous affidavits herein. I am duly authorised by the other JOL, Margot MacInnis, to make this affidavit on both our behalf. The facts and matters deposed to in this affidavit are, save where otherwise stated, known to me personally. Where known to me personally those facts and matters are true and where my knowledge is derived from another source, I state my means of knowledge and I believe the same to be true to the best of my knowledge, information and belief. There is now produced and shown to me marked Exhibit "KK101: Tabs 1 to 3" a bundle containing true copies of various documents to which I wish to refer in the course of this affidavit.

2. I make this affidavit for the purpose of explaining what directions the Court seeks at the forthcoming hearings on 26 May 2010 and the further hearing on 9 and 10 June 2010. These directions are sought in order to resolve various issues that arise in the liquidations of the SPhinX Companies. Essentially, at the hearing on 26 May 2010 the JOLs wish to obtain the Court's approval as to the role and, insofar as is possible, as to the role which any investor or creditor as a representative party will have in resolving the legal issue that need to be determined in the liquidations. It is also intended that the Court will be informed of the expanded and revised list of liquidation issues ["Liquidation Issues"] recently formulated by the JOLs in consultation with the Liquidation Committee. At the hearing on 9 and 10 June 2010 the JOLs hope to obtain procedural directions for the various issues to be determined. Any question of pre-emptive costs can be addressed at that hearing.

Background to the Issues

3. In June 2007 the JOLs caused a summons ("the June 2007 Summons") to be issued seeking the determination of the Court on a number of legal and factual issues that needed to be resolved before any distribution could be made. Many of these issues arise because of the confused and disorganised manner in which the SPhinX Companies appear to have operated prior to liquidation and the poor state of the records which the JOLs inherited.

4. The summons was adjourned pending negotiation of Schemes of Arrangement. Paragraph 4 of the Order of 15 June 2007 stayed any further proceedings on the June 2007 Summons. These negotiations proved more difficult than anyone had originally anticipated when the June 2007 Summons was adjourned. They continued over the course of some two and half years.

5. It was finally recognised that an impasse had been reached when it was made known at the creditors' and investors' meeting on 26 March 2010 and the blocking investors' meeting on 27 April 2010 that a number of blocking investors were not prepared to agree to certain aspects of the scheme. Any one blocking investor had the ability to prevent the Schemes from being approved.

6. The deal breakers, as far as some investors were concerned, included proposals for releases to be given to certain parties. One of the issues which proved particularly intractable in discussions between members of the Liquidation Committee was how to apportion the provision that the Court had already required to be made in respect of potential Indemnity Claims.

7. The investors have now waited for nearly 4 years since the SPhinX Companies were placed in voluntary liquidation. The total value of assets, largely in cash is approximately US$525m. As I have previously urged upon the Court it is important that investors obtain clarity as soon as is possible as to the amounts that are likely to be distributed to them and some clearer idea of the timing when those payments can be made. To that end it is now essential to move the Issues set out in the June 2007 Summons to a resolution with whatever expedition is possible.

8. Indeed, some investors made it clear at the creditors' and investors' meeting on 26 March 2010 that they expected the JOLs to get on with the resolution of the Issues in the Liquidation of the SPhinX Companies as quickly as possible. Certain matters were also discussed relating to the way in which the some investors wanted the process to be handled to which I will return below. I refer to the various notices which are exhibited at Exhibit KK 101 Tab 1 in which the JOLs have updated investors and creditors of matters as they have progressed. In any event, the JOLs have a duty to establish the liabilities of the estate and to distribute the assets to creditors and then shareholders.

9. I have explained the issues which need to be resolved in these liquidations in my 10th Affidavit which was sworn in support of the June 2007 summons and I crave leave to refer to this affidavit for at least a general understanding of the Issues in the June 2007 summons.

10. Since I made my 10th affidavit the arguments which arise under each issue have been developed and the impact which a particular answer would have on different classes of investors has been carefully debated and examined. The negotiations to conclude schemes of arrangement mean that the issues have been refined considerably into much more specific questions and that individual members of the Liquidation Committee now have a detailed understanding of the background to them and how the outcome will affect their own position.

11. We have therefore revisited the issues covered in the June 2007 Summons. Save for one matter we have largely concluded that the June 2007 Summons can serve with slight amendment as the umbrella under which all the more detailed legal questions can be addressed. The amendment to the June 2007 Summons is primarily concerned to introduce an issue which arises by virtue of a purported suspension of redemptions on 14 June 2006. The JOLs sought and obtained leave to amend the June 2007 summons in the form produced to the Court at the April 2010 hearing. That Amended Summons was filed on 19 May 2010.

Expansion and refinement of Liquidation Issues as formulated in the June 2007 Summons

12. Over the past two months the JOLs have sought to expand and refine the list of issues as formulated in the June 2007 Summons. It is intended to provide a roadmap for the type of legal issues which arise under each of the more broadly stated issues in the June 2007 Summons. The purpose of this task was to inform the Court and investors of the Liquidation Issues in the context of the directions being sought. The expanded list of Liquidation Issues as discussed with the Liquidation Committee was posted on the SPhinX funds website to which investors have access on 20 May 2010. A copy of that document appears at Exhibit "101 -Tab 2".

13. The expanded list of Liquidation Issues represents the JOLs' best understanding of the detailed issues, having been developed in consultation with the Liquidation Committee. I should nevertheless also say that the list is intended to be flexible. The JOLs for their part recognise that as the process moves forward there may well be

occasions when new specific questions or issues arise or existing questions or issues become obsolete. The expanded list is not intended by the JOLs to place any straightjacket on debate. At this stage, it is hoped that these expanded issues will enable the Court to give meaningful directions.

14. As will be apparent from the expanded list of Liquidation Issues that the issues have been divided into 3 broad sections. The first section deals with questions which arise in relation to the assets and certain external costs and liabilities of the SPhinX Companies. The second section deals with disputes about the relative ranking of investors who may be shareholders or redemption creditors and whose rights might be restricted in normal circumstances to certain asset pools. The final section deals with distribution.

Appearances on Issues and Representation

15. One of the questions which the JOLs hope to resolve at the earliest opportunity is their own role in this process. We are particularly concerned to ensure that our independence and neutrality is not compromised by the task we have to undertake. We are therefore concerned to have sanction from the Court that we can proceed in the way I shall outline below.

16. The JOLs have been advised that they have a responsibility to ensure that the arguments for each of the issues is fully ventilated and fairly presented to the Court. This is important so that decisions on these issues cannot later be re-opened on the basis that certain arguments were not fully addressed. The JOLs could and in some instances may have to present the arguments on an issue with no opposition and with no participation from any person with a real interest in the outcome. We have been advised that it would be preferable to have at least one party with a real interest involved in the debate.

17. The JOLs considered it appropriate for investors and creditors to be given the opportunity to be considered as representative creditors. On 1 April 2010, the JOLs wrote to a number of Investors seeking to establish their willingness to act as representative parties to argue the various legal issues that are proposed to be determined by the Court. I refer to the table at Tab 18 of Exhibit "KK100" to my 59th affidavit sworn on 10 April 2010 showing the issues then proposed to be addressed by this means and the Investors identified as potential representative parties by the JOLs. I refer to the correspondence with such Investors at Tab 18 of Exhibit "KK100".

At this stage, based on advice from their legal advisers, the JOLs had in mind that they would proceed with the conventional form of representative proceedings in which the JOLs would permit the various protagonists of each of the Issues to argue the Liquidation Issues between themselves (e.g. redemption creditors/ S shareholders vs. shareholders), with the JOLs remaining neutral on the Issues but providing assistance where necessary to all parties in the preparation of their case by explaining the Issues and providing relevant documents to them. The majority of investors responded expressing an interest in acting as a representative party with further questions about the process and in particular the costs associated with taking on the role. Before the JOLs had the opportunity to properly respond to everyone on these questions, a blocking investors' meeting was held in New York on 27 April 2010 to discuss whether there was sufficient common ground to enable a consensus to be reached on the schemes and to discuss the restoration of the June 2007 Summons to deal with the Liquidation Issues. There were significant concerns among many of the members of the group of the costs and expenses of the representative parties being met from the estate.

18. The JOLs considered that the costs of the conventional form of representative proceedings being proposed by the JOLs, namely setting up a form of tripartite proceeding to resolve the Issues whereby the JOLs remained neutral and 2 representative parties are appointed to argue the legal issues in the liquidation between themselves. It was suggested that the JOLs should instead put forward their own views on the issues on the basis that the JOLs, having been in the job for 4 years

should be in a position to state their views or conclusions on the issues. Further, the JOLs understood the view that if anyone wished to come forward to challenge and argue against the JOLs' conclusions, then they should do so at their own risk and without any form of assurance about their costs until the conclusion of the issue about which they had taken a stand which would discourage bad or unnecessary arguments being taken by parties which would only lead to wasted costs and further delays in the distribution of the assets.

19. Having discussed the alternative approach with their advisers, the JOLs then proposed to express a position on certain of the Issues insofar as they are able to do so. However, the JOLs wish to make it clear that they are not in a position to state a view on some of the Issues at this stage. The JOLs will do so knowing that it will be the Court and not they as JOLs who will resolve them. The JOLs believe that, whatever view they express, the Court is likely nevertheless to have to hear argument on particular questions and see those issues ventilated and presented fairly.

20. In fact on those Issues which deal with ranking of investors it may be that Deutsche Bank or some other substantial shareholder of SPhinX Ltd, will take up the baton of arguing the case against S Shareholders and other Redemption Creditors. That interest would be severely affected if it were to be shown that S Shareholders and redemption creditors ranked ahead of their shareholding. The Court will be aware of the fact that the JOLs have commenced proceedings against Deutsche Bank in New York seeking to recover the losses suffered by the SPhinX Companies.

21. The terms on which Deutsche Bank has asked to participate in the resolution of Issues is that the Court make a pre-emptive costs order in Deutsche Bank's favour. Deutsche Bank also wish to argue that, if it does not have an assurance on its costs, then the JOLs should remain neutral on the Ranking Issues. As a result, the Court will not then be in a position to give directions to the JOLs until it can also address the role and position of Deutsche Bank the June 2010 hearings. We believe that Deutsche Bank is likely to appear whether or not such an order for costs is made on a pre-emptive basis. We hope that Deutsche Bank is able to inform us whether it is prepared to take this step at the first of the directions hearings on 26 May 2010.

22. Apart from Deutsche Bank's role, the question which we would like resolved at the 9 and 10 June 2010 is whether the JOLs should take what might otherwise be regarded to be a partisan position adverse to that of shareholders. They would do so partly because their own legal advice favoured redemption creditors contrary to the interests of shareholders. These arguments are complex and are not the subject of case law. Accordingly, on any view that the JOLs were to express on the Ranking Issues, the JOLs realise that it may be argued that any of their conclusions are debatable. Nevertheless, the JOLs believe they should at least be willing to put forward a particular position without anyone believing we have given up our independence or objectivity.

23. There is, however, another reason why the JOLs consider it appropriate for them to put forward the case of redemption creditors. Because the JOLs shared information and legal advice with the Liquidation Committee over the last three years, shareholders such as Deutsche Bank and UBS were given an opportunity to develop their own theories to counter these arguments which those who would stand as redemption creditors have not had. This places the rest of the investors at a considerable disadvantage. Many of the ranking questions are complex and none of the redemption creditors would enjoy the same opportunity as Deutsche Bank and UBS have had to prepare their case. In fact, they will be at a considerable disadvantage in having to come up to speed on all the Issues and understanding the interplay between the various issues in a short space of time before evidence has to be filed for the substantive hearings.

24. In summary, the JOLs therefore consider that they should put forward the position of redemption creditors partly (i) because this represents their view of the correct outcome (ii) partly out of fairness to redemption creditors and (iii) partly because doing so would improve the prospects that the issues were properly ventilated before the Court. One of the purposes of this preliminary directions hearing is to understand whether the Court approves of the course which the JOLs propose to take.

25. It is also necessary to ensure that decisions that are reached on particular issues are binding on all investors. If that is not achieved then that too could create an opportunity for an investor at some later date to challenge a decision by the Court. One way to have achieved this would have been to organise for those parties representing relevant interests on particular issues to undertake the relevant debate. A representative order could have been made in respect of each such party. The JOLs would then have been expected to have remained neutral in the process.

26. If the Court approves the course which the JOLs propose to take on the Ranking Issues it may or may not be the case that some investor such as Deutsche Bank or UBS or some other investor will step up and wish to argue the contrary case. We are aware from a letter from Linklaters dated 14 May 2010 which is exhibited at Exhibit KK 101Tab 3 that Deutsche Bank is willing to act as a representative party but that their "*offer*" to do so was conditional upon a pre-emptive costs being made in its favour. On the footing that nobody opposes the JOLs' view, we understand that a decision on this issue could be rendered binding on everyone if the JOLs were representing all those investors who did not notify the JOLs that they wished to oppose the JOLs. Accordingly, the JOLs seek an order to this effect for the purposes of those issues which concern the ranking of investors.

27. Where an investor is prepared to step up and appear to advance arguments against the JOLs' position it also makes sense for a representation order to be made in respect of that investor who should bind every person who disagrees with the JOLs. If a creditor or investor does come forward to argue the contrary interest it would represent all other creditors or investors who take a position adverse to the JOLs.

28. The JOLs do not at this stage know who, if anyone, will come forward on the Ranking Issues, if Deutsche Bank decides that it will not do so. Nor do we know when Deutsche Bank would commit itself to this process. It may well be that nobody comes forward until some directions have been given. We are, however, anxious that the process of resolving the issues should not be delayed. We have therefore engaged in the process of formulating more detailed issues with a view to ensuring that some

investor would be ready if they were so inclined to participate in the more detailed directions we hope to obtain on 9 and 10 of June 2010.

Proposal for More Detailed Directions

29. As I have already explained, the Expanded Issues cover three different areas of inquiry and it is obvious to the JOLs and their attorneys that their resolution must be case-managed so as to ensure that they are concluded in a logical sequence. The prioritisation of issues is complex and needs to be carefully staged. The JOLs and their attorneys have formed some preliminary views on these which I outline briefly below.

30. Some but not all of the issues require evidence and when that is required there are one or two respects in which it is possible that the evidence will be contentious. Whatever directions are given for the resolution may need to take account of preliminary views on the evidence. We will endeavour to identify those issues on which evidence is likely to be needed before the 9 and 10 June 2010 hearing.

31. It seems to the JOLs that the question whether the assets of the SPhinX Companies have been co-mingled as a matter of fact to such an extent that it is impractical and/or impossible to identify what belongs to any specific entity is one of the most important issues, the outcome of which is likely to affect the way in which all other Liquidation Issues have to be addressed. This question is covered by Issues 1 to 4 of the Liquidation Issues. If the assets are to be treated as one or more "pools" and equitable principles determine distribution, this may well affect the Court's view of certain Ranking Issues in Section B of the Liquidation Issues. It is also likely to affect the manner in which liabilities of the various companies are addressed.

32. Before the Court or any interested party can decide these Issues the JOLs believe they need to produce evidence of the state of the SPhinX Companies' records and explain the results of their investigations into the assets to date. The JOLs are in the process of preparing a report for this purpose but I do not wish anyone to be under any illusion: the exercise is a substantial one.

33. Once a report has been provided on this issue, the outcome of Issue 4 is largely a legal one. The JOLs and investors would know the extent to which they could rely on the separation of the companies within the corporate structure or whether there is likely to be a distribution in equity (the Court would not need to be in any position at that stage to pronounce on what principles would be used to distribute assets).

34. Because they believe the answers to Issue 1 to 4 will be reasonably clear cut, the JOLs propose that they should take a position on Issues 1 to 4 and wait to see if anyone opposes them. They nevertheless, if at all possible, would seek directions at the earliest possible opportunity with a view to obtaining an early determination of these Issues.

35. In general terms, the JOLs have been advised by their legal advisers that all the Ranking Issues apart from Issues 11 and 12 (which deal with what assets were available to S Shareholders and) and the Issue which deals with solvency should be resolved before the issues relating to allocation of liabilities and the principles determining distributions are addressed. This is because it may be important for distribution purposes to know how investors rank, whether as creditors or shareholders.

36. The JOLs therefore have it in mind to invite the Court to make case management directions which place the issues on different tracks with a view to them reaching a conclusion in a logical sequence. We believe it is also imperative for investors to ensure that all Liquidation Issues are being advanced to a conclusion, even if some will be determined sooner than later. As far as possible the JOLs hope to obtain

meaningful directions to that end at the hearings on 9 and 10 June 2010. At that hearing we would also invite the Court to resolve the uncertainty about its own role and that of any party such as Deutsche Bank.

Sworn to at

this 21st day of May 2010

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NOTARY PUBLIC **KENNETH M. KRYS**

Approved as to form and content by Kenneth Krys – to be sworn on 24/25 May 2010

This Affidavit was issued by Ritch & Conolly, Attorneys-at-Law for the JOLs, whose address for service is P.O. Box 1994, 4th Floor, Queensgate House, South Church St, George Town, Grand Cayman KY1-1104.