ITEM NO. 154

JA-41

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Court of Appeal

In re Lehman Brothers International (Europe) (in administration) (No 2)

[2009] EWCA Civ 1161

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2009 Oct 26; Nov 6

Lord Neuberger of Abbotsbury MR, Longmore, Patten LJJ

Company — Scheme of arrangement — Sanction of court — Company in administration — Administrators proposing scheme of arrangement involving distribution of property held by company on trust — Whether scheme dealing with proprietary claims "compromise or arrangement" between company and its
C *creditors or any class of them — Whether court having jurisdiction to sanction proposed scheme — Companies Act 2006 (c 46), ss 895, 899*

The company provided services, including the execution, clearing and settlement of securities and derivative trades and the custody and valuation of client portfolios, to various institutional clients, many of which were hedge funds. A key feature of many of those transactions was that the clients obtained or
D retained proprietary interests in assets held by or on behalf of the company. The company went into administration and the administrators applied for an order proposing a scheme of arrangement under Part 26 of the Companies Act 2006[1] between the company and its creditors in relation to cash and securities held by the company on trust for them. Part 26 of the Act was concerned with "arrangements and reconstructions" and section 895(1) provided that the Part applied where a "compromise or arrangement" was proposed between a company and its creditors
E or its members. Section 899 empowered the court to sanction such a compromise or arrangement when it had been approved by a majority in value of creditors. The respondent, a trade association for firms in the investment banking and securities industry, opposed the scheme on jurisdictional grounds. The judge held that the court had no jurisdiction under Part 26 to sanction the scheme in so far as it was concerned with the distribution by the company of property held or controlled by it on trust for any of its creditors and to the extent that it varied or extinguished those property rights.

F On appeal by the administrators—

Held, dismissing the appeal, that the court's jurisdiction pursuant to section 895 of the Companies Act 2006 was circumscribed by the requirement that the scheme should be an arrangement between the company and its creditors; that an arrangement between a company and its creditors meant an arrangement which dealt with their rights inter se as debtor and creditor; that, although that formulation did not prevent the inclusion in the scheme of the release of
G contractual rights or rights of action against related third parties necessary in order to give effect to the arrangement proposed for the disposition of the debts and liabilities of the company to its own creditors, it did exclude from the jurisdiction rights of creditors over their own property which was held by the company for their benefit as opposed to their rights in the company's own property held by them merely as security; that a proprietary claim to trust property was not a claim in respect of a debt or liability of the company, and a beneficiary who had a

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[1] Companies Act 2006, Pt 26, s 895(1): "The provisions of this Part apply where a compromise or arrangement is proposed between a company and—(a) its creditors, or any class of them, or (b) its members, or any class of them."

S 899(1): "If a majority in number representing 75% in value of the creditors or class of creditors or members or class of members . . . agree a compromise or arrangement, the court may, on an application under this section, sanction the compromise or arrangement."

beneficial interest in property held on trust by the company was not a creditor of the company notwithstanding the wide meaning that "creditor" was to be given in section 895; and that, accordingly, the court's power to sanction a scheme of arrangement under Part 26 did not extend to the release of rights over property held by the company under a trust (post, paras 58, 59, 61, 63, 65–67, 69–71, 74, 75, 78, 87).

Decision of Blackburne J [2009] EWHC 2141 (Ch) affirmed.

The following cases are referred to in the judgments:

Alabama, New Orleans, Texas and Pacific Junction Railway Co, In re [1891] 1 Ch 213, CA
City of Swan v Lehman Brothers Australia Ltd [2009] FCAFC 130
Empire Mining Co, In re (1890) 44 Ch D 402
Lehman Brothers International (Europe) (No 3), In re [2009] EWHC 2545 (Ch)
Midland Coal, Coke and Iron Co, In re [1895] 1 Ch 267, Wright J and CA
NFU Development Trust Ltd, In re [1972] 1 WLR 1548; [1973] 1 All ER 135
Opes Prime Stockbroking Ltd, In re [2009] FCAFC 125
Quistclose Investments Ltd v Rolls Razor Ltd (in liquidation) [1970] AC 567; [1968] 3 WLR 1097; [1968] 3 All ER 651, HL(E)
Savoy Hotel, In re [1981] Ch 351; [1981] 3 WLR 441; [1981] 3 All ER 646
Sharp v Jackson [1899] AC 419, HL(E)
Sinclair v Wilson (1855) 20 Beav 324
T & N Ltd, In re [2005] EWHC 2870 (Ch); [2006] 1 WLR 1728; [2006] 3 All ER 697; [2006] 2 BCLC 374; [2006] BPIR 532
T & N Ltd (No 4), In re [2006] EWHC 1447 (Ch); [2007] Bus LR 1411; [2007] 1 All ER 851; [2007] 1 BCLC 563; [2006] BPIR 1283
Webb v Stenton (1883) 11 QBD 518, CA

The following additional case was cited in argument:

Prudential Assurance Co Ltd v PRG Powerhouse Ltd [2007] EWHC 1002 (Ch); [2007] Bus LR 1771; [2008] 1 BCLC 289; [2007] BPIR 839

No additional cases were referred to in the skeleton arguments.

APPEAL from Blackburne J

By an application dated 14 July 2009 Anthony Lomas, Steven Anthony Pearson, Michael John Andrew Jervis and Daniel Yoram Schwarzmann, the joint administrators of Lehman Brothers International (Europe) (in administration) ("LBIE") applied, pursuant to paragraphs 63 and 68(2) of Schedule BI to the Insolvency Act 1986, for directions that they should be at liberty to propose a scheme of arrangement, under Part 26 of the Companies Act 2006, between LBIE and the persons who were its creditors in relation to trust property. GLG Partners LP supported the scheme and the respondent, the London Investment Banking Association, opposed it.

On 21 August 2009 Blackburne J held that the court had no jurisdiction to sanction the scheme of arrangement. With permission of the judge and by an appellant's notice filed on 10 September 2009, the applicants and LBIE appealed on the ground, inter alia, that the judge was wrong to hold that a creditors' scheme of arrangement fell outside the jurisdiction of the court under Part 26 of the Companies Act 2006 if it varied the property rights of creditors.

The facts are stated in the judgment of Patten LJ.

A *William Trower QC* and *Daniel Bayfield* (instructed by *Linklaters LLP*) for the administrators.

Richard Snowden QC and *Andrew Thornton* (instructed by *Freshfields Bruckhaus Deringer LLP*) for London Investment Banking Association.

Antony Zacaroli QC (instructed by *Allen & Overy LLP*) for GLG Partners LP by written submissions.

B The court took time for consideration.

6 November 2009. The following judgments were handed down.

PATTEN LJ

Introduction

C **1** Lehman Bros International (Europe) ("LBIE") entered administration on 15 September 2008. Until then one of its major business areas was the provision of what are described in the evidence as prime services to various institutional clients. Most of these were hedge funds. The services in question included the execution, clearing and settlement of securities and derivative trades and the custody and valuation of the clients' portfolios.

D **2** Hedge funds do not have substantial back office functions of their own. They therefore require a third party to deal with the trades themselves and thereafter to provide custodial and reporting services. As part of these transactional arrangements, prime brokers such as LBIE lent cash and securities to the hedge funds and provided foreign exchange services. Any finance was usually secured against the assets of the hedge fund held by or through the prime broker.

E **3** These services were provided under a variety of standard form agreements which I will come to in a little more detail later in this judgment. The principal contracts under consideration in these proceedings are international prime brokerage agreements, master custody agreements, margin lending agreements and what is referred to as the credit support annex to the ISDA master agreement. As the names suggest, LBIE's prime service clients ranged from hedge funds who used the company to provide the full range of services described above to clients who placed securities with LBIE for safe custody.

F **4** It is common ground that a key feature of all these transactions was that the counterparty client obtained (or, in the case of pure custody agreements, retained) proprietary interests in the assets held by or on behalf of LBIE. LBIE held the assets through various depositories, exchanges, clearing systems and sub-custodians depending on the type of asset and the systems through which they were traded. But none of these arrangements is said to have effected any material change in beneficial ownership.

G **5** The administrators have therefore recognised that the contracts described above give many of the counterparties specific claims over the cash and securities transferred to LBIE. But they are faced with the serious difficulty that, as things stand, they cannot be certain who is entitled to the trust property in their hands. Therefore any distribution of the assets without the protection of some kind of approval from the court is likely to give rise to claims against LBIE and the administrators for breach of trust by those who claim to be entitled to the property adversely to the counterparties

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to whom it is in fact distributed. For the same reasons, the recipients of the assets are also at risk. Conversely, if no distribution takes place or delays in distributions continue, the administrators are likely to face proceedings for the return of the assets from those who claim to be entitled to them. In relation to some classes of asset, these may exceed the quantity of the relevant securities which remain available for distribution.

6 The uncertainties involved in dealing with the trust assets have three primary causes: a lack of response from clients to inquiries made about the transactions in which they were involved; the inability of the administrators to rely on LBIE's books and records; and the failure of custodians, depositories and affiliates to provide information about the assets held on behalf of LBIE.

7 These difficulties have been recognised for some time. On 7 October 2008, at an early stage in the administration, directions were obtained from Blackburne J as the designated judge under which the administrators were to take appropriate steps to identify whether money or securities might be subject to trust or proprietary claims. This order envisaged requests for information being sent to counterparties and for Linklaters (the administrators' solicitors) to devise and set up a programme for identifying the legal issues which needed to be determined before a proposal for the distribution of trust property could be prepared.

8 The administrators have written to 1,707 account holders who are thought to have potential claims against LBIE for the return of trust property. The letters ask for details of any such claims, rights or other interests in the assets in question; confirmation of the positions and balances held with LBIE immediately prior to the making of the administration order on 15 September 2008; copies of all relevant documentation; and details of any positions which have been terminated or closed since the making of the administration order. Similar requests for information have been added to the administrators' website.

9 As of 29 May 2009, 950 responses have been received, some of which are incomplete. In the same period the administrators have received some 1,214 claims for the return of trust assets. A number of these have been identified as priority claims by a hardship and prioritisation committee set up by the administrators in accordance with the prioritisation principles referred to in the order of Blackburne J dated 7 October 2008.

10 Aside from issues of priority, the administrators have had to expend considerable resources on making requests for information from clients and locating documents within LBIE's records in order to conduct a line-by-line reconciliation of the clients' positions. Where assets have been distributed, the clients have been required to enter into deeds of undertaking which give the administrators a right to recover the assets or their value where they subsequently turn out to be subject to competing claims. It goes without saying that these measures add to the cost and uncertainties involved in the distribution process.

11 In order to produce some finality for the clients and for the process of administration in respect of these claims, permission was sought from Blackburne J that the administrators should be at liberty to propose a scheme of arrangement under Part 26 of the Companies Act 2006 between LBIE and the persons who are its creditors in relation to trust property as defined in para 9 of what is referred to as the Pearson statement. This is a

witness statement made by Mr Steven Pearson, one of the administrators, on 25 February 2009 which explains the steps taken to process the proprietary claims and the reasons for seeking to promote a scheme. Mr Pearson says in para 9:

> "As set out in my first statement, made in relation to the application for the trust property order, a redacted version of which has been placed on the court file and is available on the section of the PwC [PriceWaterhouseCoopers] website dedicated to the administration of LBIE, the administrators wished to adopt a system for dealing with all property of, or held in the name of, or otherwise to the order of, LBIE which is subject to trust or proprietary claims, whether comprising moneys under the FSA's client money rules ('client money') or other moneys or assets ('trust assets') (together with 'trust property') in an orderly and efficient manner and one which balanced the importance of dealing with the potential proprietary claims and the achievement of the statutory purpose for which we have been appointed."

12 On 16 March 2009 Blackburne J gave the administrators liberty to propose a scheme of arrangement of the type sought. Section 899 of the Companies Act 2006 empowers the court to sanction a compromise or arrangement proposed between a company and its creditors or any class of creditors when it has previously been agreed to in class meetings by a majority in number representing 75% in value of the creditors or class of creditors in question.

13 There is no statutory definition of "creditor", "compromise" or "arrangement" but a scheme has been prepared under which (subject to certain exceptions which I will come to in more detail later) "scheme creditors" (as defined) who can establish proprietary claims to the assets held by LBIE at the time of administration will release those claims and any associated pecuniary claims for damages or equitable compensation and will receive, in return, what are described as new claims. They will give to each scheme creditor a right to receive, on a pooled basis, securities or other assets of the type claimed and (when it occurs) will leave the counterparty to recover as an unsecured creditor the value of any shortfall in its proprietary claim caused by the shortage of the relevant assets.

14 Scheme creditors will therefore be required under the scheme to release proprietary rights in assets which are held for their benefit by LBIE as trustee and the combination of the necessary majorities in suitably constituted class meetings and the court's sanction of the scheme will be effective to enforce those provisions against any dissenting minority of creditors who would be otherwise unwilling to give up their property rights. A question arose as to whether a scheme which has this effect falls within the provisions of Part 26. The administrators therefore applied, pursuant to paragraphs 63 and 68(2) of Schedule B1 to the Insolvency Act 1986 (as inserted by section 248 of and Schedule 16 to the Enterprise Act 2002), for a determination of this question by the court in advance of any further directions being given for the preparation of the scheme and the constitution of the class meetings. After hearing argument from the administrators and a representative of some hedge funds (GLG Partners LP) who support the scheme and from the London Investment Banking Association ("LIBA"), a trade association for firms in the investment banking and securities industry,

who oppose the scheme on jurisdictional grounds, Blackburne J decided that, in so far as the proposed scheme of arrangement is concerned with the distribution by LBIE of property held or controlled by it on trust for any of its creditors and to the extent that it varies or extinguishes those property rights, the court has no jurisdiction under Part 26 to sanction the scheme. The administrators now appeal from that decision with the leave of the judge.

The contractual arrangements

15 As mentioned earlier, the administrators have identified four principal contracts under which the counterparties will retain proprietary interests in the cash or securities held by LBIE. The issue of jurisdiction raised before the judge and on this appeal can be determined as a matter of principle without any detailed consideration of the provisions of the particular contracts which give rise to the proprietary interests. But it is useful to have in mind the various types of agreement and some of their key provisions when considering Mr Trower's submissions about the proper approach to be applied to commercial arrangements which utilise a trust mechanism in relation to the assets involved. I can therefore deal with the individual contracts quite shortly by commenting on two of the agreements which illustrate the point.

(1) International Prime Brokerage Agreement ("IPBA")

16 This governed all acquisitions and disposals of securities by LBIE as prime broker together with the provision of any related advances of cash and securities. Under the agreement LBIE acted as the counterparty's agent in settling the transactions and delivering the securities. Cash accounts were opened into which all advances of cash made to the counterparty were entered as credits. Securities delivered by the counterparty to LBIE as prime broker or received by LBIE in settlement of third party transactions were entered as debits in a securities account.

17 Clause 5.2 of the IPBA provides:

> "The parties acknowledge and agree that any cash held by us for you is received by us as collateral with full ownership under a collateral arrangement and is subject to the security interest contained in the agreement. Accordingly, such cash will not be client money pursuant to the rules (or any successor provisions thereto) and will not be subject to the protections conferred by the rules. Such cash held by the prime broker will not be segregated from the money of the prime broker or any other counterparty of the prime broker and will be held free and clear of all trusts. The parties further agree that the prime broker will use such cash in the course of its business and the counterparty will, therefore, rank as a general creditor of the prime broker in respect of such cash."

18 This is in contrast to the position in relation to securities. Clause 17.1 provides:

> "With the exception of any assets transferred to the prime broker pursuant to clause 11, any securities debited to the securities accounts shall be held by the prime broker as custodian, and the counterparty hereby appoints the prime broker, and the prime broker agrees to act, as its custodian, in accordance with the terms of schedule 2."

A **19** Paragraph 2 of schedule 2 requires LBIE to segregate assets by identifying in its books and records that the securities belong to a particular counterparty and not to LBIE and requiring any sub-custodians to do the same. But, subject to this, LBIE is authorised by paragraph 9 of Schedule 2 to hold securities in fungible accounts with the securities of other customers designated as customer accounts. The reference in clause 17.1 to clause 11 is to the right of use granted by the client to LBIE as prime broker to borrow, lend, charge or dispose of any securities charged to it under the provisions of clause 10 of the agreement. Where this right of use is exercised, the securities become the absolute property of LBIE: see clause 11.2(a). The charge granted by clause 10 in respect of the liabilities of the counterparty to LBIE includes securities debited to the securities account subject to a number of specific exceptions including securities where the certificates of title are deposited with a Lehman company and all cash credited to any cash account.

20 These provisions were recently considered in some detail by Briggs J in his judgment in *In re Lehman Bros International (Europe) (No 3)* [2009] EWHC 2545 (Ch) where he rejected an argument that the existence of a trustee/beneficiary relationship subsisting between LBIE and the counterparty in respect of securities held by LBIE was inconsistent with the right of use provisions and the permission to hold the counterparty's assets in a fungible account. The judge also decided that the provisions of clause 5.2 had no application to cash derived from securities and received by LBIE or any of its sub-custodians on or after the making of the administration order on 15 September 2008. These moneys would include the proceeds of any redemptions together with receipts in the forms of dividends or coupons. Those moneys therefore remain trust assets in the administrators' hands.

21 Clause 13 of the IPBA entitles a counterparty to terminate the agreement in the event of a failure by LBIE to provide the prime services contracted for. But the exercise of this power has the effect of making any outstanding loans from LBIE immediately repayable and of converting the obligations of the company under clause 7 to deliver the securities in specie to the counterparty on request into an unsecured obligation to pay a net cash balance arrived at by setting off against the value of the securities and any other assets held by LBIE for the client on closure of the client's liabilities to LBIE.

(2) Master Custody Agreement ("MCA")

22 The MCA covers holdings of both securities and cash on behalf of the client. It was used when only custody services were provided by LBIE and in investment banking transactions where such services were provided to the client as part of a larger transaction.

23 In earlier versions of the agreement, LBIE is granted a general lien over the property until satisfaction of all liabilities of the client to it or to any other Lehman Bros entity. But, subject to this, all versions of the agreement contain provisions requiring LBIE to separately identify property of the client in its records and to provide the client with an annual statement of the property held to the client's account. Subject to this, LBIE was entitled, in appropriate cases, to pool the property with that of other clients.

The scheme

24 The key provisions of the proposed scheme ("the scheme") are conveniently summarised in the judgment of Blackburne J, at paras 22–32, as follows:

> "22. The scheme is intended to deal with persons who are described as 'scheme creditors'. These are persons who have claims against LBIE at the time it was placed in administration (the 'time of administration') for or in respect of what are described as 'segregated assets'. The claims must be capable of being satisfied by the delivery, in whole or in part, of the segregated assets. Segregated assets are defined as 'any security which at the time of administration was held on a segregated basis' meaning that the asset 'was recorded as being held separately from LBIE's own securities in both the books and records of LBIE and also at LBIE's custodian or depository (the intermediary) . . .' 'Security' is defined as 'any financial instrument, including any share, instrument creating or acknowledging indebtedness, instrument creating or acknowledging entitlements to investments, warrant and unit in a collective investment scheme . . .' It excludes money. I was told that there are approximately 28,000 different categories of security to be dealt with.
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> "23. A scheme creditor is expressly described as excluding anyone whose claims 'are not proprietary but are only unsecured'. Equally, as Mr Trower explained in the course of argument, a scheme creditor will not include anyone who has no kind of pecuniary claim, however contingent, against LBIE. Thus, a client with a claim to a particular security but who renounces any pecuniary claim (for example, for damages for late delivery of the security) and confines his claim to its return will not be included. In short, a person is only a scheme creditor if that person (1) has a pecuniary claim against LBIE and (2) has a proprietary claim to a security which was held on a segregated basis at the time of administration.
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> "24. The scheme explains, in what is described as 'Key Concept 2', that 'the subject matter of the scheme is trust property'. Trust property is wider than 'segregated assets' because it includes assets, referred to as 'derived assets', which are derived from segregated assets, and 'recovered assets'. Recovered assets are assets received by LBIE from a source which has an obligation to redeliver to LBIE a security which had been delivered by LBIE to that source after the time of administration but prior to the date ('the effective date') when a copy of the court's order sanctioning the scheme under Part 26 (assuming such an order is made) is delivered to the Registrar of Companies.
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> "25. The scheme is intended to deal with all of a scheme creditor's proprietary claims against LBIE for the return of trust property. It extends to property which LBIE should have held even if in fact it does not. This is subject only to the requirement that LBIE must hold some property of the scheme creditor and means therefore that if the claim is confined to an unsecured pecuniary claim against LBIE, the claim will not be dealt with under the scheme.
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> "26. The key provision of the scheme, set out in Part 2 of Section 4 of the proposal, is that scheme creditors release all claims (save for certain 'excluded claims') against LBIE, the scheme supervisors, the

A administrators and other scheme creditors, including all claims for or in respect of (1) any 'asset claim' (meaning, put shortly, a claim against LBIE in respect of any trust property), (2) any payment for or on account of any asset which is or was at any time the subject of an asset claim, (3) damages, indemnity or contribution in respect of any loss, cost or expense in connection with any asset which is or was at any time the subject of an asset claim, (4) all liabilities for breach of contract, loss or damage, indemnity or contribution of any nature, (5) all rights to seek or enforce judgment, exercise any remedy or apply any set-off, netting, withholding, combination of accounts or retention or similar rights against LBIE in respect of any claim or liability, and (6) all rights in respect of any financial contract. These are defined as 'released claims'.

"27. In exchange for their released claims, scheme creditors are given what are described as 'new claims'. Broadly stated, these are (1) the right of each creditor to have its net contractual position (as earlier summarised) and what are described as 'allocations and distributions' determined on the basis set out in the scheme, (2) the right to have such part of the trust property as is available for distribution under the scheme allocated to and then delivered to the creditor, alternatively appropriated by LBIE in or towards discharge of the creditor's liabilities to LBIE (or certain affiliates or other third parties), (3) the right to claim against LBIE in accordance with the scheme for the amount of that creditor's net contractual position (assuming that the position has resulted in an amount owing by LBIE to that creditor) as a new obligation of LBIE and (4) the right to claim in LBIE's winding up or any other distribution of LBIE's assets for such amount as is determined under the scheme. The new claims are subject to an overriding proviso that no scheme creditor is entitled to recover more than once in respect of the same asset or claim.

"28. The reference to 'allocations' is, shortly stated, to the right of LBIE to allocate trust property available for distribution under the scheme to a scheme creditor by reference to individual stock lines (for example the quantity of a particular quoted security) held as trust property. Paragraph 10.7 of 'Key Concept 6' (concerned with 'Allocations and shortfalls') provides in terms that 'a scheme creditor's entitlement to participate in an allocation will be based on its asset claim'. This in turn is to be determined by LBIE based on certain information available to it. The scheme creditor has the opportunity to challenge the determination through a dispute resolution mechanism. Paragraph 10.8 requires the scheme creditor when receiving anything in respect of its asset claim to account for any assets received from an Intermediary (rather than from LBIE direct) and paragraph 10.10 provides, in effect, that if the allocations made to a scheme creditor result in a shortfall then the value of that shortfall is to rank as an unsecured claim against LBIE.

"29. The broad effect, although the drafting of the scheme is a little dense at this point, is that, subject to certain exceptions, LBIE will match a scheme creditor to a particular stock line where LBIE can be satisfied on the information available to it that the creditor has a proprietary claim (the so-called 'asset claim') to assets answering the description of that stock line. This is on the basis that the creditor's claim will be satisfied (by means of the 'distribution') out of that stock line so far as is possible having regard (1) to the overall quantity of the stock line available for

distribution and (2) to the competing claims of other creditors to the same stock line.

"30. But there is an important qualification to this which is set out in Part 3 of Section 4. This is the provision of a cut-off date (the 'bar date') for the submission of claims under the scheme. The date envisaged is either 31 December 2009 or, if later, the last business day of the second full calendar month following the effective date. Paragraph 21.1 provides that: 'Any claim submitted after the bar date can be disregarded by LBIE'. But this is subject to an exception: if by the bar date a scheme creditor has failed to submit a claim (by completing a pro forma claim form) LBIE will calculate that scheme creditor's entitlement under the scheme using 'relevant information.' This is information capable of ascertainment from LBIE's books and records, information contained in the scheme creditor's claim form (if one has been submitted) and also, shortly stated, information from various notices delivered under the scheme as well as information made available by intermediaries, affiliates and any relevant exchange. Once the bar date has passed LBIE will start allocating, appropriating and distributing on the basis of pre-bar date claim forms and other relevant information. This means that if a secured creditor fails to submit a claim form by the bar date and, by that date, LBIE is without any relevant information in relation to that scheme creditor's claim, the claim may be disregarded.

"31. However, as Mr Trower explained in the course of argument, the imposition of a bar date is not intended to have the consequence that the late claim is altogether barred. If the scheme creditor can substantiate its claim, then, notwithstanding that this is after the bar date, it may share in the particular stock line, but it may only do so if and to the extent that there is any surplus in that stock line. Thus, if there are no other claimants to a particular stock line (or the claims of those other claimants have been fully satisfied), the late claimant is unaffected by the bar date. Conversely, if there is insufficient in the stock line to satisfy the accepted claims of pre-bar date claimants, the later claimant will be left to claim as an unsecured creditor. In short, there is no 'catch-up' concept for late claimants as regards any distribution: they must await the full satisfaction of the accepted claims of pre-bar date established claims.

"32. For present purposes, the scheme may be summarised by saying that a client of LBIE who qualifies as a scheme creditor—in that the client has, or potentially has, a pecuniary claim against LBIE and is the owner of a particular asset held or controlled by LBIE (for example a quantity of a particular quoted security)—will have that asset claim satisfied on a pooled basis, ranking alongside (and in competition with) others who can establish ownership claims to the same asset, to the extent that the securities comprising that asset are available to meet the claims. The unrecovered value of the client's asset claims and any balance due to the client on computing the client's net contractual position with LBIE resulting from the closing out of all financial contracts between the client and LBIE are to rank as unsecured claims against LBIE. All other pecuniary claims of the client against LBIE are foregone."

25 As the judge recognised, there will be cases where the claims of some of those counterparties are sufficiently well documented to establish a clear entitlement to particular securities ahead of any other potential claimants.

In such cases the conversion of a counterparty's existing proprietary claims into new claims as defined will inevitably involve a loss of priority in cases where the pool of assets of a particular type (e g a particular stock line) held by LBIE is insufficient to meet the claims of all clients who are able to establish a right to assets of that kind. Clients in that position have least to gain from the scheme but are at risk of having their property rights compulsorily acquired in order to permit a speedy and effective distribution of available assets amongst the entire class of relevant claimants.

26 Likewise the scheme creditor who fails to submit a claim by the bar date in circumstances where the administrators have no relevant information as defined may find that it effectively forfeits its right over securities it once owned and is limited to recovering from any surplus of assets once the claims to that stock line by the pre-bar date claimants have been satisfied.

27 Blackburne J held that the court has no jurisdiction under Part 26 to sanction a scheme which interferes with the property rights of the clients of LBIE in this way. Although the potential effect of the bar date on some scheme creditors is perhaps the most striking example of the way in which existing property rights could be removed, the issue of principle raised before the judge and on this appeal does not turn on those particular provisions of the scheme. LIBA's objection on jurisdictional grounds centres on the identity of the scheme creditors and the nature of the rights which the scheme attempts to deal with. The judge identified the key question as being whether the scheme affects clients of LBIE in their capacity as creditors of the company. His view was that it did not in so far as it purported to deal with and discharge their proprietary rights over the securities and other assets held to their account by LBIE. There is, of course, no dispute that in respect of any pecuniary claims which they may have against the company for damages or equitable compensation for breach of trust, they are, to that extent, creditors. But the judge held that this was insufficient to entitle the court in the exercise of its Part 26 jurisdiction to sanction a scheme in so far as it compromised or removed their rights over trust property.

Jurisdiction

28 The argument advanced by Mr Snowden on behalf of LIBA which the judge accepted can be expressed quite shortly. Part 26 of the Companies Act 2006 confers on the court a jurisdiction to sanction compromises or arrangements between the company and its creditors which have been approved by a majority in value of creditors according to the conditions set out in section 899(1). Although the discretion to approve the scheme is a general one to be exercised judicially having regard to the objects of the scheme and its general fairness in relation to creditors, the jurisdiction is not an unlimited one. The "arrangement" must have the necessary features of give and take described by Brightman J in *In re NFU Development Trust Ltd* [1972] 1 WLR 1548 and it has to be an arrangement between a company and its creditors or members.

29 There is no statutory definition of "creditor" or "arrangement" for the purposes of Part 26 and, in relation to "arrangement", the courts have been careful not to attempt to provide one beyond the limited criteria described in *In re NFU Development Trust Ltd*. But Mr Snowden contends that, in order to be a creditor of the company, it is necessary to be owed

money either immediately or in the future pursuant to a present obligation or to have a contingent claim for a sum against the company which depends upon the happening of a future event such as the successful outcome of some litigation. Although a creditor for the purposes of Part 26 is not therefore limited to someone with an immediately provable debt in a liquidation, it does require that person to have a pecuniary claim against the company which (once payable) would be satisfied out of the assets as a debt due from the company.

30 As support for this, we were referred to the decision of the Court of Appeal in *In re Midland Coal, Coke and Iron Co* [1895] 1 Ch 267 in which it was accepted that a person with a contingent claim against the company qualified as a creditor under a scheme of arrangement made under the Joint Stock Companies Arrangement Act 1870 (33 & 34 Vict c 104). Lindley LJ said, at p 277, that he agreed that:

> "the word 'creditor' is used in the 1870 Act in the widest sense, and that it includes all persons having any pecuniary claims against the company. Any other construction would render the Act practically useless."

31 Based on this decision, David Richards J concluded in *In re T & N Ltd* [2006] 1 WLR 1728, para 40, that persons with contingent claims for damages against a company were creditors within what is now Part 26:

> "In my judgment, 'creditors' in section 425 of the Companies Act 1985 is not limited to those persons who would have a provable claim in the winding up of the company, although it clearly includes all those who would have such a claim. As was submitted by Mr Snowden and other counsel, one of the recognised purposes of section 425 is to encourage arrangements with creditors which avoid liquidation and facilitate the financial rehabilitation of the company: see, for example, *Sea Assets Ltd v PT Garuda Indonesia* [2001] EWCA Civ 1696 at [2]. This suggests that as wide a meaning as possible should be given to 'creditors' in the section. Having said that, it is important to bear in mind that section 425 is designed as a mechanism whereby an arrangement may be imposed on dissenting or non-participating members of the class and such a power is not to be construed as extending so as to bind persons who cannot properly be described as 'creditors'."

32 These cases were not, of course, concerned with the status of claimants who were asserting proprietary interests over the assets held by the company. But LIBA fastens on the reference in Lindley LJ's judgment to the widest use of the words being capable of extending to contingent creditors as at least an indication that the concept of a creditor does not extend further to include those whose relationship is not that of a debtor/creditor at all.

33 The foundation of Mr Snowden's argument is that a beneficiary under a trust is not ipso facto a creditor of the trustee. Although the trust relationship may give rise to unsecured claims against the trustee for breach of trust or even negligence and may sometimes exist in a wider contractual framework, it remains at its core a different legal relationship. Subject to the terms of the trust instrument, the trustee holds the trust property for the benefit of those beneficially entitled to it and has a primary obligation to maintain those particular assets (or any which replace them) to the exclusion of all other claims. The trust property does not form part of the trustee's

A estate in the event of insolvency so as to be available to meet the claims of general creditors and the beneficiary is entitled to the property in specie free of any such claims.

34 If authority is needed to make good the distinction between a creditor and a beneficiary then Mr Snowden relies, by way of example, on the decision of Romilly MR in *Sinclair v Wilson* (1855) 20 Beav 324 that the B restoration of trust property from the estate of a bankrupt to a beneficiary did not amount to a fraudulent preference in favour of a creditor.

35 He therefore submits that the definition of a scheme creditor so as to include only counterparties who have both a proprietary claim and an unsecured pecuniary claim against the company is not sufficient to enable the court to exercise the Part 26 scheme jurisdiction so as to encompass the property rights of those involved. The proposed scheme is, in that respect, C not an arrangement between LBIE and the counterparties in their capacity as creditors. The court may therefore only sanction it (if at all) so far as it compromises the ancillary money claims.

36 In response to this argument Mr Trower submits that the judge focused too much on the removal or variation of existing property rights under the scheme and failed to apply the correct statutory test which is simply whether the scheme constitutes an arrangement between the D company and its creditors. The wording of section 895(1) does not impose, he says, a jurisdictional requirement that a scheme of arrangement should be made with creditors only in their capacity as creditors and if the judge based his decision to that effect on the word "arrangement" then he was wrong to do so. The courts have steadfastly refused to attach a narrow definition to that term.

E 37 Mr Trower submits that once a person qualifies as a creditor in the sense accepted by LIBA, the scheme jurisdiction is engaged and extends to all of his rights against the company and not merely to those which give rise to a claim in debt. If this is right then the court could only refuse to sanction the scheme as an exercise of discretion under section 899.

38 Mr Trower is clearly right to say that the scheme creditors are, on any view, creditors of the company, at least in so far as they have monetary F claims against LBIE either for the net balance due on their cash accounts or because LBIE has committed breaches of contract or trust in connection with the management of the cash and securities it held. Most of these claims would be provable in a liquidation under the provisions of rule 13.12 of the Insolvency Rules 1986 (SI 1986/1925) but, as mentioned above, it is accepted that this is not a precondition to the claimant being a creditor for G the purposes of Part 26.

39 What is said to follow from this is that the existence of a trust relationship is not inimical to the existence of a debtor/creditor relationship and may be the source of it. A claim for damages or equitable compensation for breach of trust arises out of the trust relationship. To that extent, a beneficiary will be a creditor of the trustee. The duty of the trustee to account to the beneficiary for trust property and to make restitution for any H such property which has been lost is carried out in substitution for the trustee's core duty to preserve and disburse the trust fund in accordance with the terms of the trust instrument. It is artificial, Mr Trower contends, in the context of a scheme to distinguish between the enforcement of this duty which gives rise to a monetary award in favour of the beneficiary (and

thereby makes him a creditor) and the right of a beneficiary to the trust asset itself. They are simply opposite sides of the same coin.

40 He also emphasises that the fact that a creditor may have proprietary rights relating to his claim against the relevant company is not in itself a bar to the exercise of the scheme jurisdiction. The most obvious examples are debenture holders and other secured creditors who are undoubtedly creditors of the company but commonly have their security removed or modified under a scheme of arrangement.

41 So in *In re Empire Mining Co* (1890) 44 Ch D 402 North J sanctioned a scheme under the 1870 Act between the company and its debenture holders on the basis that they were creditors. The judge said, at p 409:

> "The Act gives the court power to bind 'creditors', and debenture holders are creditors. The word 'creditor' in the Act is general. No distinction is made between different kinds of creditors; there is nothing to except any particular class of creditors from the jurisdiction of the court."

42 In *In re Alabama, New Orleans, Texas and Pacific Junction Railway Co* [1891] 1 Ch 213, the Court of Appeal rejected an argument that a scheme which deprived debenture holders of their security fell outside the scope of the 1870 Act. The decision of North J that debenture holders were creditors was affirmed. In relation to whether the removal of a security could be included in a scheme, Fry LJ said, at p 246:

> "But again, what kind of compromise or arrangement is the most common? Surely the most common kind of compromise or arrangement is one in which secured creditors diminish or alter the amount of their security. I repeat, that the legislature having used the largest language, such as 'any compromise or any arrangement between a company and any class of its creditors', I think, if we were to exclude from the arrangements or compromises to be made, an arrangement or compromise which affected the security, we should be putting a most unwarrantable restriction on the generality of the language used in the Act, and therefore I have no hesitation in saying that, in my judgment, the court has jurisdiction in this matter."

43 We were also taken to a number of authorities in which, in other contexts, beneficiaries under a trust have been treated as creditors of the trustee. In *Webb v Stenton* (1883) 11 QBD 518 an application was made to garnishee the money payable to a judgment debtor by way of income as a life tenant under a trust. Before the order could be made the money had in fact been paid to the debtor but Lindley LJ, at p 526, expressed the view that a liquidated sum payable in equity by the trustee to the life tenant constituted an "equitable debt" which was capable of being attached. Similarly in *Sharp v Jackson* [1899] AC 419 the House of Lords (following earlier decisions in the Court of Appeal) held that transfers of property to beneficiaries under a trust made by an insolvent trustee in order to make good previous breaches of trust did not amount to a fraudulent preference. The decision was based on there being no intention to prefer in the circumstances, but Mr Trower referred us to a passage in the speech of the Earl of Halsbury LC, at p 426, about whether the beneficiary in that case could be a creditor:

A "It has been suggested that there was a proposition which could be maintained, as to which I confess I entertain grave doubts whether any decision goes to that extent, namely, that the relation between a cestui que trust and a trustee who has misappropriated the trust fund is not that of debtor and creditor. That it may be something more than that is true, but that it is that of debtor and creditor I can entertain no doubt. As that question has been mooted and brought before your Lordships' House as one question for decision here, I certainly have no hesitation in saying that in my opinion no such proposition can properly be maintained, and that although there are other and peculiar elements in the relation between a cestui que trust and a trustee, undoubtedly the relation of debtor and creditor can and does exist."

B

C **44** I find these cases of very limited assistance in relation to what we have to decide. The interpretation of the rules of court governing the making of garnishee orders is far removed from the issues which arise in relation to Part 26. *Sharp v Jackson* [1899] AC 419 is closer in context but the beneficiary in that case had a claim against the insolvent trustee for breach of trust which it is common ground would have made him a creditor for the purposes of a scheme. The issue in this case is whether the clients of

D LBIE are to be treated as creditors in respect of the rights in rem which they enjoy over the property held by the company. These are the elements of the trustee/beneficiary relationship which Lord Halsbury described, at p 426, as "other and peculiar". If anything, this reference is helpful to Mr Snowden's argument. But it certainly does not indicate that the Earl of Halsbury LC thought that beneficiaries ought to be regarded as creditors in respect of their proprietary claims.

E **45** Mr Trower's principal submission that a scheme of arrangement can legitimately alter the property rights of creditors begins with the unrestricted meaning to be given to the word "arrangement" in the context of Part 26. This is, of course, common ground. As mentioned earlier, judges have deliberately avoided giving the word a narrow meaning beyond indicating that it cannot amount simply to a surrender or confiscation. Subject to that,

F however, the judges of the Companies Court frequently sanction arrangements where the rights of creditors not only against the company but also inter se are varied or where creditors are required to give up rights against third parties such as under guarantees. The use of the scheme jurisdiction in relation to takeovers makes this almost essential.

46 A particular illustration of this relied upon by Mr Trower is the scheme of arrangement considered by David Richards J in *In re T & N Ltd*

G *(No 4)* [2007] Bus LR 1411. The proposed scheme in that case was between T & N Ltd and various associate companies and employees and former employees who had claims for personal injuries arising out of their exposure to asbestos. The claims included in the scheme were restricted to those covered by employers' liability insurance. The insurers had disputed liability but agreed to pay the sum of £36·74m to the administrators of the T & N

H companies on terms that a binding scheme of arrangement was put into place and approved by the court under which actual and potential claimants would agree not to bring claims against the insurers in return for being paid a dividend out of that fund.

47 One complication in the scheme was the effect of section 1 of the Third Parties (Rights Against Insurers) Act 1930. On entering

administration, the rights of T & N and the other companies under the policies (in respect of liabilities which had by then been incurred) were transferred to those claimants. These rights had to be compromised as a term of the scheme. One of the arguments addressed to the judge was that the scheme did not constitute an "arrangement" under what was then section 425 of the Companies Act 1985 because it only affected the rights between the employee claimants and the insurers and was not therefore a compromise or arrangement made between T & N and its creditors.

48 David Richards J, at paras 45 and 52–53, dismissed this objection on the grounds that the rights which the claimants had against the insurers were sufficiently connected with the claimants' rights against T & N to bring the proposed arrangement within the scope of section 425:

> "45. The first and obvious point to make is that, whatever the precise meaning of a compromise or arrangement, it must be proposed with creditors or members of a company. It is implicit that it must be made with them in their capacity as creditors or members and that it must at least concern their position as creditors or members of the company. For the reasons already given, even those EL claimants to whom T & N's rights against the EL insurers have been transferred by operation of the 1930 Act remain creditors of T & N. The extent to which certain other persons with EL claims are creditors for the purposes of section 425 is considered later in this judgment."
>
> "52. The settlement of the litigation is therefore in substance and form a tripartite matter, involving T & N, insurers and claimants. That is reflected in the proposed scheme, with T & N and the claimants as parties and with the EL insurers appearing before the court to consent to the scheme and to undertake to be bound by its terms. It is true that the scheme has no effect on the present rights of EL claimants against T & N. The right of claimants to assert their claims against T & N, and the right of T & N to defend those claims, are unaffected, and claimants are not obliged to proceed first against the trust to be established by the scheme. However, if a claimant establishes a claim under the trust distribution procedures and receives a payment, it will diminish the amount which T & N would otherwise be required to pay in respect of the claim, if the EL insurers succeeded in avoiding the policies or in limiting the cover. Although not immediately affecting rights against T & N, the scheme is likely therefore to have an impact on those rights. Mr Chivers objected that these effects resulted not from the scheme but from the settlement agreement and arrangements constituted by the trust deed and trust distribution procedures which took effect outside the scheme. In my view, it is not possible to divorce the arrangements in this way. The scheme of arrangement is an integral part of a single proposal affecting all the parties, which includes also the trust and the trust distribution procedures to be established pursuant to the scheme.
>
> "53. In my judgment it is not a necessary element of an arrangement for the purposes of section 425 . . . that it should alter the rights existing between the company and the creditors or members with whom it is made. No doubt in most cases it will alter those rights. But, provided that the context and content of the scheme are such as properly to constitute an arrangement between the company and the members or creditors concerned, it will fall within section 425. It is, as Nourse J

observed, neither necessary nor desirable to attempt a definition of arrangement. The legislature has not done so. To insist on an alteration of rights, or a termination of rights as in the case of schemes to effect takeovers or mergers, is to impose a restriction which is neither warranted by the statutory language nor justified by the courts' approach over many years to give the term its widest meaning. Nor is an arrangement necessarily outside the section, because its effect is to alter the rights of creditors against another party or because such alteration could be achieved by a scheme of arrangement with that other party."

49 Mr Trower relies on the judge's reasoning as including an acceptance that the scheme jurisdiction can extend to rights held by the creditors that are connected to the subject matter of their claims against the company but are not rights as creditors against the company. Claims against third party sureties under a guarantee would fall into the same category. If an arrangement under Part 26 can extend this far then there is no reason in principle, he says, why it should not embrace other claims which the creditor does have against the company, although of a proprietary nature. The abandonment of claims against third parties is as much a release of property rights as any variation of the property claims which the counterparties have against LBIE. There is nothing in the language of Part 26 to exclude such claims from an arrangement between the company and its creditors and any objections to their inclusion as a term of the scheme should be addressed, if at all, on the merits at the sanction hearing.

50 The question whether the scheme jurisdiction can be used to require creditors to release rights against third parties has been considered in Australia in two recent decisions of the Federal Court of Australia. In *In re Opes Prime Stockbroking Ltd* [2009] FCAFC 125 a scheme of arrangement under section 411 of the Corporations Act 2001 (which closely resembles the provisions of Part 26) included machinery under which creditors of the scheme companies were required to release claims against third party financiers (ANZ and Merrill Lynch) who had provided the scheme companies with cash and other securities in return for the securities which the scheme companies had received from their own clients. As part of an overall settlement of claims by the creditors against the scheme companies, ANZ and Merrill Lynch, a fund was created for the benefit of creditors into which the two finance companies paid some $226m in cash and released cash and assets of the scheme companies valued at a further $27m. It was a term of the scheme of arrangement that, in return for being able to prove against the fund, ANZ and Merrill Lynch would be released from any claims by either the scheme creditors or the scheme companies. The circumstances were therefore very similar to those considered by David Richards J in *In re T & N Ltd (No 4)* [2007] Bus LR 1411.

51 The judge at first instance rejected a submission by a creditor that he had no jurisdiction under section 411 to sanction an arrangement which required the release of the creditor's third party claims against ANZ and Merrill Lynch. He approved the scheme. A Full Federal Court dismissed the creditor's appeal.

52 The submission made to the Federal Court was that a scheme of arrangement could not affect interests other than those of a creditor qua creditor of the company and that section 411 did not authorise the court to approve an arrangement between the company and its creditors which

extinguished rights belonging to the creditor in some other capacity: in that case as a creditor of ANZ and Merrill Lynch. The Federal Court, at paras 66–69, rejected that argument for the following reasons:

"66. Doubtless there are limitations on the extent to which a scheme of arrangement purporting to be between a company and its creditors or a class of its creditors can purport to affect property of the creditor that has no connection with the company or the relationship of creditor and debtor between the creditor and the company. The mere fact that a person or entity is a creditor of a company would not, of itself, justify an arrangement between that person or entity on the one hand and the company on the other whereby property of the person or entity were confiscated without any benefit to the person or entity. Such an arrangement would not be approved by the court pursuant to section 411(4)(b).

"67. A purported scheme of arrangement must involve some arrangement in a sense that is to be construed liberally. No narrow interpretation should be given to the expressions 'compromise' or 'arrangement'. An arrangement within the meaning of section 411 connotes some element of give and take. A proposal that conferred no benefit on creditors and constituted the mere confiscation of interests would not be an arrangement within the meaning of section 411. An arrangement must involve some bargain giving benefit to both sides. However, there is no reason to construe the term in section 411 as restricting in any way the nature of the bargain that might be made between company and creditors (*In re Sonodyne International Ltd* (1994) 15 ASCR 494, 497–498), subject only to the additional requirement that the arrangement must be within the power of the company and not in contravention of the Corporations Act.

"68. A scheme of arrangement between a company and its creditors or a class of creditors is no more than a proposal to vary or modify the company's obligations in relation to its debts and liabilities owed to the creditors or class of creditors. There is nothing to prevent the company from posing, as part of the arrangement, a term to the effect that, in consideration of what the company has provided under the scheme, the creditors will discharge not only the debts and liabilities of the company, but also the liabilities of, for example, sureties for the same debts and liabilities of the company.

"69. It is permissible to incorporate in a scheme of arrangement an involvement or participation by an outsider, being a person or entity who is not a party to the scheme as a company or creditor (see *In re Glendale Land Development Ltd* (1982) 1 ACLC 540; 7 ACLR 171). Such arrangements are commonplace in relation to schemes involving takeovers. A scheme of arrangement made between a company and its creditors under section 411 binds only the company and the creditors. Nevertheless, there is no reason why a bargain might not be struck between a company and creditors whereby the creditors are bound to enter into an arrangement with third parties. So long as there is some element of give and take, such that the creditors receive something in return for the benefit conferred on a third party, there is no reason in principle why that term could not be part of a scheme of arrangement as contemplated by section 411."

53 This decision is consistent with the reasoning of David Richards J in *In re T & N Ltd (No 4)* [2007] Bus LR 1411 but it has not met with universal approval in Australia. In a subsequent decision of the Federal Court in *City of Swan v Lehman Brothers Australia Ltd* [2009] FCAFC 130 which was concerned not with the approval of a scheme of arrangement under section 411 but with a deed of company arrangement made pursuant to section 444D(1) of the Corporations Act 2001, another full court held that a deed of company arrangement did not have the effect of releasing creditor claims against a third party but only those against the company.

54 The relevant statutory language in section 444D(1) is that: "A deed of company arrangement binds all creditors of the company, so far as concerns claims arising on or before the day specified in the deed under paragraph 444A(4)(i)."

55 The judgments in *City of Swan v Lehman Brothers* [2009] FCAFC 130 distinguish between these provisions and those of section 411 on the grounds that the deed of company arrangement procedure is unsupervised and therefore more restricted in what it is intended to achieve. But, in some of the judgments, the members of the full court are careful not to endorse the correctness of the decision in *In re Opes Prime Stockbroking Ltd* [2009] FCAFC 125 and even go so far as to suggest that it is inconsistent with earlier Australian authorities.

Conclusions

56 So that there should be no doubt about it, I accept (as the judge did) that the proposed scheme represents a considered attempt to overcome the difficulties faced by the administrators in reconciling the entries in the company's books and records with the claims made against the assets held. I also accept that although the scheme, if implemented, will undoubtedly remove any existing proprietary rights over the assets in question, it will do so with a view to substituting for them a distribution of the securities amongst the relevant clients which is designed to secure for them the return of their property so far as that is possible consistently with a fair apportionment of available assets. But we are not concerned on this appeal with the fairness or reasonableness of the proposal. Whether the removal of vested and provable rights in this way is fair and reasonable as between the various classes of creditors is a matter to be addressed (if at all) at a sanction hearing. It is not necessary for this court to express any view about that.

57 The question whether the court's power to sanction a scheme of arrangement under Part 26 can extend to the release of rights over property held by the company under a trust is one of statutory construction. Considerations of expediency and convenience are only relevant if and so far as they can be assumed to have influenced the legislature when the statutory provisions were formulated. We have not been asked to treat the Companies Act 2006 as a consolidation measure for the purposes of Part 26 but it is evident that the current provisions have remained essentially unchanged since they first appeared in the 1870 Act and there is nothing to suggest that Parliament has recently intended to give them any different or wider meaning.

58 Conceptually no statutory power can be unlimited and, in this case, the court's jurisdiction is circumscribed by the requirement that the scheme should be an arrangement between the company and its creditors. When the

constituent parts of this formula are looked at in isolation there is a considerable measure of agreement as to what they can include. As mentioned earlier, a "creditor" will consist of anyone who has a monetary claim against the company which, when payable, will constitute a debt. Contingent claims are included for this purpose. A claim (e g) for damages in tort is still a legal liability of the company which will ultimately result in either an agreed payment or a judgment debt. The scheme has been drafted so as to exclude anyone whose only claim against the company will be one in rem. To be a scheme creditor one has to have a current or contingent claim for damages or equitable compensation against the company, either of which is sufficient to render the claimant a creditor at least in that respect.

59 Mr Snowden, of course, relies upon this as an implicit acceptance by the administrators that a purely proprietary claimant does not qualify as a creditor. The requirement that all scheme creditors should have both an unsecured monetary claim as well as their proprietary claims is criticised as a device to enable, as he put it, the tail to wag the dog. But the resolution of these issues does not depend on a resort to canine metaphors. It is obvious that someone with a purely proprietary claim against the company is not its creditor in any conventional sense of that word. As a matter of ordinary language, a creditor is someone to whom money is owed. The use of this word with that meaning is a long-established and essential part of English company law. The Companies Act (and now the Insolvency Act) regime for the administration of insolvent companies and their assets depends upon being able to identify creditors and not to confuse them with those whose property rights do not fall into the insolvent estate: see, for example, *Quistclose Investments Ltd v Rolls Razor Ltd* [1970] AC 567. Given that "creditor" is not defined in the legislation, it is inconceivable that Parliament should have used the word in the 2006 Act in any but its literal sense.

60 For these reasons, one gets no real assistance from the cases on secured creditors. No one can dispute that a creditor with security for what is owed remains a creditor of the company. Their security exists and is only enforceable to the extent and for so long as the underlying indebtedness continues. All that *In re Empire Mining Co* (1890) 44 Ch D 402 and *In re Alabama, New Orleans, Texas and Pacific Junction Railway Co* [1891] 1 Ch 213 establish is that a creditor with security is none the less a creditor for the purposes of the scheme jurisdiction. That conclusion is hardly surprising given the absence from the legislation of any restriction of what is now Part 26 to unsecured creditors. Nor is it to the point that under a scheme of arrangement a debenture-holder or other secured creditor may be required to give up the whole or part of his security. The charges in question will have been granted by the company over its own property. The interests granted to secured creditors (which, in the case of real property, amount to a legal estate) are only ever held as security interests subject to the debtor's equity of redemption. An arrangement under which that indebtedness is reorganised will therefore necessarily impact on any security held in respect of it and may involve the repatriation of the debtor's property free from the charge. When this occurs the secured creditor is simply returning to the debtor property which the creditor never owned beneficially and was only ever held as security for the debt. Blackburne J was quite right to regard this as wholly different from the converse case of property which has never formed part of the company's assets but is held by it only as trustee.

A **61** What then of an "arrangement"? As described earlier, the court's approach has been to give this a relatively unrestricted meaning. Mr Trower relies on this to support his argument that there is nothing in the statutory language to restrict the content of an arrangement to the reorganisation of rights enjoyed by creditors qua creditors. But the question whether section 895 imposes that restriction has to be determined not by the meaning of "arrangement" alone, but by the use of the word in the phrase B "an arrangement between a company and its creditors". Although "arrangement" is a wide expression, it is given content and meaning by the parties to it.

62 In terms of authority Mr Trower places some weight on the decisions in *In re T & N Ltd (No 4)* [2007] Bus LR 1411 and *In re Opes Prime Stockbroking Ltd* [2009] FCAFC 125 as indicating that the rights which can C be released or re-organised under a scheme are not limited to those enjoyed by scheme creditors as creditors of the company. Both cases indicate that they can include rights against third parties related to and essential for the operation of the scheme. At first sight these authorities are helpful to the administrators in that they do establish that a scheme can extend beyond monetary claims by the creditors against the scheme company alone. But what they do not do is to suggest that claims which do lie against the D company can be included if they are proprietary rather than contractual or tortious in nature.

63 Although the decision in *In re T & N Ltd (No 4)* [2007] Bus LR 1411 has not been the subject of any judicial criticism in this country, the principle it establishes has proved controversial at least in Australia. It seems to me entirely logical to regard the court's jurisdiction as extending to E approving a scheme which varies or releases creditors' claims against the company on terms which require them to bring into account and release rights of action against third parties designed to recover the same loss. The release of such third party claims is merely ancillary to the arrangement between the company and its own creditors. Mr Snowden has not invited us to overrule *In re T & N Ltd (No 4)* and it would not be appropriate for us to do so without hearing full argument on the point.

F **64** But when properly analysed, these cases do not, in my judgment, really assist Mr Trower in his argument. It seems to me tolerably clear from the judgments in both cases that the courts did not consider that they were changing the basic criteria for the approval of a scheme of arrangement. David Richards J (in the passage in para 45 of his judgment quoted above) refers expressly to it being implicit in section 425 that the G arrangement must be made with creditors in their capacity as creditors and must concern their position as creditors. In *In re Opes Prime Stockbroking Ltd* [2009] FCAFC 125, para 68 the Federal Court describes a scheme of arrangement as no more than a proposal to vary or modify the company's obligations in relation to its debts and liabilities owed to the creditors or class of creditors.

H **65** It seems to me that an arrangement between a company and its creditors must mean an arrangement which deals with their rights inter se as debtor and creditor. That formulation does not prevent the inclusion in the scheme of the release of contractual rights or rights of action against related third parties necessary in order to give effect to the arrangement proposed for the disposition of the debts and liabilities of the company to its own creditors.

But it does exclude from the jurisdiction rights of creditors over their own property which is held by the company for their benefit as opposed to their rights in the company's own property held by them merely as security.

66 I do not accept Mr Trower's submission that the reference to a creditor was intended to act as no more than a gateway to the inclusion of that person in the scheme and that section 895 leaves the court with jurisdiction to sanction the compromise or removal of rights which the creditor does not hold as a creditor. That would, I think, be inconsistent with the expressed purpose of the legislation which must be to allow the company to re-arrange its contractual or similar liabilities with those who qualify as its creditors. A person is the creditor of a company only in respect of debts or similar liabilities due to him from the company. I am not persuaded that Parliament can have intended to allow creditors to be compelled (if necessary) to give up not merely those contractual rights but also their entitlement to their own property held by the company on their behalf.

67 A proprietary claim to trust property is not a claim in respect of a debt or liability of the company. The beneficiary is entitled in equity to the property in the company's hands and is asserting his own proprietary rights over it against the trustee. The failure by a trustee to preserve that property in accordance with the terms of the trust may give rise to a secondary liability to make financial restitution for the loss which results, but that is a consequence of the trust relationship and not a definition of it.

68 Part of Mr Trower's argument seeks to minimise these legal distinctions by treating agreements such as the IPBA as an overall commercial arrangement which should be looked at in the round for the purposes of Part 26. The commercial nature of these agreements is not in dispute but the trust mechanism has long been regarded as an important safeguard against insolvency and has been imported into commercial contracts for that very reason. In the case of pure custody agreements, it is, of course, paramount. I do not therefore accept that the trust element in these arrangements ought in some way to be merged into the general contractual framework and treated merely as ancillary when considering the limits of the scheme jurisdiction or (which is more important) that Parliament ever intended to deal with it in that manner.

69 The language of section 895 ought therefore in my view to be read in the way that Blackburne J construed it. I would therefore dismiss this appeal.

LONGMORE LJ

70 I agree with the judgment of Patten LJ and with the judgment of Lord Neuberger of Abbotsbury MR.

LORD NEUBERGER OF ABBOTSBURY MR

71 I agree that this appeal must be dismissed. Despite the undoubted attraction of implementing the proposed scheme of arrangement in this case ("the scheme"), it seems to me that Blackburne J was right to hold that he had no jurisdiction to approve the scheme in so far as it was concerned with the distribution of property held or controlled by it on trust for any of its creditors. I entirely agree with the reasons given for this conclusion given by Patten LJ, and indeed by the judge below. However, as the point is of some importance, I will briefly express my reasons in my own words.

A 72 The terms of the scheme are long and complex, and the detailed provisions of the standard form "International Prime Brokerage Agreement" and "Master Custody Agreement" used by Lehman Bros International (Europe) ("LBIE") are not simple. However, as Patten LJ has explained, the question thrown up by this appeal is one of principle, albeit that it can be expressed in more than one way. Mr William Trower QC, for the B administrators of LBIE ("the administrators"), put it thus: can a scheme of arrangement be approved by the court under section 895 of the Companies Act 2006 if it varies proprietary rights? I prefer to express it rather more specifically, if more wordily: can a scheme be approved under section 895 if it extends to property which is held on trust by the company concerned (a) generally; or alternatively (b) where the persons for whose benefit the property is held on trust are also creditors of the company? The judge held C that the answer to the question was no.

73 Part 26 of the 2006 Act is concerned with "Arrangements and Reconstructions", and section 895, whose origins go back to section 2 of the Stock Companies Arrangement Act 1870, states, in subsection (1), that it applies "where a compromise or arrangement is proposed between a company and (a) its creditors . . . or (b) its members . . ."

D 74 It has been held that the expression "creditors" in section 895 should be given a wide meaning (see *In re Alabama, New Orleans, Texas and Pacific Junction Railway Co* [1891] 1 Ch 213, 236–237 and *In re Midland Coal, Coke and Iron Co* [1895] 1 Ch 267, 277), and the same principle seems to apply to the meaning of "arrangement" (*In re Savoy Hotel Ltd* [1981] Ch 351, 359 and 361). Bearing in mind the purpose of section 895, as discussed by David Richards J in *In re T & N Ltd* [2006] 1 WLR 1728, paras 32–40, E and in *In re T & N Ltd (No 4)* [2007] Bus LR 1411, paras 43–55, it is plainly right that that is so.

75 It was argued by Mr Trower that, in the light of the very wide meaning which is to be accorded to the word "creditors" in section 895(1)(a), it is capable of extending to a beneficiary under a trust. However, I find it very hard to see how it could be said that a person ("a beneficiary") who has F the beneficial interest in property ("trust property") held on trust by the company is thereby a "creditor" of the company, even bearing the wide meaning that word is to be given in section 895.

76 As Mr Richard Snowden QC, appearing for the London Investment Banking Association ("LIBA") who oppose the appeal because of what they regard as the unfortunate implications for London as a world financial centre should the administrators succeed on this appeal), says, in relation to G such property, the beneficiary is "not a creditor of the [company] but . . . the owner of certain specific property in the possession of the [company]"—to adapt an observation of Romilly MR in *Sinclair v Wilson* (1855) 20 Beav 324, 331. The duty of a trustee is thus to account to the beneficiary for trust property. Although a breach of trust by the trustee will normally give rise to a claim which constitutes the beneficiary a creditor, the trustee-beneficiary relationship will not of itself give rise to the beneficiary having any H "pecuniary claims" (to quote from the very passage relied on by the administrators in the judgment of Lindley LJ in *In re Midland Coal, Coke and Iron Co* [1895] 1 Ch 267, 277) against the trustee. It would also be surprising if a scheme under what is now section 895 could have been proposed and sanctioned in relation to trust property for over 100 years

without anyone, including all the writers of the leading company law and trust law textbooks, apparently being aware of this important feature of the company law legislation. And it seems most unlikely that the legislature would have intended beneficiaries' rights to be capable of being altered by a scheme if the trustee was a company, when there would be no such possibility if the trustee was an individual.

77 As an alternative, Mr Trower has a more subtle argument. It is that, where a person has the beneficial proprietary interest in property held in the name of a company, a scheme in relation to that property can be validly approved under section 895 provided that the person concerned is also a creditor of the company. In other words, even though (on this alternative argument) such a person is not a creditor of the company qua beneficiary, and therefore a scheme could not extend to the trust property if he was not also a creditor, the argument is that, provided the beneficiary is also a creditor of the company, a scheme could extend to the trust property. So, on the administrators' case, once a person is, to any extent, a creditor of the company, a section 895 scheme in respect of the company can extend to any property or interest of that person.

78 In the absence of clear and binding authority to support that contention, I consider that this alternative submission should also be rejected. As a matter of ordinary language, section 895 appears quite clearly to be dealing with arrangements between a company and one or both of two groups of people—its members and its creditors. If a person's claim cannot be said to render him a creditor or a member, then it appears to me to follow that the subject matter of the claim could not be covered by the arrangement. The fact that he may, in connection with a different claim, be a creditor, does not justify him being treated as a creditor for the purpose of the first claim.

79 The practical consequences of the alternative contention would also be startling. Why should the mere fact that a beneficiary happens also to be a creditor of the company entitle the company, or its liquidators or administrators, to include his property in a scheme, when they could not otherwise do so? What commercial sense or logic is there in the notion, which would follow from the contention, that a beneficiary who is also a creditor could take the trust property out of the potential grasp of a scheme by waiving the debt, or by assigning the debt to another person? Equally, what commercial sense or logic is there in the notion that the company could engineer trust property being potentially brought within a scheme by breaching the trust, thereby creating a claim, and thus a debt, in favour of the beneficiary?

80 However, Mr Trower raised a number of arguments which, he contended, call into question the views I have expressed as to his arguments. First, he relied on the wide meaning of the term "arrangement" in section 895, to which I have already referred. That gets the administrators no further: however generous a meaning is given to the word, there is no getting away from the fact that, in order to be within section 895, an arrangement must be made with the "creditors" (or members) of the company concerned.

81 Secondly, it was said that the court always has a discretion to refuse to sanction a scheme even when it satisfies the formal requirements of the section. This point, again, does not address the central problem faced by the administrators, namely that a beneficiary is not a creditor within

section 895(1)(a). In any event, the relatively loose rein which the court normally adopts when approving a scheme which has been approved by the requisite majority of the various classes of creditors would scarcely be appropriate when it was sanctioning a scheme which extended to trust property.

82 Mr Trower's third point was that it has been authoritatively established more than 100 years ago, ever since the Court of Appeal decided *In re Alabama, New Orleans, Texas and Pacific Junction Railway Co* [1891] 1 Ch 213, 236–237, that schemes can affect proprietary rights, and in particular creditors' rights in respect of the security they enjoy over the company's assets. In my view, that principle, which I accept unreservedly, does not assist the administrators here. In the case of a secured creditor, the security is an incident of the debt; to put the point another way, it is parasitic on the debt. If there is no longer any debt, there is no security (save that it can survive in some sort of inchoate form to underwrite future debts). Accordingly, as section 895 enables a scheme which varies the debt, then it must follow that the variation must, as it were, be followed through to the security. No such argument can be mounted in relation to trust property held in the name of the company, which also happens to have a debt to the beneficiary, even if the debt arises out of the trustee-beneficiary relationship. Further, as Mr Snowden said, a secured creditor merely has the right to look to his security to enable his debt to be repaid: unlike the beneficiary in relation to the trust property, he does not own the security. So, if the sale of the security realises more than he is owed, the rest of the proceeds of sale are available to other creditors.

83 Fourthly, Mr Trower relied on the fact that, in *In re T & N Ltd (No 4)* [2007] Bus LR 1411, a scheme was held to be capable of extending to, and varying, claims which creditors of the company had against third parties. In *In re T & N Ltd (No 4)*, at para 53, it was held that statutory rights which creditors of the company enjoyed against insurers could be varied as part of an arrangement under section 425 of the 1985 Act (the predecessor of section 895 of the 2006 Act) between those creditors and the company. However, unlike the rights of beneficiaries in respect of trust property, the creditors' rights against the insurers in *In re T & N Ltd (No 4)* (a) were closely connected with their rights against the company as creditors, (b) were personal, not proprietary, rights and (c) if exercised and leading to a payment by the insurers, would have resulted in a reduction of the creditors' claims against the company. Bearing in mind these three factors, it seems to me, as it does to Patten LJ, that the decision of David Richards J was correct, but is of no help to the administrators in this case. Indeed, like the security enjoyed by a secured creditor, the rights of the creditors against the insurers were effectively contingent on the existence of the creditors' claims against the company. It is right to add that, at least as presently advised, I am of the view that the decision in *In re T & N Ltd (No 4)* on this point was near the outer limits of the scope of section 895.

84 Fifthly, there is the argument (which was put to Mr Trower, rather than raised by him) that there could be said to be some support from the cases for the administrators' contention in the fact that money, such as sums received as dividends or rent paid in respect of trust property, owed from the trust to the beneficiary, can be characterised as an "equitable debt" due from the trustee to the beneficiary: if money due from the trust is such a debt, then

it can be said that it would render the beneficiary, at least to that extent, a creditor, and, on that basis, logic might suggest that he should be treated as a creditor in respect of the trust assets. In my view, however, there is nothing in that point for the purposes of this appeal. As Mr Trower realistically accepted, a beneficiary would not be a creditor of the company for the purpose of section 895, if the trust fund, of which the company was bare trustee, included money, whether or not it was received as income derived from trust property: the money would beneficially be his property just like any asset held in the trust. Cases such as *Webb v Stenton* (1883) 11 QBD 518 may support the proposition that in some contexts (in that case, for the purpose of an attachment order) an equitable debt arises when money is due and payable from a trust fund to a beneficiary: see, in ascending order of force, 11 QBD 518, 522, 526–527 and 530. However, even if that is right, it cannot begin to justify the notion that, in the case of a bare trust, income, received by the trustee qua trustee and held in the trust, is a debt to the beneficiary such that he can be to that extent treated as a creditor of the company for the purpose of section 895.

85 Finally, it is worth noting that, far from there being any authority to support the administrators' contention, such judicial observation as there is on the point tends to support Blackburne J's approach. In *In re T & N Ltd (No 4)* [2007] Bus LR 1411, para 45, David Richards J, who has considerable experience of company law, described it as an "obvious point" and that it was "implicit" in the immediate statutory predecessor to section 895 (namely, as mentioned, section 425 of the Companies Act 1985) that a scheme of arrangement thereunder "must be made with [the creditors or members] in their capacity as creditors or members and that it must at least concern their position as creditors or members of the company".

86 Like Patten LJ and Blackburne J, I have some sympathy with the administrators' desire to have a scheme under section 895 which extends to trust property, in the light of the difficulties which would otherwise almost certainly arise in connection with seeking to satisfy the rights of beneficiaries in relation to trust property held in the name of LBIE. However, as Blackburne J held, the fact that such a scheme might well represent a reasonable proposal in this case is plainly not enough to bring it within the ambit of section 895, and, as is evidenced by the opposition to the proposed scheme mounted by LIBA, it may, viewed in the wider perspective, be positively undesirable that such a scheme could be approved under section 895. I hope, indeed I would expect, that, if the administrators decide to make an application under the Trustee Acts or pursuant to the court's inherent equitable jurisdiction, in relation to dealing with beneficiaries' rights, the court will provide effective assistance, by arriving at a practical and fair outcome, while ensuring that delay and cost are kept to a minimum.

87 As it is, however, I, too, would dismiss this appeal.

Appeal dismissed.

CJCF

ITEM NO. 156

JA-42

A

Supreme Court

Belmont Park Investments Pty Ltd and others *v* BNY Corporate Trustee Services Ltd and another (Revenue and Customs Comrs and another intervening)

B [On appeal from **Perpetual Trustee Co Ltd *v* BNY Corporate Trustee Services Ltd**]

[2011] UKSC 38

2011 March 1, 2, 3; July 27

Lord Phillips of Worth Matravers PSC, Lord Hope of Craighead DPSC, Lord Walker of Gestingthorpe, Baroness Hale of Richmond, Lord Mance, Lord Clarke of Stone-cum-Ebony JJSC, Lord Collins of Mapesbury

C

Insolvency — Winding up — Anti-deprivation rule — Contractual provisions switching priority and changing allocation of costs on insolvency — Whether provision contrary to principle that insolvent's assets remaining available for distribution among creditors — Whether valid

D The first claimant and the second claimant, the latter being one of 29 Australian companies, institutions, authorities and charities, invested in a series of notes issued under a multi-issuer secured obligation programme established by a company in the L group through a special purpose vehicle. Investments bought with the subscription money were vested in the first defendant trust corporation ("the trustee"). As part of the transaction a swap agreement was entered into whereby the second defendant, another company in the L group, paid the issuer the amounts due by the issuer to the E noteholders in exchange for sums equal to the yield on the collateral, the amount by which the sum payable under the swap agreement exceeded the yield on the collateral representing credit insurance provided by the noteholders. The collateral was charged by the issuer in favour of the trustee to secure its obligations to the noteholders and the second defendant on terms which changed their respective priorities on the occurrence of certain specified events. In the event of a default the priority over the assets in the special purpose vehicle was switched from the second F defendant to the noteholders. On 15 September 2008 the parent company of L group filed in the United States Bankruptcy Court for protection under Chapter 11 of the US Bankruptcy Code. That constituted an event of default and gave rise to noteholder priority. From that date interest payments due under the notes were not paid on their due dates, and on 3 October 2008 the second defendant company filed for protection under Chapter 11, which was a further event of default giving rise to noteholder priority. The claimants brought claims under CPR Pt 8 for orders to G procure the realisation of the collateral held by the trustee in respect of each of the relevant issues and the application of the sums so realised in favour of the respective noteholders in priority to any claim of the second defendant. The second defendant contended that the claimants as noteholders were not entitled to rely on those events of default as triggering noteholder priority because that would offend against the anti-deprivation rule, by which it was contrary to public policy for parties to contract out of the mandatory provisions of the Insolvency Act 1986 by removing from the H bankrupt's estate assets otherwise available for distribution pari passu to the creditors. The judge gave judgment for the claimants and the Court of Appeal dismissed the second defendant's appeal.

On appeal by the second defendant—

Held, dismissing the appeal, that the anti-deprivation rule was aimed at a different mischief from the rule that it was contrary to public policy to contract out of

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pari passu distribution, viz at attempts to withdraw an asset on bankruptcy or liquidation or administration thereby reducing the value of the insolvent estate to the detriment of creditors; that the rule was too well established to be discarded despite the detailed provisions set out in modern insolvency legislation, all of which were to be taken to have been enacted against the background of the case law establishing that certain deprivations on bankruptcy were impermissible and void; that in determining whether the rule applied, the court was to look at the substance of the agreement rather than its form and ask whether the purpose and effect of the relevant provision amounted to an illegimate intent to evade the bankruptcy law or had a legitimate commercial basis; that (Lord Mance JSC dissenting) although the second defendant had been deprived of property in the form of swap counterparty priority on its bankruptcy, applying the anti-deprivation rule in a broad and commercially sensitive manner, taking into account the policy of party autonomy and the upholding of proper commercial bargains, since the security in question had in commercial reality been provided by the noteholders to secure what was in substance their own liability, but subject to terms, including the priority provisions, in a complex commercial transaction entered into in good faith with no suggestion that those provisions had been deliberately intended to evade insolvency law, the loss by the second defendant of its swap counterparty priority was not invalided by the rule; and that, accordingly, the provisions on which the claimants sought to rely were valid and enforceable (post, paras 1, 78–79, 102–106, 108–109, 122, 132, 133, 148, 150, 185).

Ex p Newitt; In re Garrud (1881) 16 Ch D 522, CA, *British Eagle International Airlines Ltd v Cie Nationale Air France* [1975] 1 WLR 758, HL(E) and *Money Markets International Stockbrokers Ltd v London Stock Exchange Ltd* [2002] 1 WLR 1150 considered.

Decision of the Court of Appeal [2009] EWCA Civ 1160; [2010] Ch 347; [2010] 3 WLR 87; [2010] Bus LR 632 affirmed.

The following cases are referred to in the judgments:

Alderson v Temple (1768) 4 Burr 2235
Apex Supply Co, In re [1942] Ch 108; [1941] 3 All ER 473
Ayerst v C & K (Construction) Ltd [1976] AC 167: [1975] 3 WLR 16; [1975] 2 All ER 537, HL(E)
Barter, Ex p; Ex p Black; In re Walker (1884) 26 Ch D 510, CA
Bombay Official Assignee v Shroff (1932) 48 TLR 443, PC
Borland's Trustee v Steel Bros & Co Ltd [1901] 1 Ch 279
British Eagle International Airlines Ltd v Cie Nationale Air France [1974] 1 Lloyd's Rep 429, CA: [1975] 1 WLR 758; [1975] 2 All ER 390; [1975] 2 Lloyd's Rep 43, HL(E)
Carreras Rothmans Ltd v Freeman Mathews Treasure Ltd [1985] Ch 207; [1984] 3 WLR 1016; [1985] 1 All ER 155
Detmold, In re; Detmold v Detmold (1889) 40 Ch D 585
Halstead, In re; Ex p Richardson [1917] 1 KB 695, CA
Higinbotham v Holme (1812) 19 Ves Jun 88
Holmes v Penney (1856) 3 K & J 90
International Air Transport Association v Ansett Australia Holdings Ltd [2008] HCA 3; [2008] BPIR 57; 234 CLR 151
Jay, Ex p; In re Harrison (1880) 14 Ch D 19, CA
Jennings' Trustee v King [1952] Ch 899; [1952] 2 All ER 608
Johns, In re; Worrell v Johns [1928] Ch 737
King's Trusts, In re (1892) 29 LR Ir 401
Kitchen v Royal Air Force Association [1958] 1 WLR 563; [1958] 3 All ER 241, CA
Lehman Bros Holdings Inc, In re (2009) 422 BR 407
Lehman Bros Special Financing Inc v Carlton Communications Ltd [2011] EWHC 718 (Ch)

Lester v Garland (1832) 5 Sim 205
Lomas v JFB Firth Rixson Inc (International Swaps and Derivatives Association Inc intervening) [2010] EWHC 3372 (Ch); [2011] 2 BCLC 120; [2011] BPIR 788
Mackay, Ex p; Ex p Brown; In re Jeavons (1873) LR 8 Ch App 643
Mackintosh v Pogose [1895] 1 Ch 505
Maxwell Communications Corpn plc, In re [1993] 1 WLR 1402; [1994] 1 All ER 737
Mayhew v King [2010] EWHC 1121 (Ch); [2010] 2 BCLC 440; [2011] EWCA Civ 328; [2011] Bus LR 1327, CA
Money Markets International Stockbrokers Ltd v London Stock Exchange Ltd [2002] 1 WLR 1150; [2001] 4 All ER 223; [2001] 2 All ER (Comm) 344
Newitt, Ex p; In re Garrud (1881) 16 Ch D 522, CA
Powdrill v Watson [1995] 2 AC 394; [1995] 2 WLR 312; [1995] ICR 1100; [1995] 2 All ER 65, HL(E)
R v J [2004] UKHL 42; [2005] 1 AC 562; [2004] 3 WLR 1019; [2005] 1 All ER 1, HL(E)
Roe d Hunter v Galliers (1787) 2 Durn & E 133
Scientific Investment Pension Plan Trusts, In re [1999] Ch 53; [1998] 3 WLR 1191; [1998] 3 All ER 154
Sharp's Settlement Trusts, In re [1973] Ch 331; [1972] 3 WLR 765; [1972] 3 All ER 151
Stephenson, In re; Ex p Brown [1897] 1 QB 638
Tito v Waddell (No 2) [1977] Ch 106; [1977] 2 WLR 496; [1977] 3 All ER 129
Whitmore v Mason (1861) 2 J & H 204
Williams, Ex p; In re Thompson (1877) 7 Ch D 138
Wilson v Greenwood (1818) 1 Swans 471, CA

The following additional cases were cited in argument:

Brandon v Robinson (1811) 18 Ves Jun 429
Byblos Bank SAL v Al-Khudhairy [1987] BCLC 232, CA
Campbell (A Bankrupt), In re [1997] Ch 14; [1996] 3 WLR 626; [1996] 2 All ER 537
Celtic Extraction Ltd, In re [2001] Ch 475; [2000] 2 WLR 991; [1999] 4 All ER 684, CA
Cooke, Ex p (1803) 8 Ves Jun 353
Lockyer v Savage (1733) 2 Str 946
Machu, In re (1882) 21 Ch D 838
Peregrine Investment Holdings Ltd v Asian Infrastructure Fund Management Co Ltd [2004] 1 HKLRD 598
Rochford v Hackman (1852) 9 Hare 475
Rooney v Cardona [1999] 1 WLR 1388, CA
Staveley v Parsons (1736) 2 Ves Jun Supp 114n

APPEAL from the Court of Appeal

On 28 July 2009 Sir Andrew Morritt C [2009] EWHC 1912 (Ch); [2009] 2 BCLC 400 gave judgment for the first claimant, Perpetual Trustee Co Ltd, and the second claimants, Belmont Park Investments Pty Ltd and 28 others, as the holders of ten series of notes issued under the Lehman "Dante" multi-issuer secured obligation programme, on their claim (commenced under CPR Pt 8) against the first defendant, BNY Corporate Trustee Services Ltd, as the note trustee of the notes and the security trustee of the collateral purchased with the proceeds of the notes, and the second defendant, Lehman Brothers Special Financing Inc ("LBSF"), as parties to swap agreements contained in ISDA (International Swaps and Derivatives Association) master agreements. The judge granted, inter alia, declarations that two events of default within section 5(a)(vii)(4) of the ISDA master agreements had

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occurred and that the second defendant was the defaulting party in relation to those events of default, that the issuers had validly and effectively terminated each swap agreement under section 6(a) of those agreements, and that the notes had become due and payable to the claimants at their early redemption amount with accrued interest, and the security constituted by the principal trust deed and the supplemental trust deeds was enforceable.

On 6 November 2009, the Court of Appeal (Lord Neuberger of Abbotsbury MR, Longmore and Patten LJJ) dismissed the second defendant's appeal and refused leave to appeal.

On 26 March 2010 the Supreme Court (Lord Hope of Craighead DPSC, Lord Walker of Gestingthorpe and Lord Clarke of Stone-cum-Ebony JJSC) granted the second defendant permission to appeal. On 12 January 2011, the second defendant filed an application with the Supreme Court to withdraw the appeal in respect of the proceedings involving the first claimant and on 17 January 2011 the Supreme Court ordered that that appeal be withdrawn with no order as to costs. On 4 February 2011 the Revenue and Customs Commissioners were given permission to intervene by written submissions and the Football Association Premier League were subsequently also granted such permission.

The issues for the Supreme Court, as stated in the agreed statement of facts and issues, were as follows. (1) The nature and scope of the anti-deprivation rule, including: (a) whether the rule had a continuing role to play in the light of the detailed provisions set out in modern insolvency legislation and, if so, in what circumstances it applied; (b) whether the rule should apply to corporate insolvency; (c) the interaction between the rule and the principle of freedom of contract; (d) whether the rule could or should be applied to an executory contract; (e) whether the rule could or should be applied in favour of a contracting party which, by reason of insolvency, cannot or will not render any further performance; (f) whether the rule had any application if the insolvent was not deprived of property absolutely vested in it at the commencement of the insolvency in a manner inconsistent with the insolvency legislation; (g) whether there was or should be a distinction between inherently determinable interests and interests which were defeasible upon a condition subsequent, namely insolvency; (h) whether the rule did not apply to the extent that the assets in which the insolvent had an interest had been acquired with money provided by the other party (as held by Lord Neuberger of Abbotsbury MR [2010] Ch 347, paras 64–67); (i) whether the rule, being a rule of public policy, could or should be applied in circumstances which amounted to an injustice; and (j) whether the decision of the House of Lords in *British Eagle International Air Lines v Cie Nationale Air France* [1975] 1 WLR 758 should be overruled or declared to be inapplicable since the coming into force of the Insolvency Act 1986. (2) The proper construction of clause 6.3 of the principal trust deed, clause 5.5 of the supplementary trust deed and condition 44.2 of the notes and, if the anti-deprivation rule had a continuing role to play, whether any of those provisions engaged the rule. (3) Whether, in that context, the transaction was properly characterised as one in which: (a) the right granted to LBSF was a security right over assets purchased with the noteholder's money (as per para 62 of the Court of Appeal's judgment); (b) the effect of the documentation was that the noteholders were granting to LBSF rights over assets derived from their moneys (para 61 of the Court of Appeal

judgment); (c) or one in which (as LBSF contended but the second claimants denied) the assets were purchased by the issuer with its own moneys. (4) Whether (as held by Patten LJ, at paras 135–137, but not by Lord Neuberger of Abbotsbury MR, paras 66–67) the arangements were not objectionable because there was no change in the asset retained by LBSF on the basis that the relevant contractual provisions were an original feature of the contractual arrangement. (5) Whether the noteholders were unable to rely on the earlier event of default (the Chapter 11 filing of the ultimate parent of LBSF, Lehman Brothers Holdings Inc ("LBHI")) so as to exclude the operation of the anti-deprivation rule including: (a) whether the issuers were required to take affirmative steps and provide appropriate notice to the parties to the agreements before there could be an application of noteholder priority pursuant to the relevant provisions and, if the issuers were so required, whether, as a result, swap counterparty priority applied as at the date of LBSF's Chapter 11 filing on 3 October 2008 (given that the issuers did not send event of default notices until after that date and in those notices relied, without prejudice to any other event of default, upon LBSF's Chapter 11 filing as the relevant event of default); or (b) whether the relevant provisions operated automatically so as to apply noteholder priority on LBHI's filing for Chapter 11 on 15 September 2008 and without any further action being required.

The second defendant, in its notice of appeal, stated its intention to contend as follows. (1) Lord Neuberger of Abbotsbury MR [2010] Ch 347, paras 64–67 had erred in placing reliance on a supposed principle that the anti-deprivation rule did not apply to the extent that the assets in which the insolvent company had an interest had been acquired with money provided by the other party. (2) No such principle could be ascertained from the authorities. Lord Neuberger MR [2010] Ch 347, paras 34, 64–65, 67, had relied heavily upon dicta of Wood V-C in *Whitmore v Mason* (1861) 2 J & H 204 that were plainly obiter and related to some old cases on marriage settlements. Those cases had actually been decided on the basis that the property purportedly settled by the husband, with a proviso that it should go to the wife on the husband's bankruptcy, was in reality the wife's property all along. (3) Such old cases also appeared to be peculiar to marriage settlements. They could not support a proposition of general application in commercial cases that, merely because a party (A) provided money by way of loan to C to enable C to buy an asset, A could validly contract that the security rights of B, another creditor of C, over C's asset, should be defeated in the event of B's insolvency. It was also wholly unclear how Lord Neuberger MR envisaged that his thesis would apply in a case in which, for example, A had not provided all of the money to enable C to buy the asset in question, but had only provided, for example, 50%, raising the question whether the anti-deprivation principle would apply to invalidate the clause in question in some aliquot part. (4) In that regard, Lord Neuberger MR had also erred in fact and in law in his assessment of the transactions and, in particular, his determinations that (a) the right granted to LBSF was a security right over assets purchased with the noteholders' money (para 62) and (b) the effect of the documentation was that the noteholders were granting to LBSF rights over assets derived from their moneys: para 65. Both propositions were incorrect. The assets were purchased by the issuer with its own moneys. It was true that those funds

had (for the most part) been lent to the issuer by noteholders, but by concentrating exclusively on the provision of funds from the noteholders, Lord Neuberger MR had lost sight of the fact that the transaction also involved LBSF providing substantial funding to the issuer in the form of the enhanced payments under the swap agreement which substantially exceeded the income yield which the issuer would have been able to obtain from the collateral. Such payments enabled the issuer to fund enhanced payments to noteholders. (5) Patten LJ had erred in law and fact (paras 135–137) in holding that the arrangements were not objectionable because there was no change in the asset retained by LBSF on the basis that the "flip" provisions were an original feature of the contractual arrangement. The application of the anti-deprivation principle had to depend upon the meaning and effect of the relevant clauses, not simply whether they had been included in the arrangements from the outset. (6) In that respect, it had made no difference in *Ex p Mackay; Ex p Brown; In re Jeavons* (1873) LR 8 Ch App 643 that the proviso which devalued the right to royalties in the event of the creditor's bankruptcy had been included in the contractual arrangements from the start. Nor, in *British Eagle International Airlines Ltd v Cie Nationale Air France* [1975] 1 WLR 758, had it made any difference that the clearing house arrangements had been included in the IATA arrangements from the outset. (7) Moreover, as Lord Neuberger MR indicated in his judgment, at para 67, the right which was vested in LBSF to recover the moneys owing to LBSF under the charge over the collateral in priority to the noteholders was as much an asset of LBSF as the right of the bankrupt in *Ex p Mackay* to receive payment of royalties. The "flip" clauses which were designed to operate in the event of LBSF's insolvency (and which were in fact operated in reliance upon that event) were indistinguishable in effect from the proviso which was designed to operate in the event of bankruptcy which had been struck down in *Ex p Mackay*. The proviso was impermissible because it had the effect, in the event of the creditor's bankruptcy, of granting the debtor a right of retention of moneys otherwise payable to the bankrupt, thereby reducing the value of the royalty stream which was and remained an asset of the bankrupt at all times. (8) It was implicit in Patten LJ's judgment that he considered that LBSF's interest was inherently determinable and hence the "flip" clauses were permissible, rather than an interest which the clauses operated to defeat upon a condition subsequent (i e LBSF's insolvency), which he would have held to be impermissible. In the context of insolvency, that distinction was inappropriate and ought not to be part of the law. The validity or invalidity of a clause should be determined by reference to its effect and the public policy of ensuring that the estates of insolvent parties were not improperly diminished in value or extent in the event of their insolvency. (9) All members of the Court of Appeal had erred in law and fact in concluding that the deprivation in question was "complete" prior to LBSF's filing for Chapter 11 protection. The fact that LBHI had filed for Chapter 11 protection and hence an event of default had occurred under the swap agreement on 15 September 2008 did *not* mean that any deprivation had taken prace prior to LBSF's insolvency. It was neither legally nor practically inevitable that the security over the collateral would be enforced by the trustee following LBHI's filing. (10) Even now, the deprivation contemplated by the second paragraph of condition 44 and

clause 5.5 of the supplemental trust deed had not taken place. Such clauses could only operate as and when the notes became subject to early redemption and thereafter, upon the collateral being realised. That only became possible because of actions taken by the noteholders and the issuer in serving notices to terminate the swap agreements. Those notices had only been served after LBSF filed for Chapter 11 protection and expressly relied upon that event as the relevant event of default under the swap agreements.

The facts are stated in the judgments.

Richard Snowden QC and *James Potts* (instructed by *Weil Gotshal & Manges LLP*) for the second defendant.

The anti-deprivation rule prevents a person from entering into an agreement which, in the event of his own bankruptcy, would deprive his creditors of the benefit of property which the insolvency legislation requires to be available to meet his creditors' claims. The rule applies equally to the bankruptcy of individuals and to the winding up of companies and is of importance in ensuring that full effect is given to the policy inherent in the terms of the insolvency legislation.

The fundamental principle underlying the rule is that a person cannot validly contract out of the insolvency legislation, which has as its objective when rescue is impossible that all of the debtor's property (as defined) at the date of his bankruptcy must be got in and realised and that the proceeds must be distributed in accordance with the statutory scheme. Similarly, the broad definition of "property" in section 436 of the Insolvency Act 1986 reflects the policy mandate that creditors should obtain the fullest possible access to the tangible and intangible assets and the personal or proprietary rights of their debtor to ensure repayment of the amounts which they are owed. Just as a person cannot contract to deprive his creditors of the benefit of property which the insolvency legislation requires to be available to meet their claims, neither can he contract or otherwise arrange for a different order of distribution of his assets in his bankruptcy than the statute prescribes. The operation of the rule does not fetter freedom of contract to any greater extent than the legislation itself.

The effect of the rule is to invalidate those provisions in a contract which purport to limit or diminish the property which will form part of a bankrupt's estate, and which do so by reason of the bankruptcy itself. The rule is not restricted to clauses which seek to transfer a tangible asset out of the estate in the event of bankruptcy but extends to those which seek to limit the characteristics and consequent value of an intangible asset belonging to the bankrupt by reference to the event of bankruptcy itself.

The rule operates irrespective of the subjective intentions of the parties. It makes no difference whether the provision in question was entered into by the relevant person prior to his acquisition of the property, at the time of its acquisition, as a facet of the creation of the property, or after its acquisition. It is the nature and effect of the provision which matters, not when it was inserted into the arrangements. Nor, if the asset or right to which the provision relates is property of the bankrupt within the meaning of the

statute, does it matter how or by whom the acquisition of that asset or right was funded. A

The limited exception to the rule where the asset or right forming the property of the bankrupt within the meaning of the Act allows the bankrupt to use the continuing property of another but contains a term limiting or enabling the grantor to terminate the property created in the event of bankruptcy of the grantee (for example a lease or a licence) will only apply where it is consistent with the inherent nature of the property. Otherwise, the insertion of an insolvency-triggered flaw will not be legitimate because it serves only to evade the insolvency statute. B

For each of the transactions in issue in this case, the second defendant had the benefit of continuing security, namely a first fixed charge over a portfolio of collateral provided by the issuer as the sole recourse for any debt which would be due to the second defendant from the issuer under the swap agreement between them, including any amounts due in the event of termination of the swap agreement. The second defendant's rights under the swap agreement and the rights created over the collateral to secure them were the property of the second defendant within the meaning of the Insolvency Act and formed part of its insolvent estate. At the time of its filing for bankruptcy (and at the early termination date), the second defendant had existing contractual rights which, on final maturity or in the event that the issuer elected to terminate the swap agreement early, would result in a right to payment to the second defendant from the issuer. That was so whether or not the second defendant was the defaulting party under the swap agreement. Those rights, and the accompanying security rights over the collateral to secure such payment, were property which formed part of the second defendant's bankruptcy estate. In the event, the issuer did (months after the bankruptcy filing of the second defendant) elect to terminate the swap agreements. When it did so, it did so expressly in reliance upon the second defendant having filed for bankruptcy. Those terminations gave rise to an undisputed debt payable by the issuers to the second defendant and which is charged on the collateral. C D E F

The effect of the disputed clauses is to deprive the second defendant of property to which it is entitled in its bankruptcy. The security for the obligations owed to the second defendant under the swap agreement cannot validly be altered in reliance on its bankruptcy any more than the associated debt could be altered in reliance upon such bankruptcy. That is, however, the effect of clause 5.5 and condition 44.2. Those provisions are accordingly void and unenforceable under English law. [Reference was made to *Ayerst v C & K (Construction) Ltd* [1976] AC 167; *In re Campbell (A Bankrupt)* [1997] Ch 14; *Rooney v Cardona* [1999] 1 WLR 1388; *In re Celtic Extraction Ltd* [2001] Ch 475; *Ex p Jay; In re Harrison* (1879) 14 Ch D 19; *British Eagle International Airlines Ltd v Cie Nationale Air France* [1975] 1 WLR 758; *International Air Transport Association v Ansett Australia Holdings Ltd* [2008] BPIR 57; *Ex p Mackay; Ex p Brown; In re Jeavons* (1873) LR 8 Ch App 643; *Borland's Trustee v Steel Bros & Co Ltd* [1901] 1 Ch 279; *Whitmore v Mason* (1861) 2 J & H 204; *Roe d Hunter v Galliers* (1787) 2 Durn & E 133; *Mayhew v King* [2010] 2 BCLC 440; *Powdrill v Watson* [1995] 2 AC 394 and *Lester v Garland* (1832) 5 Sim 205.] G H

A *Richard Salter QC* and *Jonathan Davies-Jones* (instructed by *Lawrence Graham LLP*) for the claimants.

The anti-deprivation rule is to be distinguished from, and applies in different situations from, the principle that parties cannot contract out of mandatory provisions of the insolvency legislation applied in *British Eagle International Airlines Ltd v Cie Nationale Air France* [1975] 1 WLR 758. B The *British Eagle* case was about the pari passu principle, and how the insolvent estate should be distributed. The anti-deprivation rule is concerned with the prior question of what assets should form part of the insolvent estate.

The anti-deprivation rule is a judge-made exception to the principle of insolvency law that a trustee in bankruptcy takes the assets of the bankrupt as he finds them at the commencement of the bankruptcy, with no greater C rights than the bankrupt had at that moment. It was developed at a time when statutory provisions for protecting the interests of creditors were much less well developed than now.

If the rule continues to have any role to play at all, it is important for the courts to confine it narrowly. In all of the cases in which it has successfully been invoked, it has been on the basis of some actual transfer or disposition D of property, not simply because the relevant transaction reduced or limited the economic value of the debtor's estate without any such transfer or disposition taking place. The rule distinguishes between property absolutely vested in a debtor at the commencement of the bankruptcy, and property granted to the debtor on the basis that it is inherently limited to determine (or to be determinable on notice) on bankruptcy. Limitations of the latter kind are not generally invalidated by the rule.

E The rule also recognises the distinction between accrued or executed property rights, on the one hand, and accruing or executory property rights, on the other—and does not generally invalidate provisions terminating the latter on bankruptcy. It cannot be engaged by deprivations which occurred before the start of formal bankruptcy proceedings, or by deprivations which occurred upon the happening of events other than the bankruptcy of the F debtor. Nor should it apply where the beneficiary of the "deprivation" had been the source of the relevant assets, given the principle (which emerged in relation to marriage settlements—see, for example, *Lester v Garland* (1832) 5 Sim 205—but which was extended to other contexts by *Whitmore v Mason* (1861) 2 J & H 204) that an owner of property may, on alienation, limit the interest of his alienee by a condition to take effect on bankruptcy G and, in such event, might stipulate for the property to revert.

If there is to be any development in the law relating to the rule it should be in the direction of reducing or eliminating its scope, not extending it or eliminating any of the existing limitations and qualifications. Bankruptcy law is essentially a creature of statute. The Insolvency Act 1986 has created a number of specific and limited exceptions to the principle that a trustee in bankruptcy takes the assets of the bankrupt as he finds them, for example, in H relation to transactions at an undervalue, wrongful preferences, post-bankruptcy dispositions and transactions intended to defraud creditors. Having regard to the extent to which this area is now covered by statute, there is good reason why the rule, with its uncertain basis and scope and its imperfections, should no longer represent the law.

Even if the rule does continue to have a role to play, it is not engaged here. The impugned provisions do not work any deprivation or, at the least, any that engages the rule. The only interest that the second defendant at any time had in the collateral charged by the various issuers in favour of the trustee was a beneficial interest under the trust created by the principal trust deed and supplemental trust deed in relation to each series of notes. It retains that interest. What the second defendant seeks to impugn in these proceedings are the provisions of that trust which define its interest as a limited one, giving it priority in certain conditions but not in others. Those provisions simply define the extent of its interest in the particular issuer's property and do not deprive the second defendant of any of its own property, let alone property absolutely vested in it. The only interest the second defendant ever acquired in the issuer's property was an inherently limited interest. Priority was to cease on the occurrence of particular events. Such a limited or determinable right does not engage the rule. Nor does the rule invalidate provisions, such as those in issue here, determining rights dependent upon continuing ability to perform executory obligations.

The purchase of the collateral was entirely funded by the noteholders in seven of the nine series and largely funded by them in the other two. The impugned provisions ensured that the second defendant received no windfall by ceasing to perform its executory obligations and that noteholders were repaid from the collateral they funded. The rule does not apply in such situations.

The second defendant cannot rely upon the rule to rewrite the trust or its interest under it, or to obtain priority over assets which the noteholders funded in circumstances where it is in default and the contract provides for the noteholders to have priority in that event. The clauses which altered priority to the collateral under clause 5.5 of the supplemental trust deed and the increased amounts payable to noteholders under condition 44.2 of the terms and conditions were an intrinsic part of the bargain.

In any event, the rule can only apply to deprivations which take effect by reason of the beginning of formal insolvency proceedings affecting the party said to be deprived. It follows that even if the provisions under consideration would otherwise have engaged the rule, they cannot do so on the facts of this case. The trustee became obliged to apply the trust property in accordance with noteholder priority when Lehman Bros Holdings Inc ("LBHI") filed for Chapter 11 protection nearly three weeks before the second defendant filed for protection. Alternatively, the trustee would be obliged to apply the trust property in accordance with noteholder priority now on account of LBHI's Chapter 11 filing. Neither situation can or does engage the rule, because there has been (or will be) no deprivation triggered by the second defendant's bankruptcy.

The claimants are not precluded from relying on the LBHI event of default because it was not referred to in the swap termination notices served in 2009. English law entitles a party to justify his actions by reference to facts then existing but only discovered later: see *Byblos Bank SAL v Al-Khudhairy* [1987] BCLC 232. [Reference was also made to *In re Johns; Worrell v Johns* [1928] Ch 737; *Ex p Williams; In re Thompson* (1877) 7 Ch D 138; *Peregrine Investment Holdings Ltd v Asian Infrastructure Fund*

Management Co Ltd [2004] 1 HKLRD 598; *Lockyer v Savage* (1733) 2 Str 946; *Staveley v Parsons* (1736) 2 Ves Jun Supp 114n; *Roe d Hunter v Galliers* (1787) 2 Durn & E 133; *Ex p Cooke* (1803) 8 Ves Jun 353; *Brandon v Robinson* (1811) 18 Ves Jun 429; *Wilson v Greenwood* (1818) 1 Swans 471; *Rochford v Hackman* (1852) 9 Hare 475; *In re Machu* (1882) 21 Ch D 838; *Ex p Barter; Ex p Black; In re Walker* (1884) 26 Ch D 510; *Mackintosh v Pogose* [1895] 1 Ch 505; *In re Scientific Investment Pension Plan Trusts* [1999] Ch 53; *Money Markets International Stockbrokers Ltd v London Stock Exchange Ltd* [2002] 1 WLR 1150; *Mayhew v King* [2010] 2 BCLC 440; *Lomas v JFB Firth Rixson Inc (International Swaps and Derivatives Association Inc intervening)* [2011] 2 BCLC 120; *Ayerst v C & K (Construction) Ltd* [1976] AC 167; *Ex p Jay; Ex p Harrison* (1879) 14 Ch D 19; *Ex p Newitt; In re Garrud* (1881) 16 Ch D 522; *Higginbotham v Holme* (1812) 19 Ves Jun 88 and *Ex p Mackay; Ex p Brown; In re Jeavons* (1873) LR 8 Ch App 643.]

Mark Howard QC and *Stephen Midwinter* (instructed by *Hogan Lovells International LLP*) for the first defendant.

The anti-deprivation rule can be stated in three propositions. (1) Where a person has absolute legal title to property other than a chose in action, a contract provision which purports to divest him of that property, or of any rights in it, on bankruptcy is invalid. (2) Where a person has a property right in relation to property other than a chose in action which is less than absolute legal title, a contract provision which limits that right so that it comes to an end on bankruptcy is valid provided that the donor of the property right was not the bankrupt person himself. (3) Where a person has a property right in a chose in action, a contract provision which limits that right so that it comes to an end on bankruptcy is valid, save that a term which purports to divest the bankrupt person of an accrued right (i e an immediately enforceable right, such as a debt which has fallen due) is invalid.

There was no deprivation of property here. Moreover, since the rule can only apply where the deprivation occurs on or after bankruptcy of the person holding the right, even if the second defendant had had a right to be paid in priority to the noteholders, it was deprived of that right when an event of default occurred on the Chapter 11 filing of LBHI.

Further, the clauses in the transaction documents which effect the reversal of priorities are terms which bring the second defendant's right in a chose in action to an end on bankruptcy and do not purport to divest it of any accrued or immediately enforceable right. They are therefore valid.

Even if the anti-deprivation rule is defined more broadly, applying it to the present case would involve an extension of the rule beyond its current ambit and beyond the terms of the insolvency legisiation. There is no reason to extend the rule in this way. On the contrary, party autonomy and freedom of contract require that the rule should be kept within narrow bounds. Commercial parties should be free to define their contractual rights. The commercial impact of a ruling in favour of the second defendant would be significant. In a case such as the present between commercial parties, the court should not lightly reach a conclusion that public policy requires a conclusion which upsets market expectations.

Gregory Mitchell QC (instructed by *Solicitor, Revenue and Customs Comrs*) for the Revenue and Customs Commissioners, intervening, made written submissions.

The anti-deprivation rule is an important part of English law and should remain so. It is part of a wider principle of public policy, applicable where a particular contractual provision offends against the principle of pari passu distribution between creditors of the insolvent estate and so is expressly or impliedly forbidden by statute. Its application must necessarily be nuanced depending on the facts of the case, the purpose of the particular contractual provisions, and the importance in any particular case to be given to other values such as party autonomy, freedom of contract and legal certainty.

The court should not overrule existing case law on the rule because the decided cases mark out its boundaries and allow draftsmen of contracts to know what can and what cannot be done. The fact that the precise ambit and limits of the rule cannot easily be defined is no criticism of the rule. The difficulty necessarily follows from the fact that it is based on public policy.

The existence of anti-avoidance provisions in the Insolvency Act 1986 giving express powers to the court to undermine transactions is no reason for the rule to be abolished or curtailed: see sections 238 and 339, sections 239 and 340, and section 423. Those provisions, by creating a statutory cause of action against third parties to claw back assets in defined circumstances, give a basis for a claim where otherwise there would be no cause of action at common law. By contrast, the anti-deprivation rule does not create a cause of action but invalidates a contractual right upon which a particular creditor seeks to rely in order to obtain an advantage over other creditors. The existence of the statutory provisions is thus no reason to abolish or curtail the anti-deprivation rule.

Gabriel Moss QC and *Daniel Bayfield* (instructed by *McCormicks, Harrogate*) for the Football Association Premier League Ltd, intervening, made written submissions.

Apart from the comprehensive statutory scheme contained in the Insolvency Act 1986 there should not be any judge-made additional restrictions on freedom of contract based on the ill-defined anti-deprivation rule of public policy in *British Eagle International Airlines Ltd v Cie Nationale Air France* [1975] 1 WLR 758. In particular, the freedom of commercial parties to agree to complex financial structures should not be interfered with by such a nebulous concept. While the precise result in the *British Eagle* case may be justifiable on pure statutory grounds, there is no historical or logical basis for the anti-deprivation rule and even less scope for the application of any such rule following the expansion of statutory interference in freedom of contract under the 1986 Act, which is Parliament's balancing of freedom of contract against the needs of insolvency law.

The policy of striking down contractual provisions which were a "fraud on the bankruptcy law" arose in the old bankruptcy (personal insolvency) case law. One branch of that policy, preventing deprivation of property, migrated without challenge to corporate insolvency to become the anti-deprivation rule. However, the principal cases relied on to support the rule, such as *Ex p Mackay; Ex p Brown; In re Jeavons* (1873) LR 8 Ch App 643 and the *British Eagle* case [1975] 1 WLR 758, do not require any resort to

A public policy at all but can be explained on the basis of the inability of an ordinary contractual provision to remove from a bankruptcy or liquidation estate property which has vested in it. Any effective deprivation of a debtor's property (whether by transfer, settlement on trust, creation of charge, conferment of powers or otherwise) has to take place prior to the vesting in the trustee in bankruptcy or the liquidation estate or by a contract specifically enforceable (with the permission of the court) against an insolvency estate. These results arise from the relevant insolvency statutes and there is no need to have resort to public policy.

There may, before 1986, have been rare and limited cases which required the court to have resort to public policy, such as where a debtor settles his own property on trust for himself until he becomes bankrupt and then on his wife and children, but that would be a "fraud on the bankruptcy". The public policy did not apply where the property originated from a third party such as a wife or father-in-law and the exception is not limited to marriage settlements.

Just as there can be no public policy objection to a third party providing property to a debtor on condition that, if he become bankrupt, it passes back to the provider, there should be no difference as a matter of policy whether the condition is a condition precedent or subsequent. Even less should there be a public policy if it is part of an arm's length commercial transaction for valuable consideration.

The public policy relating to bankruptcy cases was not applied so as to invalidate freely entered into arm's length commercial transactions in corporate insolvency before the *British Eagle* case and there had been no need to apply it in that case. The policy as set out in the *British Eagle* case is vague, easy to draft round, full of exceptions and destructive of arm's length commercial contracts. It is not fit for purpose as an invalidating public policy and should not be followed. The *British Eagle* case should be overruled.

Snowden QC in reply.

The second defendant is not seeking to rewrite the contract. The issue is whether the deprivation clauses which were operated on its bankruptcy were lawful. To assert that clause 5.5 and condition 44.2 were an intrinsic part of the bargain merely begs the question whether the insertion of such clauses was lawful in the first place. The clauses in issue did effect a relevant deprivation of property. Although swap counterparty priority was part of the mechanism by which the second defendant's interest in the collateral was defined, that is not the point. Prior to its bankruptcy it had a bundle of rights under the swap agreement and the trust. These were valuable rights which could have been sold. The fact that its right to swap counterparty priority was contingent is also irrelevant. The right was not inherently limited but would have applied unless taken away by the operation of contractual provisions which were triggered by reference to its bankruptcy: cf *Ex p Mackay; Ex p Brown; In re Jeavons* (1873) LR 8 Ch App 643.

Executory contracts are not an exception to the anti-deprivation rule. There is no legitimate policy argument for such an exception and every indication in the very broad definition of property in the Insolvency Act 1986 that it is not permitted. To hold otherwise would allow parties rountinely to insert a term into a contract which allows a party who has made what in the event turns out to be a bad bargain to escape that bargain if

the counterparty becomes insolvent and thereby to deprive the counterparty's creditors of the benefit of the bargain.

The issue of whether a contract can be terminated by reason of the bankruptcy of one of the parties should not be confused with the issue of whether the contract can be terminated after bankruptcy for breach or a failure by the bankrupt to perform. There can be no objection to the latter. It is unobjectionable for rights of termination on breach to be provided under a commercial contract on the basis that accrued rights are enforced and future rights to performance abandoned subject to claims for damages against the defaulting party. Whether a right to terminate a contract, not for breach, but in the event of a counterparty's bankruptcy, engages the anti-deprivation rule will depend on the terms upon which such termination takes place. Where, as here, the exercise of a right of termination is on terms which provide for the deprivation of the rights of the bankrupt to his detriment purely because of his bankruptcy, that would infringe the rule. The effect of the deprivation clauses is to permit the claimants to walk away from the transaction without any account being taken of future credit events. In the same way that a bankrupt cannot be put in a better position on insolvency than he would otherwise have been, he cannot be put in a worse position as a result of the operation of a clause triggered purely by reference to his bankruptcy.

The first defendant is wrong to say that a clause in a contract which deprives a bankrupt of his contractual rights is valid except in so far as it purports to deprive the bankrupt of an accrued right: see *Mayhew v King* [2010] 2 BCLC 440.

It cannot be germane to the operation of the insolvency legislation or the anti-deprivation rule that the money with which an insolvent person acquired the asset in question might have been provided by the person in whose favour the deprivation operates. If the asset in question comprises property of the insolvent person it cannot matter how the acquisition was financed at any earlier time. The ratio of *Whitmore v Mason* (1861) 2 J & H 204 is that the deprivation clause was unlawful: dicta relating to who supplied the money are obiter and at best tentative. *Lester v Garland* (1832) 5 Sim 205 is equally unsuitable as the foundation for any modern principle of law.

The anti-deprivation rule performs a valuable function which is not encompassed within the anti-avoidance statutory provisions. The latter are subject to significant limitations and would not catch many of the anti-deprivation cases.

The court took time for consideration.

27 July 2011. The following judgments were handed down.

LORD COLLINS OF MAPESBURY

I. Introduction: the anti-deprivation rule and the pari passu principle

1 The anti-deprivation rule and the rule that it is contrary to public policy to contract out of pari passu distribution are two sub-rules of the general principle that parties cannot contract out of the insolvency legislation. Although there is some overlap, they are aimed at different mischiefs: Goode, "*Perpetual Trustee* and Flip clauses in Swap Transactions"

(2011) 127 LQR 1, 3–4. The anti-deprivation rule is aimed at attempts to withdraw an asset on bankruptcy or liquidation or administration, thereby reducing the value of the insolvent estate to the detriment of creditors. The pari passu rule reflects the principle that statutory provisions for pro rata distribution may not be excluded by a contract which gives one creditor more than its proper share.

The anti-deprivation rule

2 What is now described as the anti-deprivation principle dates from the 18th century, although the expression "deprivation" has been in use in this context only since the decision of Neuberger J in *Money Markets International Stockbrokers Ltd v London Stock Exchange Ltd* [2002] 1 WLR 1150. In 1812 Lord Eldon LC confirmed that a term which is "adopted with the express object of taking the case out of reach of the bankrupt laws" is "a direct fraud upon the bankrupt laws" from which a party cannot benefit: *Higinbotham v Holme* (1812) 19 Ves Jun 88, 92.

3 Classic statements of the principle include these:

> "the law is too clearly settled to admit of a shadow of doubt that no person possessed of property can reserve that property to himself until he shall become bankrupt, and then provide that, in the event of his becoming bankrupt, it shall pass to another and not to his creditors": *Whitmore v Mason* (1861) 2 J & H 204, 212, per Sir William Page Wood V-C.
>
> "a simple stipulation that, upon a man's becoming bankrupt, that which was his property up to the date of the bankruptcy should go over to some one else and be taken away from his creditors, is void as being a violation of the policy of the bankrupt law": *Ex p Jay* (1880) 14 Ch D 19, 25, per James LJ.

4 In the case of personal bankruptcy, section 306(1) of the Insolvency Act 1986 Act provides that a bankrupt's estate vests in the trustee in bankruptcy immediately upon his appointment and section 283(1) provides that a bankrupt's estate comprises

> "all property belonging to or vested in the bankrupt at the commencement of the bankruptcy; and . . . any property which by virtue of any of the following provisions of this Part is comprised in that estate or is treated as falling within the preceding paragraph."

5 In the case of corporate insolvency, the insolvent company continues to be owner of its property but holds it on trust for the creditors in accordance with the provisions of the 1986 Act: *Ayerst v C & K (Construction) Ltd* [1976] AC 167. For companies, section 436 defines "property" so that it

> "includes money, goods, things in action, land and every description of property . . . and also obligations and every description of interest, whether present or future or vested or contingent, arising out of, or incidental to, property . . ."

The pari passu principle

6 In the case of personal bankruptcy, by section 328 of the 1986 Act, subject to preferential payments, and with the exception of certain deferred

debts, all other debts are to be paid equally. For companies, section 107 provides that, subject to the provisions relating to preferential payments, "the company's property in a voluntary winding up [should] on the winding up be applied in satisfaction of the company's liabilities pari passu". By rule 4.181 of the Insolvency Rules 1986 (SI 1986/1925) similar provision is made for a winding up by the court. In such a winding up, the liquidator must "secure that the assets of the company are got in, realised and distributed to the company's creditors" and, subject to that, he must "take into his custody or under his control all the property and things in action to which the company is . . . entitled": sections 143 and 144 of the 1986 Act.

7 In *British Eagle International Airlines Ltd v Cie Nationale Air France* [1975] 1 WLR 758 the House of Lords by a bare majority (reversing Templeman J and a unanimous Court of Appeal [1974] 1 Lloyd's Rep 429, with Russell LJ delivering the judgment of the court) decided that a clearing house arrangement between a large number of airline companies relating to debts arising as between them was ineffective as against the liquidator of one of the companies, British Eagle. All members of the House upheld the principle that contracting out of the pari passu provisions of what was then section 302 of the Companies Act 1948 was contrary to public policy and void. The difference between the majority and minority related largely (but not exclusively) to the question whether the arrangement resulted in no debt being due. The conclusion of the majority in the House of Lords was that, in so far as the arrangement purported to apply to debts which existed when the members of the company passed the resolution to go into creditors' voluntary liquidation, it would have amounted to contracting out of the statutory requirement that the assets owned by the company at the date of its liquidation should be available to its liquidator, who should use them to meet the company's unsecured liabilities pari passu, under what is now section 107 of the 1986 Act.

8 The ratio of the decision was accurately stated by Peter Gibson J in *Carreras Rothmans Ltd v Freeman Mathews Treasure Ltd* [1985] Ch 207, 226 as being that

> "where the effect of a contract is that an asset which is actually owned by a company at the commencement of its liquidation would be dealt with in a way other than in accordance with [the statutory pari passu rule] . . . then to that extent the contract as a matter of public policy is avoided."

9 The distinction between the two sub-rules is by no means clear-cut. Several decisions which are regarded as decisions on the anti-deprivation rule could also be characterised as cases in which the parties sought to disturb pari passu distribution. *Ex p Mackay*; *Ex p Brown*; *In re Jeavons* (1873) LR 8 Ch App 643 is usually regarded as an anti-deprivation case. It involved two transactions: the first was the sale of a patent for improvements in the manufacture of armour plates by Mr Jeavons to Brown & Co and Cammell & Co in consideration of the companies paying royalties; the second was a secured loan of £12,500 from the companies to Mr Jeavons. The parties agreed that (1) the companies would keep half the royalties towards satisfying the debt, and (2) in the event of Mr Jeavons's bankruptcy, they could also keep the other half of the royalties until the debt had been

A fully paid. It was held that provision (1) was valid against Mr Jeavons's trustee, but provision (2) was not.

10 James LJ said, at p 647, that provision (1) represented "a good charge upon one moiety of the royalties, because they are part of the property and effects of the bankrupt", but provision (2) "is a clear attempt to evade the operation of the bankruptcy laws" as it "provide[d] for a different distribution of his effects in the event of bankruptcy from that which the law provides". Mellish LJ said, at p 648, (citing *Higginbotham v Holme* 19 Ves Jun 88, 92) that the case fell within the principle that

> "a person cannot make it a part of his contract that, in the event of bankruptcy, he is then to get some additional advantage which prevents the property being distributed under the bankruptcy laws . . ."

11 What James and Mellish LJJ said cannot be applied unconditionally, since "a different distribution" and "additional advantage" can be obtained by lawful charges between debtor and creditor and by subordination agreements between creditors, and the same applies to what Lord Cross of Chelsea said about "contracting out" generally. The reference, therefore, by James LJ to a "different distribution of his effects in the event of bankruptcy from that which the law provides" is an early expression of the pari passu principle. That is perhaps why the decision was the only prior relevant decision discussed in Lord Cross's sole speech for the majority in *British Eagle*. He said, at p 780:

> "In *Ex p Mackay* LR 8 Ch App 643, the charge on [the] second half of the royalties was . . . an animal known to the law which on its face put the charge[e] in the position of a secured creditor. The court could only go behind it if it was satisfied—as was indeed obvious in that case—that it had been created deliberately in order to provide for a different distribution of the insolvent's property on his bankruptcy from that prescribed by the law."

12 Lord Morris of Borth-y-Gest, in his dissenting speech, agreed that *Ex p Mackay* was a case where the relevant provisions were "a clear attempt to evade the operation of the bankruptcy laws", or "a 'device for defeating the bankruptcy laws' ": p 770.

13 By the time that *International Air Transport Association v Ansett Australia Holdings Ltd* (2008) 234 CLR 151 was decided by the High Court of Australia the rules of the clearing house scheme had been modified following the *British Eagle* decision so as to exclude any liability or right of action for payment between member airlines. The High Court decided by a majority (Kirby J dissenting) that the rule changes were effective to make IATA the sole creditor of Ansett, and that the revised system did not have the effect of administering debts due to an insolvent company otherwise than in accordance with the mandatory pari passu rule. In their joint judgment Gummow, Hayne, Heydon, Crennan and Kiefel JJ also referred to *Ex p Mackay* and suggested that Lord Cross's speech in *British Eagle* was based in part on the anti-deprivation principle; and that there was no need for recourse to the rule that a contract which is contrary to public policy is void, because the statute was an overriding one which applied according to its terms: paras 74 and 76. There is much to be said for the observation that recourse to public policy is unnecessary for the application of the mandatory

statutory pari passu principle. There is little difference in practice between declaring a contractual provision invalid or ineffective because it is inconsistent with the statute and declaring it contrary to public policy for the same reason, but this is not the occasion for the decision in *British Eagle* to be reconsidered. Although it must be said that the decision of the minority and of the lower courts makes more sense commercially than that of the majority, there was no real disagreement on the applicable principles.

14 But it does not follow from the fact that it is difficult in some cases to draw the line between the two categories that there are no relevant differences. The anti-deprivation rule applies only if the deprivation is triggered by bankruptcy, and has the effect of depriving the debtor of property which would otherwise be available to creditors. The pari passu rule applies irrespective of whether bankruptcy or liquidation is the trigger. There is a question whether the bona fides of the parties is equally relevant to the application of the two principles. These points will be taken up below.

15 This is a case in which only the anti-deprivation principle is potentially applicable. The noteholders are creditors of the issuer. There is no question of disturbance of the pari passu rule as between the creditors of Lehman Brothers Special Financing Inc ("LBSF"). What is said, in effect, is that the parties have unlawfully extracted an asset belonging to LBSF, namely its first charge on the collateral, and passed it to the noteholders.

Anti-avoidance provisions

16 There are anti-avoidance provisions for personal and corporate insolvency. They are relevant on this appeal because of an argument that the anti-deprivation rule dates from a time when there were anti-avoidance provisions which, if they existed at all, were in their infancy, and that consequently the need for the rule needs to be re-visited in the light of legislative developments. For personal bankruptcies, section 284 of the 1986 Act provides that where a person is adjudged bankrupt, any disposition of property made by that person in the period from the day of the presentation of the petition for the bankruptcy order is void except to the extent that it is or was made with the consent of the court, or is or was ratified by the court. There are claw-back provisions dealing with the setting aside of transactions at an undervalue and preferences in sections 339 to 340 of the Act.

17 For companies, section 127 provides that "any disposition of the company's property . . . made after the commencement of the winding up is, unless the court otherwise orders, void". Sections 238 and 239 enable a liquidator to apply to the court for an order to restore the position where the company has entered into a transaction at an undervalue, or has done anything which, in the event of the company's insolvent liquidation, would put a creditor (or guarantor) of the company in a better position than he would otherwise be in. By section 423 the court may set aside transactions entered into at an undervalue at any time if they were entered into

> "for the purpose . . . of putting assets beyond the reach of a person who is making, or may at some time make, a claim against him, or . . . of otherwise prejudicing the interests of such a person in relation to the claim."

II. Background

18 Prior to the events which form the background to this appeal, the Lehman Brothers group was the fourth largest investment bank in the United States. On 15 September 2008, Lehman Brothers Holdings Inc ("LBHI"), the parent company of the Lehman Brothers group, applied to the US Bankruptcy Court for the Southern District of New York for protection under Chapter 11 of the United States Bankruptcy Code.

19 This appeal concerns the effect of the security arrangements in a complex series of credit swap transactions under which, in effect, investors gave credit protection to Lehman Brothers by reference to the performance of a basket of underlying obligations.

20 The Lehman Brothers vehicles used for what was called the "Dante Programme" (named after the first special purpose vehicle ("SPV") used in the programme) were LBSF and SPVs incorporated in jurisdictions chosen for tax reasons. The programme was what was called a synthetic debt repackaged note issuance programme.

21 At the time of the Lehman Brothers collapse in September 2008 there were 19 SPVs being used as note issuers in the programme with a total of about 180 series of notes with an aggregate principal amount of $12·5bn. LBSF filed for Chapter 11 protection in the United States Bankruptcy Court for the Southern District of New York on 3 October 2008.

22 The documentation is complex, but, in broadest outline, the transactions in the representative example series before the court on this appeal were these. (1) Lehman Brothers set up an SPV ("the issuer") in a suitable jurisdiction (in the representative example, Saphir Finance plc, incorporated in the Republic of Ireland). (2) Investors ("the noteholders") subscribed for notes issued by the issuer. The notes were floating rate medium-term notes (with a seven year maturity) with a margin of 1·3% over Australian dollar denominated three month bills. (3) The issuer used the subscription moneys to purchase government bonds or other secure investments (in the representative, triple-A rated floating rate Rabo Australia Ltd notes guaranteed by Rabobank Nederland) ("the collateral"). (4) The collateral was vested in a trustee (in the present case BNY Corporate Trustee Services Ltd) ("the trustee"). (5) LBSF entered into a credit default swap agreement with the issuer under which LBSF would pay the issuer the amounts due by the issuer to the noteholders in exchange for the payment by the issuer to LBSF of sums equal to the interest received on the collateral. (6) The amount by which the sum payable under the swap agreement by LBSF exceeded the yield on the collateral represented what has been described as the premium for credit protection insurance provided by the noteholders. (7) The amount payable by LBSF to the issuer on the maturity of the notes (or on early redemption or termination) was the initial principal amount subscribed by the noteholders less amounts (if any) calculated by reference to the credit events occurring during a specified period by reference to one or more reference entities. In return, LBSF would receive the proceeds of the collateral. (8) The payment due from LBSF at maturity of the swap agreement (and also the outstanding principal amount of the notes) could be reduced (in extreme circumstances to zero) during the term of the swap agreement (and the notes) if credit events occurred and were notified in accordance with the terms of the swap agreement. (9) Credit protection or insurance is a misnomer because there was no requirement for LBSF to have

any direct exposure to the reference portfolio (substantially the same 260 reference entities in the two tranches before the court on the appeal): it was expressly provided that the swap did not constitute a contract of insurance and that payments would be due in the event of credit events without proof of economic loss to LBSF. (10) There was in effect an "excess" because the notified credit events would lead to a reduction only if they exceeded a stated "subordination amount." In the representative example before the court A$70m was the amount of the issue, the subordination amount was A$126m, and the offering circular indicated that the notes would be reduced to zero when the cumulative losses on the reference portfolio reached A$196m. (11) If credit events did not occur the noteholders were due to receive the full amount of the notes, and LBSF was to put the issuer in funds to redeem the notes. (12) If credit events occurred, the amounts payable by LBSF and the principal amount due on the notes were to be reduced from time to time as and when such credit events occurred and were notified. (13) Consequently, the performance of the notes was linked to the performance of the obligations of the reference entities. In effect, LBSF was speculating that sufficient credit events would occur for it to be required to pay less than the noteholders had invested and to net a substantial part of the collateral; and the noteholders were speculating that the credit reference portfolio was safe and that any credit events within it would not "burn through" the net amount of the subordination amount. (14) The collateral was charged by the issuer in favour of the trustee to secure its obligations to LBSF under the swap agreement and to the noteholders under the terms and conditions of the notes. (15) The claims of LBSF and the noteholders were limited to the collateral and they had no right of recourse against the issuer. (16) The respective priorities of LBSF under the swap agreement and the noteholders were described as "swap counterparty priority" and "noteholder priority." (17) The respective priorities of LBSF and the noteholders depended on whether there had been an event of default under the swap agreement, which included the institution by LBSF (or LBHI as LBSF's "credit support provider" under the swap agreement) of proceedings in insolvency or bankruptcy (such as filing for Chapter 11 protection). (18) If there were no such event of default, then LBSF would have priority in relation to the collateral, but if there were an event of default in respect of which LBSF (or LBHI) was the "defaulting party," the noteholders would have priority over LBSF.

23 The central issue in the proceedings and the appeal is the validity of those provisions for alteration of priority. The practical importance of the question is that under the terms of the swap, in the event of its early termination, it was to be unwound with certain "unwind costs" payable either to LBSF or to the issuer. The unwind costs represented the market assessment of the amount either LBSF or the issuer were expected to receive under the swap were it to run to maturity. The commercial purpose was to reflect the value of the swap in the market place as at the point of termination.

24 Since, following the financial crisis, many more credit events were expected to occur in the future, the unwind costs (representing a payment for the future losses) would be due to LBSF. If swap counterparty priority subsists LBSF would be entitled to recourse to the collateral towards satisfaction of its claims. But if the noteholders have priority, the collateral

A would be exhausted in repayment of the notes where credit events did not occur before termination so as to reduce the amount due on the notes and to make some of the collateral available to LBSF.

III. The litigation

25 The first 29 respondents (which will for convenience be called "the
B Belmont respondents" after the first respondent, Belmont Park Investments Pty Ltd, or "the noteholders", depending on the context) are Australian companies, institutions, authorities and charities who are noteholders in ten series of notes, nine of which are involved in this appeal. After 15 September 2008, periodic payments due to the noteholders were not made. The same applied in respect of other note series under the Dante Programme, including two series held by Perpetual Trustee Co Ltd ("Perpetual").

C **26** The total outstanding under those nine series of notes is approximately A$250·23m (approximately £155m) of which the Belmont respondents account for approximately A$91·1m. The contractual documentation differs between the various Belmont series, but the parties are content for the court to consider the Saphir 2004-4 note documentation as, for relevant purposes, representative, and the documentation before the
D court has included the documents relating to two tranches. The facts set out below relate to those tranches. There are minor differences in relation to some other series, but they are immaterial for present purposes.

27 On 15 September 2008, LBHI filed for Chapter 11 protection under the US Bankruptcy Code, and on 3 October 2008, LBSF filed for Chapter 11 protection.

28 Later in 2008 or in March/April 2009, following directions by the
E noteholders, the trustee caused the issuer to terminate the swap agreement. The swap termination notices served in respect of the notes relied on the event of default constituted by LBSF's Chapter 11 filing and reserved all rights, claims and defences in relation to all other events of default. On 6 May 2009, the trustee issued condition 10 notices declaring the notes to be due and payable at their early redemption amount.

F **29** LBSF's position was that the effect of the provisions for a change in priority on default was unlawfully to deprive LBSF of property to which it is entitled in its bankruptcy, because they purported to modify the priority which was enjoyed over collateral by LBSF in favour of the noteholders after an insolvency event; and changed the allocation of unwind costs in favour of the noteholders to exclude payment to LBSF.

30 In May and June 2009 respectively Perpetual and the Belmont
G respondents issued CPR Pt 8 claims in England against the trustee for orders designed to procure the realisation of the collateral held by the trustee in respect of each of the series of notes held by them respectively and the application of the collateral and its proceeds in favour of the noteholders in priority to any claim of LBSF as swap counterparty in accordance with the contractual provisions. LBSF was subsequently joined as a party.

H **31** Proceedings were also commenced (but not by the Belmont respondents) against the trustee by LBSF (and other Lehman entities) in the United States Bankruptcy Court for the Southern District of New York claiming a declaration that the provisions in the note issues held by Perpetual modifying LBSF's rights to a priority distribution solely as a result of a Chapter 11 filing were unenforceable because they were clauses which

sought, in breach of the United States Bankruptcy Code, to modify contractual relationships due to a filing of a bankruptcy petition ("ipso facto clauses").

32 On 28 July 2009 Sir Andrew Morritt C found that the contractual provisions were effective as a matter of English law and, in particular, did not offend the anti-deprivation rule; alternatively, if the provisions were capable of offending the anti-deprivation rule, the rule was not engaged because an alternative event of default (the Chapter 11 filing by LBHI) had occurred prior to the Chapter 11 filing by LBSF, and consequently the Chapter 11 filing did not deprive LBSF of any property: *Perpetual Trustee Co Ltd v BNY Corporate Trustee Services Ltd* [2009] 2 BCLC 400. On 6 November 2009 Sir Andrew Morritt C's judgment was upheld by the Court of Appeal [2010] Ch 347.

33 Following communications between the High Court in England and the Bankruptcy Court in New York, it was agreed that, in order to limit potential conflict between decisions in the two jurisdictions, relief would be limited to declaratory relief: *Perpetual Trustee Co Ltd v BNY Corporate Trustee Services Ltd* [2010] 2 BCLC 237; *In re Lehman Bros Holdings Inc* (2010) 422 BR 407 (US Bankruptcy Court, SDNY).

34 In January 2010 Judge Peck, sitting in the US Bankruptcy Court for the Southern District of New York, granted summary judgment in favour of LBSF on its application for a declaration that the provisions in the Perpetual documentation were ineffective because they were in breach of the US Bankruptcy Code: *In re Lehman Bros Holdings Inc* 422 BR 407.

35 Permission was granted by this court to LBSF to appeal from the decision of the Court of Appeal. The trustee was given leave by the United States District Court to appeal from Judge Peck's decision. But before the appeal to the United States District Court, or the appeal to this court, were heard, the proceedings in relation to the notes held by Perpetual were settled and the appeals were withdrawn. This appeal consequently concerns the notes held by the Belmont respondents only.

IV. The contractual provisions

36 All of the documents are expressly governed by English law. The relevant provisions of the documentation are set out in an appendix to the judgments on this appeal, but for present purposes the following account of the crucial provisions should be sufficient.

37 The notes are governed by: (1) a principal trust deed (the "principal trust deed") between Dante Finance plc ("Dante"), the first issuer under the programme, and the trustee under which the Dante Programme was established, which has effect in relation to any specific note issue as amended by the supplemental trust deed and drawdown agreement relating to that issue; (2) a supplemental trust deed and drawdown agreement ("the supplemental trust deed") made between the issuer, the trustee (together with its associated custodian and paying agent), LBSF (described as the swap counterparty) and the Lehman company which arranged the Dante Programme, Lehman Brothers International (Europe); and (3) the terms and conditions of the notes ("the terms and conditions") which appeared in a schedule to the principal trust deed and which were also supplemented or amended by additional terms which were attached to the prospectus sent to potential investors.

A **38** The credit default swap agreement ("the swap agreement") is constituted by: (1) an ISDA master agreement, including the schedule (and credit support annex) ("the ISDA master agreement") between Dante and LBSF (to which the issuer subsequently acceded); and (2) a swap confirmation between LBSF and the relevant issuer.

B *The principal trust deed*

39 Clause 5.5 of the principal trust deed provides that

> "the security . . . shall become enforceable if (i) any amount due in respect of the notes is not paid or delivered when due or (ii) a swap agreement terminates with sums due to the swap counterparty [i e LBSF] . . ."

C **40** Clause 6.1 of the principal trust deed provides that moneys received, otherwise than in connection with the realisation or enforcement of the security, are to be held by the trustee, after payment of the trustee's costs, on trust to pay, first, the amounts due to LBSF, the noteholders and others pari passu, and, secondly, the amounts due to the issuer.

41 Clause 6.2 of the principal trust deed directs the trustee:

D

> "[to] apply all moneys received by it under the principal trust deed and the relevant supplemental trust deed in connection with the realisation or enforcement of the security . . . as follows"

and goes on to provide that "swap counterparty priority" means that the claims of LBSF are payable in priority to the claims of the noteholders, E whereas "noteholder priority" means the converse, in each case after providing for payment of certain specified costs and charges. The priority which is to apply in any particular case is that specified in the supplemental trust deed.

The supplemental trust deed

F **42** Clause 5.2 contains a charge by the issuer "as continuing security in favour of the trustee" over the collateral and other property representing it from time to time.

43 Clause 5.3 provides that such security is

> "granted to the trustee as trustee for itself and/or the holders of notes and [LBSF] the custodian and the paying agents as continuing security G (i) for the payment of all sums due under the trust deed and the notes, (ii) for the performance of the issuer's obligations (if any) under the swap agreement . . ."

44 Clause 5.5 provides that:

> "The trustee shall apply all moneys received by it under this deed in connection with the realisation or enforcement of the mortgaged H property as follows: swap counterparty priority unless . . . an event of default (as defined in the swap agreement) occurs under the swap agreement and the swap counterparty is the defaulting party (as defined in the swap agreement) . . . in which case noteholder priority shall apply."

45 Clause 8.3 provides:

> "[LBSF] hereby agrees that, if an event of default (as defined in the ISDA master agreement) occurs under the swap agreement and [LBSF] is the defaulting party (as defined in the ISDA master agreement) . . . and unwind costs are payable by the issuer to [LBSF], the issuer shall apply the net proceeds from the sale or realisation of the collateral (1) first in redeeming the notes in an amount as set out in the conditions and (2) thereafter, in payment of such unwind costs to [LBSF]."

Terms and conditions

46 The second paragraph of condition 44 ("condition 44.2") provides:

> "if an event of default (as defined in the ISDA master agreement . . .) occurs under the swap agreement and [LBSF] is the defaulting party (as defined in the ISDA master agreement) . . ."

the early redemption amount payable on each note is to be equal to:

> "(i) such note's pro rata share of the proceeds . . . from the sale or realisation of the collateral . . . plus (ii) (but only if payable to the issuer) the amount of any applicable unwind costs divided by the total number of notes outstanding; provided that if the amount determined pursuant to sub-paragraphs (i) and (ii) above results in an excess amount (as defined above), such excess amount shall be payable by way of an additional payment of interest on each note. In the event that unwind costs are payable by the issuer to the swap counterparty, the issuer shall apply the net proceeds from the sale or realisation of the collateral as aforesaid (1) first in redeeming each note in an amount equal to its outstanding principal amount as of the early redemption date plus the accrued early redemption interest amount and (2) thereafter, in payment of such unwind costs to the swap counterparty."

The ISDA master agreement

47 Section 5 of the ISDA master agreement defines an "event of default" as being: "[t]he occurrence [of certain specified events] at any time with respect to [LBSF], or if applicable, any credit support provider" of LBSF. According to paragraph 9(iv) of the swap confirmation, the credit support provider is LBHI, the ultimate parent of LBSF. The defined events of default include (i) failure to pay any sums due under the ISDA master agreement (if such failure is not remedied after three local business days' notice of such failure), and (ii) the institution by LBSF or by LBHI of any proceedings "seeking a judgment of insolvency or bankruptcy or any other relief under any bankruptcy or insolvency law or other similar law affecting creditors' rights . . ."

48 Section 6 of the ISDA master agreement deals with early termination and provides that:

> "If at any time an event of default with respect to a party (the 'defaulting party') has occurred and is then continuing, the other party . . . may, by not more than 20 days notice to the defaulting party specifying the relevant event of default, designate a day not earlier than

A the day such notice is effective as an early termination date in respect of all outstanding transactions . . ."

V. The decisions of Sir Andrew Morritt C and the Court of Appeal

LBSF's position

49 LBSF's position is, in summary, that the rights under the swap B agreement and the rights created over the collateral to secure them were property of LBSF within the meaning of the Insolvency Act 1986 and formed part of LBSF's insolvent estate. At the time of its filing for bankruptcy on 3 October 2008 (and at the early termination date), LBSF was "in the money" under each of the swap agreements. LBSF had existing contractual rights which, on final maturity or if the issuer elected C to terminate the swap agreement early, would result in a right to payment to LBSF from the issuer. That was so whether or not LBSF was the defaulting party under the swap agreement. It was illegitimate to provide for the alteration of those rights in reliance on LBSF's bankruptcy so as to deprive LBSF of the benefit of its first priority right of recourse to the collateral.

50 When the issuer elected to terminate the swap agreements it did so D expressly in reliance upon LBSF having filed for bankruptcy on 3 October 2008. That termination gave rise to a debt payable by the issuer to LBSF and which is charged on the collateral. The effect of the disputed clauses was to deprive LBSF of property to which it was entitled in its bankruptcy: clause 5.5 of the supplemental trust deed removed the senior ranking rights which LBSF had to the proceeds of sale of the collateral and E instead LBSF was given second ranking rights which ranked behind the claims of the noteholders in some instances, and even further behind the portfolio manager in other transactions; by condition 44.2 of the terms and conditions of the notes, the amount due to LBSF in respect of its claim under the terminated swap agreement was disregarded when determining what the issuer should pay to noteholders on early redemption of the notes. The result of the offending provisions was that the collateral was treated as F being freed from the charge to secure the debt to LBSF and was simply divided up among the noteholders in proportion to their original subscriptions.

51 The fundamental change brought about by the operation of these clauses depends upon the issuer having elected to terminate the swap agreement in reliance on LBSF's bankruptcy. The security for the G obligations owed to LBSF under the swap agreement cannot validly be altered in reliance on LBSF's bankruptcy, and offends against the anti-deprivation rule. Consequently, the provisions are void and unenforceable under English law.

52 On the noteholders' alternative case, that the event of default occurred on 15 September 2008, when LBHI filed for Chapter 11 protection, H LBSF says that clause 5.5 and the concepts of swap counterparty priority and noteholder priority only have relevance in relation to events taking place after the collateral has been sold. The parties could not have intended any permanent changes in the operation of clause 5.5 and condition 44.2 to have occurred unless and until the service of a notice by the non-defaulting party to terminate the swap agreement.

Sir Andrew Morritt C

53 Sir Andrew Morritt C decided that clause 5.5 of the STD was not contrary to public policy. The collateral was bought by the issuer with the money subscribed by the noteholders. It was not derived directly or indirectly from LBSF. The court should not be astute to interpret commercial transactions so as to invalidate them, particularly when doubt might be cast on other long-standing commercial arrangements. As long as the swap agreement was being performed it was appropriate for LBSF to have security for the obligations of the issuer in priority to security in respect of the issuer's obligations to the noteholders, but the intention of all parties was that the priority afforded to LBSF was conditional on LBSF continuing to perform the swap agreement. Such beneficial interest by way of security as LBSF had in the collateral was, as to its priority, always limited and conditional, and could never have passed to a liquidator or trustee in bankruptcy free from those limitations and conditions as to its priority. Alternatively, LBSF was a defaulting party on 15 September 2008 when LBHI filed for Chapter 11 protection, and the anti-deprivation rule was not engaged if deprivation occurred on a ground other than bankruptcy of the entity alleged to be unlawfully deprived.

Court of Appeal

54 In the Court of Appeal [2010] Ch 347 Lord Neuberger of Abbotsbury MR's conclusion that the provisions were valid relied to a large extent on the fact that the collateral was acquired with money provided by the noteholders and that the change in priorities was included to ensure that the noteholders were repaid out of those assets: para 67. In particular he relied on these matters (at para 61 et seq): (a) so long as there was no risk of default, the noteholders were prepared for LBSF to have priority when it came to unwinding the transaction; (b) the scheme provided, and was sold on the basis that, if LBSF or LBHI defaulted so that they could not, or did not, pay the interest and the capital on the notes, then it would be the noteholders who would have priority both in relation to repayment and in relation to the unwind costs; (c) the effect of the "flips" would not be to entitle the noteholders to more than they had subscribed, and, if there was no shortfall, LBSF would not have been out of pocket as a result of the "flips". The right granted to LBSF was a security right over assets purchased with the noteholders' money, and, from the very inception, the priority, and the extent of the benefits, enjoyed by LBSF in respect of the security were contingent upon there being no event of default.

55 He agreed with Sir Andrew Morritt C's conclusion on the LBHI point. Longmore LJ agreed with Lord Neuberger MR.

56 Patten LJ thought that the anti-deprivation rule did not apply because (paras 135–136):

> "135. . . . The reversal of the order of priority under clause 5.5 was always a facet of the security designed to regulate the competing interests over the collateral of LBSF and the noteholders. To say that its operation in the event of the company's bankruptcy constitutes the removal of an asset from the liquidation is to confuse the security itself with the operation of its terms in the events prescribed by the charge. LBSF retains the same asset as it had before its bankruptcy and is free to deal with any

A recoveries for the benefit of its general creditors in accordance with the applicable statutory regime . . .

"136. . . . Condition 44 is said to have the effect of increasing the amount payable to noteholders in the event of LBSF being the defaulting party under the swap agreement by diverting to the noteholders moneys which would otherwise have been payable to it in order to discharge the issuers' liability for unwind costs . . . Although the amount of the B security available to meet LBSF's claims is obviously reduced in the event of a shortfall in the value of the security over what it would have been had no event of default occurred, that is simply a function of the change in priority which was always a feature of the security which the company enjoyed."

C **57** Lord Neuberger MR, while not disagreeing, had some reservations about this approach (paras 66–68), particularly because the authorities did not support the view that arrangements which were an original feature of the transaction were insulated from the anti-deprivation rule.

VI. The principles

58 Lord Neuberger MR rightly pointed out in his judgment (at para 32) D in these proceedings that it was not easy to identify the precise nature or limits of the anti-deprivation rule. He was echoing what he had said as Neuberger J in *Money Markets International Stockbrokers Ltd v London Stock Exchange Ltd* [2002] 1 WLR 1150, para 87, a decision which contained the first full judicial analysis of the principles, at paras 117–118.

59 The rule has existed for nearly 200 years, and it is therefore E necessary to look at the development of the rule to see what its nature and limits are. All but one of the relevant cases prior to the decision of the House of Lords in *British Eagle International Airlines Ltd v Cie Nationale Air France* [1975] 1 WLR 758 on the pari passu principle are cases of personal bankruptcy. The principal decisions are *Whitmore v Mason* (1861) 2 J & H 204 (Page Wood V-C); *Ex p Mackay; Ex p Brown*; *In re Jeavons* (1873) LR 8 Ch App 643 (CA); *Ex p Jay*; *In re Harrison* (1880) 14 Ch D 19 (CA); F *Ex p Newitt*; *In re Garrud* (1881) 16 Ch D 522 (CA); *Ex p Barter*; *Ex p Black*; *In re Walker* (1884) 26 Ch D 510 (CA); *In re Detmold*; *Detmold v Detmold* (1889) 40 Ch D 585 (North J); *Borland's Trustee v Steel Bros & Co Ltd* [1901] 1 Ch 279 (Farwell J); *In re Johns, Worrell v Johns* [1928] Ch 737 (Tomlin J); *Bombay Official Assignee v Shroff* (1932) 48 TLR 443 (PC); and *In re Apex Supply Co Ltd* [1942] Ch 108 (Simonds J) (the sole G liquidation case).

The anti-deprivation rule applied

60 The anti-deprivation rule was applied to invalidate contractual provisions in the following decisions. In none of them did it matter whether the provision was in a contract from the inception of the relationship. *Whitmore v Mason* 2 J & H 204 is a classic case of the application of the H anti-deprivation rule. It was concerned with a provision in a partnership deed that, in the event of the "bankruptcy or insolvency" of a partner, an account was to be taken, and the bankrupt partner was to lose his interest in the partnership assets (mines in Portugal) at a market valuation (save that his interest in a mining lease was to be excluded from the valuation).

Page Wood V-C accepted the assignee's argument, at p 207, that the exclusion of the lease was void because it was "an attempt to evade the rule in bankruptcy, which provides that, upon an act of bankruptcy being committed, all the property of the bankrupt vests in his assignees", and held that, in so far as it related to the lease, the provision was void as being "in fraud of the bankrupt laws" (p 213), because

> "the law is too clearly settled to admit of a shadow of doubt that no person possessed of property can reserve that property to himself until he shall become bankrupt, and then provide, that, in the event of his becoming bankrupt, it shall pass to another and not to his creditors." (p 212)

61 So also in *Ex p Mackay* LR 8 Ch App 643, 648, discussed above, the agreement that the lender could keep the royalties in the event of the borrower's bankruptcy was an unlawful "additional advantage". This, like several of the other decisions, is really about an unsuccessful attempt to create a charge. It was applied in *Ex p Williams*; *In re Thompson* (1877) 7 Ch D 138 (sham rent intended to give lender additional security of distraining on chattels).

62 In *Ex p Jay* 14 Ch D 19 a clause in an agreement for a lease between a landowner and a builder (under which the builder was to build 40 houses on land in Waltham Cross) provided that, until the lease had actually been granted, in the event that the builder was in default of any of his obligations or became bankrupt, any materials on the land should be forfeited to the landowner. A few weeks later the builder granted a charge over the materials, but it was not registered as a bill of sale. At a time before the builder had completed the development or any lease had been granted, and when the builder was not in default of any of his obligations, he was made bankrupt. A dispute arose between his trustee in bankruptcy and the landowner over a quantity of building materials which the builder had brought onto the land. The Court of Appeal held that the provisions of the agreement purporting to forfeit such building materials to the landowner were void as being a violation of the policy of the bankruptcy law, and that the building materials were the property of the trustee.

63 In *Ex p Barter* 26 Ch D 510 a shipbuilding contract provided that, if at any time the builder should cease working on the ship for 14 days, or should allow the time for completion and delivery of the ship to expire for one month without it having been completed and ready for delivery, or in the event of the bankruptcy or insolvency of the builder, the buyer could cause the ship to be completed, and could employ materials belonging to the builder as should be then on his premises. It was held that the clause was void as against the trustee in his bankruptcy as being an attempt to control the user after bankruptcy of property vested in the bankrupt at the date of the bankruptcy, and as depriving the trustee of the right to elect whether he would complete the ship or not as might seem most advantageous for the creditors under the bankruptcy. This decision is an application of a general principle that the bankrupt's property vests in the trustee, and its user cannot be contractually controlled.

64 *In re Johns*; *Worrell v Johns* [1928] Ch 737, concerned an arrangement between mother and son, whereby the amount repayable by the son in respect of periodic loans made by the mother (which could not

A exceed £650, and might be as little as £10, in all) was to increase from £650 to £1,650 (plus interest) in the event of the son's bankruptcy. Tomlin J said that the principle was that a "person cannot make it a part of his contract that, in the event of bankruptcy, he is then to get some additional advantage which prevents the property being distributed under the bankruptcy laws" (quoting *Ex p Williams*; *In re Thompson* 7 Ch D 138, 143) and described the agreement as "a deliberate device to secure that more money should come to the mother if the son went bankrupt, than would come to her if he did not; and, that being so, . . . the device is bad": p 748. The agreement would also have offended the pari passu principle, because the claim of the mother's estate in the insolvent estate would have increased.

The principle not infringed

C **65** The anti-deprivation principle did not apply in the following decisions. These decisions are particularly important for the light which they throw on the limits of the principle.

66 *Ex p Newitt* 16 Ch D 522 was decided by the same Court of Appeal which had decided *Ex p Jay* a year earlier. This was also a case of a bankrupt builder. The provision for forfeiture operated on breach and not on bankruptcy, and was held to be valid. The bankrupt builder had broken the terms of his agreement with the landowner and it was provided in the agreement that the chattels would be forfeited to the landowner "as and for liquidated damages", whereas in *Ex p Jay* the builder was not in breach of contract, and the right to forfeit was expressed to be triggered, inter alia, on the builder becoming bankrupt. James LJ said, at p 531:

> "Another point taken before us, which does not appear to have been really argued before the judge of the county court, was this—that the seizure was not made in sufficient time, that it was not made before the filing of the liquidation petition. To my mind it is immaterial at what particular moment the seizure was made. The broad general principle is that the trustee in a bankruptcy takes all the bankrupt's property, but takes it subject to all the liabilities which affected it in the bankrupt's hands, unless the property which he takes as the legal personal representative of the bankrupt is added to by some express provision of the bankrupt law. There is no such provision applicable to the present case. The building agreement provides, in effect, that in a certain event certain property of the builder may be taken by the landowner in full satisfaction of the agreement. It appears to me analogous to a sale of property with a power of repurchase in a certain event."

67 The relevance of this decision lies in the effect of a provision for forfeiture on an event other than bankruptcy which takes place after bankruptcy, and it will be necessary to revert to it.

68 In *In re Detmold* 40 Ch D 585 a marriage settlement provided that income on the property in the settlement (originating from the husband) should pass to the wife for life in the event of an alienation by, or the bankruptcy of, the husband. The provision was held valid against the husband's trustee in bankruptcy, on the ground that it had been triggered by the alienation effected as the result of the appointment of a judgment creditor as receiver (by way of equitable execution) of the income on the property in the settlement, prior to the commencement of the bankruptcy

two months later. *In re Detmold* is an illustration of a provision held valid because, though it worked a deprivation, it did so *prior* to the onset of bankruptcy even though it was also expressed to operate on bankruptcy.

69 In *Borland's Trustee v Steel Bros & Co Ltd* [1901] 1 Ch 279 Mr Borland was a shareholder in Steel Bros & Co Ltd. Its articles of association contained pre-emption rights, the effect of which was that on a shareholder becoming bankrupt, he had, on receiving a transfer notice from the directors, to transfer his shares to a manager or assistant at a fair value calculated in accordance with the articles. Mr Borland's trustee in bankruptcy claimed that the transfer articles were void because, among other reasons, the articles constituted a fraud upon the bankruptcy laws, and could not prevail when bankruptcy had supervened, since the effect was that the trustee in bankruptcy was forced to part with the shares at something less than their true value, with the result that the asset was not fully available for creditors.

70 The argument was rejected. Farwell J started with the principle that

> "a simple stipulation that upon a man's becoming bankrupt that which was his property up to the date of the bankruptcy should go over to some one else and be taken away from his creditors, is void as being a violation of the policy of the bankrupt law" (p 290, quoting *Ex p Jay* 14 Ch D 19, 25).

The basis of the decision was that there was a commercial arrangement. The provisions were inserted bona fide and constituted a fair agreement for the purposes of the business of the company and were binding equally upon all persons who came in as shareholders. There was no suggestion of fraudulent preference of one over another. There was nothing obnoxious to the bankruptcy law in a clause which provided that if a man became bankrupt he should sell his shares. The price was a fixed sum for all persons alike, and no difference in price arose in the case of bankruptcy. The purpose was that there should be in the company, if it were so desired, none but managers and workers in Burma. There was nothing repugnant in the way in which the value of the shares was to be ascertained. It would have been different if there were any provision in the articles compelling persons to sell their shares in the event of bankruptcy at something less than the price that they would have otherwise obtained, since such a provision would be repugnant to the bankruptcy law: p 291.

71 In *Bombay Official Assignee v Shroff* 48 TLR 443 the bankrupt had been a registered broker in the Bombay Broker's Hall, an unincorporated association. The rules of that association permitted only those "holding . . . a card" to enter the hall and conduct business. The rules also allowed the directors to declare a member a defaulter. Following the bankrupt's failure to pay funds owing to other members, he was declared a defaulter, his card and right of membership was forfeited. About a week later, he was declared bankrupt. The official assignee contended (relying on *Whitmore v Mason* 2 J & H 204 and *In re Borland's Trustee* [1901] 1 Ch 279) that his card and/or right of membership of the association or the value thereof vested in him as the assignee in the insolvency, because among other reasons,

> "if the effect of the rules be that the proceeds of sale of the insolvent's card do not enure for the benefit of the general body of his creditors the rules are contrary to the law of insolvency."

Lord Blanesburgh, speaking for the Board, said, at p 446:

> "It being agreed . . . that the rules of this association are entirely innocent of any design to evade the law of insolvency, it may be that even these cases, although cases of a company and a partnership, are more favourable to the [association] than to the [official assignee] . . . [T]he real answer to this contention of the [official assignee] [is] in the nature and character of the association as they have described it whereby in the case of a defaulting member who is expelled from the association no interest in his card remains in himself, and none can pass to his assignee, whether his expulsion does or does not take place before the commencement of his insolvency."

72 The decision of the Privy Council was applied by Neuberger J in *Money Markets International Stockbrokers Ltd v London Stock Exchange Ltd* [2002] 1 WLR 1150. The claimant was a member of the stock exchange and defaulted on its obligations. Under provisions in the articles of association of the stock exchange its share was transferred away and the claimant lost its membership. Neuberger J held the anti-deprivation rule did not apply because the share was incapable of uncontrolled transfer and was closely connected with a right in respect of which a deprivation provision was effective, viz membership of the exchange.

73 In *In re Apex Supply Co Ltd* [1942] Ch 108 a hire purchase agreement provided that if the hirer should go into liquidation, and the owner should retake possession, the hirer would pay a sum by way of compensation for depreciation. Applying *Ex p Mackay* and *In re Johns*, Simonds J held that the provision for the payment of compensation was not a fraud on the bankruptcy laws as giving the owner company an undue advantage in the event of the hirer company going into liquidation. The provision was not a deliberate device to secure that more money went to the creditor: "it would be extravagant . . . to suggest that this clause is aimed at defeating the bankruptcy laws or at providing for a distribution differing from that which the bankruptcy laws permit": p 114.

The limits of the anti-deprivation rule

Good faith and commercial arrangements

74 The first question is whether absence of good faith, or an intention to obtain an advantage over creditors in the bankruptcy, is an essential element for application of the principle.

75 From the earliest days of the rule, it has been based on the notion of a fraud, or "a direct fraud" (Lord Eldon LC in *Higinbotham v Holme* 19 Ves Jun 88, 92), on the bankruptcy laws, and that decision was taken to be authority for the proposition that where a person settles property in such a way that his interest determines on his bankruptcy "that is evidence of an intention to defraud his creditors": *In re Stephenson*; *Ex p Brown* [1897] 1 QB 638, 640, per Vaughan Williams J. The overall effect of the authorities is that, where the anti-deprivation rule has applied, it has been an almost invariably expressed element that the party seeking to take advantage of the deprivation was intending to evade the bankruptcy rules; but that where it has not applied, the good faith or the commercial sense of the transaction has been a substantial factor. By contrast, in the leading pari passu principle

case, *British Eagle* [1975] 1 WLR 758, it was held by the majority that it did not matter that the clearing transaction was a sensible commercial arrangement not intended to circumvent the pari passu principle. Although Lord Morris of Borth-y-Gest, at p 763, placed weight in his dissenting speech on the fact that there was "no trace in the scheme of any plan to divert money in the event of a liquidation" his conclusion was not based on the absence of bad faith. The basis of his reasoning was that transactions had taken place and services had been rendered on the basis that clearance would follow; it was not open to the liquidator to seek to alter ex post facto the contractual arrangements pursuant to which the airlines had supplied services to British Eagle; and the effect of the clearing was that no sum was due: pp 763–764.

76 To take first the cases in which the anti-deprivation rule was held to apply: in *Whitmore v Mason* 2 J & H 204 the exclusion of the lease on bankruptcy of the partner was void and Page Wood V-C said that "no one can be allowed to derive benefit from a contract that is in fraud of the bankrupt laws": p 213. In *Ex p Mackay* LR 8 Ch App 643, 647, James LJ said that the provision was an ineffective charge and was "a clear attempt to evade the operation of the bankruptcy laws" as it "provide[d] for a different distribution of his effects in the event of bankruptcy from that which the law provides". As Lord Cross of Chelsea said of *Ex p Mackay* in *British Eagle* [1975] 1 WLR 758, 780:

> "The court could only go behind [the transaction] if it was satisfied—as was indeed obvious in that case—that it had been created deliberately in order to provide for a different distribution of the insolvent's property on his bankruptcy from that prescribed by the law."

And Lord Morris agreed that *Ex p Mackay* was a case where the relevant provisions were "a clear attempt to evade the operation of the bankruptcy laws", or "a 'device for defeating the bankruptcy laws' ": p 770. In *Ex p Jay* 14 Ch D 19, the case of the housebuilder's materials, there was no mention of evasive intent, but that was probably because it was obvious that the intention was to ensure that the property did not go to the trustee. In *In re Johns; Worrell v Johns* (the case of the increase of the debt on bankruptcy) the agreement was described [1928] Ch 737, 748 as "a deliberate device to secure that more money should come to the mother, if the son went bankrupt, than would come to her if he did not . . ."

77 By contrast, where the anti-deprivation rule was held not to apply, good faith and the commercial sense of the transaction have been important factors. In *Borland's Trustee v Steel Bros & Co Ltd* [1901] 1 Ch 279 (the case of pre-emption rights on bankruptcy) Farwell J relied specifically on the fact that the provisions were inserted bona fide and constituted a fair agreement for the purposes of the business of the company, and that there was no suggestion of fraudulent preference. So also in *Bombay Official Assignee v Shroff* 48 TLR 443 (forfeiture of membership of the Bombay Broker's Hall) Lord Blanesburgh, at p 446, referred to the fact that it had been agreed that the rules of the association were "entirely innocent of any design to evade the law of insolvency . . ." Again, in *In re Apex Supply Co Ltd* [1942] Ch 108 (the hire purchase case) Simonds J accepted that the provision was not a deliberate device to secure that more money went to the creditor and that, at p 114, "it would be extravagant . . . to suggest that this

A clause is aimed at defeating the bankruptcy laws or at providing for a distribution differing from that which the bankruptcy laws permit".

78 Thus there is an impressive body of opinion from some of the most distinguished judges that, in the case of the anti-deprivation rule, a deliberate intention to evade the insolvency laws is required. That conclusion is not affected by the decision in *British Eagle* [1975] 1 WLR 758. The pari passu rule is clear. Parties cannot contract out of it. That is why, by contrast with the anti-deprivation cases, Lord Cross was able to accept (p 772) that the clearing house was a commercial arrangement which was for the mutual advantage of the airlines, but that the power to go behind agreements, the result of which were repugnant to the insolvency legislation, was not confined to cases in which the dominant purpose was to evade its operation. It was irrelevant that the airlines had "good business reasons for entering" into the arrangements and "did not direct their minds to the question how the arrangements might be affected by the insolvency of one or more of [them]": p 780.

79 That does not mean, of course, that a subjective intention is required, or that there will not be cases so obvious that an intention can be inferred, as in *Ex p Jay* 14 Ch D 19. But it does suggest that in borderline cases a commercially sensible transaction entered into in good faith should not be held to infringe the anti-deprivation rule. Although he did not accept that absence of good faith was a necessary element, Neuberger J suggested in *Money Markets International Stockbrokers Ltd v London Stock Exchange Ltd* [2002] 1 WLR 1150, para 103 that if a deprivation provision, which might otherwise be held to be valid, could be shown to have been entered into by the parties with the intention of depriving creditors of their rights on an insolvency, then that might be sufficient to justify holding invalid the provision when it would not otherwise have been held invalid.

Anti-deprivation rule does not apply if the deprivation takes place for reasons other than bankruptcy

80 By contrast with the pari passu principle, it is well established that if the deprivation takes place for reasons other than bankruptcy, the anti-deprivation rule does not apply. In *British Eagle* [1975] 1 WLR 758 the clearing house system was ineffective to avoid the pari passu principle, even though it applied throughout irrespective of whether the airlines went into liquidation. But the position is different with regard to the anti-deprivation rule, which is intended to operate only where provision is made for deprivation on bankruptcy. Thus in *Ex p Jay* 14 Ch D 19 (the case of the builder's materials) both Brett and Cotton LJJ accepted, at p 26, that if forfeiture had taken place on the builder's breach (as the provision envisaged) then it would have been valid:

> "It appears that there was no default on the debtor's part up to the filing of the petition, and the [owner] cannot, therefore, succeed except by virtue of the provision for forfeiture on bankruptcy, and according to the authorities such a stipulation is void" (Brett LJ)

and "One of the two events is not hit by the decided cases"(Cotton LJ). In *Ex p Barter* 26 Ch D 510 (shipbuilding materials) the contract provided for events other than bankruptcy in which the property could be seized, but it

was held that it was the bankruptcy which was the basis of the powers of control exercised by the buyers: p 519.

81 So also in *In re Detmold* 40 Ch D 585 (marriage settlement providing that income on the property in the settlement, originating from the husband, should pass to the wife for life in the event of an alienation by, or the bankruptcy of, the husband) the provision was held valid against the husband's trustee in bankruptcy, on the ground that it had been triggered by the alienation effected as the result of the appointment of a judgment creditor as receiver (by way of equitable execution) of the income on the property in the settlement:

> "the limitation of the life interest to the settlor was validly determined by the fact that, in consequence of the order appointing the receiver, he ceased to be entitled to receive the income. This took place before the commencement of the bankruptcy, and, therefore, the forfeiture is valid as against the trustee in the bankruptcy" (p 588, per North J).

82 In *Ex p Newitt* 16 Ch D 522 (as has been seen, like *Ex p Jay*, a case of a bankrupt builder) the provision for forfeiture was on breach and not on bankruptcy and was held to be valid. The controversial point in the case is that the forfeiture took place after bankruptcy, but it is not clear when the breach occurred. In the present case the Court of Appeal [2010] Ch 347 expressed the view (obiter) that the anti-deprivation rule would apply in such circumstances and that once bankruptcy commences, deprivation on any grounds would be impermissible: paras 93–94 and 161–163 per Lord Neuberger MR and Patten LJ. They considered (echoing what Neuberger J had said in *Money Markets International Stockbrokers Ltd v London Stock Exchange Ltd* [2002] 1 WLR 1150, para 105) that the decision in *Ex p Newitt* 16 Ch D 522 could not survive *British Eagle* [1975] 1 WLR 758.

83 Whether *Ex p Newitt* was correctly decided does not arise for decision on this appeal. It was cited, with apparent approval, by Harman J in *Jennings' Trustee v King* [1952] Ch 899, 911. It was not mentioned in any of the phases of the litigation in *British Eagle* [1975] 1 WLR 758 other than in the dissenting speech of Lord Morris (at p 771), who used it in support of the proposition that a right in a contract is not defeated by the commission of an act of bankruptcy before the contractual right is exercised. The view of the majority was that the netting-off in the clearing house which occurred after the liquidation was ineffective, and consequently the majority must be taken to have rejected the proposition. But it does not follow that the principle identified by Lord Morris is no longer good law in the context of the anti-deprivation rule. On the facts of *Ex p Newitt*, however, the pari passu principle as well as the anti-deprivation principle may have been engaged, and it may be that the right to forfeiture after bankruptcy or liquidation was not the type of equity to which a trustee or liquidator would take subject. In either of those cases, the forfeiture would not have been effective.

Determinable and defeasible interests and "flawed assets"

84 The law reporter, Mr Clement Swanston, summarised some of the early cases in a note to his report of the decision of Lord Eldon LC in *Wilson v Greenwood* (1818) 1 Swans 471, 485, and his summary was quoted with approval in *Whitmore v Mason* 2 J & H 204, 209–210 by Page Wood V-C,

A by the Court of Appeal in *Ex p Barter* 26 Ch D 510, 519 and by Stirling J in *Mackintosh v Pogose* [1895] 1 Ch 505, 511. Mr Swanston said:

> "The general distinction seems to be, that the owner of property may, on alienation, qualify the interest of his alienee, by a condition to take effect on bankruptcy; but cannot, by contract or otherwise, qualify his own interest by a like condition, determining or controlling it in the event
B of his own bankruptcy, to the disappointment or delay of his creditors . . ."

85 In *Whitmore v Mason* 2 J & H 204, 212 Page Wood V-C distinguished the exclusion of the lease on the partnership account to be taken on bankruptcy from "the ordinary condition in a demise of land, that in the event of the tenant becoming bankrupt the land shall revert to the
C landlord". This reflected the old rule that a provision for forfeiture of a lease on winding up did not contravene the principle since it was merely a qualification of the lessee's estate: *Roe d Hunter v Galliers* (1787) 2 Durn & E 133. A provision of this kind is common form in most leases and is recognised by section 146(7)(9)(10) of the Law of Property Act 1925. By providing for limited relief against the operation of such clauses, the
D legislation implicitly endorses the validity of such provisions at common law. The lease cases show that such a provision is regarded by the law as effective to bring the lease to an end whether the lease is expressed (a) to run "until bankruptcy" or (b) as a lease with "a proviso for forfeiture" in that event. The result has not depended upon linguistic differences of expression, and section 146(7) of the 1925 Act proceeds on the basis that no difference is to be drawn between the two situations.

E 86 So also licences of intellectual property expressed to determine (or to be determinable on notice) on bankruptcy of the licensee are valid; and interests under protective trusts granted by the settlor to a beneficiary until the beneficiary's bankruptcy: *Lewin on Trusts*, 18th ed (2008), para 5-135; and section 33 of the Trustee Act 1925.

87 The distinction for the purposes of insolvency law is between an
F interest determinable on bankruptcy/liquidation and an absolute interest which is made defeasible on bankruptcy/liquidation by a condition subsequent. A determinable interest is an interest the quantum of which is limited by the stipulated event, so that the occurrence of that event marks the end of the duration of the interest, whereas a defeasible interest is one which is granted outright and then forfeited. As Professor Sir Roy Goode points out in his comment (2011) 127 LQR 1, 8 on the decision of the Court of Appeal in
G this case, the difference between a determinable interest, limited to last until bankruptcy, and an interest forfeitable on bankruptcy as a condition subsequent, turning as it does on fine verbal distinctions, has been categorised as "little short of disgraceful to our jurisprudence" when applied to a "rule professedly founded on considerations of public policy" (quoting *In re King's Trusts* (1892) 29 LR Ir 401, 410, per Porter MR, a case on the rule against repugnancy, which is offended by forfeiture but not by termination).

H 88 Professor Sir Roy Goode rightly accepts (ibid) that the principle that a determination clause is not an attempt to remove an asset from the company but simply a delineation of the quantum of the asset or the duration of the transferee's entitlement is too well established to be dislodged otherwise than by legislation. That is particularly so for these

reasons. It would go far beyond the judicial function to hold that the distinction is indefensible. To hold that both types of determination are contrary to the anti-deprivation principle would be thoroughly destructive of commercial expectations in many areas. So also to say that both types of determination are valid would at a stroke do away with a 200-year-old principle, which could only be justified if the mischief which the anti-deprivation rule seeks to remedy were adequately covered by statute. No doubt to some extent the anti-avoidance provisions go some way to dealing with the mischief, but they cover different ground and contain time limitations which do not constrain the common law rule.

89 But it does not follow that any proprietary right which is expressed to determine or change on bankruptcy is outside the anti-deprivation rule, still less that a deprivation which has been provided for in the transaction from the outset is valid. If it were so, then the anti-deprivation rule would have virtually no content. This is the "flawed asset" theory, the idea that, where it is an inherent feature of an asset from the inception of its grant that it can be taken away from the grantee (whether in the event of his insolvency or otherwise), the law will recognise and give effect to such a provision. If that theory were generally applicable, it would represent such an easy way of avoiding the application of the principle, that the principle would be left with little value: *Money Markets International Stockbrokers Ltd v London Stock Exchange Ltd* [2002] 1 WLR 1150, paras 91–92, per Neuberger J.

90 The theory is also inconsistent with most of the cases in which the principle has been applied: see especially *Whitmore v Mason* 2 J & H 204; *Ex p Mackay* LR 8 Ch App 643; *Ex p Jay* 14 Ch D 19; *Ex p Barter* 26 Ch D 510. To the extent that this idea underpins Patten LJ's judgment in the present case (which is by no means certain), it should not be accepted because it would empty the basic rule of any substantive content.

91 For the same reason the answer cannot be found by characterising or describing the right as limited by the condition. If it were possible to characterise LBSF's right as "a right to be repaid in priority to the noteholders when there was not at the date of termination an event of default in relation to which it was the defaulting party" then it would have been possible so to characterise the rights in cases in which the rule has been applied: e g an interest in the partnership mine if not bankrupt (*Whitmore v Mason*); or a right to royalties if not bankrupt: *Ex p Mackay*.

Acquisition of property with own assets

92 In *Whitmore v Mason* 2 J & H 204, 214–215 Page Wood V-C said:

> "If his co-partners had advanced a definite sum of money on account of his share, then the property might have been considered to the extent of the money so advanced by them, as identically their money; but this has not been done."

93 Page Wood V-C's statement was based on a marriage settlement case, *Lester v Garland* (1832) 5 Sim 205, which confirmed a long line of cases which had established that the wife's portion would be protected in the event of the husband's bankruptcy:

> "A variety of cases, beginning with the case of *Lockyer v Savage* [(1732) 2 Str 947], which was decided about 100 years ago, have

established that, though there cannot be a settlement of the husband's own estates so as to make his life interest cease in the event of his becoming a bankrupt, in order that the benefit of the estate might be given to the wife or children of the marriage, yet the wife's estate may be so settled": p 222.

94 As Stirling J put it in *Mackintosh v Pogose* [1895] 1 Ch 505, 511:

> "it has been long established that if husband and wife both bring property into such a settlement [viz, a marriage settlement], a trust of the income of the wife's property in favour of the husband until his bankruptcy is good, while a similar trust of the income of the husband's property is bad . . ."

The basis of the rule was that "the courts treated the property of the husband as being in substance the property of the wife . . . [and] as the identical property brought by her into settlement": pp 514–515.

95 In *Higinbotham v Holme* 19 Ves Jun 88, 92–93 Lord Eldon LC distinguished the case of the settlement by the bankrupt husband on himself of a life interest, from, firstly, "the case of the wife's property limited until the bankruptcy of her husband; that is, where she reserves a power over her own property", and, secondly, "the case of a lease made determinable by the bankruptcy of the lessee: that is a reservation by the owner of the property of a power over it."

96 The marriage settlement cases are not far removed from the category of determinable and defeasible interests or "flawed assets," but they do suggest that the source of the assets is an important element in determining whether there has been a fraud on the bankruptcy laws. Lord Neuberger MR's conclusion [2010] Ch 347, para 64 was that *Whitmore v Mason* 2 J & H 204 is authority for the view that the anti-deprivation rule may have no application to the extent that the person in whose favour the deprivation of the asset takes effect can show that the asset, or the insolvent person's interest in the asset, was acquired with his money.

97 That conclusion is supported by the very frequent formulation of the anti-deprivation rule in terms of the bankrupt's "own property." Thus in *Holmes v Penney* (1856) 3 K & J 90, 102 Page Wood V-C stated the general principle as being that

> "a trader cannot, even for valuable consideration, *settle his own property* in such a manner as that he should take an interest in it until his bankruptcy, and, afterwards, it should be held in trust for his wife and children"

(emphasis added) and there are many similar references in the older cases to the settlement or disposition of the bankrupt's own property: e g *In re Detmold* 40 Ch D 585, 588, per North J; *In re Stephenson* [1897] 1 QB 638, 640, per Vaughan Williams J; and *In re Halstead, Ex p Richardson* [1917] 1 KB 695, 709, per Warrington LJ.

98 The anti-deprivation rule of course only applies where the bankrupt's own property is in issue, and these dicta do not show that the rule has no application where the source of the bankrupt's asset is the person to whom it is to go on bankruptcy. Nor would it be right for there to be a general and universally applicable exception to the general rule based simply

on the source of the assets. But if the source of the assets is the person to whom they are to go on bankruptcy that may well be an important, and sometimes decisive, factor in a conclusion that the transaction was a commercial one entered into in good faith and outside the scope of the anti-deprivation rule.

Provision operating on insolvency (as distinct from bankruptcy/liquidation)

99 This point does not arise for decision on this appeal. The only potentially relevant events of default are the Chapter 11 filings by LBSF and LBHI. The point was considered in *Whitmore v Mason* 2 J & H 204, 215, where it was held that it did not matter that under the partnership deed the account was to be taken in the event of bankruptcy or insolvency, and insolvency had occurred before any act of bankruptcy:

> "A bankrupt is usually insolvent before he commits an act of bankruptcy. First he becomes insolvent, and then bankrupt; and if that construction were to prevail the bankrupt laws might, in all cases, be defeated."

Executory contracts

100 It is a very common provision in commercial contracts that performance may be withheld in the case of the other party's bankruptcy or liquidation. In *Lomas v JFB Firth Rixson Inc (International Swaps and Derivatives Association Inc intervening)* [2011] 2 BCLC 120 interest swap counterparties withheld payments due to Lehman Brothers International (Europe) in reliance on a provision of the ISDA master agreement that a party's payment obligations were subject to the condition precedent that there was no continuing event of default with respect to the other party. On the question whether the anti-deprivation principle applied, Briggs J considered that the authorities justified a distinction between (a) cases where the asset of the insolvent company was a chose in action representing the quid pro quo for something already done, sold or delivered before the onset of insolvency; and (b) cases where the right in question consists of the quid pro quo (in whole or in part) for services yet to be to be rendered or something still to be supplied by the insolvent company in an ongoing contract. He held that in the former situation the court would more readily hold that the anti-deprivation rule applied. This decision was distinguished in *Folgate London Market Ltd v Chaucer Insurance plc* [2011] EWCA Civ 328 at [22]; The Times, 13 April 2011, where there was a contractual provision for a right of indemnity to be terminated in the event of liquidation: it was a naked attempt to provide that the obligation to pay was to be extinguished if payment would be available for creditors generally in the event of insolvency.

101 The swap agreement in the present case is subject to the same provision, but its effect is not in issue in these proceedings. Accordingly the important and difficult question of the extent to which payment obligations in executory contracts are affected by the anti-deprivation rule does not arise on this appeal, and since it is a live issue in other proceedings it is best not to express a view on it, except to say that accrued property rights such as debts must be at least capable of being caught by the rule.

VII. Conclusions

102 It would go well beyond the proper province of the judicial function to discard 200 years of authority, and to attempt to re-write the case law in the light of modern statutory developments. The anti-deprivation rule is too well-established to be discarded despite the detailed provisions set out in modern insolvency legislation, all of which must be taken to have been enacted against the background of the rule.

103 As has been seen, commercial sense and absence of intention to evade insolvency laws have been highly relevant factors in the application of the anti-deprivation rule. Despite statutory inroads, party autonomy is at the heart of English commercial law. Plainly there are limits to party autonomy in the field with which this appeal is concerned, not least because the interests of third party creditors will be involved. But, as Lord Neuberger stressed [2010] Ch 347, para 58, it is desirable that, so far as possible, the courts give effect to contractual terms which parties have agreed. And there is a particularly strong case for autonomy in cases of complex financial instruments such as those involved in this appeal.

104 No doubt that is why, except in the case of a blatant attempt to deprive a party of property in the event of liquidation (*Folgate London Market Ltd v Chaucer Insurance plc* [2011] EWCA Civ 328; The Times, 13 April 2011), the modern tendency has been to uphold commercially justifiable contractual provisions which have been said to offend the anti-deprivation rule: *Money Markets International Stockbrokers Ltd v London Stock Exchange Ltd* [2002] 1 WLR 1150; *Lomas v JFB Firth Rixson Inc* [2011] 2 BCLC 120; and the judgments of Sir Andrew Morritt C and the Court of Appeal in these proceedings. The policy behind the anti-deprivation rule is clear, that the parties cannot, on bankruptcy, deprive the bankrupt of property which would otherwise be available for creditors. It is possible to give that policy a common sense application which prevents its application to bona fide commercial transactions which do not have as their predominant purpose, or one of their main purposes, the deprivation of the property of one of the parties on bankruptcy.

105 Except in the case of well-established categories such as leases and licences, it is the substance rather than the form which should be determinant. Nor does the fact that the provision for divestment has been in the documentation from the beginning give the answer, nor that the rights in property in question terminate on bankruptcy, as opposed to being divested. Nor can the answer be found in categorising or characterising the property as "property subject to divestment on bankruptcy".

106 If the anti-deprivation principle is essentially directed to intentional or inevitable evasion of the principle that the debtor's property is part of the insolvent estate, and is applied in a commercially sensitive manner, taking into account the policy of party autonomy and the upholding of proper commercial bargains, these conclusions on the present appeal follow.

107 The answer is not to be found in the noteholders' argument that (a) LBSF's property was a beneficial interest under a trust, of which it was one of a number of beneficiaries (clause 5.3 of the STD) and that (b) LBSF retains its beneficial interest under the trust to this day. The fact that the security interests were held by the trustee is not determinative. The court has to look to the substance of the matter, which is that LBSF had a security interest, the content and extent of which altered when it filed for Chapter 11

protection. Nor is it to be found in the fact that the potential for change in priority was in the documentation from the beginning, nor in the "flawed asset" argument or variant of it, that the security interest, or the right under the trust to have the trust property administered in accordance with swap counterparty priority, was inherently qualified or limited, because it applied only for so long as there had been no event of default under the swap agreement for which the swap counterparty was the defaulting party.

108 The answer is to be found in the fact that this was a complex commercial transaction entered into in good faith. Although, as a matter of law, the security was provided by the issuer out of funds raised from the noteholders, the substance of the matter is that the security was provided by the noteholders and subject to a potential change in priorities.

109 The security was in commercial reality provided by the noteholders to secure what was in substance their own liability, but subject to terms, including the provisions for noteholder priority and swap counterparty priority, in a complex commercial transaction entered into in good faith. There has never been any suggestion that those provisions were deliberately intended to evade insolvency law. That is obvious in any event from the wide range of non-insolvency circumstances capable of constituting an event of default under the swap agreement.

110 The offering circular supplement emphasised that, in addition to the notes being credit-linked to the reference portfolio, noteholders would also have exposure to the collateral, and impairment of the collateral might result in a negative rating action on the notes. The document went on:

> "Purchasers of notes should conduct such independent investigation and analysis regarding the issuer, the security arrangements and the notes as they deem appropriate to evaluate the merits and risks of an investment in the notes. In particular, purchasers should note that the credit risk of the notes includes that of the collateral, the swap counterparty and the reference entities and that the notes allow a purchaser to obtain the stated coupon in exchange for assuming such credit risk. The coupon and initial principal amount may be at risk if one or more credit events occur and in certain circumstances the notes may redeem at zero."

111 There were three main risks for noteholders: (1) credit event risk, that is, the risk that credit events might occur and be notified under the swap agreement, reducing the amount payable by the issuer; (2) collateral risk, being the risk that the collateral might default or decline in value (a more likely eventuality in modern conditions than it might have seemed in 2004); and (3) LBSF risk, being the risk that LBSF might not be in a position to provide sufficient funds to the issuer for it to pay the noteholders interest or principal. The documents were intended to regulate the delicate relationship between noteholders' risk and LBSF's risk.

112 The noteholder priority provisions were intended to deal with LBSF risk. The fact that, in certain circumstances, the change in priority would lead to a (possibly unanticipated) benefit to the noteholders and to the loss of LBSF's security rights in the collateral in respect of unwind costs does not unravel this highly complex transaction.

113 These transactions were designed, arranged and marketed by the Lehman group. The investors who bought the notes were in the main not banks. In the case of the Belmont noteholders they were Australian local

A authorities, pension funds, private investment companies and private individuals. There was evidence that the fact that the noteholders would have priority over the collateral in the event of LBSF's insolvency was a very material factor in obtaining Triple A credit ratings which enabled Lehman to market the notes.

114 For these reasons Sir Andrew Morritt C and the Court of Appeal were right to find that the key provisions were valid and enforceable.

B

VIII. The LBHI point

115 This point does not arise in view of the conclusion that the noteholders are right on the main point. LBHI filed for Chapter 11 relief on 15 September 2008. If that was an event of default on that date for the purposes of clause 5.5 of the STD and condition 44 of the terms and

C conditions, then noteholder priority replaced swap counterparty priority and condition 44.2 replaced condition 44.1. If that occurred before, and not because of, LBSF's filing for Chapter 11 relief, the anti-deprivation rule would not be engaged because the change in LBSF's priority would not have been because of its filing, but because of LBHI's filing. The anti-deprivation rule has no application where an entity is deprived by a person of its

D property prior to bankruptcy and on grounds which do not depend upon bankruptcy. Sir Andrew Morritt C and the Court of Appeal accepted that the noteholders were right on this point.

116 LBSF's position was as follows. (1) Clause 5.5 of the STD and condition 44.2 of the terms and conditions, and the concepts of swap counterparty priority and noteholder priority, only had relevance in relation to events taking place after the collateral has been sold.

E (2) Condition 44.2 of the notes prescribed how the early redemption amount payable to noteholders on an early redemption date was to be calculated. (3) But early redemption could only take place after service of a notice by the issuer following termination of the swap transaction or service of a notice by the issuer to accelerate the notes following an event of default. (4) On the true interpretation of the arrangement, the parties

F could not have intended any permanent changes in the operation of clause 5.5 and condition 44.2 to have occurred unless and until the service of a notice by the non-defaulting party to terminate the swap agreement. (5) Clause 5.5 and condition 44.2 operated with respect to the payments which would be due to LBSF and the noteholders on early termination of the swap transaction and early redemption of the notes. (6) Neither of those events would occur automatically upon an event of default

G occurring under the swap agreement: each required the service of a notice by the issuer terminating the swap agreement. (7) Part 1(h) of the schedule to the ISDA master agreement contained the option for the contracting parties to select automatic early termination ("AET") of their swap agreement. (8) If AET was selected, termination of the swap was deemed to occur automatically on the occurrence of a specified number of

H events of default, including bankruptcy. (9) The AET option was not taken in respect of any of the swap agreements in issue in this case. (10) The result was that the mere happening of an event of default based upon bankruptcy was plainly not intended to, and did not, result in the automatic termination of the swap transaction. (11) Parties to a swap agreement need to know, with certainty, a number of fundamental

matters. They need, for example, to know whether or not the transaction is still operative or has been terminated; if it has been terminated, they need to know with certainty when it terminated, and which of them is the defaulting party and which is not. (12) In the absence of AET, it is the service of a notice under section 6(a) which fixes those rights and obligations.

117 In my judgment, Sir Andrew Morritt C and the Court of Appeal were right on this point. The combined effect of section 5 of the ISDA master agreement and paragraph 9(iv) of the swap confirmation is that the institution by LBHI (a "credit support provider") of proceedings for Chapter 11 relief is an event of default. The direction to the trustee in clause 5.5 of the STD is to apply noteholder priority if an event of default has occurred under the swap agreement and the swap counterparty is the defaulting party. For this purpose LBSF is the defaulting party: section 6(a) of the ISDA master agreement. Condition 44.2 of the terms and conditions provides that if an event of default has occurred under the swap agreement and the swap counterparty is the defaulting party, then, where unwind costs are payable by the issuer to the swap counterparty, the issuer is to apply the collateral proceeds first in redeeming the notes.

118 Consequently the priorities were fixed on the happening of the event of default. There is nothing in the documents to require a notice of termination for this purpose, by contrast with the procedure in clause 6(a) of the ISDA master agreement for early termination. Under clause 5.5 of the principal trust deed the security became enforceable when any amount due in respect of the notes was not paid.

119 LBSF in effect asks the court to write in a further condition that notice of termination has been given in respect of that event of default. This would be unnecessary and contrary to principle. The fact that it might make more commercial sense (to LBSF's benefit) should yield to the following considerations: first, the documents were prepared and marketed by Lehman Brothers, who could reasonably have been expected to ensure that their interests were adequately protected. Secondly, the notes were bearer instruments intended to be widely marketed, and it is particularly important in such circumstances for the documents themselves to be capable of being relied on in the market. In this connection it is worthy of note that the offering circular supplement itself (under "Security Arrangements") substantially repeated clause 5.5 of the STD. Noteholders were entitled to rely on the documents as presented to them.

120 I would therefore dismiss the appeal.

LORD WALKER OF GESTINGTHORPE JSC

121 I gratefully acknowledge Lord Collins of Mapesbury's summary of the complicated documentation in this case, and his comprehensive survey of the authorities on the anti-deprivation rule. Between them Lord Collins in his judgment in this court, and Lord Neuberger of Abbotsbury MR in his judgment in the Court of Appeal (*Perpetual Trustee Co Ltd v BNY Corporate Trustee Services Ltd* [2010] Ch 347) have analysed the cases most thoroughly. What emerges from the analysis is that the rule is a general principle of public policy which (in the traditional phrase) prevents a fraud on the insolvency statutes: as Lord Rodger of Earlsferry put it in *R v J* [2005] 1 AC 562, para 64:

A "The notion of a fraud upon an Act, acting in fraudem legis, is ancient. Although the outer limits of the doctrine remain notoriously difficult to define, this case at least falls squarely within its scope."

122 There is a good deal of common ground between Lord Collins and Lord Neuberger MR. Where they differ in their analysis I respectfully prefer the view taken by Lord Collins, and I am hesitant about adding anything that B might in any way obscure the clarity of his judgment. What follows should be read as no more than footnotes.

123 The outer limits of the anti-deprivation rule are indeed difficult to define. There are some reasonably well demarcated areas in which it is clear that the principle does not apply. One is the grant of a lease, in which the reservation of a power of re-entry and forfeiture in the event C of bankruptcy is standard practice, is unquestionably valid, and is recognised by statute. This is noted by Lord Collins, at paras 84 and 85, and Lord Neuberger MR [2010] Ch 347, para 64, citing *Whitmore v Mason* (1861) 2 J & H 204, 209–210 and *Ex p Barter* (1884) 26 Ch D 510, 519–520.

124 Another area in which the principles are well established is in the law of trusts. This was, in the early days of the anti-deprivation rule, D the area in which most of the relevant cases were decided, the earliest notable decision being that of Lord Eldon LC in *Higinbotham v Holme* (1812) 19 Ves Jun 88, where by a marriage settlement the husband conveyed land which he owned to trustees in trust for himself for life "unless he shall embark in trade, and in the life of his wife become bankrupt" (as happened a few years later). Lord Eldon LC stated, at E pp 92–93:

"it is not competent to a party, giving a consideration for a contract, that is a direct fraud upon the bankrupt laws, to have the benefit of it. I cannot assimilate this to the case of the wife's property limited until the bankruptcy of her husband; that is, where she reserves a power over her own property; or to the case of a lease made determinable by the F bankruptcy of the lessee: that is a reservation by the owner of the property of a power over it . . ."

But (as Lord Eldon LC implies in that passage) a settlor can validly settle his own property so as to confer on another person an interest terminable on the bankruptcy of that other person. That also has received statutory recognition in the statutory protective trusts in section 33 of the Trustee Act G 1925, subsection (3) of which provides that the section does not operate to validate any trust which would, if contained in the instrument creating the trust, be liable to be set aside.

125 A further much more limited exception has been made for assets (in particular, shares in an incorporated professional or business association) which are closely linked with professional or business activities for which bankruptcy is a disqualification: *Bombay Official Assignee v Shroff* (1932) H 48 TLR 443 and *Money Markets International Stockbrokers Ltd v London Stock Exchange Ltd* [2002] 1 WLR 1150.

126 It is hard to see how much of the old learning about marriage settlements can be applied to a highly sophisticated commercial transaction such as that now before the court. But the old cases leave us in no doubt that

among the landed gentry in the 18th and 19th centuries (especially before the Married Women's Property Act 1882) marriage, if not a commercial transaction, had financial implications which were taken very seriously. In *Lester v Garland* (1832) 5 Sim 205, for instance, the wife (who was under 21) was entitled under her uncle's will to a legacy of £1,000 contingently on attaining full age, and the legacy would on her marriage vest in her husband; this legacy, and a further £4,000 paid by her father to her husband, was treated as if it had been settled by the wife, and not by the husband, so as to accelerate the wife's interest in that part of the settled property on his bankruptcy. The Court of Chancery was there looking at what happened as a matter of substance rather than form.

127 *Lester v Garland* was considered in a commercial context in *Whitmore v Mason* 2 J & H 204. In that case the bankrupt, Mr Smith, had been a partner in a firm that had a 50-year lease of mines in Portugal. Mr Smith had paid in one-thirteenth of the firm's capital of £6,500. The impugned provision of the partnership deed directed that on a partner's bankruptcy his interest in the lease should be discounted in the taking of a partnership account. It is instructive to look at the report of counsel's arguments. The argument for the partners was that partnership deeds were exceptional, and that such a provision was frequently inserted in them. Mr Rolt QC argued, at p 209, that "In forming a partnership each partner is making a bargain with the rest, and is entitled to stipulate for such advantages as he can obtain from the rest"; and he referred by way of analogy to a lease. After the Vice-Chancellor had made a discouraging reference to *Wilson v Greenwood* (1818) 1 Swans 471, Mr Giffard QC, following, argued that even on the rule as stated in Mr Swanston's note to *Wilson v Greenwood* (p 485) "the rule would allow two co-partners, part owners of a mine, to limit their shares to each other until bankruptcy, and then over; and the limitation over would be valid": 2 J & H 204, 210.

128 That is the context of the Vice-Chancellor's dictum, at pp 214–215:

> "If his co-partners had advanced a definite sum of money on account of his share, then the property might have been considered to the extent of the money so advanced by them, as identically their money; but this has not been done."

The Vice-Chancellor had already rejected Mr Giffard's over-ingenious argument. His dictum implies that it might have been different if Mr Smith had introduced no partnership capital of his own, and had merely covenanted to perform his partnership obligations, including paying off the initial advance of capital from his partners.

129 This suggests, putting it more generally, that even in fully commercial transactions, if the bankrupt was not in substance the provider of the asset of which he is to be divested, the anti-deprivation rule may not apply. If a party to a transaction brings to it nothing but his own covenant, like a tenant under a lease, the property interest which he takes is what the landlord agrees to grant him. The maxim "cujus est dare ejus est disponere" (mentioned by the Vice-Chancellor in *Whitmore v Mason* 2 J & H 204, 212–213 in relation to a lease) is not restricted to gratuitous dispositions.

A 130 Briggs J, who has wide experience of litigation relating to interest rate swaps, seems to have taken a similar view in *Lomas v JFB Firth Rixson Inc (International Swaps and Derivatives Association Inc intervening)* [2011] 2 BCLC 120 (a case on facts very much closer to those of this appeal). Having referred to *Ex p Mackay; Ex p Brown; In re Jeavons* (1873) LR 8 Ch App 643, *British Eagle International Airlines Ltd v Cie Nationale* B *Air France* [1975] 1 WLR 758 and the judgment of the Court of Appeal in this case as each concerned with a chose in action with a built-in "flaw" triggered by bankruptcy, Briggs J observed, at paras 108–110:

> "108. Where the asset of the insolvent company is a chose in action representing the quid pro quo for something already done, sold or delivered before the onset of insolvency, then the court will be slow to C permit the insertion, even ab initio, of a flaw in that asset triggered by the insolvency process. By contrast, where the right in question consists of the quid pro quo (in whole or in part) for services yet to be rendered or something still to be supplied by the insolvent company in an ongoing contract, then the court will readily permit the insertion, ab initio, of such a flaw, there being nothing contrary to insolvency law in permitting a party either to terminate or adjust what would otherwise be an ongoing D relationship with the insolvent company, at the point when it goes into an insolvency process.
>
> "109. Examples of the former type are the royalty stream in *Ex p Mackay*, which was the quid pro quo for a patent sold outright by the person who later became bankrupt, and the debt owed by Air France to British Eagle, which was for services already rendered by British Eagle E to Air France prior to the commencement of its winding up.
>
> "110. Familiar examples of the latter category are leases and licences, where the right to enjoy the underlying asset accrues over time, in exchange, also over time, for payment of rent or fees, and which have always been terminable on bankruptcy without infringing the rule: see *Perpetual Trustee Co Ltd v BNY Corporate Trustee Services Ltd* [2010] F Ch 347, para 64."

Briggs J then went on to refer to the security right enjoyed by LBSF.

131 This proposed test inevitably lacks precision, but it is in my respectful opinion a valuable contribution to the search for principle in this area. Moreover the more contrived and unconventional the chose in action is (unconventional, that is, outside the bizarre world of swaps) the G stronger are the arguments for taking the chose in action as the parties have fashioned it.

132 I am therefore inclined to give some weight to asking what it is that the bankrupt has brought to the transaction, so long as that is looked at as a matter of substance, and contrived arrangements or analyses (such as that suggested by counsel in *Whitmore v Mason* 2 J & H 204) are disregarded. In this case the noteholders were, as a matter of substance, the only party who H contributed real assets—in many cases the pension funds of hard-working Australian citizens. LBSF contributed only promises, and then proved unable to perform them. Its only proprietary interest was under a charge to secure sums that might become due to it on due performance of its obligations.

133 But these are, as I have said, only footnotes. The essential ground of the decision is set out in para 108 of the judgment of Lord Collins, with which I am in full agreement.

134 I also agree with Lord Collins on what he refers to as the LBHI point. I would therefore dismiss this appeal on both grounds.

LORD MANCE JSC

Introduction

135 This appeal concerns a Lehman Brothers product called the Dante Programme. Sir Andrew Morrit C [2009] 2 BCLC 400, para 1outlined its essential elements in a description adopted by the Court of Appeal [2010] Ch 347, para 5:

> "(l) the issue of notes ['the notes'] to investors by a [special purpose vehicle] ('the issuer') formed by a Lehman company in a tax friendly jurisdiction; (2) the purchase by the issuer with the subscription money paid for the notes of government bonds or other secure investments ('the collateral') vested in a trust corporation; (3) a swap agreement entered into by a Lehman company and the issuer under which the Lehman company paid the issuer the amounts due by the issuer to the noteholders in exchange for sums equal to the yield on the collateral; (4) the amount by which the sum payable under the swap agreement by the Lehman company exceeded the yield on the collateral represented the premium for the, in effect, credit insurance provided by the noteholders; (5) the amount payable by the Lehman company to the issuer on the maturity of the notes (or on early redemption or termination) was the initial principal amount subscribed by the investors less amounts calculated by reference to events defined as credit events occurring during a specified period by reference to one or more reference entities, thereby giving effect to the effective insurance aspect of the programme; (6) the collateral was charged by the issuer in favour of the trust corporation to secure its obligations to the noteholders and the Lehman company on terms which changed their respective priorities on the occurrence of certain specified events, including the insolvency of the Lehman company; (7) each of the transactions summarised above (except the purchase of the collateral) is governed by English law."

In the absence of any insurable interest, the description "credit insurance" is, on any view, colloquial or commercial rather than strictly legal.

136 Under the particular tranche of the representative series put before the Supreme Court, the issuer was Saphir Finance plc ("Saphir"), the Lehman company which was Saphir's counter-party in the swap was Lehman Brothers Special Financing Inc ("LBSF") and the trust corporation was BNY Corporate Trustee Services Ltd ("BNY"). The notes were issued in July 2004 and were due to mature after seven years. The amount expressed to be payable by the issuer to LBSF on their maturity was an amount equal to the amount realised from the collateral (which would be netted off against the amount payable by LBSF to the issuer as mentioned in point (5) above, giving a net sum payable one way or the other). As a result of non-recourse clauses, Saphir was not itself liable to either the noteholders or LBSF beyond the amount realised by the collateral. The collateral was highly secure,

consisting of A$40m triple A rated floating notes issued by Rabo Australia Ltd and guaranteed by Rabobank Nederland. Due to its floating rate, the value of the collateral would not alter significantly, upwards or downwards. The reference entities were at least double A rated, the credit events which might trigger a reduction in the amounts (capital, and as a result interest) due under the notes were of some severity, and the noteholders had the further protection of a "subordination amount" of A$72m (over 50% higher than the Standard & Poor's recommended level): only after that amount had been "burned through" by losses resulting from credit events would the amounts outstanding under the notes reduce, leading also to a reduction in the total payable thereon by way of interest. The reference entities were not entities with which LBSF necessarily had any financial relation, and the extent to which the programme or this tranche covered, directly or indirectly, any actual market exposure of LBSF is unclear.

137 The attraction for noteholders was an interest rate on their notes of 1·3% above that earned by the Rabo collateral. If there were no credit events at all, then during the period of their notes the noteholders would receive interest at this uplifted rate on the notes' face value (their only effective security in respect of the 1·3% uplift being LBSF), and on the notes' maturity they would receive repayment in full via Saphir from LBSF. In return, LBSF would receive via Saphir during the period of the notes an amount equivalent to the interest payable on the Rabo collateral and on maturity the value of the collateral (less minor trustee, etc fees). If there were duly notified credit events giving rise to losses above the subordination level, the downside for noteholders was that the amount outstanding on their notes, and so also the interest payable from time to time, would be reduced (even to zero). In that event, LBSF would on maturity receive credit in the full value of the collateral, while crediting correspondingly less to Saphir for the benefit of the noteholders, thereby making a "credit insurance" recovery. With the hindsight of the credit crisis of 2007 onwards, it can be seen that, however safe a bet the transaction may have appeared in July 2004, its timing was unfortunate.

138 The contract documentation is of a purgatorial complexity fitting the programme's name. The judgments below have set out many detailed provisions, and the appendix contains the most salient. These defined and regulated, in particular, the consequences of an "event of default" in respect of which LBSF was the "defaulting party", and provided for early termination (clauses 5 and 6 of the ISDA master agreement). In the event, there were two relevant events of default, one consisting of the commencement on 15 September 2008 of Chapter 11 proceedings involving Lehman Brothers Holdings Inc ("LBHI"—LBSF's parent and guarantor in the transaction) and the second consisting of the commencement on 3 October 2008 of such proceedings in respect of LBSF itself. The latter event of default led Saphir on 24 March 2009 to give notice specifying that event of default only and designating 24 March 2009 as an early termination date in respect of the swap.

139 This appeal concerns the provisions governing an event of default and/or "early termination". In summary, on early termination, the noteholders were to be paid by Saphir their share of the outstanding amount of the notes, that is the face value reduced by reference to any credit events which had already occurred and had been duly notified after they had burned

through the subordination amount. The swap was to be unwound by making a market-based estimation of any credit events likely to occur during the remaining period of the notes, and by taking into account on the other side the future interest payments which LBSF would have had to make, had the transaction run to maturity. A balance, described as unwind costs, was thus to be struck, one way or the other, to unwind the swap (clauses 5.5 and 8.3 of the supplemental trust deed ("STD"), read with condition 44 of the offering circular supplement ("OCS")). In the absence of any event of default involving LBSF as the defaulting party, the result on early termination was to mirror in effect that which it was estimated would exist on maturity: clauses 5.5 and 8.3 of the STD and condition 44 of the OCS. In the case of a balance due to the issuer (which would in practice only occur, as a result of the interest rate uplift of 1·3%, where there were no or few credit event losses above the subordination amount), the noteholders would receive its benefit. In the event of a balance due to LBSF, the noteholders would suffer diminution in their recovery by reference to both past and estimated further credit events in excess of the subordinated amount; on the other side of the coin, LBSF would be covered and secured via Saphir out of the collateral in respect of losses from both past and estimated future credit events.

140 In the case of an event of default where LBSF was the defaulting party, a different scheme was to apply. The noteholders were to continue to be entitled to be paid their share of the outstanding amount of the notes, that is their face value reduced by reference to any credit events which had already occurred and been duly notified. The swap was to be unwound, and a balance of unwind costs struck, in the same way as where there had been no default. In the case of a balance struck favouring Saphir, the noteholders' position was to be as before. In the case of a balance struck in favour of LBSF, the noteholders were to be entitled to first recovery. LBSF was to remain entitled to the balance struck in its favour, but only after Saphir had, out of the collateral, satisfied the noteholders' prior claim to recovery of their share of the outstanding value of the notes: clauses 5.5 and 8.3 of the STD and condition 44 of the OCS. Since the value of the collateral was not envisaged or intended to increase, and since there was no recourse against Saphir itself, LBSF's entitlement to the balance struck in its favour was more theoretical than practical. The collateral would be exhausted in (a) meeting any past credit losses in excess of the subordination amount incurred prior to early termination and (b) paying the noteholders the outstanding amount of their notes. There would be nothing left to meet estimated future credit losses (reflected in the unwind costs), if they were not deducted by Saphir from the amount payable to noteholders and passed on by way of a correspondingly increased payment out of the collateral to LBSF.

The present dispute

141 This change (or "flip" as it has been called), between the positions where there has not been and where there has been an event of default with LBSF the defaulting party, gives rise to the present appeal. LBSF is the appellant. The respondents are Belmont Park Investments Pty Ltd, a noteholder, 28 other Australian charities and public bodies who are also noteholders, and BNY. The primary issue is whether the loss by LBSF in such an event of its priority in respect of future estimated credit losses is invalidated by a principle (which I can conveniently call an anti-deprivation

principle), preventing a person from being deprived of his, her or its property upon insolvency. There is a further issue whether, on the facts of this case, the loss did occur upon LBSF's insolvency, bearing in mind that there was an event of default affecting its parent, LBHI, which occurred some two weeks before LBSF was subject to Chapter 11 proceedings. In this connection, the parties disagree as to whether the occurrence of an event of default (here, that involving LBHI on 15 September 2008) automatically introduces noteholder priority as opposed to swap counterparty priority, or whether priority depends upon the giving of notice, and the realisation or enforcement of the collateral, pursuant to a particular event of default (here, the notice given on 24 March 2009 relying on the event of default relating to LBSF).

142 The starting point of LBSF's case is the wide definition of "property" in section 436 of the Insolvency Act 1986 to include

> "money, goods, things in action, land and every description of property . . . and also obligations and every description of interest, whether present or future or vested or contingent, arising out of, or incidental to, property . . ."

LBSF's case is that, prior to its insolvency, it had property in the form of a present, future or contingent interest in the collateral, securing a prior claim to unwind costs due to it on termination, that it was deprived of the claim and/or collateral upon or by reason of its insolvency, and that such a deprivation is invalid as contrary to the policy of the insolvency legislation.

143 Neither of the courts below has accepted LBSF's case. Sir Andrew Morritt C [2009] 2 BCLC 400, para 45 noted five points: the money used by the issuer to buy the collateral derived from the noteholders, not LBSF; the courts should not be astute to upset commercial transactions; it was appropriate for LBSF to have prior security over the collateral only so long as it continued to perform the swap; LBSF's priority had never extended to a time after the event of default in respect of which it was the defaulting party; and LBSF's prior security was thus always limited and conditional. In the Court of Appeal, Patten LJ [2010] Ch 347, para 135 considered that, whether or not the date for determining priority under clause 5.5 of the STD was 15 September 2008 or 24 March 2009:

> "The only interest or property which [LBSF] ever enjoyed in the collateral was a charge granted by [Saphir] on the terms of the [STD]. That security interest remains part of the property of [LBSF] unchanged by the event of its bankruptcy. The reversal of the order of priority under clause 5.5 was always a facet of the security designed to regulate the competing interests over the collateral of LBSF and the noteholders. To say that its operation in the event of the company's bankruptcy constitutes the removal of an asset from the liquidation is to confuse the security itself with the operation of its terms in the events prescribed by the charge. LBSF retains the same asset as it had before its bankruptcy and is free to deal with any recoveries for the benefit of its general creditors in accordance with the applicable statutory regime".

144 Patten LJ applied similar reasoning (in para 136) to condition 44 of the offering supplementary circular, holding that

> "the operation of condition 44 does not give to the noteholders more than the right to recover the whole of the sums due under the notes in

priority to any claim over the collateral by LBSF for the unwind costs. It simply adjusts the balances on early termination to ensure that the noteholders are paid the whole of what is due to them in priority to the sums payable to LBSF. If there is no shortfall in the security LBSF will recover the sums due to it in full. Condition 44 does not therefore remove an asset from LBSF. Nor does it give to the noteholders security over an asset in which they previously had no interest. It merely regulates the order in which the company and the noteholders are entitled to be recouped out of the security. Although the amount of the security available to meet LBSF's claims is obviously reduced in the event of a shortfall in the value of the security over what it would have been had no event of default occurred, that is simply a function of the change in priority which was always a feature of the security which the company enjoyed."

145 In para 174, Patten LJ summarised his view as being that:

"it is not possible to strike down the provisions of clause 5.5 and condition 44 merely because their operation may affect the value of the security available to LBSF in the event of a shortfall. There is nothing in the English authorities which supports the extension of the anti-deprivation principle to encompass transactions which do not alter the property of the insolvent company in the asset in question . . ."

He also expressed doubt (paras 171–173) whether, in the light of the statutory provisions for setting aside transactions in insolvency, there was any scope for any anti-deprivation principle, apart from that applied by the House of Lords in *British Eagle International Airlines Ltd v Cie Nationale Air France* [1975] 1 WLR 758 which precludes a disposition of property in insolvency otherwise than pari passu in accordance with the legislative scheme.

146 Lord Neuberger of Abbotsbury MR, with whose reasoning Longmore LJ concurred, identified a number of features as supporting Sir Andrew Morritt C's decision: first, and it appears most importantly in his view, he stressed that the collateral has been funded by the noteholders' money (paras 61–64); second, from the very outset the scheme provided and was marketed on the basis that, if LBSF or LBHI defaulted, the noteholders would have priority; third, LBSF retained their right to be paid, did not lose any vested asset and would merely rank behind rather than ahead of the noteholders in relation to the collateral, and not be out of pocket "if there was no shortfall" (paras 61 and 63–64); fourth, a charge or provision for repayment, while not identical to a lease or licence, "has features of similarity . . . and differs from ownership": para 64.

147 Lord Neuberger MR, at para 66, saw Patten LJ as having decided the case

"on the simple basis that the 'flip', that is, the reversal of the order of priority against a company as the holder of a charge, in favour of another chargee over the same assets, cannot be caught by the rule, even if it operates after the liquidation of the company, at least if such a reversal was an original feature of the company's charge when it was granted."

A He said that he had considerable sympathy with that view, but preferred, at para 67, to rest his conclusion on a more limited ground, namely that:

> "in addition to the facts relied on by Patten LJ, the assets over which the charge exists were acquired with money provided by the chargee in whose favour the 'flip' operates, and that the 'flip' was included merely to ensure, as far as possible, that that chargee is repaid out of those assets all
B that he provided (together with interest), before the company receives any money from those assets pursuant to its charge."

He thought that, without these additional facts:

> "there may be room for argument that, in the absence of these additional facts, the arrangement in this case would have fallen foul of the
C analysis in *Ex p Mackay* LR 8 Ch App 643 (which was arguably approved in the *British Eagle* case . . .), on the basis that the right in that case to retain the second half of the royalties in the event of bankruptcy was, like the 'flip' provisions here, an original feature of the contractual arrangement, and the right to recoup money under a change in priority to another chargee is every bit as much of an asset as the right to moneys (in the form of royalties) arising in the future. There is also a danger that the
D simple analysis adopted by Patten LJ could, in the light of the very limited circumstances in which the court will hold a transaction to be a sham, make it very easy to dress up sale transactions in such a way as to enable the rule to be circumvented."

An anti-deprivation principle?

E **148** I am satisfied that there are, and ought to be, two principles in this area. One is the principle applied in *British Eagle*, which precludes a bankrupt from agreeing to distribute his, her or its property other than pari passu in bankruptcy (although it does not preclude creditors from agreeing inter se on the distribution inter se of their pari passu shares: *In re Maxwell Communications Corpn plc* [1993] 1 WLR 1402). The other is a concurrent
F principle, whereby dispositions of property on bankruptcy may be invalidated as being in fraud or an evasion of the bankruptcy laws. The only challenge to the former principle has been in written submissions made by the Premier League as interveners (closely related to pending proceedings brought against it by Her Majesty's Revenue and Customs). I see no basis for any fundamental challenge to the principle, and I shall in view of the pending proceedings say nothing about particular issues which may arise
G there about the scope of the principle or its application to direct payment clauses such as those discussed in para 6-11 of Professor Sir Roy Goode's *Principles of Corporate Insolvency Law*, 3rd ed (2005). It is the latter principle which is in issue on this appeal. This, an anti-deprivation principle, was examined and applied by Lord Eldon LC in *Higinbotham v Holme* (1812) 19 Ves Jun 88, and in a series of later cases, such as *Lester v Garland*
H (1832) 5 Sim 205, *Whitmore v Mason* (1861) 2 J & H 204, *Ex p Mackay* (1873) LR 8 Ch App 643 (CA in Chancery), *Ex p Jay; In re Harrison* (1880) 14 Ch D 19 (CA), *Ex p Barter* (1884) 26 Ch D 510 (CA) and *In re Johns* [1928] Ch 737 and, more recently, *Mayhew v King* [2010] 2 BCLC 440. It was recognised and considered, without adverse comment, by the Privy Council in *Bombay Official Assignee v Shroff* (1932) 48 TLR 443 and by the

House of Lords in *British Eagle* [1975] 1 WLR 758. Section 33(1)(ii) of the Trustee Act 1925 also assumes the existence of such a principle.

149 While the two principles are conceptually distinct, they are quite closely allied. *British Eagle* addresses what happens in bankruptcy. An anti-deprivation principle addresses what happens on bankruptcy. If contracting out of the statutory rule requiring pari passu distribution in bankruptcy is impermissible, it would be surprising if there were no concurrent principle capable of invalidating certain dispositions which, by removing property from the bankrupt on bankruptcy, had the same ultimate effect. The general principle of pari passu distribution in bankruptcy would otherwise easily be evaded, as the court observed in *Ex p Mackay* LR 8 Ch App 643. It is also unsurprising that the facts of some of the authorities (e g *Whitmore v Mason* 2 J & H 204 and *Ex p Mackay*) might plausibly have been analysed as falling within either principle. Further, it is clear that there is no conceptual difference between removing specific property from the bankrupt estate for no consideration (*Whitmore v Mason*), increasing the security given to a particular creditor (*Ex p Mackay*) and increasing the bankrupt estate's liability to a particular creditor: *In re Johns* [1928] Ch 737. All these fall within the anti-deprivation principle.

150 The existence in the Insolvency Act 1986 of other provisions protecting the interests of creditors in bankruptcy does not supersede or make redundant an anti-deprivation principle. First, the 1986 Act must have been enacted against the background of the case law establishing that certain deprivations on bankruptcy are impermissible and void. Second, the statutory provisions cover different ground. Section 127 concerns dispositions after the commencement of the winding up, section 238 transactions at an undervalue and section 239 preferences. Sections 238 and 239 only avoid transactions within specified periods ending with the onset of insolvency (from six months to two years). Section 423 requires proof of both a transaction at an undervalue and a specific intent to put assets beyond the reach of or prejudice a potential claimant. These provisions have their own historical antecedents, dating back to the Fraudulent Conveyances Act 1571 (13 Eliz 1, c 5) and the doctrine of fraudulent preference formulated by Lord Mansfield in 1768: see *Alderson v Temple* (1768) 4 Burr 2235 and later incorporated in statutory form in the Companies Act 1862 (25 & 26 Vict c 89).

151 The more difficult question concerns the character of transaction and the state of mind which will attract the operation of the anti-deprivation principle. In my opinion, the court has to make an objective assessment of the purpose and effect of the relevant transaction or provision in bankruptcy, when considering whether it amounts to an illegimate evasion of the bankruptcy law or has a legitimate commercial basis in other considerations. The references in the cases to "fraud" of the bankruptcy law are not to fraud in a strict sense or even to conduct which is morally opprobrious. Equity took a broader approach to "fraud": *Snell's Equity,* 32nd ed (2010), para 8-001; and see e g the cases on fraudulent concealment preventing the running of a limitation period: *Kitchen v Royal Air Force Association* [1958] 1 WLR 563; *Tito v Waddell (No 2)* [1977] Ch 106, 245B–C. Counsel for the unsuccessful wife in *Higinbotham v Holme* 19 Ves Jun 88, 90 made the distinction between actual and other fraud clear when he said that the settlement "being free from objection for want of consideration or upon

A actual fraud" could only be represented as a fraud upon the bankruptcy law in one of two ways, either on the basis of (the then existing, but in that case irrelevant and since the Insolvency Act 1985 finally abolished) doctrine of reputed ownership "or by considering it as a subtraction from the creditors of his estate, which he enjoys and possesses for every other purpose".

152 In a number of the old authorities, a conclusion that the anti-
B deprivation principle applied was expressed in terms referring to an express or deliberate object of evading the bankruptcy law. Lord Eldon LC in *Higinbotham v Holme* and the Court of Appeal in *Ex p Mackay* LR 8 Ch App 643 based themselves on an analysis of the transaction which led them to conclude that the "express object" was to take the case out of the reach of the bankruptcy laws. The palpably artificial scheme in *In re Johns* [1928] Ch 737, 748 was described as "a deliberate device to secure that more money
C should come to the mother, if the son went bankrupt, than would come to her if he did not". In dicta in *British Eagle* [1975] 1 WLR 758, 780, Lord Cross of Chelsea said that existences of a charge in *Ex p Mackay* meant that

> "The court could only go behind it if it was satisfied—as was indeed obvious in that case—that it had been created deliberately in order to provide for a different distribution of the insolvent's property on his
D bankruptcy from that prescribed by the law."

153 Other cases have however stated an anti-deprivation principle in terms focusing on the character of the transaction or provision, identified objectively. In a note to *Wilson v Greenwood* (1818) 1 Swans 471 (another decision of Lord Eldon LC) which was subsequently quoted by Lord Hatherley LC in argument in *Whitmore v Mason* 2 J & H 204, 209–210 and
E by Fry LJ in *Ex p Barter* 26 Ch D 510, 519–520, Mr Swanston stated simply that

> "the owner of property may, on alienation, qualify the interest of his alienee by a condition to take effect on bankruptcy; but cannot by contract or otherwise qualify his own interest by a like condition, determining or controlling it in the event of his own bankruptcy, to the
F disappointment or delay of his creditors . . ."

That is an objective test. In *Ex p Jay* 14 Ch D 19 a building owner demised land to a builder for 99 years, with detailed covenants to build thereon within certain times and subject to a power of distress and entry in case of either default in performance or bankruptcy or insolvency on the part of the builder, in either of which cases all the builder's improvements, plant and
G chattels on site were to be forfeited to the building owner. There was a commercial advantage behind the forfeiture provision, and Bacon CJ in fact said at first instance that

> "There was no fraud, but a transaction perfectly consistent with the speculation into which both parties had entered, that the materials brought upon the land were to be used in constructing the buildings":
H p 23.

But the Court of Appeal held that (there having been, prior to the bankruptcy, no default which could by itself have triggered the forfeiture) the forfeiture was void in the event that happened, of its being triggered by the builder's bankruptcy.

154 In *Ex p Barter* 26 Ch D 510, a similar point arose under a shipbuilding contract, which entitled the owners, in various events including the builders' cessation of work for 14 days or bankruptcy or insolvency, to take possession of the vessel and complete it using such of the builders' materials as were on their premises intended for use in completion. The builders went bankrupt and the owners claimed the right to use their materials. In justification, they argued strenuously the question was "whether at the time when the contract was entered into the parties intended to defeat the bankruptcy law;—whether it was an honest or a dishonest contract" (p 515), and the clause was for the builders' benefit since completion of the ship would reduce their bankrupt estate's liability. The Court of Appeal noted that the latter argument was fallacious, since the effect of the clause was to transfer to the owner the trustee's right to elect whether or not to complete. The court went on to reject the owner's case without reference to any state of mind, on the simple basis of the rule stated by Mr Swanston. To similar effect is, as Neuberger J noted in *Money Markets International Stockbrokers Ltd v London Stock Exchange Ltd* [2002] 1 WLR 1150, para 102, a passage in the judgment of Farwell J in *Borland's Trustee v Steel Bros & Co Ltd* [1901] 1 Ch 279, 291. In *Borland's* case, Farwell J, while accepting that the second principle did not apply to provisions compelling sale of shares on bankruptcy at their fair value, added that a provision compelling their sale at something less than the price they would otherwise obtain "would be repugnant to the bankruptcy law". The reasoning of Lord Blanesburgh in *Bombay Official Assignee v Shroff* 48 TLR 443, 446, to which Neuberger J also referred is, as I see it, equivocal and the judgment went off on another point.

155 An objective approach is also consistent with authorities which show that what matters is whether the deprivation was triggered by bankruptcy, and that, if it is, it is irrelevant that there was also events other than bankruptcy, which if they had occurred would have triggered deprivation, but which did not in fact occur. In *Higinbotham v Holme* 19 Ves Jun 88 there was a settlement by a prospective husband of moneys on trust for the husband unless and until he should, during his wife's lifetime, die or become bankrupt in which case she should receive an annuity. The annuity in favour of the wife was held void as regards the period between the husband's bankruptcy and death, but Lord Eldon made clear that it would still be payable as and from the date when her husband later died. In *Ex p Jay* 14 Ch D 19 and *Ex p Barter* 26 Ch D 510 the relevant clauses authorised forfeiture of the builder's materials on certain defaults in performance as well as on bankruptcy, but no such other events had occurred prior to the builders' bankruptcy, upon which the clauses were actually operated. In *In re Detmold* (1889) 40 Ch D 585, a settlor made a marriage settlement settling income on himself for life or until

> "he shall become bankrupt, or shall assign, charge, or incumber the said income, or shall do or suffer something whereby the same . . . would through his act, default, or by operation or process of law . . . become vested in or payable to some other person . . ."

A judgment creditor obtained the appointment of a receiver over the income on 19 July 1888 and on 29 July 1888 the settler was adjudicated bankrupt.

A The wife's interest vested on the appointment of the receiver and was held valid as against the creditors.

156 In *Whitmore v Mason* 2 J & H 204, the fact that the trigger for the anti-deprivation principle is bankruptcy was ingeniously invoked in an argument that, since the clause purportedly removing property from the bankrupt partner's estate was expressed to take effect in the event of "bankruptcy or insolvency", it therefore "took effect in this case immediately B the partner was unable to pay his debts, and consequently before any act of bankruptcy under which his assignees could claim"; but Page Wood V-C gave the argument short shrift, saying that a bankrupt is usually insolvent before he commits an act of bankruptcy and "if that construction were to prevail, the bankrupt laws might, in all cases, be defeated": p 215. In contrast, in *Ex p Newitt* (1881) 16 Ch D 522 the clause in a building lease C entitled the building owner to re-enter, and provided for forfeiture on re-entry of the builder's materials by way of liquidated damages, if the builder defaulted in fulfilling the agreement. The builder defaulted but, on one view of the facts, there was no re-entry and forfeiture prior to bankruptcy. The Court of Appeal held that, since the trustee in bankruptcy took possession subject to any pre-existing rights, the right to re-enter and forfeit could be exercised even after the bankruptcy. In the present case, Lord D Neuberger MR and Patten LJ [2010] Ch 347, paras 93, 163 thought that the decision in *In re Newitt* cannot survive *British Eagle* [1975] 1 WLR 758, in so far as it held that a right to forfeit could be exercised after bankruptcy. But it is unnecessary in this case to consider whether that is correct.

157 A further point is that it may be possible to sever a transaction or provision which infringes the anti-deprivation principle, avoiding it only to E the extent that it has this character. This is indicated by *Lester v Garland* 5 Sim 205 (where a husband's provision that moneys settled on himself should on his bankruptcy go to his wife and children was held valid as to 15 sixty-sixths, on the basis that so much of the moneys derived from her father and could be treated as coming from her, and void as to the rest). Lord Eldon's indication in *Higinbotham v Holme* 19 Ves Jun 88 that it was only in F the period between the settlor's bankruptcy and death that the creditors would take priority over the wife is in the same sense.

158 Mr Swanston's note to *Wilson v Greenwood* 1 Swans 471 covers two categories of situation: first, the owner of property may, on alienation, qualify the interest of his alienee by a condition to take effect on bankruptcy; the anti-deprivation principle does not prevent that; but, secondly, he cannot by contract or otherwise qualify his own interest by a condition, determining G or controlling it in the event of his own bankruptcy. A straightforward instance of the first situation is provided by the protective trust, within the meaning of section 33 of the Trustee Act 1925, created by a third party: *Money Markets International Stockbrokers Ltd* [2002] 1 WLR 1150, paras 47–49, and Sir Roy Goode, "*Perpetual Trustee* and Flip Clauses in Swap Transactions" (2011) 127 LQR 1, 8. Provisions for the forfeiture of H leases on a tenant's bankruptcy were seen as falling within the same category: *Whitmore v Mason* 2 J & H 204, 212–213. This was despite their mutual aspect (perhaps because it was assumed that landlords could dictate their own terms). Such provisions are now recognised as valid in section 146(9) of the Law of Property Act 1925. A straightforward instance of the second situation is the settlement by a person of his own property on

terms depriving him (and so his creditors) of it upon his bankruptcy. Early examples are *Higinbotham v Holme* 19 Ves Jun 88 and *Lester v Garland* 5 Sim 205.

159 Contractual situations present more difficulty. As Mr Swanston's note makes clear, the fact that two contracting parties have agreed a provision does not make it valid. The autonomy of contracting parties cannot axiomatically prevail over the interests of third party creditors in bankruptcy. By the same token, it can be no answer to a suggestion of evasion of the bankruptcy law that the provision for deprivation was in the contractual arrangements from the outset. That will commonly be the case (and was so in many of the cases, e g *Whitmore v Mason* 2 J & H 204, *Ex p Mackay* LR 8 Ch App 643, *Ex p Jay* 14 Ch D 19 and *Ex p Barter* 26 Ch D 510). However, it is reasonably clear that Mr Swanston's note was focusing on contracts affecting a pre-existing property interest. Even in that connection, the note would, read literally and generally, go too far, as the position regarding leases shows.

160 Where the property interest arises out of or in close connection with the relevant contract providing for its determination on bankruptcy, it may be easier to suggest a real commercial or other basis for the deprivation provision, and correspondingly more difficult to invoke the anti-deprivation principle. Thus, in *Borland's Trustee* [1901] 1 Ch 279 the purpose of the requirement, that any holder of the company's shares who became bankrupt should sell them at a specified price, was that the company should remain under the control of its managers and workers in Burma. There was, Farwell LJ said, "nothing repugnant to any bankruptcy law in such a provision as that". Turning to the price, he said that there was also nothing repugnant in that, since it was a fair value, although there would have been, had the obligation been to sell the shares at a lesser price: p 291. In the *Money Markets* case [2002] 1 WLR 1150, Neuberger J identified deprivation provisions operating on bankruptcy in relation to valueless assets or to assets ownership of which depends upon the personal characteristics of their owner as likely also to fall outside the second principle. He noted that it was presumably on this basis that the loss of membership of the relevant stock exchange on bankruptcy had not been challenged in *Bombay Official Assignee v Schroff* 48 TLR 443 or in *Money Markets*. In the former case, Lord Blanesburgh said, at p 445, that

> "if such an organisation is to attain its ends membership must plainly be a personal thing, incapable of uncontrolled transfer: expulsion from membership must normally follow default or misconduct: upon expulsion all interest of the defaulting member in the property of the organisation must cease."

In *Money Markets*, Neuberger J extended this approach to an ancillary asset in the form of a share in the London Stock Exchange which was liable to rescission for no consideration on bankruptcy. It is unnecessary to engage with the detail of the case or its outcome, but the conclusion that assets which are ancillary to a personal right may be forfeited on bankruptcy is understandable, although I believe that the terms of forfeiture might require particular consideration if there was nothing personal about the assets themselves and they were detachable and separately alienable.

161 The existence of a contractual scheme, which is said to create the relevant property interest, but at the same time to include provisions providing for its illegitimate deprivation on bankruptcy, raises several questions: First, how far did the scheme confer any property interest on the subsequently bankrupt party? Second, how far did it deprive him of any such property on bankruptcy? Third, in so far as it did deprive him of any such property on bankruptcy, did this amount to an illegitimate evasion of the anti-deprivation principle? The first question is exemplified by the difference between the majority and minority in *British Eagle* as to whether the International Air Transport Association ("IATA") arrangements then in force had given rise to any indebtedness between IATA members, and by the conclusion of the majority of the High Court of Australia in *International Air Transport Association v Ansett Australia Holdings Ltd* (2008) 234 CLR 151 that the modified IATA arrangements did not do so.

162 The parallel issue in the present case is whether the swap between Saphir and LBSF gave LBSF any property in the form of either or both of a contractual right to priority in respect of unwind costs and a proprietary interest in the collateral to secure such unwind costs. In answering that question, it is necessary to examine the terms and effect of the contractual arrangements, summarised above. There can be a fine distinction between arrangements conferring a limited or determinable benefit and arrangements conferring a larger benefit but making it forfeitable in circumstances including bankruptcy. Such a distinction has also been examined in the context of the common law rule of repugnancy which prevents a condition subsequent from being attached to an outright gift. The court was invited to sweep away any such distinction, at least in the present context. Mr Snowden made the invitation on the basis that limited or determinable interests should be assimilated with conditions subsequent, rendering the termination potentially invalid in all cases; Mr Salter and Mr Howard made it on the opposite basis that conditions subsequent should be assimilated with limited or determinable interests, and party autonomy given effect in all such situations.

163 In the context of the rule against repugnancy, the distinction between limited or determinable interests and conditions subsequent has been regularly criticised—although, one notes, with few positive suggestions as to what might replace it. Porter MR in *In re King's Trusts* (1892) 29 LR Ir 401, 410 thought it "little short of disgraceful to our jurisprudence" that in reference to a rule professedly founded on public policy there should be a distinction between a gift of an annuity for life coupled with a proviso for cessation if the donee married (treated as giving a life interest) and a gift until he marries (treated as giving an interest only until marriage). Porter MR's criticism appealed, in similar contexts, to Pennycuick V-C in *In re Sharp's Settlement Trusts* [1973] Ch 331, 340G and to Rattee J in *In re Scientific Investment Pension Plan Trusts* [1999] Ch 53, 59F–G, as well as to Professor Sir Roy Goode: *Principles of Corporate Insolvency Law*, 3rd ed, pp 186–187 and 127 LQR 1, 8. However, all of these authorities have taken the distinction as well established and one which has to be accepted, and either of the extremes embraced by Mr Snowden on the one hand and Mr Salter and Mr Howard on the other could have far-reaching implications. But I think that there is some scope for looking at the substance, rather than the form, when considering whether an agreement confers a limited or

determinable interest or amounts to a condition subsequent depriving the bankrupt of property on bankruptcy. This would be consistent with the first instance decision in *Mayhew v King* [2010] 2 BCLC 440, which no one challenged before the Supreme Court, and which was upheld by the Court of Appeal [2011] Bus LR 1327 after the hearing before the Supreme Court. The broker's undertaking by the settlement agreement in that case to indemnify the lorry owners (Millbank Trucks Ltd) against their liability to Mr Mayhew—as to 85% up to £1m, and as to 100% above £1m—clearly reflected effective acceptance of a pre-existing exposure to the lorry owners in negligence, and the clause limiting or terminating that agreement upon the lorry owners' bankruptcy can have had no commercial or other object, except to prevent the lorry owners continuing to have the benefit of the indemnity to meet the claims of Mr Mayhew and/or their other creditors in whatever way would ordinarily follow in the event of such a bankruptcy. (In fact the lorry owners' administrators had assigned the benefit of the indemnity to the lorry owners' insurance company which had had under section 151 of the Road Traffic Act 1988 to meet Mr Mayhew's claim against the lorry owners.)

164 Professor Worthington in "Insolvency Deprivation, Public Policy and Priority Flip Clauses" (2010) 7 International Corporate Rescue 28, 36 also criticises a distinction which hangs on the form of words or "wafer-thin differences in language", but herself advances a more substantive distinction between necessarily time-limited interests (like leases) and others. I do not accept that distinction, which would have its own incongruities: a 999-year lease is to all practical intents a permanent interest, and it is hard to see, in its potential termination in say 900 years, any relevance to the question whether its termination on the tenant's bankruptcy should be permissible; a distinction between such a lease and a permanent licence is equally unconvincing.

165 In *Ansett* (2008) 234 CLR 151, paras 151–179, Kirby J (dissenting) was, if necessary, prepared to look behind or through the parties' actual contractual arrangements, in order to identify a deprivation of property in a contractual scheme which as a matter of law eliminated any indebtedness between IATA members at any time. That must, I think, also go too far and appears to me inconsistent with the assumption of both the majority and the minority in *British Eagle*. Courts cannot rewrite or review contractual arrangements to give them an effect contrary to the substance of what the parties have agreed, even though this means that the bankrupt has less property than would otherwise be the case before and when he becomes bankrupt.

Analysis

166 In the present case, the first question is whether LBSF had, under the contractual arrangements, any relevant property, whether limited and determinable or forfeitable. The parties' submissions have focused on the difference in priorities in relation to the collateral between the situations of swap counterparty priority and noteholder priority. As a matter of contract, as Patten LJ noted, LBSF retained the right to recover any unwind costs payable to it in either situation. But the priority accorded to this right, as against both Saphir and the collateral, depended upon which form of priority applied: see in particular clauses 5.5 and 8.3 of the supplemental trust deed,

as well as the conditions of the OCS referred to in clause 8.3. Since there was by agreement no recourse against Saphir except to the extent covered by the collateral, the real right was against the collateral, to the extent that the collateral was sufficient to enable payment. Since the collateral's value would remain stable, priority was essential to the effectiveness of the right. References in the Court of Appeal judgments (see paras 144 and 146 above) to there being "no shortfall" in the collateral might suggest that the present dispute arises from some problem with the collateral and its performance. Far from it. The expectation of notified credit events in excess of the subordination amount, giving rise to unwind costs payable to LBSF, coupled with provision that no deduction should be made for such unwind costs from the amounts payable to Saphir and the noteholders, simply meant that the total claims against the collateral exceeded any value that it was ever contemplated that the collateral could or would have.

167 The reality is therefore that, if unwind costs were payable to LBSF, but the transaction was closed by payment to Saphir and so the noteholders out of the collateral of the current value of the notes, without reduction for such unwind costs, LBSF would have no effective right to recover such unwind costs. The difference between swap counterparty priority and noteholder priority is a difference between different priority contractual rights against Saphir secured by different priority rights against the collateral held by BNY. In reality, however, it amounts to a difference between having a right and having no effective right. The collateral on which most of the argument in this case has focused is a more visible form of property than a bare claim, but a bare contractual claim is also a form of property. If Saphir, as LBSF's contractual counterparty, had been liable without limit and good financially, the difference in priority over the collateral would have had no significance. But here there was an effective limit on Saphir's liability as counterparty, consisting of the value of the collateral. Hence, the focus on the significance of priority in respect of the collateral.

168 On one reading of paras 135, 136 and 174 of his judgment, Patten LJ took the view that the only asset that LBSF ever had was security over the collateral, and that swap counterparty priority did not involve a different form of property interest to noteholder priority. For the reasons I have given, I do not accept that analysis. The two types of priority over the collateral involve different property interests, but so too do the two types of contractual priority created by the parties' arrangements. However, these paragraphs in Patten LJ's judgment also point towards a different truth. The collateral was acquired by Saphir and given to BNY as trustee expressly to await events. All the relevant provisions relating to priority are expressly relevant only "in connection with the realisation or enforcement" of the collateral: clause 6.2 of the principal trust deed, clauses 5.5 and 8.3 of the STD and condition 44 of the OCS. What events occurred determined who acquired priority. As it happened, the relevant event was one of default, with LBSF the defaulting party, and priority fell accordingly to be given to the noteholders. Prior to the occurrence of an event determining which form of priority was to apply, I do not consider that LBSF could be said to enjoy either. This is a conclusion which is equally applicable to the question whether LBSF could be regarded as having been deprived of property in the form of a contractual right to priority. It follows that the occurrence of an event determining that noteholder priority applied did not deprive LBSF of

any previous property in the form of swap counterparty priority. The event prevented LBSF from acquiring swap counterparty priority, rather than deprived it of such priority. I add that, even if it were right to regard LBSF as having enjoyed property in the form of swap counterparty priority "unless" an event of default occurred with LBSF being the defaulting party, the case would fall within the category of interests limited to last until a certain event, rather than that of interests forfeitable upon a certain event. These conclusions also correspond, as I see it, with Sir Andrew Morritt C's pithy reasoning: see para 143 above.

169 If a contrary answer were given to the first question identified in paragraph 161 above, the second question, how far LBSF was deprived of such property on bankruptcy, would arise. That involves in this case the issue about the trigger and timing of any deprivation identified in paragraph 141 above. I will leave that issue for the moment, and assume that there was a deprivation by reason of a switch in priority on LBSF's bankruptcy. The third question is then whether this amounted to an illegitimate evasion of the anti-deprivation principle.

170 In answering this third question in the Court of Appeal [2010] Ch 347, Lord Neuberger MR attached considerable significance to the fact that the noteholders put up the money with which Saphir purchased the collateral held by BNY as trustee. Lord Neuberger MR referred to *Whitmore v Mason* 2 J & H 204, where partners had agreed that, on the bankruptcy of any one of them, his interest in partnership mines and premises, except for one specified lease, grant and concession, should be valued and paid to him. The exception was held invalid, but Page-Wood V-C, after referring to *Lester v Garland* 5 Sim 205, said, 2 J & H 204, 214–215, that "If his co-partners had advanced a definite sum of money on account of his share, then the property might have been considered to the extent of the money so advanced by them, as identically their money". This generous dictum, derived from old authority decided in an era in which wives could not own separate property, is a tenuous basis for enabling a particular creditor to stipulate for priority in his debtor's bankruptcy, without having previously taken any security.

171 In any event, the dictum is in my view difficult to apply to the facts of the present case, involving not an out-and-out contribution to marriage or another venture, but security in respect of complex contractual arrangements. First, it was the essence of the transaction that the collateral should stand as neutral security for (indeed as the limit of) potential indebtedness of Saphir to either LBSF or the noteholders. The case cannot be approached on the basis that the noteholders had an inherent or pre-existing right either to contractual priority or to the collateral. Their rights depended upon the terms agreed in the documentation. Secondly, although the reality in this case is that LBSF would never be paid unless it retained priority over the collateral, one can imagine a case where there was no collateral, but a simple contractual provision depriving LBSF of the right to payment (or subordinating its right to payment to those of others, in such a way that it would not in practice be paid) in the case of a default where LBSF was the defaulting party. The present problem could not then be solved by inquiring into the source of the collateral, since there would be none. Yet it is difficult to think that the answer to the present problem turns on whether or not there was collateral. For these reasons, I would not subscribe to the line of

reasoning suggested in paras 92–98 of Lord Collins's judgment. If one is assuming, as I presently am, that LBSF had a first priority property right to recover unwind costs payable to it and that it was deprived of this and the collateral securing it upon its bankruptcy, some other justification for this deprivation must be found than the fact that the noteholders funded the security.

172 Accordingly, bearing in mind the reality that the difference in priority over the collateral amounts to a difference between having and not having any right to recover unwind costs, it is I think instructive to start by considering to what extent English bankruptcy law permits contracting parties to agree that one shall have the right to terminate or vary the priority of rights, as well as security in respect of rights, under a contract upon the bankruptcy of the other. In *Principles of Corporate Insolvency Law*, para 7.11, Professor Sir Roy Goode notes that it is generally assumed that provisions for termination of leases or the hiring of chattels "or, indeed, of any kind of agreement, upon the bankruptcy or liquidation of a party" are valid. However, he also suggests that the general American bankruptcy rule, that ipso facto termination clauses are ineffective, is one which English law "could sensibly follow". He adds that it is "a matter for some astonishment that the validity of contractual provisions for termination of rights on winding up has yet to be authoritatively determined".

173 It is relevant to note that the American bankruptcy rule invalidating ipso facto termination clauses is a product of legislation: section 365(e) of the Bankruptcy Code 1978, which was considered by the Hon James M Peck, United States Bankruptcy Judge, in his ruling in the parallel United States litigation concerning the Dante Programme. Section 365(e) provides that:

> "an executory contract . . . may not be terminated or modified . . . and any right or obligation under such contract . . . may not be terminated or modified, at any time after the commencement of the case solely because of a provision in such contract . . . that is conditioned on . . . the commencement of a case under this title . . ."

This is complemented by section 541(c) which provides that any interest of the debtor in property

> "becomes property of the estate . . . notwithstanding any provision in an agreement . . . that is conditioned . . . on the commencement of a case under this title . . . and that effects or gives an option to effect a forfeiture, modification, or termination of the debtor's interest in property . . ."

174 The anti-deprivation principle recognised in English case law finds a parallel in section 541. But the English case law has to date focused on deprivation of property, and has not recognised any equivalent principle to that enacted in section 365(e). Further, section 365(e) is itself qualified by the "safe harbour" provisions of section 560, which specifically protect a non-defaulting swap participant's contractual rights to liquidate, terminate or accelerate a swap agreement because of a condition of the kind specified in section 365(e)(1), that is the insolvency or financial condition of the debtor and the commencement of a bankruptcy case. District Judge Peck considered section 560 inapplicable because, he concluded, there was nothing in the ISDA master agreement or the swap agreement referring to the STD or noteholder priority or condition 44 of the OCS; and the

provisions of the latter documentation, while dictating the means by which the proceeds of each swap agreement would be distributed, were not part of the swap agreement. It is not for this court to go further into that conclusion, which may yet be challenged in further United States litigation. What it does suggest is that any general rule invalidating ipso facto termination clauses ought to be a matter for legislative attention, rather than novel common law development.

175 How far contracting parties may validly agree to one party terminating further performance on the bankruptcy of another was recently considered at first instance in *Lomas v JFB Firth Rixson Inc (International Swaps and Derivatives Association Inc intervening)* [2011] 2 BCLC 120. The case was decided after the present Court of Appeal decision. It concerned five fixed rate/floating rate swaps to which another Lehman company, Lehman Brothers International Europe ("LBIE") was party. An event of default as defined in the contract documentation occurred on 15 September 2008 consisting of LBIE's entry into administration. Under section 2(a)(iii) of the ISDA master agreement, each party's obligation to make payment or delivery under the swaps was

> "subject to (1) the condition precedent that no event of default . . . with respect to the other party has occurred and is continuing, (2) the condition precedent that no early termination date in respect of the relevant transaction has occurred or been effectively designated."

LBIE would have benefited from the continuation of the swaps to their natural expiry dates. LBIE's counterparties relied upon clause 2(a)(iii) to withhold further performance, netting off against amounts owed by LBIE the amounts they owed to LBIE but for LBIE's default. LBIE argued that the power to withhold further performance infringed the second principle. Briggs J rejected the submission. He distinguished between an asset in the form of "a chose in action, representing the quid pro quo for something already done, sold or delivered before the onset of insolvency" and a right consisting of "the quid pro quo (in whole or in part) for services yet to be rendered or something still to be supplied by the insolvent company in an ongoing contract". He held that there is "nothing contrary to insolvency law in permitting a party either to terminate or adjust what would otherwise be an ongoing relationship with the insolvent company, at the point when it goes into an insolvency process" (para 108), and that (para 112):

> "Reduced to its bare essentials, the condition precedent that there should be (inter alia) no bankruptcy event of default was a provision designed to ensure that LBIE would only receive its quid pro quo for providing an interest rate hedge for as long as it was in a financial condition to be able to do so."

In *Lehman Bros Special Financing Inc v Carlton Communications Ltd* [2011] EWHC 718 (Ch) at [38] Briggs J followed his previous decision and applied similar reasoning to an interest rate swap on the basis that the condition precedent in section 2(a)(iii) of the ISDA master agreement was valid "to relieve the non-defaulting party from payment obligations for as long as the defaulting party is, by reason of the bankruptcy, incapacitated from providing the promised hedge", whenever during the life of the transaction such incapacity arose.

176 I would accept that the forfeiture of contractual rights on the bankruptcy of the party enjoying them is in some circumstances capable of constituting a deprivation of property within the principle precluding evasion of the bankruptcy law. This is so not only with accrued rights, but may also be the case with other rights, as, for example, where the bankrupt has performed his part before going bankrupt or the right can fairly be treated as independent of any as yet unperformed obligation. I question, even at common law, whether an insured who enjoys third party liability cover for a period on a claims made basis and goes bankrupt part way through that period could properly be deprived of the benefit of such cover in respect of claims arising from his activities prior to his bankruptcy. To that extent, section 1(3) of the Third Parties (Rights against Insurers) Act 1930 may well have done no more than reflect what would have been held to be the common law.

177 However, Mr Snowden advanced propositions which would mean that any provision for termination on bankruptcy, which would deprive the trustee or liquidator of the opportunity of continuing the contract and so the bankrupt estate of future potential advantage, would infringe the principle. There is in my opinion no basis for any such rule. Where a contract provides for the performance in the future of reciprocal obligations, the performance of each of which is the quid pro quo of the other, I see nothing objectionable or evasive about a provision entitling one party to terminate if the other becomes bankrupt. That is particularly so, having regard to the purpose and character of the present transaction, viewed rather more broadly than the Court of Appeal did in its detailed reasoning.

178 As Sir Andrew Morritt C stated, in the passage quoted in paragraph 135 of this judgment, the transaction provided LBSF with a benefit, which can loosely be described as credit insurance, in return for which LBSF was to pay interest to Saphir for the benefit of the noteholders at a rate higher than the Rabo Bank rate. Under an insurance in return for the payment periodically of premium, it is natural that the one should be made conditional upon the other. Just so, under the present transaction, it is natural that payment of the interest should be made a condition of LBSF benefitting. Mr Snowden submits that this raises no problem, since LBSF could only obtain continuing benefit under the present transaction by confirming it and continuing to credit Saphir with the full amount of the interest due until expiry. No doubt that is so. It is what LBSF would have wished to be able to do, since the transaction was probably already profitable from its viewpoint, it could not become less so and it was certainly predicted that it would become more so. Hence the present litigation. But the submission misses the point. Had the transaction neither given rise, nor appeared likely to give rise, to credit events exceeding the subordination amount, LBSF could and would have disclaimed it. Saphir would then have been left to prove in LBSF's liquidation for the benefit of the noteholders for such percentage of the already outstanding and future interest payments as they could recover. In LBSF's liquidation, therefore, the position would be one way. Saphir (and through it the noteholders) could only lose. That is a risk that no insurer would ordinarily run. Nor is a conventional right to determine on LBSF's default of assistance to Saphir or noteholders in this situation. There will be no default unless LBSF would lose money by continuing the contract.

179 I see no reason therefore why the law should preclude a commercial party in the position of Saphir (acting for the benefit of noteholders) from insisting that it would only provide the desired cover so long as LBSF was able, whatever the predicted outcome of the transaction, to perform its part in full. The purpose and effect of such a provision is not to evade the bankruptcy law. It is to protect the natural interest of any contracting party, and particularly someone who is providing in effect credit insurance, that it should not find itself having to perform to its disadvantage, without being able to enforce performance if this would be to its advantage. It is a prudent limitation on the duration and operation of the contract. The result reached by Briggs J in *Lomas v JFB Firth Rixson Inc* [2011] 2 BCLC 120 was correct in relation to the mutual contractual obligations with which he was concerned.

180 For reasons I have already explained, no different result can follow in the present case, where, although a prior right over the collateral may be more obviously identifiable as property within the principle precluding evasion of the bankruptcy law, it is no more than collateral for (and indeed the measure of liability under) a chose in action. It would be curious if termination of the right to future performance of the chose in action was itself permissible, but became impermissible if collateral had been provided for its performance. This is particularly so in the present case where the collateral and the cause of action are effectively indistinguishable.

Timing

181 The further question (the second identified in paragraph 161 above) is whether, in this case, the loss did occur upon LBSF's insolvency, bearing in mind that there was an event of default affecting its parent, LBHI, which occurred some two weeks before LBSF was subject to Chapter 11 proceedings. In view of the conclusions I have already reached, this question does not require decision. Saphir and BNY submit that the replacement of swap counterparty priority by noteholder priority was and is, under clause 5.5, the automatic result of the occurrence of any event of default. Whether anyone acts on the event of default, and whether the collateral is realised or enforced in relation to the event of default is immaterial. Even though the event of default passes unnoticed and even if it is cured, noteholder priority persists. Here, there was an event of default, consisting of LBHI's Chapter 11 bankruptcy on 15 September 2008, that no one had ever acted upon. None the less, they submit, that is sufficient to ensure noteholder priority in respect of the event of default which was acted upon, LBSF's Chapter 11 bankruptcy, which occurred on 3 October 2008.

182 I prefer to reserve my position on the correctness of these submissions. The contrary argument is that they do not marry with the general scheme effected by the documentation as a whole. As already emphasised, clauses 5.5 and 8.3 and condition 44 of the OCS are all expressly and solely concerned with situations where Saphir or BNY is applying moneys received in connection with the realisation or enforcement of the collateral. It is in that context only that it is agreed that, if "an event of default . . . occurs under the swap agreement and the swap counterparty is the defaulting party . . ." or a tax event occurs, then noteholder rather than swap counterparty priority will apply. Mr Salter accepts that the only situation in which the difference between swap counterparty and noteholder

priority is relevant or comes into operation is where there has been early termination. The sole purpose of the "flip" is to deal with unwind costs in the manner indicated in clause 8.3 and condition 44, in other words to avoid Saphir and through it the noteholders having actually to bear the burden of any future credit events in excess of the subordination amount which might on early termination be taken into account to their disadvantage in calculating the unwind costs. A past event of default which has not been acted upon will have no connection with any early termination or with the realisation or enforcement of the collateral in any circumstances.

183 The natural inference of clause 5.5 and especially clause 8.3, confirmed by the present tense "occurs", is that they contemplate an event of default connected with the realisation and enforcement of the collateral. The reference in clause 5.5 to a defaulting party is a reference to clause 6(a) of the ISDA master agreement, which deals with early termination following an event of default, and requires not more than 20 days' notice "specifying the relevant event of default" and designating "a day" not earlier than the day such notice is effective as an early termination event in respect of all outstanding transactions. The requirement to specify the "relevant" event of default suggests that early termination is to work itself out by reference to the event of default so specified. Condition 44, one of the conditions to which clause 8.3 refers, is concerned with early redemption amounts payable under the notes in various circumstances, but its second paragraph makes specific provision for the early redemption amount payable when an event of default occurs under the swap and LBSF is the defaulting party, as well as for unwind costs. These are defined as meaning the value of the termination payment due from or to LBSF under the swap. Again, the inference is that early termination under the swap works itself out by reference to a specific event of default. The alternative is that an event of default which has perhaps not even been detected and certainly has not been acted upon can dictate priority if there should at any subsequent date be early termination not involving any further default on the part of the swap counterparty. On the actual termination, Saphir and the noteholders could then avoid having to credit any unwind costs otherwise due to LBSF in respect of anticipated future credit events. The justification for such an analysis would seem questionable, when the swap will, by definition, have been satisfactorily performed in the meanwhile and LBSF will not have been responsible for its actual termination. Accordingly, since it is unnecessary for the decision in this case, I prefer not to express any view on the second issue.

Conclusion

184 For the reasons I have given in relation to the first issue, I would dismiss the appeal.

LORD PHILLIPS OF WORTH MATRAVERS PSC, LORD HOPE OF CRAIGHEAD DPSC, BARONESS HALE OF RICHMOND and **LORD CLARKE OF STONE-CUM-EBONY JJSC**

185 For the reasons given by Lord Collins of Mapesbury and Lord Walker of Gestingthorpe JSC, with which we are in agreement, we too would dismiss this appeal.

APPENDIX

The principal trust deed

1. Clause 5.1: "The issuer with full title guarantee and as continuing security grants in favour of the trustee such charge and/or security interest as set out in the relevant supplemental trust deed in respect of the relevant series."

2. Clause 5.2:

> "For each series, the charges and/or security interest created pursuant to sub-clause 5.1 are granted to the trustee as continuing security (i) for the payment of all sums due under the trust deed and the notes and the coupons of such series, and (ii) for the performance of the issuer's obligations (if any) under certain agreements as set out in the relevant supplemental trust deed in respect of such series. The trustee shall release from such charges any part of the mortgaged property when it becomes payable or deliverable to the extent that payment or delivery of it may be obtained and duly paid or made (as the case may be) to a swap counterparty under a swap agreement and/or to the holders of notes, coupons and receipts . . ."

3. Clause 5.5: ". . . the security . . . shall become enforceable if (i) any amount due in respect of the notes is not paid or delivered when due or (ii) a swap agreement terminates with sums due to the swap counterparty [i e LBSF]."

4. Clause 5.6 provides that: "at any time after any security . . . shall have become enforceable . . . the trustee shall . . . (. . . subject to it having been indemnified to its satisfaction . . .) enforce the security over the mortgaged property" if so directed by the noteholders in certain specified circumstances, or otherwise at its discretion.

5. Clause 6.1 provides that moneys, received otherwise than in connection with the realisation or enforcement of the security, are to be held by the trustee, after payment of the trustee's costs, on trust to pay, first, the amounts due to LBSF, the noteholders and others pari passu, and, secondly, the amounts due to the issuer.

6. Clause 6.2 directs the trustee: ". . . [to] apply all moneys received by it under this principal trust deed and the relevant supplemental trust deed in connection with the realisation or enforcement of the security . . . as follows" and goes on to provide that "swap counterparty priority" means that the claims of LBSF are payable in priority to the claims of the noteholders, whereas "noteholder priority" means the converse, in each case after providing for payment of certain specified costs and charges. The priority which is to apply in any particular case is that specified in the supplemental trust deed.

7. Clause 7.2:

> "In relation to any series in respect of which there is a swap counterparty, such swap counterparty shall, by execution of the relevant supplemental trust deed, covenant and agree: 7.2.1: . . . that its recourse in respect of its claims under the swap agreement is limited to the proceeds of the mortgaged property in relation to such series as it is entitled to, as provided in the trust deed and no debt shall be owed by the issuer in respect of any shortfall . . ."

8. Part C of Schedule 2 contains terms and conditions of the notes to be applied to all notes of any series, subject to the terms of the relevant supplemental trust deed and the terms and conditions in the note series prospectus.

9. Condition 10 of Part C of Schedule 2 provides that in certain events (including default for a specified period by the issuer in payment under the notes) the trustee may, and if requested by holders of at least one-fifth in principal amount of the notes or if directed by an extraordinary resolution of the noteholders must, give notice to the issuer that the notes are, and shall immediately become, due and payable at their early redemption amount (a "condition 10 notice").

10. Condition 6(d)(ii) of Part C of Schedule 2 also provides for the early redemption of the notes if a swap agreement is terminated. In that event, the issuer is

A required to give the trustee, the noteholders and LBSF notice, at the expiration of which the notes are to be redeemed at their early redemption amount. Condition 6(d)(ii) was amended by condition 38 in the terms and conditions: below, para 17.

The supplemental trust deed

11. Clause 5.2 contains a charge by the issuer "as continuing security in favour of the trustee" over the collateral and other property representing it from time to time.

B 12. Clause 5.3 provides that such security is

> "granted to the trustee as trustee for itself and/or the holders of notes, and [LBSF], the custodian and the paying agents as continuing security (i) for the payment of all sums due under the trust deed and the notes, (ii) for the performance of the issuer's obligations (if any) under the swap agreement . . ."

13. Clause 5.5:

C

> "The trustee shall apply all moneys received by it under this deed in connection with the realisation or enforcement of the mortgaged property as follows: swap counterparty priority unless . . . an event of default (as defined in the swap agreement) occurs under the swap agreement and the swap counterparty is the defaulting party (as defined in the swap agreement) . . . in which case noteholder priority shall apply . . ."

D 14. Clause 8.3:

> " . . . [LBSF] hereby agrees that, if an event of default (as defined in the ISDA master agreement) occurs under the swap agreement and [LBSF] is the defaulting party (as defined in the ISDA master agreement) . . . and unwind costs are payable by the issuer to [LBSF], the issuer shall apply the net proceeds from the sale or realisation of the collateral (1) first in redeeming the notes in an amount as set out in the conditions and (2) thereafter, in payment of such unwind costs to

E [LBSF]."

Terms and conditions

15. The prospectus to which the terms and conditions are attached points out that the notes are "credit-linked" to the reference entities (i e the securities whose credit was being, in effect, insured). The prospectus also points out that the noteholders

F have exposure to the value of the collateral so that "impairment of the collateral may result in a negative rating action on the notes".

16. Condition 6 of the terms and conditions as set out in Schedule 2 to the supplemental trust deed contains the details of how and by how much the principal amount due on the notes is reducible in the event of credit events affecting a reference entity.

17. Condition 38 in the terms and conditions specifies or refers to certain events

G which can give rise to early redemption of the notes including termination in whole or in part of the relevant swap agreement (see condition 6(d)(ii) in Part C of Schedule 2 to the principal trust deed) and default in payment of any interest due for the period specified in the condition (which period varies from each series of notes). If any such event occurs, condition 38 requires the relevant issuer to serve a notice notifying the trustee, the relevant rating agency and the noteholders, of the occurrence of the event and giving notice of the date fixed for redemption of the notes. In the event of such a notice being served the notes become redeemable at their

H early redemption amount.

18. Condition 40 (ii), headed "Security Arrangements," provides for the trustee to apply all moneys received by it

> "in the following order of priorities: swap counterparty priority unless (i) an event of default (as defined in the ISDA master agreement) occurs under the swap

agreement and the swap counterparty is the defaulting party (as defined in the ISDA master agreement) or (ii) a tax event (as defined in the ISDA master agreement) occurs under the swap agreement and the swap counterparty is the sole affected party (as defined in the ISDA master agreement), in which case noteholder priority shall apply."

19. Condition 44 deals with the determination of the early redemption amounts referred to in conditions 6(d) and 10 of Part C of Schedule 2 to the principal trust deed. It also includes a definition of "unwind costs", being the amount due to or, as the case may be, from LBSF, by way of termination payment under the relevant swap agreement at its early termination. That amount is to be assessed in accordance with the provisions of the relevant swap agreement including by reference to quotations taken in the market, when the relevant swap agreement terminates, for what a third party would pay to enter into a swap arrangement on similar terms, or, alternatively, what the issuer would have to pay a third party to enter into such a swap arrangement.

20. The first paragraph of condition 44 ("condition 44.1") provides that "Subject to the immediately succeeding paragraph below . . ." the early redemption amount payable on each note is to be the amount equal to:

"(i) such note's pro rata share of the proceeds . . . from the sale or realisation of the collateral . . . plus (if payable to the issuer) or minus (if payable to [LBSF]) (ii) the amount of any applicable unwind costs . . ."

21. Under condition 44.1, if termination occurs early, an early redemption amount is to be calculated, and if unwind costs are payable under the swap to LBSF on termination, they are to be deducted when calculating any amount which would be due to the noteholders, and if such unwind costs are payable to the issuer, they are to be added to the amount payable to the noteholders. Condition 44.1 continues:

"provided that if the amount determined pursuant to sub-paragraphs (i) and (ii) above exceeds (the amount of any such excess being the 'excess amount') such note's outstanding principal amount as of the early redemption date together with interest accrued from, and including, the immediately preceding interest payment date . . . to, but excluding, such early redemption date (such interest being the 'accrued early redemption interest amount') and, such excess amount shall be payable by way of an additional payment of interest on each note."

22. The second paragraph of condition 44 ("condition 44.2") provides: "Notwithstanding the above, if an event of default (as defined in the ISDA master agreement) occurs under the swap agreement and [LBSF] is the defaulting party (as defined in the ISDA master agreement) . . .", the early redemption amount payable on each note was to be equal to:

"(i) such note's pro rata share of the proceeds . . . from the sale or realisation of the collateral . . . plus (ii) (but only if payable to the issuer) the amount of any applicable unwind costs divided by the total number of notes outstanding; provided that if the amount determined pursuant to sub-paragraphs (i) and (ii) above results in an excess amount (as defined above), such excess amount shall be payable by way of an additional payment of interest on each note. In the event that unwind costs are payable by the issuer to the swap counterparty, the issuer shall apply the net proceeds from the sale or realisation of the collateral as aforesaid (1) first in redeeming each note in an amount equal to its outstanding principal amount as of the early redemption date plus the accrued early redemption interest amount and (2) thereafter, in payment of such unwind costs to the swap counterparty."

The ISDA master agreement

23. Section 5 of the ISDA master agreement defines an "event of default" as being: "The occurrence [of certain specified events] at any time with respect to [LBSF], or if

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A applicable, any credit support provider" of [LBSF]. According to paragraph 9(iv) of the swap confirmation, the credit support provider is LBHI, the ultimate parent of LBSF.

24. The defined events of default include (i) failure to pay any sums due under the ISDA master agreement (if such failure is not remedied after three local business days' notice of such failure), and (ii) the institution by LBSF or by LBHI of any proceedings "seeking a judgment of insolvency or bankruptcy or any other relief under any
B bankruptcy or insolvency law or other similar law affecting creditors' rights . . ."

25. Section 6 of the ISDA master agreement deals with early termination and provides that:

> "(a) *Right to terminate following event of default.* If at any time an event of default with respect to a party (the 'defaulting party') has occurred and is then continuing, the other party . . . may, by not more than 20 days' notice to the
C defaulting party specifying the relevant event of default, designate a day not earlier than the day such notice is effective as an early termination date in respect of all outstanding transactions . . ."

26. In all cases, the parties selected "second method" and "market quotation" as the valuation mechanisms for the swaps. In addition, in all cases, the parties did not select automatic early termination ("AET") of the swap agreements under Part 1(h) of the schedule to the ISDA master agreement, which would have resulted in the swaps
D being deemed automatically to have terminated on the occurrence of specified events of default, including bankruptcy. However, in the swap confirmations for all cases the parties did specify certain events (such as the notes being declared due and payable) which would be "additional termination events" upon the occurrence of which an early termination date for the swap would immediately occur.

27. Part 5(g) of the schedule to the ISDA master agreement provides:

> "In relation to each transaction, each party confirms that it is bound by the
E terms of the trust deed and that the terms of such trust deed prevail to the extent they conflict with terms relating to such transaction. [LBSF] agrees that its recourse against [the issuer] in respect of the relevant transaction is limited to the assets on which the liabilities of [the issuer] under the relevant transaction are secured pursuant to the trust deed and that its right to enforce the security created by [the issuer] over those assets is limited as provided in the trust deed. If the net
F proceeds of realisation of the security are insufficient to meet all claims secured thereon, the obligations of [the issuer] in respect thereof will be limited to such net proceeds and accordingly no debt shall be owed by [the issuer] in respect of any shortfall remaining after realisation of the security and application of the proceeds in accordance with the trust deed . . ."

Swap confirmation

G 28. Paragraph 9 of the swap confirmation includes an acknowledgment by the issuer and LBSF that the transaction was not intended to constitute insurance business so that payments by each party under the transaction were independent and not dependent on proof of economic loss of the other.

29. The "credit protection" provided to LBSF under the swap agreement related to the occurrence of "credit events" in relation to the reference entities set out in the swap confirmation.

H 30. The payment obligations of the buyer (LBSF) and seller (issuer) are specified in paragraphs 3 and 4 of the swap confirmation.

Appeal dismissed.

COLIN BERESFORD, Barrister

ITEM NO. 157

JA-43

Certain Limited Partners in Henderson PFI Secondary Fund II LP (a firm) *v* Henderson PFI Secondary Fund II LP (a firm) and others

[2012] EWHC 3259 (Comm)

2012 Nov 5, 6, 7; 16 Cooke J

Partnership — Limited partnership — Derivative claim — General partner appointing sister company as partnership manager — General partner and manager causing partnership to make investments which limited partners subsequently claimed to be unauthorised — Whether limited partners entitled to bring derivative claims on behalf of partnership against general partner and manager — Whether limited partners having individual claims against general partner precluding derivative action — Whether special circumstances existing to justify derivative claim against manager — Factors to be taken into account — Whether derivative claim to be allowed in circumstances — Whether limited partner bringing derivative claim losing limited liability because it "takes part in the management of the partnership business" — Limited Partnerships Act 1907 (7 Edw 7, c 24), s 6(1)

The first defendant firm was a limited partnership established to invest in private finance initiative and public private partnership concession companies. The second and third defendants were companies in the same group. By a management deed the third defendant, the general partner, appointed the second defendant to manage the partnership's investment portfolio. The relationship between the parties was governed by the partnership agreement, the Limited Partnerships Act 1907[1] and the management deed. The claimants, comprising a majority of the limited partners, alleged that the second and third defendants had used the partnership's capital to make unauthorised investments. They sought to pursue, as derivative actions on behalf of the partnership, claims against the second defendant for breaching its obligations under the management deed and against the third defendant by breaching its obligations under the partnership agreement. An order was made for the determination of a number of preliminary issues, including (1) whether the claimants were entitled to pursue the claims as derivative claims on behalf of the partnership; and (2) if so, whether pursuit of those claims constituted taking part in the management of the business of the partnership for the purposes of section 6(1) of the 1907 Act, such that the claimants would forfeit their limited liability.

On the preliminary issues—

Held, (1) that in so far as any claim that the third defendant had breached its obligations under the limited partnership agreement and in equity was concerned, each limited partner could bring an individual contractual or fiduciary claim which would not involve management of the partnership business; and that there was therefore neither need nor room for a derivative action against the third defendant (post, paras 28, 31–32, 174).

(2) That any claim against the second defendant was a partnership asset and could be pursued only by the general partner in the name of the partnership or by means of a derivative claim; that in assessing whether there were special circumstances to justify a derivative claim the root question was whether injustice would be caused if no such claim were allowed; that unless they were strongly in favour of one party or another, the merits of the claim played little part in that assessment; that, although it was not conclusive, the existence of an alternative

[1] Limited Partnerships Act 1907, s 6(1): see post, para 13.

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A remedy was a factor to be taken into account; that, in light of the relationship between the second and third defendants and the resulting conflict of interest for the third defendant, in reality no suit would be brought by the third defendant in the name of the partnership; that, although under the partnership agreement the third defendant could be removed and replaced and an action against the second defendant brought by the new general partner in the name of the partnership, such a course entailed drastic consequences; and that, in those circumstances, justice required that
B the limited partners be permitted to bring a derivative claim (post, paras 26, 34–35, 37, 39, 55, 57, 59, 174).

Roberts v Gill & Co [2011] 1 AC 240, SC(E) applied.

But (3) that in bringing such a derivative action the claimants would be taking part in the management of the business of the partnership for the purposes of section 6(1) of the Limited Partnerships Act 1907 and would forfeit their limited liability and render themselves liable to creditors of the partnership generally, as if
C they were the general partner, for the period during which a derivative claim was pursued (post, paras 60–61, 66, 68–70, 78, 174).

Inversiones Frieira SL v Colyzeo Investors II LP [2012] Bus LR 1136 considered.

The following cases are referred to in the judgment:

Barrett v Duckett [1995] 1 BCLC 243, CA
D *Bell Houses Ltd v City Wall Properties Ltd* [1966] 2 QB 656; [1966] 2 WLR 1323; [1966] 2 All ER 674, CA
Buckton, In re; Buckton v Buckton [1907] 2 Ch 406
Den Norske Creditbank v Sarawak Economic Development Corpn [1988] 2 Lloyd's Rep 616
HIH Casualty & General Insurance Ltd v Chase Manhattan Bank [2003] UKHL 6; [2003] 1 All ER (Comm) 349; [2003] 2 Lloyd's Rep 61, HL(E)
E *HR Trustees Ltd v German; In re IMG Pension Plan* [2010] EWHC 321 (Ch); [2010] Pens LR 131
Hughes v Weiss [2012] EWHC 2363 (Ch)
IBM United Kingdom Pensions Trust Ltd v Metcalfe [2012] EWHC 125 (Ch)
Inversiones Frieira SL v Colyzeo Investors II LP [2011] EWHC 1762 (Ch); [2012] EWHC 1450 (Ch); [2012] Bus LR 1136
Johnson v Gore Wood & Co [2002] 2 AC 1; [2001] 2 WLR 72; [2001] 1 All ER 481, HL(E)
F *Kleanthous v Paphitis* [2011] EWHC 2287 (Ch); [2012] BCC 676
McDonald v Horn [1995] ICR 685; [1995] 1 All ER 961, CA
Roberts v Gill & Co [2010] UKSC 22; [2011] 1 AC 240; [2010] 2 WLR 1227; [2010] 4 All ER 367, SC(E)
Smith v Croft [1986] 1 WLR 580; [1986] 2 All ER 551
Wallersteiner v Moir (No 2) [1975] QB 373; [1975] 2 WLR 389; [1975] 1 All ER 849, CA
G *Watson v Imperial Financial Services Ltd* (1994) 111 DLR (4th) 643

The following additional cases were cited in argument:

Cinematic Finance Ltd v Ryder [2010] EWHC 3387 (Ch); [2012] BCC 797
Comr for Corporate Affairs v Bracht (1988) 7 ACLC 40
Field, decd, In re [1971] 1 WLR 555; [1971] 1 All ER 1104
H *Foss v Harbottle* (1843) 2 Hare 461
Hayim v Citibank NA [1987] AC 730; [1987] 3 WLR 83, PC
Market Wizard Systems (UK) Ltd, In re [1998] 2 BCLC 282
Prudential Assurance Co Ltd v Newman Industries Ltd (No 2) [1982] Ch 204; [1982] 2 WLR 31; [1982] 1 All ER 354, CA
Waddington v Chan Chun Hoo [2009] 4 HKC 381

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The following additional cases, although not cited, were referred to in the skeleton arguments:

Armitage v Nurse [1998] Ch 241; [1997] 3 WLR 1046; [1997] 2 All ER 705, CA
Barnard, In re [1932] 1 Ch 269
Cherry Tree Investments Ltd v Landmain Ltd [2012] EWCA Civ 736; [2013] Ch 305; [2013] 2 WLR 481, CA
Henderson v Merrett Syndicates Ltd [1995] 2 AC 145; [1994] 3 WLR 761; [1994] 3 All ER 506; [1994] 2 Lloyd's Rep 468, HL(E)
Heyting v Dupont [1963] 1 WLR 1192; [1963] 3 All ER 97
IFE Fund SA v Goldman Sachs International [2006] EWHC 2887 (Comm); [2007] 1 Lloyd's Rep 26
Kelly v Cooper [1993] AC 205; [1992] 3 WLR 936, PC
Keren Kayemeth Le Jisroel Ltd v Inland Revenue Comrs [1931] 2 KB 465, CA; [1932] AC 650, HL(E)
Konamaneni v Rolls Royce Industrial Power (India) Ltd [2002] 1 WLR 1269; [2002] 1 All ER 979
Mediterranean Salvage and Towage Ltd v Seamar Trading and Commerce Inc [2009] EWCA Civ 531; [2010] 1 All ER (Comm) 1, CA
Nurcombe v Nurcombe [1985] 1 WLR 370; [1985] 1 All ER 65, CA
Oxford Group v Inland Revenue Comrs [1949] 2 All ER 537, CA
Pavlides v Jensen [1956] Ch 565; [1956] 3 WLR 224; [1956] 2 All ER 518
Reed v Young [1986] 1 WLR 649; 59 TC 196, HL(E)
Whitworth Street Estates (Manchester) Ltd v James Miller & Partners Ltd [1970] AC 583; [1970] 2 WLR 728; [1970] 1 All ER 796, HL(E)
Yeatman v Yeatman (1877) 7 Ch D 210

PRELIMINARY ISSUES

The claimants, 22 of the limited partners in the first defendant, Henderson PFI Secondary Fund II LLP, sought to bring derivative claims for compensation against the second defendant, Henderson Equity Partners Ltd (the first defendant's manager), and the third defendant, Henderson Equity Partners (GP) Ltd (the first defendant's general partner), alleging that investments made and allocated by them to the first defendant were not authorised by the partnership agreement or by the management deed and that the second and third defendants were in breach of their obligations to the claimants under the management deed and partnership agreement. Teare J ordered the determination of three preliminary issues: (1) whether the claimants were entitled to a declaration that pursuit of derivative claims against the second and third defendants would not constitute taking part in the management of the partnership business for the purposes of section 6(1) of the Limited Partnerships Act 1907, such that the claimants' liability for the debts and obligations of the partnership would remain limited to the extent of each of their commitments to the partnership; (2) subject to the court having granted such a declaration, whether the claimants were entitled to pursue the claims as derivative claims against the manager and general partner of the partnership; and (3) subject to the court having granted such a declaration, whether the claimants were entitled to be indemnified out of the partnership's assets in respect of the legal costs of such claims.

The facts are stated in the judgment.

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A *Iain Milligan QC* and *Emily Wood* (instructed by *Asburst LLP*) for the claimants.

Any cause of action under the management deed belongs to the partnership, namely all of the partners jointly, not the limited partners severally: see *Inversiones Frieira SL v Colyzeo Investors II LP* [2012] Bus LR 1136.

Derivative claims are not limited to the corporate context; they also arise B in other contexts where the justice of the case so demands and where there are special circumstances warranting a departure from the usual rule that the party in whom the cause of action vests must bring the claim: see *Roberts v Gill & Co* [2011] 1 AC 240; *Watson v Imperial Financial Services Ltd* (1994) 111 DLR (4th) 643; *Wallersteiner v Moir (No 2)* [1975] QB 373; *Waddington v Chan Chun Hoo* [2009] 4 HKC 381; *Hayim v Citibank NA* [1987] AC 730 and *In re Field, decd* [1971] 1 WLR 555. What matters is C that the person seeking to pursue the derivative claim has a legitimate interest in the relief claimed sufficient to justify bringing proceedings to obtain it: see *Waddington v Chan Chun Hoo* [2009] 4 HKC 381.

The cause of action against the general partner and manager is vested in the partnership as a whole in circumstances where, under the Limited Partnerships Act 1907 and the restated partnership agreement, only the D general partner can institute proceedings on behalf of the partnership but cannot or will not do so. Justice therefore requires the claimants to bring a derivative action in the name of the partnership against the general partner and manager. The existence of alternative remedies did not debar or militate against the claimants' entitlement to bring a derivative claim.

If derivative claims are pursued the claimants should be indemnified out of the partnership's assets in respect of legal costs incurred in the pursuit of E those claims: see *Wallersteiner v Moir (No 2)* [1975] QB 373.

Robin Dicker QC and *Jeremy Goldring* (instructed by *Clifford Chance*) for the defendants.

A limited partner cannot take part in the management of the partnership business, has no power to bind the firm and so no authority to commence proceedings on its behalf: see *Inversiones Frieira SL v Colyzeo Investors II* F *LP* [2012] Bus LR 1136. A derivative claim constitutes taking part in the management of the partnership business and would be prohibited by section 6(1) of the Limited Partnerships Act 1907 and the partnership agreement. Allowing a derivative claim would undermine and subvert the basis of the commercial deal into which the parties had entered in accordance with the statutory framework. The limited partners can bring G proceedings in the ordinary way, through a substitute general partner. In pursuing litigation against the manager, the limited partners would be taking a role which would be performed by a board of directors of a company rather than its members: see *In re Market Wizard Systems (UK) Ltd* [1998] 2 BCLC 282 and *Comr for Corporate Affairs v Bracht* (1988) 7 ACLC 40.

Claims on behalf of limited partners against a third party are different in principle from derivative claims permitted on behalf of members of H companies or beneficiaries of trusts: see *Foss v Harbottle* (1843) 2 Hare 461 and *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)* [1982] Ch 204. The court has permitted beneficiaries of private trusts to sue third-party debtors in place of the trustee: see *Hayim v Citibank NA* [1987] AC 730 and *Roberts v Gill & Co* [2011] 1 AC 240. However, relief will only be

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permitted in special or limited circumstances: see *Cinematic Finance Ltd v Ryder* [2012] BCC 797.

The potential for future litigation involving the general partner and manager is part of the contractual framework inherent in the partnership agreement. The general partner does not owe any separate or additional duties to the partnership which could give rise to any distinct claim. Whilst it is open to each of the limited partners to bring claims against the general partner alleging breach of contract, there is no separate claim "on behalf of the partnership". There is no fidicuiary duty owed to "the partnership" and the fiduciary duties alleged are inconsistent with the terms of the partnership agreement. If derivative claims are pursued, the costs of those claims should be dealt with in the usual way: see *McDonald v Horn* [1995] ICR 685 and *Smith v Croft* [1986] 1 WLR 580.

Milligan QC and *Wood* replied.

The court took time for consideration.

16 November 2012. **COOKE J** handed down the following judgment.

Introduction

1 I have to determine ten preliminary issues, the form of which has been agreed between the parties, following an order by Teare J in respect of the first three, which relate to the question whether the claimants can bring a derivative action against the defendants and, if so, the effect of it. The balance relate to issues of construction of two agreements, with reference to a third document, which are said to govern the relationship between the parties and the conduct of the limited partnership which is central to the dispute between them.

2 The firm named as the first defendant is a limited partnership regulated by a partnership agreement dated 12 September 2006, as amended and restated on 19 September 2006 and by the Limited Partnerships Act 1907. It was established to invest in private finance initiative ("PFI") and public private partnership ("PPP") concession companies. (It is referred to in this judgment as "the partnership" or as "Fund II".)

3 The claimants are 22 of the 29 limited partners in the partnership, all of which administer or are trustees of substantial pension or investment funds. Fund II is a private equity fund, only available to sophisticated institutional investors. The claimants invested in the partnership as limited partners, with partnership capital and loan capital under a partnership agreement, which, in its original form dated 12 September 2006 with the general partner and two founding partners in the Henderson group, was registered under sections 5 and 6 of the 1907 Act the following day. The third defendant is the general partner and the second defendant the manager appointed by the general partner, on behalf of the partnership, under a management deed dated 14 September 2006. The partnership was expected to last for at least ten years, with the possibility of seven annual extensions thereafter (although there are provisions for earlier termination).

4 In December 2006 the manager (who had identified the potential for such an investment in November 2005) caused Fund II to acquire equity interests in the subsidiaries of John Laing plc ("Laing plc"). Laing plc was a

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large public company whose shares were listed on the London stock exchange. It was the holding company for a group (the "Laing group"), which specialised in projects arising out of the PFI, and as such owned a portfolio of shares in numerous operational and non-operational PFI concession companies. The group also included other infrastructure assets such as Chiltern Railway Co, a rail franchise, and a minority stake in Octagon Group Ltd ("Octagon"), a house builder. Fund II had been established to take advantage of the investment opportunity in the Laing group, although, because of the requirements of the takeover code, the manager was forbidden to identify the target to potential investors. The fund acquired the whole of the issued, and to be issued, share capital of Laing plc for £1,004m by way of scheme of arrangement. The acquisition was actually made by Henderson Infrastructure Holdco Ltd ("HIH") which was funded by a loan from West LB of £220m, £288m approximately from another limited partnership (Fund I), £530m approximately from Fund II and some £2·75m from co-investment funds.

5 In return for its contribution to the funding of the acquisition, Fund II was to receive part of the revenue derived from part of the businesses of Laing plc. In particular the PFI concession agreements were expected, with their indexed linked payments, to produce a good return for onward transmission through the complex structure of the arrangements to the partners.

6 Among the claims made by their amended particulars of claim, the claimants claim that neither the investment in Laing plc nor the way in which the benefits and burdens of the investment were allocated to Fund II (as compared with a parallel fund, Fund I) were authorised by the restated partnership agreement or by the management deed. The construction issues relate to these two instruments.

7 Commitments to Fund II were solicited by a draft private placement memorandum dated 8 December 2005 ("the draft PPM") which was circulated by the manager with a draft of the partnership agreement and a blank deed of adherence. Commitments were made by undated deeds of adherence executed between 7 December 2005 and August 2006 and addressed to the manager and the general partner. By virtue of clause 1 of the deed of adherence the manager had the right to accept the commitment and to admit the applicant to the partnership.

8 On 19 September 2006 (i) the amended and restated limited partnership agreement was executed, with minor revisions which are not material to the preliminary issues ("the RPA"); (ii) Henderson informed investors that the condition, to which clause 1 of the deeds of adherence referred, had been fulfilled and of the acceptance of their deeds of adherence, with the result that each investor became party to the RPA by virtue of clause 1 of the deeds of adherence and clause 2.1 of the RPA; (iii) the final version of the PPM was issued to the investors; the only difference between it and the draft was the omission of the paragraph stating that no investment decision should be made on the basis of the draft PPM; (iv) Henderson revealed for the first time that the investment it was about to make on behalf of the partnership entailed the purchase of the entire issued and to be issued share capital of Laing plc; and (v) HIH announced that it would make a cash offer of £886·9m for the shares in Laing plc.

9 By reason of a rival bid, it was not until 22 December 2006 that the takeover was concluded at an increased price of £1,004m.

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The claims

10 The claimants' fundamental allegation is that the manager and the general partner did not cause Fund II to invest in a portfolio consisting exclusively or principally of PFI concession companies, as they say it was required to do, but instead used the capital advanced by investors to acquire a corporate group, which included substantial quantities of assets which fell outside that definition.

11 The claims based on the claimants' fundamental allegation, fall into three main groups:

(i) Claims for compensation against the manager: all 22 of the claimants allege that the manager's involvement in the investment in Laing plc caused the manager to breach its obligations under the management deed. It is said that these claims, which are to be advanced by the claimants solely as "*derivative claims*" on "*behalf of the partnership*", will be advanced only if the claimants obtain declaratory relief excluding or limiting their liability in respect of the partnership's debts and they are permitted by the court to advance such claims.

(ii) Claims for compensation against the general partner: the claimants allege that the general partner's involvement in the investment in Laing plc caused it to breach the obligations it owed under the RPA and other obligations said to arise in equity. These claims are to be advanced by 20 of the claimants individually (called "personal claimants") and will also be advanced by all 22 of the claimants as "*derivative claims*" on "*behalf of the partnership*", but only if the claimants obtain declaratory relief excluding or limiting their liability in respect of the partnership's debts; and they are permitted by the court to advance such claims.

(iii) Claims for compensation against the manager arising out of alleged misstatements in the draft PPM: all 20 of the personal claimants seek damages said to arise out of alleged misstatements in the draft PPM. Only the first eight claimants (called "misrepresentation claimants") assert however that they were in fact misled.

12 The present hearing is concerned with the first and second types of claims only. The claimants together make up about 83·52% of the total amounts that were committed to the partnership but they are all limited partners, with the restrictions placed upon them by the 1907 Act.

13 The Limited Partnerships Act 1907 provides:

> "3. *Interpretation of terms*
>
> "In the construction of this Act the following words and expression shall have the meanings respectively assigned to them in this section, unless there be something in the subject or context repugnant to such construction—'Firm', 'firm name', and 'business' have the same meanings as in the partnership Act 1890: 'general partner' shall mean any partner who is not a limited partner as defined by this Act.
>
> "4. *Definition and constitution of limited partnership*
>
> ". . . (2) A limited partnership . . . must consist of one or more persons called general partners, who shall be liable for all debts and obligations of the firm, and one or more persons to be called limited partners, who shall at the time of entering into such partnership contribute thereto a sum or sums as capital or property valued at a stated amount, and who shall not

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A be liable for the debts or obligations of the firm beyond the amount so contributed."

"6. *Modifications of general law in case of limited partnerships*

"(1) A limited partner shall not take part in the management of the partnership business, and shall not have power to bind the firm:

"Provided that a limited partner may by himself or his agent at any B time inspect the books of the firm and examine into the state and prospects of the partnership business, and may advise with the partners thereon.

"If a limited partner takes part in the management of the partnership business he shall be liable for all debts and obligations of the firm incurred while he so takes part in the management as though he were a general C partner.

"7. *Law as to private partnerships to apply where not excluded by this Act*

"Subject to the provisions of this Act, the Partnership Act 1890, and the rules of equity and of common law applicable to partnerships, except so far as they are inconsistent with the express provisions of the last mentioned Act, shall apply to limited partnerships." D

14 It is clear therefore, that in the ordinary way, the limited partners cannot sue a third party in the name of the partnership. Only the general partner can do that, since the commencement, conduct and settlement of proceedings is part of the management of the partnership. Should a limited partner take such a step, the effect would be as set out in the third sub-paragraph of section 6(1). Here, the claimants wish to sue the general E partner and a third party, the manager, which is a sister company of the general partner (and was required to be such, by the terms clause 5.1 of the RPA) and to do so by way of derivative action in the name of the partnership without potential liability either for the debts of the partnership or for the costs of the derivative actions.

15 The first three issues for determination are as follows:

F "1. Are the claimants entitled to a declaration that pursuit of the derivative claims (in para 89 of the particulars of claim) will not constitute taking part in the management of the partnership business for the purposes of section 6(1) of the Limited Partnerships Act 1907, such that the claimants' liability for the debts and obligations of the partnership would remain limited to the extent of each of their G commitments to the partnership (alternatively that any unlimited liability of the claimants is restricted to the debt and obligations incurred as a result of or in connection with pursuit of the derivative claims (viz legal costs))?

"2. Subject to the court having granted the relief referred to in para 1, are the claimants entitled (or are they to be permitted) to pursue the claims in para 89 of the particulars of claim as derivative claims against H the manager and general partner on behalf of the partnership?

"3. Subject to the court having granted the relief referred to in para 1, are the claimants to be granted a costs order that they be indemnified out of the partnership's assets in respect of the legal costs of the derivative claims?"

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16 The preliminary issues of construction are as follows:

"4. Did the investment in John Laing plc breach the obligation on the manager (under para 1 of schedule 2 to the management deed) to manage the investments, money, assets and borrowings of the partnership on the basis that the partnership's investment objective was as set out under the 'Investment strategy and objectives' on p 15 of the private placement memorandum, for the following reason: that the assets and liabilities of John Laing plc were not a portfolio of investments in, or at least principally in, operational PFI concession companies?

"5. Does the proviso in para 1 of schedule 1 of the partnership agreement require the test in sub-paras 1(a)(b)(c) of that paragraph to be applied on a 'look through' basis to each of John Laing plc's individual PFI projects or to assets which are not PFI projects or to the investment in John Laing plc itself?

"6 & 7. Did the investment in John Laing plc fall outside the final bullet of schedule 2 to the RPA because, while that investment included investments in operational concession companies and pre-operational concession companies, and occurred during the commitment period: (a) it was not an investment principally in operational PFI concession companies; (b) it was not an investment principally in PFI concession companies; (c) it included investments in assets other than operational PFI concession companies, which investments were not ancillary to the investments in operational PFI concession companies; or (d) it included investments in assets other than PFI concession companies, which investments were not ancillary to the investments in PFI concession companies?

"8. Was the acquisition debt a borrowing within clause 5(3)(g) of the RPA?

"9. Would it make any difference to the outcome of the preliminary issues of construction referred to above if any or all investors knew or suspected in advance of the transaction being announced that the investment opportunity was John Laing plc?

"10. If the answers to any of the issues in paras 4, 6 or 8 above is 'yes' or the answer to the issues in paras 5 or 7 is 'no', are the general partner and the manager entitled to the benefit of the exculpation in clause 18.1 of the RPA and/or the indemnity in clause 18.2 of the RPA (subject to any arguments that the claimants raise in respect of fraud, wilful misconduct, bad faith reckless disregard or negligence on the part of the general partner and the manager or, in the case of the manager only, in respect of the breach of any duty it may have, or any liability it may incur, to the partnership or any investor under the regulatory system (as defined in the Financial Services Authority (FSA) rules) applicable to it under the Financial Services and Markets Act 2000)?

"11. If the answer to question 10 is 'yes' in respect of the indemnity, are the general partner and the manager entitled to the benefit of the indemnity in clause 18.2 of the RPA with retrospective effect and in priority to any indemnity that the claimants might be awarded pursuant to para 1(c) of the order of Teare J dated 27 January 2012."

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The derivative claims and the effect of pursuing them

17 It is first necessary to explore the nature of a derivative claim. The classic example is that of the minority shareholder who seeks to bring a derivative claim on behalf of a company against wrongdoers who are in control of the company. The classic expression of the rationale behind the procedure is Lord Denning MR's dictum in *Wallersteiner v Moir (No 2)* [1975] QB 373, 390:

> "suppose [a company] is defrauded by insiders who control its affairs—by directors who hold a majority of the shares—who can then sue for damages? Those directors are themselves the wrongdoers. If a board meeting is held, they will not authorise the proceedings to be taken by the company against themselves. If a general meeting is called, they will vote down any suggestion that the company should sue themselves. Yet the company is the one person who is damnified. It is the one person who should sue. In one way or another, some means must be found must be found for the company to sue. Otherwise the law would fail in its purpose. Injustice would be done without redress."

18 It is common ground that derivative claims are not limited to the corporate context. They can arise in other circumstances where the justice of the case demands it, such as where a beneficiary sues to enforce the cause of action vested in a trust or where a legatee under a will seeks to enforce a cause of action vested in the estate. There is however a need for "special circumstances" to justify a derivative action. What matters is the person seeking to pursue the derivative action has a legitimate interest in the relief claimed, sufficient to justify him in bringing the proceedings to obtain it. It is agreed that there is no example in English law of a claimant limited partner seeking to pursue a derivative claim on behalf of a limited partnership, but the claimant submits there is no reason in principle why such a claim should not be made provided that there are special circumstances which would warrant a departure from the usual rule that the party in whom the cause of action vests must bring the claim. There is an example of such a claim which was accepted by the Court of Appeal of British Columbia in *Watson v Imperial Financial Services Ltd* (1994) 111 DLR (4th) 643, where the general partner was conflicted and the limited partners were allowed to bring a claim. Since the point of principle was not however argued, the decision is of no real assistance.

19 Both parties focused on the decision in *Roberts v Gill & Co* [2011] 1 AC 240, where a beneficiary of an estate sought to bring a derivative action on the part of the personal representatives of the estate against two firms of solicitors who had given advice to them.

(i) The Supreme Court held that a beneficiary under a will could only bring a derivative action if the circumstances of the case were sufficiently special to make it just for the beneficiary to have the remedy rather than the personal representatives. The judgments make it clear that the firms of solicitors did not owe duties in the circumstances to the beneficiary, who therefore sought to bring a derivative action in his own name on behalf of the estate against the third party.

(ii) Lord Collins of Mapesbury JSC, at para 22, described the action as "a derivative action in which the beneficiary stands in the place of the administrator and sues in right of the estate, and does not enforce duties

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owed to him rather than to the administrators". He found that there was a need for special circumstances before the court would countenance a derivative action. The other members of the court agreed. Derivative actions were not confined to the mismanagement of companies, which is now provided for by statute.

(iii) Lord Walker of Gestingthorpe JSC stated that the unifying factor in what is special is the need for a derivative action in order to avoid injustice. A beneficiary might be able to bring a derivative action, standing in the place of the trustee where a trustee may have committed a breach of trust or was involved in a conflict of interest and duty if the remedy was necessary to avoid injustice. The derivative action is brought in representative form (see CPR r 19.6) and the entity, in whose right the proceedings were brought, has to be joined as a defendant in order for it to be bound by and receive the fruits of any judgment. Joinder has a substantive basis also, since the beneficiary has no personal right to sue and sues on behalf of the estate or trustee as the case may be.

(iv) Whilst the category of "special circumstances" has never been defined and is not closed, Lord Walker JSC made it plain that, whilst in a non-company situation, there was no need to obtain the prior permission of the court to bring a derivative action, the claimant has to plead the special circumstances which entitled him to the court's indulgence. Those special circumstances are part of the cause of action.

20 In *Lewin on Trusts*, 18th ed (2008) the authors state that a derivative action is one in which the beneficiary stands in the place of the trustees and sues in right of the trust and does not enforce duties owed to him personally, rather than to the trustees. A beneficiary can bring a derivative action only in special circumstances,

> "for example circumstances which tend to disable the trustees from suing (as where their acts and conduct with reference to the trust fund are impeached), or circumstances rendering it difficult or inconvenient for the trustees to sue, as where there is a conflict between their interest and duty. Special circumstances are not confined to circumstances of these kinds": para 43-05.

The special circumstances/conflict of interest

21 In the present case the only relevant plea is the conflict of interest which is said to arise on the part of the general partner who in practice cannot or will not sue itself or the manager which is a sister company. Clause 5.1.1 and 5.1.2 give rise to this inescapable conflict of interest, to which all the limited partners agreed.

22 The claimants say that it is not necessary for the general partner here to be acting in breach of duty in failing to sue the manager. It is enough that there is a conflict of interest where the reality is that the general partner will not sue the manager and cannot or will not sue itself.

23 It is common ground that, in order to bring a derivative claim, the claimants, as limited partners, must be seeking to pursue a course of action which is vested in an entity or individuals other than themselves. Otherwise there is no need for such an action at all. The claimants maintain that the cause of action against the general partner and the manager are both vested in the partnership as a whole in circumstances where, under the 1907 Act

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and the RPA, only the general partner can institute proceedings on behalf of the partnership but cannot or will not do so. Justice therefore requires, in the claimant's submission, that the claimant should be entitled to bring a derivative action in the name of the partnership against the general partner and manager.

The derivative claim against the general partner

24 The defendants submit that there is a significant difference between, on the one hand, the derivative claims that the claimants wish to bring against the general partner and, on the other, the claims that they wish to bring against the manager. The claim against the general partner is made under the RPA whereas that made against the manager is made under the management deed. There is no bar to the claimants pursuing the general partner under the RPA in their individual capacities, as 20 of them are currently doing. This constitutes an inter partner dispute of a kind with which the courts are familiar, albeit in this case it is a dispute between limited partners and a general partner in a limited partnership governed by the RPA (to which they are all parties) and the 1907 Act.

25 The management deed, by contrast, was concluded by the general partner on behalf of the partnership with the manager in the name of the partnership. Clause 1.1 provides:

> "The partnership hereby appoints the manager to be the manager of the partnership with full power and authority (subject to the following provisions of this deed) to act as manager of the partnership, including for the avoidance of doubt the exercise of all of the powers expressed to be granted to the manager pursuant to the partnership agreement, and as such manager to manage the partnership to the total exclusion of any other person and the manager hereby agrees with the partnership to act as such manager and to accept and carry out such management responsibilities and duties otherwise imposed by the partnership agreement on the manager of the partnership."

26 It is undisputed that any claim against the manager is a partnership asset, owned jointly by the partners. Under the provisions of section 6(1) of the 1907 Act and clause 5.2 of the RPA, which reinforces the statutory provision, no limited partner could, on behalf of the other partners and so as to bind them, sue the manager, which is a third party. Only the general partner can manage the business of the partnership and its assets. Only the general partner has the right to act for the partnership in external relations in such a way as to bind the partnership and therefore to bring proceedings against the manager. If the general partner will not do so, and here, under the arrangements made, because the manager is its sister company, with a resulting conflict of interest for the general partner, there is in reality no way a suit can be brought by the partnership, unless a new general partner is brought in who will pursue that cause of action, or the court permits a derivative suit of some kind by limited partners in the name of the partnership.

27 The defendants say that a derivative action should not be permitted however, since the claimants have all agreed to the structure of the partnership, under the provisions of the 1907 Act and the RPA, with their restrictions on the role of the limited partners (and concomitant tax benefits

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from the use of such a limited partnership as an investment vehicle) and since they are in a position to remove the general partner by a 75% majority vote and appoint another, they can bring proceedings in the ordinary way through a substitute general partner (assuming that the substitute is willing to do so).

28 The partnership, unlike a limited company, does not possess a corporate legal personality. Like an ordinary partnership under the 1907 Act, "the partnership" is simply a convenient way of referring to the body of partners as a whole. In my judgment therefore, no difficulty arises for a limited partner's claim against the general partner, regardless of whether or not removal and substitution of the general partner is possible. The claim to be made against the general partner is that of the individual limited partners and is not a partnership asset. Each limited partner has its own contractual or fiduciary claim for its own loss, where the inter-relationship with the general partner is governed by the RPA. The partnership, which consists of the limited partners and the general partner together has no form of joint right or claim against the general partner, as the claimants suggest.

29 The claimants draw attention to various provisions in the RPA which refer to the partnership as such, when elsewhere there is reference to a partner or partners and to investors (defined as any person who becomes a limited partner by signing a deed of adherence and any successors). The partnership does not have any legal personality, being made up of the partners themselves, including the general partner. Outside entities may contract with the partnership, but all that means is that, in the case of an ordinary partnership, all partners are liable on the contract. In the case of a limited partnership, only the general partner is liable, but that does not affect the nature of the partnership, which is a legal relationship between the partners themselves.

30 None of the provisions of the RPA, in any event, provide for the general partner to be liable to the partnership as a whole, even if that were possible. The obligations set out in schedules 1 and 2 and in clause 6, which are expressed to be partnership obligations, bind the general partner to invest on behalf of the partnership in accordance with those provisions, but do not create any rights in any entity which is separate from the individual limited partners, nor create some sort of joint right on the part of the partnership as a whole against one of its partners. Likewise, clause 5.1.1 and clause 5.3 merely give the manager duties and powers to act on behalf of the partnership in such a way as to bind it in the respects there set out. Clause 16.3.6 allows a limited partner to sue the partnership in debt for an outstanding loan, meaning, as the sub-clause makes clear that it is repayable out of partnership assets alone. Clause 16.3.2 provides however that the general partner shall not be personally liable on that debt, so that the individual partner would sue the other partners for repayment, pursuing the general partner in the name of the partnership. "The partnership" is used as a convenient shorthand for the body of partners, as it is in clause 18.1. The reference in clause 6.4.3 to "the partnership" and to "the investors" is of no assistance to the claimants in their contention, since the distinction appears to be made in the context of removal of the general partner, which requires investor consents in differing percentages, depending on the reason for removal.

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A 31 The general partner can therefore be sued by any limited partner in respect of its liabilities under the RPA and there is no suggestion that this involves management of the partnership business; nor could any such suggestion sensibly be made.

32 In these circumstances, there is simply no need and no room for a derivative action on the part of the claimants against the general partner. Each can sue for its own loss on its own claim, without reference to the losses
B of other limited partners who have chosen not to make such a claim. Why the claimants should wish to pursue a derivative claim is a matter of speculation, but there is no reason why they should represent other limited partners who do not wish to be represented nor obtain any protection in costs or exemption from any obligation there might be to indemnify non-consenting partners against any loss suffered by them from the bringing
C of proceedings in their name.

33 The claimants further submit that if an individual limited partner were to succeed in a claim against the general partner, without a derivative claim on behalf of the partnership as a whole against it, a difficulty would arise in respect of recoverable losses, if, as they submit, a derivative claim can be brought against the manager. The partnership would not be able to give credit in any claim against the manager for any recoveries by a limited
D partner against the general partner. In my judgment this is unreal. There is no problem of the kind to which reference is made in *Johnson v Gore Wood & Co* [2002] 2 AC 1, 62, where the shareholder is not entitled to recover for his reflective loss and the company itself alone recovers to the exclusion of the shareholder. If a derivative claim against the manager is allowed, any recoveries made by the partnership will redound to the benefit of the
E individual partners and diminish the loss suffered by each as a result of any breach by the general partner. There can be no element of double recovery and the issue is simply a function of the order in which proceedings take place, assessment of damages occurs and recovery is made, which is a matter which the court can control and upon which the parties can make submissions.

F *The derivative claim against the manager*

34 The claim against the manager is however a partnership asset and, it is recognised, could not be pursued by any of the claimants individually. If the claim is to be pursued against the manager for breach of the duties governed by the management deed, either the general partner must sue in the name of the partnership, or it must be replaced by a new general partner who
G will sue, or a derivative action must be permitted.

35 As this action is not in the company context, there is no requirement for permission to bring such a derivative claim but, equally, this is not a strike out application by the defendants. The question of entitlement to bring such a derivative claim is before this court as a preliminary issue to be determined on the materials available to the court. It is in this context
H therefore that the court has to consider whether or not there are "special circumstances" which would justify the bringing of the claim in the context of the alternative rights and remedies available to the claimant.

36 The question then arises as to whether or not the merits of the claim should feature in the court's assessment. The decision of Newey J in *Kleanthous v Paphitis* [2012] BCC 676, paras 39–42 is authority that there is

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no merits threshold for the granting of permission under section 261 of the Companies Act 2006. In that case it was submitted that the claimant should show a strong case before being granted permission but the judge, referring to an earlier decision of Roth J and the Law Commission's report upon which the 2006 Act was to a considerable extent based (*Shareholder Remedies* (1997) (Law Com No 246) (Cm 3769)), concluded that there should be no threshold test on the merits. He none the less accepted that the merits of the claim would be relevant to the granting of permission but without any set threshold.

37 In my judgment, in the context of a preliminary issue of the kind with which I am concerned, merits can play little part unless the merits are very strongly in favour of one party or the other. If the claimant had no realistic prospects of success, it could be said that there were no special circumstances which would justify the bringing of the derivative claim. If the merits were strongly in favour of the claimant, this would be a factor forming part of the assessment of special circumstances and the root question of whether injustice would be caused if no derivative claim was allowed.

38 Whilst I have to determine a number of preliminary issues, there remain other questions, such as allocation of the Laing plc business between Fund I and Fund II which are not to be determined and where it cannot be said, at this stage, that the case of one party or the other is so strong that it plays a part in the decision on special circumstances.

39 The existence of an alternative remedy to the derivative claim is plainly a factor to be taken into account when deciding whether there are special circumstances. The existence of such a remedy is not however conclusive of the matter. Judge Keyser QC sitting as a deputy judge so held in *Hughes v Weiss* [2012] EWHC 2363 (Ch) at [58]–[62], by reference to earlier first instance decisions under the law preceding the 2006 Act, contrary to a dictum of Peter Gibson LJ in *Barrett v Duckett* [1995] 1 BCLC 243, 250. Section 263(3)(f) of the 2006 Act makes the existence of an available remedy a factor to be taken into account in the exercise of the court's discretion on the grounds of permission. In the context of a non-company derivative action, this must now be the correct approach. In *Lewin on Trusts*, 18th ed, paras 43-04, 43-05, there is no suggestion that the ability of a beneficiary to apply for the removal of trustees or for an administration action would constitute a bar to any claim but self-evidently the availability of such remedies impacts upon the question of special circumstances which might justify the bringing of the derivative action.

40 Under clause 16.1 of the RPA, the removal of the general partner pursuant to clause 6.4 results in the automatic termination of the partnership. Under clause 6.4.2,

> "Investors between them holding at least 75% of the total commitments may, by resolution at a meeting . . . remove the general partner provided that such removal shall also be approved by an investors special consent, without prejudice to the rights of the general partner to compensation in an amount of twice the general partner's share in respect of the accounting period immediately prior to the accounting period that termination occurs."

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41 Under clause 16.2, a termination of the partnership under clause 16.1(d) gives rise to a reconstitution of the partnership.

> "If the partnership would otherwise be terminated . . . the partnership shall be reconstituted and its business continued . . . in the case of a termination pursuant to clause 16.1(d), pursuant to an investors special consent electing to continue the partnership and electing a new general partner, which consent must be obtained within 60 days after all partners have been notified of the event of termination, whereupon the existing general partner shall cease to be the general partner."

Contrary therefore to a submission made by the claimants, the effect of such a termination and appointment of a new general partner would be to vest the claim against the manager in the reconstituted partnership which the new general partner could then pursue in the name of the partnership. The phrase "and its business continued" is not capable of any other meaning.

42 The claimants submit however that this is not an adequate remedy and that the existence of this alternative remedy does not debar or even militate against their entitlement to bring a derivative claim. The fact that a beneficiary could bring proceedings to remove or replace a trustee does not bar the beneficiary from pursuing a claim by way of derivative action. Nor does the fact that the beneficiary/legatee could have commenced an administration action to compel the trustees/personal representatives to sue. None the less these are factors to bear in mind in the context of deciding whether or not there are "special circumstances" which justify the bringing of the derivative claim.

43 The claimants here however, in the form of the third witness statement of Mr Sparrow, have produced evidence that there was not and is not, in fact, a 75% majority of investors (by commitment size) willing to exercise the powers set out in clause 6.4.2 to remove the general partner. At an early stage in the preparation of the proceedings there was a view amongst investors, which remains a continuing view, that to replace the general partner and the manager (which would necessarily occur since the manager has to be a sister company of the general partner and one authorised to conduct investments under the Financial Services and Markets Act 2000) would be expensive and might well exacerbate the losses already suffered by the partnership.

44 Mr Sparrow elaborates on this at paras 11–16 of his statement pointing out that since the partnership has so far been loss making, any new general partner who would become liable for the debts and obligations of the firm would not assume the responsibilities under the management deed without receiving a substantial reward for doing so, as well as some indemnity in respect of potential exposure on existing debts and liabilities. Moreover there would be an exposure to the outgoing general partner for the compensation referred to in clause 6.4.2 of the RPA. Additionally, a new incoming general partner would have to assess the merits of the dispute in order to determine whether it was in the best interests of the partnership to pursue the claims against the old manager and it is suggested that this could not be determined without making the very application to this court which is currently being made.

45 It is also said that the claims being made are not of mismanagement of the partnership as such, since the challenge is only to the decision to invest

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in Laing plc, the unauthorised allocation of assets and liabilities of Laing plc as between Fund I and Fund II and the extent of borrowing incurred in order to invest in Laing plc. It is said to be plainly in the best interests of the partnership that it continues to be managed by the existing manager and general partner because of the general experience of the Henderson group in managing such assets and because the partnership's investment in Laing plc, which is its only asset is held through a string of Henderson group companies, which means that, in practical terms, it would be extremely difficult, if not impossible, for an entity outside the group to gain control over the management of the assets or liabilities of Laing plc itself. The present manager is able to exercise control over Laing plc so that releasing the manager from its contractual duties to the partnership would be contrary to the interests of the partnership whilst the manager and the general partner continue to be associated with Laing plc and Fund I.

46 In general terms the claimants are not, according to Mr Sparrow, dissatisfied with the general partner and the manager's efforts to ameliorate the losses already suffered by the partnership and any transfer of responsibilities would expose the claimants to an argument that losses had been exacerbated by the transfer and the actions of the new manager.

47 These are persuasive commercial reasons for the approach of the claimants but the defendants submit that this is just a matter of commercial convenience in circumstances where the claimants as, sophisticated investors, committed themselves to the structure set out in the RPA and the 1907 Act which gave rise to very different rights. The effect of allowing a derivative claim would be to undermine and subvert the basis of the commercial deal into which the parties had entered in accordance with the statutory framework.

48 The defendants submit that the claimants should be held to the bargain that they made when concluding the RPA under the 1907 Act, whereby only the general partner can take such action against the manager; hence no derivative action should be allowed. The defendants point to the statutory scheme for limited partnerships and the difference between that and other cases where derivative actions have been permitted. There is no statutory prohibition on shareholders being directors or taking part in the management of a limited company. There is now statutory provision for shareholder derivative actions under section 260 of the 2006 Act. There is no statutory prohibition on beneficiaries or legatees taking part in the management of a trust or the administration of an estate and the court has a general supervisory power over both. There is no undermining of any statute in allowing a derivative action in such circumstances, whereas the effect of allowing it, in the case of a limited partnership is to vest, in the limited partners, the very rights which statute prevents them from having.

49 The defendants point to the scheme of the 1907 Act and the RPA with a general partner who runs the business and specifically, by clause 5.3(h) has power to conduct litigation pertaining to the partnership or any of the partnership assets. By clause 5.5(d) the general partner is given authority to represent the partnership in its dealings with the manager or in relation to the partnership assets "or in any other respect except where the power to do so is conferred on the manager under clause 5.3 or has been assumed by the manager under the earlier provisions of this clause".

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A 50 By the very terms of section 6(1) of the 1907 Act, a limited partner is not to take part in the management of the partnership business and does not have power to bind the firm, which means that the limited partner cannot act in the name of the partnership in litigation under the first paragraph of that section. In other circumstances where derivative claims have been permitted, there is nothing like section 6(1) of the 1907 Act.

B 51 Clause 5.2 of the RPA provides:

> "The limited partners shall take no part in the operation of the partnership or the management or control of its business and affairs, and shall have no right or authority to act for the partnership or take part in or in any way to interfere in the conduct or management of the partnership or vote on matters relating to the partnership other than as provided in
C the [1907 Act] or as set forth in this agreement but they shall at all reasonable times, subject to having given reasonable notice, have access to and the right to inspect during normal business hours the books of the partnership."

52 There is also no equivalent provision in other cases where derivative actions have been permitted to that set out in clause 5.2 of the RPA, which
D provides that the limited partners shall take no part in the operation of the partnership or the management or control of its business and affairs and "have no right or authority to act for the partnership".

53 The defendants submit therefore that the court cannot confer powers on the limited partner which run contrary to the 1907 Act and the terms of the RPA, or at the very least, should not do so. The quid pro quo for the restriction on the limited partners and the conferring of powers on the
E general partner is that the limited partners are not liable for the debts of the partnership whereas the general partner is. That is the whole basis upon which a limited partnership proceeds.

54 These points carry considerable weight but in my judgment do not conclude the issue. They reinforce the need for "special circumstances" before a derivative claim can be made, but if there is, in truth, no realistic
F way in which the limited partners can obtain redress against the manager, such an action may be required in order to avoid injustice.

55 The defendants point out that the claimants can pursue their personal claims against the general partner for failure to supervise the manager under clause 5.1.1 of the RPA but that is self-evidently not the same as being able to pursue the manager and the test for liability would be
G different. The general partner could be removed under the provisions of the RPA (with consequent removal of the manager) but the evidence shows that this course has such disadvantages that it is not a realistic course. If the only way to hold the manager to account is by disposing of the general partner (and consequently the manager itself) an injustice may be perpetrated, since huge losses may follow in addition to those currently suffered. As the claimants submit, there is an irremediable conflict of interest between
H the general partner and the manager and the fact that this is built into the architecture of the partnership, both by contract and statute, is, in the end, nothing to the point.

56 What is more, section 6(1), in one sense, does not provide an absolute prohibition on a limited partner taking part in the management of

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the partnership business because the third sub-paragraph of the section expressly provides for what happens if a limited partner does so.

57 In my judgment, it is this third paragraph that holds the key to the current situation. The limited partners are correct in saying that the irreconcilable conflict of interest experienced by the general partner means that the partnership's prospects of obtaining redress against the manager (without a change in the identity of the general partner) via the route provided for in the RPA and 1907 Act are virtually eliminated, save for the case where the manager's defaults are so self-evident and the manager can have no defence at all. There, even a sister company might feel compelled to sue. Absent such circumstances, the general partner is likely to be impervious to the "advice" of limited partners who sue the manager and redress will not be available to the partnership. It is here, of course, that the merits of any claim against the manager come into play. As appears hereafter, there are serious arguments available to the general partner and the manager which fall to be determined in the context of the claims against them. The current general partner might consider the arguments to be well founded and replacement of the general partner by a substitute might result in a new general partner taking the same view, without the conflict of interest resulting from a sister company relationship.

58 Moreover, if the limited partners sought to sue the general partner for failure to take proceedings against the manager, the test for liability of the general partner would be different from that which would apply for determination of liability on the manager itself.

59 If the limited partners are correct in their allegations that the manager has exceeded the authority given to it in making the investments it did and/or in allocating the business that it did, a matter that can only be determined by this court after examination of the merits of the claim, then the partnership would be deprived of bringing that justified claim against the manager without removal of the general partner or being permitted to bring a derivative claim. It does not seem to me that this is just. The difficulties and uncertainties in removing the general partner have been set out above. It is, as the claimants point out, the irreconcilable conflict of interest on the part of the general partner in this limited partnership which constitutes the "special circumstance" which would require a derivative claim to be pursued. Justice requires they be able to take this step, rather than remove the general partner with all the drastic consequences that this entails.

60 Justice also requires however that regard be had to the statutory provisions relating to limited partnerships. Whilst special circumstances may exist to permit a derivative claim to be made by the limited partners in the name of the partnership, where the statute provides that they should be brought by the general partner, the statute also provides what should take place if a limited partner takes part in the management of the partnership business. In such circumstances the limited partner is to be liable for all debts and obligations of the firm incurred while he so takes part in the management as though he were a general partner.

61 In my judgment there is no doubt whatsoever that the taking of proceedings against a third party such as the manager is no different (for the purposes of the 1907 Act) from taking proceedings against any other third party engaged by the partnership, whether a solicitor, accountant, surveyor or financial advisor. The claim itself is a partnership asset and the

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partnership assets have to be managed in accordance with the 1907 Act and the RPA. If limited partners are pursuing a claim, albeit a derivative claim, standing in the place of the general partner, acting for the partnership, they will be acting in such a way as to bind the firm contrary to the first paragraph of section 6(1) of the 1907 Act and clause 5.2 of the RPA. It is self-evidently necessary for the firm to be bound if proceedings are to be commenced, conducted or settled. Commencing such proceeding is the province of the general partner in management.

62 Whilst there may be some grey areas about what might or might not constitute participation in management, the second sub-paragraph of section 6 shows just how limited the limited partner's involvement can be without so participating. In *Inversiones Frieira SL v Colyzeo Investors II LP* [2012] Bus LR 1136, 1147, 1150, Norris J drew attention to the proviso in the second paragraph of section 6(1) which allows for a limited partner to inspect the books of the firm, examine the state and prospects of the partnership business and "advise" with the partners thereon. Such activity will not constitute participation in the management of the partnership business. Norris J points out at p 1150E that, having obtained information about the partnership's affairs, a limited partner who examines and analyses the material and confers with other limited partners does not thereby become involved in the management of the partnership. An expression of a view to the general partner about the performance of the partnership, or the strategy or future direction of the partnership, or even a preference about how a particular asset should be dealt with equally does not constitute management. As soon however as there is participation in the decision making process by requiring notice of individual decisions and the ability to make representations about individual decisions, scrutinising and commenting upon the operational business decisions taken by the general partner, the limited partner will be involved in management. There are potentially grey areas no doubt but the conducting of litigation on the part of the partnership is not one of them.

63 It is nothing to the point that the claim against the manager is that the manager has exceeded its authority. That does not prevent management of the partnership asset, in the shape of that claim, being management of the partnership business. It is the making of the claim which matters, not the basis upon which it is made. Moreover the general partner's conflict of interest cannot affect the question as to whether or not the making of the claim is management for this purpose.

64 I was referred to the 2001 Law Commission consultation paper on the 1907 Act and the draft Bill produced in consequence: *Limited Partnerships Act 1907: A Joint Consultation Paper* (2001) (Law Com No 161). The consultation paper contains a discussion on what constitutes "management" and draws attention to the position in other jurisdictions, in some of which a limited partnership constitutes a separate legal personality. In the consultation paper, the suggestion is made that the "ordinary matters" of the business should be equated with "management" and that limited partners should not be precluded from participating in decisions on "extraordinary" matters such as a change in the nature of the business or the structure or organisation of the partnership. It is suggested that specific protection might be given, as in the law of Jersey to voting and approval or disapproval of transactions in which one or more of the general partners has

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an actual or potential conflict of interest with one or more of the limited partners. The paper concludes that clarification is required in respect of certain classes of decisions, namely whether or not they constitute management. The draft Bill, in schedule 6 provided that the enforcement of rights under the partnership agreement should be open for a limited partner "unless those rights are to carry out management functions". Equally, taking part in a decision which involves an actual or potential conflict of interest between a limited partner (or limited partners) and a general partner, should be permitted.

65 Not only has nothing been done about the consultation paper or draft Bill in the years since they were produced but nothing in those documents could touch the position which obtains here. Whereas the pursuit of a dispute between partners, whether limited or general, is self-evidently not management of the partnership business, a claim against a third party, such as the manager plainly is.

66 In the current circumstances which are special enough to give rise to a derivative claim, it follows, in my judgment that the claimants, if they choose to pursue that claim, take part in the management of the partnership business and therefore are liable in accordance with the third sub-paragraph of section 6(1) of the 1907 Act.

67 This gives rise to a further dispute between the parties since the claimants submitted that the wording of the third sub-paragraph—"shall be liable for all debts and obligations of the firm incurred while he so takes part in the management as though he were a general partner", did not have a temporal meaning. It was submitted that the words required a connection between the debts and obligations incurred and the actions actually taken. The contrary, it was said, would give rise to arbitrary and unworkable results. It would be very difficult to work out when a limited partner took part in management, if he did a number of isolated acts, and to ascertain the period during which debts were incurred for which he would be liable if the temporal criterion was correct.

68 In my judgment the meaning of the third paragraph of section 6(1) is plain. The words "while he so takes part in the management" self-evidently have a temporal connotation, whatever factual inquiry may be necessitated by the application of the test. The underlying rationale of the sub-paragraph is that, if a limited partner chooses to act as if he were the general partner in a limited partnership, he is to be treated like a general partner in that period in which he does so. He thus becomes liable for all the debts and obligations for which the general partner is liable during the period in which he so acts. The contrary to my mind is untenable.

69 Section 9 of the Partnership Act 1890 (53 & 54 Vict c 39) provides that every partner of a firm is liable jointly with the other partners for all debts and obligations of the firm incurred while he is a partner. There is a temporal definition and although there is no equivalent for the general partner in section 4(2) of the 1907 Act, the subsection provides that the general partner is liable for "all debts and obligations of the firm", which self-evidently creates liability for obligations incurred throughout the term of the partnership. The effect therefore of the third paragraph of section 6(1) is that during the period in which the limited partner takes part in the management, the limited partner is liable in exactly the same way as the general partner for all debts and liabilities incurred by the partnership.

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70 There is self-evidently the possibility that if the limited partner takes part in management, debts may be incurred by that activity for which the general partner is rendered liable. The claimants submit that this is all that section 6(1) was intended to catch but that is not what the section provides and the underlying rationale is as I have set out, different. If the limited partner takes part in the management and seeks to bind the firm, he supplants the general partner and becomes liable as if he were the general partner.

The claim for a pre-emptive costs order

71 In *McDonald v Horn* [1995] ICR 685 Hoffmann LJ gave the lead judgment in a case where several members of a pension scheme sought to bring an action against their employers, the pension fund trustees and others, alleging breaches of trust and fiduciary duty. They applied for a pre-emptive costs order because there was no serious likelihood that they could raise funds to fight the litigation on the scale involved. At pp 695–696, Hoffmann LJ drew attention to *In re Buckton; Buckton v Buckton* [1907] 2 Ch 406, 413–415 where Kekewich J (an acknowledged master of Chancery procedure) divided trust litigation into three categories. The first consisted of proceedings brought by trustees to have the guidance of the court as to the construction of the trust instrument or some question arising in the course of administration. In such cases the costs of all parties were treated as necessarily incurred for the benefit of the estate and were ordered to be paid out of the fund. Secondly there were cases in which the application was made by someone other than the trustee but raised the same kind of point as in the first class of case and would have justified an application of that kind by the trustees. That class was to be treated in the same way as the first. Thirdly, there were cases in which a beneficiary was making a hostile claim against the trustees or other beneficiaries and that class of case was to be treated in the same way as an ordinary common law piece of litigation, with costs following the event. It was said to be difficult often to distinguish between cases in the second and third categories but, once it was determined that the issue was the rights of adverse litigants, then ordinary costs orders should follow.

72 Hoffmann LJ [1995] ICR 685, 696–697, then stated that the court might feel sufficiently confident that the case fell within the first or second categories to be able to make a prospective order that parties other than the trustees were to have their costs in any event (the pre-emptive cost order). Unless however a judge was satisfied that he would be likely to make an order that all parties' costs were to come out of the fund at the end of the day, it could not be right to make an order at an earlier stage of the proceedings. In order to grant a pre-emptive application in ordinary trust litigation or trust proceedings concerning the ownership of a fund held by a trustee or other fiduciary, the judge had to be satisfied that the judge at the trial could properly exercise his discretion only by ordering the applicant's costs to be paid out of the fund. Otherwise the trial judge's discretion would be fettered. The only circumstances in which such an order could be made in hostile litigation would be where the claimants were impecunious and, unless the litigation were funded, serious claims would never be investigated. That in itself would not be a sufficient reason for a pre-emptive order but, in

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the context of a derivative action, it was a relevant factor to the exercise of discretion.

73 It is accepted by the parties that a minority shareholder bringing a derivative action and suing as if it were a trustee suing on behalf of a fund could be entitled to be indemnified out of the assets against costs incurred by it and any costs it might be ordered to pay to the other party. Hoffmann LJ stated, at p 700, that the power to make such an order in a pension fund case should be exercised with considerable care because of the dangers in too easily making orders which allow minority shareholders to litigate at the cost of the company. If the claimants had shown a sufficient case for further investigation, there might be a case for ordering the payment of costs out of the fund up to a later point in the proceedings, such as disclosure, whereupon the position could be re-evaluated.

74 In *Smith v Croft* [1986] 1 WLR 580, 597, Walton J expressed the need to hold the balance as fairly as possible between claimants and defendants in a minority shareholders action against a company and some of its directors. He said it was incumbent on the claimants applying for an order to show it was genuinely needed inasmuch as they did not have sufficient resources to finance the action in the mean time. If they had, he saw no reason at all why the extra burden should be placed upon the company. The rationale for a pre-emptive order was to ensure that the claimant in a minority shareholder's action should not be prevented from pursuing an obviously just case through lack of funds or fear that he might, for some reason, fail at the end of the day and be at risk as to costs which he could not possibly pay. The making of such an order might turn out to have imposed on the company a liability which ought never to have been imposed, which meant that caution was required in making any such order.

75 I was referred also to the decisions of Arnold J in *HR Trustees Ltd v German; In re IMG Pension Plan* [2010] Pens LR 131 and Warren J in *IBM United Kingdom Pensions Trust Ltd v Metcalfe* [2012] EWHC 125 (Ch) where each explored the basis on which a pre-emptive costs order could be made in a pensions case, where the *Buckton* principles (see *In re Buckton* [1907] 2 Ch 406), as elaborated in *McDonald v Horn* [1995] ICR 685 were set out and applied: see *IBM United Kingdom Pensions Trust Ltd v Metcalfe* [2012] EWHC 125 (Ch) at [19].

76 In the present case, the claimants cannot and do not say that they are not in a financial position to pursue this litigation. Most of the claimants are pursuing this litigation on an individual basis, regardless of the derivative claims. If this case falls into the third category referred to by Hoffmann LJ and Kekewich J, then a pre-emptive order is out of the question. If it arguably falls into the first or second category, then a pre-emptive order should only be made if I can be satisfied that, at the end of the day, a trial judge would order that the costs be paid out of the fund. I am not so satisfied. Nor if I were exercising any residual discretion, could I see any reason to make such an order. In my judgment this plainly is hostile litigation as between the limited partners, albeit suing the manager in the place of the partnership, and the general partner, as well as the manager. The claim against the general partner and the manager are closely intertwined. There is a partnership dispute bound up with the claim against the manager. Moreover, even if the claim against the manager does not, of itself, fall into category three, I cannot say at this stage that, at the end of a

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A trial a court would be bound to find costs payable out of the fund, if the claimants failed. If their claims prove to be unfounded, there is no reason why the general partner, which is liable for all the debts and obligations of the fund should be prejudiced by the payment of the unsuccessful claimants costs out of that fund. I decline therefore to make any such pre-emptive order.

B *The relief sought in respect of the derivative claims*

77 In para 85 of the amended particulars of claim, the claimants state that they do not make and will not pursue any derivative claims unless the court makes one of two declarations. The first declaration sought is that pursuit of the derivative claims will not in and of itself constitute "taking part in the management of the partnership business" for the purposes of C section 6(1) of the 1907 Act. The alternative declaration is that, if pursuit of those claims would constitute taking part in the management of the partnership business for the purpose of section 6(1), "the unlimited liability of the claimants is restricted to the debts and obligations incurred as a result of or in connection with that action (viz legal costs)".

78 The claimants stated that they were prepared to proceed with the D derivative claims even if the declaration bound only the general partner and the manager although, in the title of the action as currently constituted, the manager is "sued on its own behalf and on behalf of all creditors of Henderson PFI Secondary Fund II LP from time to time" and the manager is also reportedly sued on the same basis. As I have decided that pursuit of the derivative claims would constitute taking part in the management of the partnership business with concomitant liability to all creditors, the E claimants are not entitled to either of the declarations sought and the question of other creditors being bound in a representative action does not rise. I am bound to say however that I see considerable difficulty in the idea that there is a common interest between the general partner and the manager on the one hand and all other creditors of the fund who might have very diverse interests in wishing to pursue the limited partners in respect of debts of the partnership, on the other. It is at this stage impossible to anticipate F what their interests might be and how they might differ from those of the general partner or the manager. Whilst at present the manager and general partner are apparently the only creditors, future creditors might have security for loans or rights of set-off which could be affected if specified limited partners were or were not exempt from liability as if they were a general partner. Without more, it is difficult to see how the words "on behalf G of all creditors" can properly be included at this stage.

79 It is, I think, common ground that the seeking of the declarations does not amount to the participation in the management of the partnership business but, regardless of whether it is or is not common ground, in my judgment it is not. The claimants raise these matters as questions of principle in ascertaining what their own rights are against the general partner and the manager and that does not constitute partnership business. H In consequence the costs of the application for these elements of relief must fall to be dealt with on the usual basis as between claimants and defendants on that footing.

80 Subject to any further submissions the parties may wish to make, it seems to me that the defendants are entitled to their costs on issues 1 and 3.

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The general partner must equally be entitled to its costs on issue 2 but the costs relating to the derivative claim against the manager have to be determined. Whilst I have held that it is open to bring a derivative claim against the manager, the claimants have said that they will not do so without one of the declarations set out in para 85 of the amended particulars of claim which I have refused to make. Moreover, even if such a claim were now to be pursued, the costs of determining the question of principle which I have decided in favour of the claimants on issue 2, as against the manager, could, at best, from the claimant's perspective fall to be assessed in the light of the ultimate success or failure of that claim and the considerations to which I have already referred in relation to determination of costs of the derivative action.

Issues of construction

81 It is common ground that the RPA can have only one meaning regardless of the fact that different parties to it may have had differing background knowledge to bring to bear. The factual matrix, according to the claimants excludes information provided by the Henderson companies to individual investors except for the draft PPM, the draft partnership agreement and the draft deed of adherence since the limited partners committed themselves to the arrangements by executing the deeds of adherence between about December 2005 and September 2006. By clause 15(d) of the deed of adherence, each limited partner warranted that the purchase of a commitment in the partnership was made on the basis of the information in the draft PPM and the draft partnership agreement and not on any other oral or written statement. Although the draft PPM said that no investment decision should be made on the basis of it, the claimants case is that, by the manager's acceptance of the deed of adherence on 1 September 2006 there was agreement that the investors could rely on the draft PPM subject to amendments.

82 It is accepted that the terms of the RPA prevail over the PPM both because para 2 of the draft PPM provided that the partnership agreement would override it and because clause 20.3 of the RPA stated in terms that, in the event of any conflict, the terms of the RPA should prevail.

83 It is accepted that the limited partners are sophisticated investors. Fund II was an unregulated collective investment scheme which was only made available to such sophisticated institutional investors. The effect of section 238 of the Financial Services and Markets Act 2000 was that it could not be promoted to the general public but could be promoted to investment professionals or sophisticated investors within the meaning of the Financial Services and Markets Act 2000 (Promotion of Collective Investment Schemes) (Exemptions) Order 2001 (SI 2001/1060). Such investors were capable of taking advice both from consultants and lawyers and many apparently did so. Several of them had previously invested in Fund I.

84 The draft PPM also stated:

> "limited partners will not be entitled to participate in the management of the fund in respect of investment or other decisions. Accordingly, investors must be prepared to entrust the management of the fund to the manager."

The document provided, in the shape of the draft partnership agreement, made it plain that the manager was to be an authorised person under the

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A 2000 Act who would manage the investment portfolio under the supervision and authority of the general partner and that it would be the second defendant.

85 The manager issued the draft PPM and it and the deed of adherence made it plain that the closing of Fund II was conditional upon the consummation of a single transaction that had been identified by the manager. Under the heading "Investment risk" the following appeared:

B

> "The fund is being established to take advantage of a portfolio investment opportunity that the manager has identified. There can be no guarantee that such investment opportunity will be successfully completed, however, prospective investors will be asked to send completed irrevocable binding deeds of adherence to the manager prior to the date that the manager will become aware of whether or not the C investment opportunity has been successful. In the event that the investment opportunity which the manager has identified is not consummated, the deeds of adherence will be returned to investors, the investors will be permanently and unconditionally released from any obligation to make a commitment to the fund and the fund will not hold a closing. If the investment opportunity is consummated, the investors' D deeds of adherence will be accepted at the discretion of the manager."

86 Investors also knew that this "portfolio investment opportunity" was on a large scale since Fund II was aiming to raise total commitments of between £350m and £500m but that these sums would not be sufficient to consummate the transaction. The draft PPM explained that additional capital would be provided by other funds and, if necessary by borrowing E money in significant amounts up to 30% of total commitments on a short term basis.

87 The portfolio investment opportunity related to Laing plc but because it was a listed company, the takeover code applied and investors could not be told its identity. Whether or not any of the claimants worked out that Laing plc was the target does not appear from the evidence but, even if they did, they would not have been able to conduct any "due diligence" F prior to being bound by their commitment and they would not know in any event whether all or part of the Laing business would be subject of the investment.

88 For the purpose of the preliminary issues I proceed on the basis put forward by the claimants, namely that there were no other sources of information beyond those to which I have already referred. It is right to G bear in mind that the RPA is the primary document governing the inter-relationship between the general partner and the limited partners, quite apart from the express agreement of the parties that it should prevail in the event of any conflict with the PPM. The PPM was not a contractual document as such although the RPA makes reference to it in specific prohibitions and it is part of the background against which the RPA falls to be construed. As a placement memorandum on a confidential basis to a H limited number of investors for the purpose of providing information about an investment in the fund, it related to the full life of the partnership, a minimum of ten years, but with specific reference to the early years also. The focus is none the less on the fund as it would be after it had been constituted.

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The relevant provisions of the RPA

89 It is necessary to set out a number of these provisions in extenso, although I shall refer to specific provisions in detail when considering each of the remaining preliminary issues. The purpose of the partnership was set out in clause 1.2 of the RPA in the following terms:

> "Without limitation the purpose of the partnership is to carry on the business of an investor and in particular but without limitation to identify, research, negotiate, make and monitor the progress of and sell, realise, exchange or distribute investments which shall include but shall not be limited to the purchase, subscription, acquisition, sale and disposal of unquoted shares and securities, debentures, convertible loan stock and other securities, and the making of loans whether secured or unsecured to such companies in connection with equity or equity related investments in entities or companies involved in private finance initiatives. The partnership (acting through the general partner or persons authorised on behalf of the partnership pursuant to this agreement) may execute, deliver and perform all contracts and other obligations and engage in all activities and transactions as may in the opinion of the manager be necessary or advisable in order to carry out the foregoing purposes and objectives, subject to and in accordance with the provisions of this agreement and the investment policy."

90 Clause 6.1 provided that "the partnership will comply with the investment restrictions and investment procedures set out in schedule 1". In so far as relevant for the current dispute, schedule 1 provided:

> "The partnership will not, without the prior consent of the advisory committee: (a) invest (excluding any bridging investment) an amount in excess of £30m in the securities of any single portfolio company and its associates; (b) invest (when including any bridging investment) an amount in excess of 30% of total commitments in the securities of any single portfolio company and its associates; (c) invest an amount in excess of 20% of total commitments in: (i) the securities of any portfolio companies where the underlying project is substantially in its construction phase; or (ii) the securities of any portfolio companies where the underlying project is of a PFI type but is not officially promoted by a governmental (or similar) body or organisation . . . provided however that for the purpose of this provision where the partnership is investing into a portfolio company with more than one PPP or PFI project the tests in 1(a)(b)(c) shall be applied on a look through basis looking at each individual project and not at the investment in the portfolio company."

91 Clause 5.3 of the RPA set out the authority and powers of the manager in the following manner, so far as relevant:

> "*Authority and powers of the manager*
> "The manager shall have full power and authority, on behalf of the partnership and so as to bind the partnership thereby— (a) to identify, evaluate and negotiate investment opportunities, to prepare and approve investment agreements and to (or agree to) subscribe, purchase or otherwise acquire, alone or together with others, investments falling

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within the investment policy, and to sell, exchange or otherwise dispose of investments for the account of the partnership whether by way of asset swap or otherwise, and to enter into investment agreements or execute investment agreements on behalf of the partnership accordingly . . . (b) to enter into, or require the partnership to enter (directly or through an investment holding company) into underwriting commitments, to acquire investments in a syndicate with other investors or to enter into bridging investments . . ."

92 The investment policy is set out in schedule 2 as follows (with paragraph numbers added):

"[1] The partnership will invest, directly or indirectly in private finance initiative ('PFI') and public private partnership ('PPP') concession companies in Europe with the principal focus being on investments in the United Kingdom.

"[2] Investments will typically be purchased in the secondary market with the intention of meeting the following objectives:

- Providing a gross average cash yield from the investments of 10–12% per annum;
- Creating a diversified portfolio of investments; and
- The potential to achieve, by the termination of the partnership a gross IRR of 15–18%, or greater.

"[3] Without limitation to the above the partnership may also:

- make investments in portfolio companies whose primary business involves the holding of pre-operational assets;
- invest, directly or indirectly in portfolio companies which are designed to achieve the same objectives as PFI or PPP concession companies but which may not be part of a European countries [sic] PFI or PPP programme provided that the aggregate amount invested in such portfolio companies shall not exceed 20% of total commitments; and
- invest, during the commitment period, in investments in assets or portfolio companies which fall outside the investment policy set out above provided that the manager shall use it[s] reasonable endeavours to realise or otherwise divest itself of such assets or portfolio companies during the commitment period."

93 The commitment period referred to is, for practical purposes, the period of two years from the admission of the first investor as a limited partner. Bridging investments are defined in the definitions sections of the RPA as

"Either investments made by the partnership (or by an investment holding company) in excess of the requirement of the partnership with a view to selling the excess to a third party within twelve months of its acquisition . . . or investments made by the partnership as part of a multiple investment transaction where the investment manager considers one or more of those investments are likely to be sold or otherwise realised (whether through an asset swap or otherwise) during the commitment period."

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94 The management deed contains the following relevant provisions:

"1.1 The partnership hereby appoints the manager to be the manager of the partnership with full power and authority (subject to the following provisions of this deed) to act as manager of the partnership, including for the avoidance of doubt the exercise of all of the powers expressed to be granted to the manager pursuant to the partnership agreement, and as such manager to manage the partnership to the total exclusion of any other person and the manager hereby agrees with the partnership to act as such manager and to accept and carry out such management responsibilities and duties otherwise imposed by the partnership agreement on the manager of the partnership."

"1.3 Without limitation to clause 1.1, it is agreed that: (a) investments shall be managed in accordance with and subject to the provisions set out in schedule 2 to this deed . . ."

95 The relevant part of schedule 2 of the management deed reads:

"1. The manager will manage the portfolio in compliance with the FSA rules and on the basis that the partnership's investment objective is as set out in the section in the information memorandum headed 'Investment strategy and objectives' in the section headed 'Investment process' . . .

"2. The partnership may invest only in investments complying with the investment policy. Moneys awaiting investment will be placed on deposit in a partnership bank account with a bank of repute. The manager will comply with the investment policy. There is no other restriction on the amount or value of any one investment or on the proportion of the portfolio which may be constituted by any one Investment or on the types of Investments or markets (if any) in which the partnership wishes transactions to be effected."

96 It can be seen that references made in para 1 of this schedule to the investment objective set out in the PPM which in turn read:

"The investment strategy for the fund is to build a diversified portfolio of investments in operational PFI concession companies in lower risk sectors of the market, such as schools, hospitals, accommodation, water and transportation. The primary geographic focus of the fund will be the more mature UK market. However, opportunities in continental Europe will also be considered.

"Through this investment strategy, the fund's objective is to provide investors with a strong income stream, from the first year of investment, and stable capital values.

"The fund will target gross returns of:

- An average running cash yield of 10% to 12% per annum; and
- An IRR of 15% to 18% with the potential for further upside."

Issues 6/7

"6 & 7. Did the investment in John Laing plc fall outside the final bullet of schedule 2 to the RPA because, while that investment included investments in operational concession companies and pre-operational concession companies, and occurred during the commitment period: (a) it was not an investment principally in operational PFI concession

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companies; (b) it was not an investment principally in PFI concession companies; (c) it included investments in assets other than operational PFI concession companies, which investments were not ancillary to the investments in operational PFI concession companies; or (d) it included investments in assets other than PFI concession companies, which investments were not ancillary to the investments in PFI concession companies?"

97 Clause 5.3 of the RPA gives the manager power to make investments falling within the investment policy, whilst clause 6.1 provides that the partnership will comply with the investment restrictions and procedures set out in schedule 1. That in itself is significant inasmuch as it reinforces the meaning of the words "policy" on the one hand and "restrictions" on the other. The investment policy refers to an approach to be adopted, rather than to specific requirements or prohibitions on investment, whereas "restrictions" do set out specific limitations on what can properly be done.

98 The claimants point out that the first paragraph of schedule 2 repeats in slightly different wording the phraseology of p 1 of the PPM. It provides for a policy of investment in PFI concession companies (not specifically in operational PFI concession companies), neither of which are defined in the RPA. The second paragraph is a précis of the second paragraph of p 15 of the PPM under the heading Investment strategy and objectives (as set out above). It states that, as part of the policy, investments will typically be purchased in the secondary market, which is not defined in the RPA. The PPM explains the UK PFI market in sections 1 to 4 and that the secondary market is for the purchase of equity interests in a consortium that has already been awarded a PFI concession contract. This can be at any point after such an award but

> "more usually investment opportunities arise in concession companies that have completed their construction phase or are in the lower risk operational phase of the project's life."

The parties are expected to know this background information provided by the PPM.

99 The third paragraph is expressly without limitation to the earlier two paragraphs and contains three bullet points, of which the meaning of the third is in dispute. Whilst the general policy is to invest in PFI concession companies and the typical purchase is to be in the secondary market, the first bullet point makes it clear that the partnership may invest in companies whose primary assets are still at the pre-operational (i e the construction) stage. The second bullet point then allows for investment in companies which are like PFI companies but not state approved, provided that the aggregate amount invested does not exceed 20% of the total commitments. The second bullet point and arguably the first have the effect of expanding the areas of investment beyond that which appears in the general policy statement in the first paragraph of the schedule. If reference is made to schedule 1 which sets out investment restrictions, it will be seen that the first and second bullet point additions to the policy in schedule 2 are subject to the limitation set out in para 1(c)(i)(ii) of schedule 1, namely to investment of 20% of the total commitment in them, (in the case of the second bullet point, a repetition of the limit set out in the bullet point itself).

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100 The claimants accept that the third bullet point, if read literally, has the effect of allowing the manager to invest in any assets at all in the commitment period (essentially the first two years), whether in PFI concession companies or otherwise. It is submitted that this cannot be what is meant, because the effect would be to make a nonsense of the PPM and the policy referred to.

101 Reference is then made to p 1 of the PPM where it is said that "the fund will invest in existing shareholder interests . . . of operational PFI concession companies", to the investment strategy and objectives set out in the PPM (and quoted above), to p 11 where it is said that "the fund will principally be investing in these operational PFI concession companies owing to their lower risk and higher income generation" and to the reference at p 13 to "typical operational PFI investments [which] deliver an average income yield of approximately 11% pa". It is said that the fund objective of target returns of 10% to 12% pa is only available from PFI concession companies at the operational stage.

102 In consequence, it is submitted by the claimants, the third bullet point in the last paragraph of schedule 2 to the RPA must be read as an adjunct to enable ancillary investments to be made in non-PFI assets only where the portfolio in which investment is made consists principally of interests in operational PFI concession companies. The third bullet point does not therefore permit investment in PFI companies at the bidding phase or in non-PFI assets generally but only to the extent that investment in such assets is ancillary to investment in such operational PFI concession companies.

103 The claimants say that if 85% of the total commitment was in PFI operational concession companies or projects, or even such concession companies or projects at any phase, the criteria would be satisfied. Whilst they do not state what the minimum qualifying proportions would be, they then point to their calculation that only 39% of the total commitment was invested in operational PFI concession companies or projects and only 51% in PFI concession companies or projects, at any phase. They submit that there is a clear breach of authority in the making of such investments.

104 In my judgment this is simply not what the third bullet point says and there is no reason to read down the wording by reference to the PPM, nor to import concepts of proportionality in the size of investments in PFI and non-PFI assets. The third bullet provides for "investments in assets or portfolio companies which fall outside the investment policy set out above" with a limiting proviso, which is the only proviso required by the schedule. The rationale is not hard to fathom. The manager is to be able to purchase non-PFI assets in the initial period of two years or so, in order to seek to achieve the objective of a strong income stream from the first year of investment and the target returns set out in the PPM, whilst pursuing the strategy of building a diversified portfolio of investments in operational PFI concession companies. The proviso means that the manager can only make such acquisitions, if it uses reasonable endeavours to divest itself of such non-PFI assets, falling outside the first two paragraphs and the first two bullet points of the third paragraph of the schedule, within the limited first two years or so that constitute the commitment period.

105 This position is made plain when reference is made to the other provisions of the RPA, which permit investment in bridging investments.

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A Clause 5.3(a) empowers the manager to invest in investments falling within the investment policy whilst clause 5.3(b) empowers it to enter into bridging investments, which include both excess PFI assets (which it is intended to sell within 12 months of acquisition) and other investments which are part of a multiple investment transaction where the manager considers that they are likely to be sold during the commitment period. Bridging investments do not need to be in PFI assets but, if they are not, they can only be purchased as B part of a multiple investment transaction where such PFI assets are purchased, and only with a view to sale of the non-PFI assets in the commitment period. Furthermore, by reason of the proviso in schedule 2, the manager is bound to use reasonable endeavours to make such disposals.

106 Schedule 2 and clause 5 do therefore place limits on the powers of the manager to acquire non-PFI assets but not the limits which the claimants C suggest, by reference to "principal" investment in PFI assets and "ancillary" investment in non-PFI assets on a quantitative basis.

107 The claimants submitted that on no view could the acquisition of a pension deficit of £158·7m fall within the ambit of what was permitted investment. It was said not to be investment in a PFI concession company. It transpired that the deficit comprised debts owed by three companies in the Laing group, one of which had multiple PFI projects. The acquisition of D Laing plc was a multiple investment transaction which involved the acquisition of some 47 PFI concession contracts. The price paid for the group, with those companies and debts, would have taken account of that deficit, unless there was some failure on the part of the manager in negotiation, which is not alleged. I cannot see that any separate point arises from this.

E 108 There is no basis for incorporating the PPM into the RPA, which prevails in any event if there is inconsistency between the two. The RPA is clear in what the general policy is—investment in PFI concession companies, typically in the secondary market, with various add-ons, including the third bullet point in schedule 2, which contains its own limitation on the purchase of non-PFI assets, and is to be read alongside the other provisions of the RPA, with their limitations on such purchases. There is no room for F importing quantitative limits whether by purported reference to the PPM or otherwise.

109 The answer to all four questions raised in issue 6/7 is "no".

Issue 4

"4. Did the investment in John Laing plc breach the obligation on the G manager (under para 1 of schedule 2 to the management deed) to manage the investments, money, assets and borrowings of the partnership on the basis that the partnership's investment objective was as set out under the 'investment strategy and objectives' on p 15 of the private placement memorandum, for the following reason: that the assets and liabilities of John Laing plc were not a portfolio of investments in, or at least principally in, operational PFI concession companies?"

H 110 The manager by clause 1.2 of the management deed agreed to comply with the applicable provisions of the RPA and to ensure that all investments fell within the investment policy. It agreed also that investments should be managed in accordance with, and subject to the provisions of schedule 2 to the management deed.

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111 Para 1 of schedule 2 to the management deed provides that the manager will manage the portfolio "on the basis that the partnership's investment objective is as set out in the section [in the PPM] headed 'Investment strategy and objectives' ". There is here direct reference to the PPM. Para 2 of the same schedule provided that the partnership could only invest in investments complying with the investment policy in schedule 2 to the RPA.

112 The claimants submit that, when reference is made to the PPM, it is clear that the objective is to provide the strong income stream from the first year of investment and stable capital values, with target returns but that this is to be done through the investment strategy of investment in operational PFI concession companies, as set out in the first paragraph of the section of the PPM. Managing on the basis of the objective is said to involve the adoption of the strategy, which the manager cannot ignore. Even if, contrary to their earlier submissions, the last bullet point of para 3 of schedule 2 to the RPA does not restrict investment in the manner for which the claimants contended, the effect of this provision in the management deed is to the same effect.

113 This argument faces an insurmountable difficulty because of the second paragraph of schedule 2 to the management deed. This provides that the manager will comply with the investment policy but that

> "there is no other restriction in the amount or value of any one investment or on the proportion of the portfolio which may be constituted by any one investment or on the basis of investments or markets in which the partnership wishes transactions to be effected."

The investment policy is reaffirmed and the manager cannot be restricted by the management deed above and beyond the restrictions set out in the RPA.

114 The schedule to the management deed is not therefore apt to create a narrower range of permitted activity on the part of the manager. The objective set out in the PPM does refer to income stream from the first year of investment and stable capital values and targeted returns. The strategy is to build a diversified portfolio of investments in operational PFI concession companies but this does not restrict the powers of the manager given elsewhere as the means by which he should set about that strategy and that objective. Self-evidently it takes time to "build" a portfolio in accordance with any strategy, and managing the portfolio "on the basis of" the objective does not entail success, nor the achievement of the targeted returns which may or may not have been achievable only from operational PFI concession companies and the prompt sale of non-PFI assets. In the context of a multiple investment transaction with PFI assets and non-PFI assets of the kind that the Laing acquisition involved, the objective might or might not be achieved immediately or even over time. No allegation is made that the manager failed to have regard to the objective or to the strategy in what it did. It is simply alleged that the investments made were outwith the authority conferred on it and the general partner. Yet the management deed can add nothing since the investment policy is to be found in schedule 2 to the RPA, to which the management deed expressly refers, whilst the specific restrictions on acquisitions and investments are to be found in schedule 1 to the RPA, to which issue 5 relates.

115 The answer to the question posed in issue 4 is "no".

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Issue 5

"5. Does the proviso in para 1 of schedule 1 to the partnership agreement require the test in sub-para 1(a)(b)(c) of that paragraph to be applied on a 'look through' basis to each of John Laing plc's individual PFI projects or to assets which are not PFI projects or to the investment in John Laing plc itself?"

116 Both parties agreed, on their primary cases on construction, that the "look through" proviso in the last sub-paragraph of para 1 of schedule 1 to the RPA, referred only to individual PFI projects and not to non-PFI assets. The difference between the parties related to sub-para (b) and whether this referred to bridging investments which were in PFI projects only or to investments in non-PFI assets. The point at issue is that sub-para (b) sets an investment limit of 30% of the total commitment (unless prior advisory committee consent is obtained) in any single portfolio company and its associates and specifically provides for bridging investments to be included for the purposes of calculating that percentage.

117 The definition of bridging investments includes excess PFI projects and non-PFI assets purchased as part of a multiple investment transaction, as referred to earlier in this judgment. The Laing acquisition was a multiple investment transaction.

118 Laing plc is a portfolio company in which some 92·5% of the total commitment was invested by the fund. It is agreed that Laing plc had more than one PFI project within the meaning of the "look through" proviso and a large number of bridging investments in non-PFI assets. (The defendants say that it had 48 PFI projects.)

119 The claimants say that all Laing plc's bridging investments must be included in the assessment to be made under sub-para (b) of the schedule and that the investment in Laing plc therefore exceeded the 30% limit. The defendants maintain that the effect of the "look through" proviso is that the relevant examination is simply to see whether there is an excess of 30% invested in any one of the PFI projects in the Laing group.

120 The claimants say that the proviso cannot operate in that way, because sub-para (b) requires all bridging investments to be taken into account, including all the non-PFI assets. The "look through" proviso, by contrast only refers to PFI projects, so it does not help when considering the 30% limit on investment in any one portfolio company, with bridging investments included in the calculation. There are therefore, in their submission, two possibilities. Either Laing plc must be considered without reference to the proviso, so that the 30% limit is breached by reference to all the PFI projects and non-PFI projects that it directly owns. Alternatively, if contrary to that submission, the "look through" proviso is applied, then the 30% limit can be applied to each of the PFI projects it indirectly owns, but the total of the non-PFI elements held directly or indirectly by Laing plc falls to be taken into account in assessing whether there is a breach. Either way, it is said, the limit is breached. (The pension deficit, on its own, is said to represent almost 30% of the total commitment by the fund.)

121 If it were otherwise, say the claimants, there would be no concentration limit which would include bridging investments as required by sub-para (b), save where the PFI project and the bridging investment were held by the same company. This, it is said, would make no commercial sense

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because it would mean that there was no limit on bridging investments which were not held directly together with PFI projects. Further, it makes no sense to limit the concentration of investment in PFI projects in construction (sub-para (c)(i)) and in non-governmental PFI type projects (sub-para (c)(ii)) yet not to impose any limit on bridging investments.

122 On the claimants' construction, however, the "look through" proviso does not truly work in accordance with its terms. The first alternative involves looking at the total investment in the portfolio company (Laing plc), which the proviso forbids. The second alternative involves looking at PFI assets held directly but non-PFI assets held indirectly, for which the paragraph and the proviso make no provision.

123 There are limits to bridging investments as I have already held. They are temporary investments only as the definition shows, and where they consist of non-PFI assets they can only be acquired as part of a multiple investment transaction and subject to the intention to dispose of them within the commitment period with an obligation on the part of the manager to use reasonable endeavours to do so. The restriction on bridging investments is to be found in schedule 2 to the RPA and the definition itself.

124 The key to the construction of para 1 of schedule 1 to the RPA is to examine the proviso and to see how the paragraph works with and without it.

125 It is common ground that the proviso only enables one to look at PFI projects. The contrary is unarguable because the proviso only operates with a portfolio company with more than one PFI project. The tests in para 1(a)(b)(c) are then to be applied "on a look through basis, looking at each individual project", which can only mean such a PFI project. The proviso goes on specifically to state that "the investment in the portfolio company" in such circumstances is to be ignored. There can therefore be no possibility of looking at any bridging investment which was not part of that PFI project in making the assessment of the percentage of the total commitment, when looking at that portfolio company with more than one PFI project.

126 That demonstrates the rationale which underlies para 1 of the schedule as a whole. What the draftsman had in mind, as the proviso shows, was the avoidance of concentration of investment in any single PFI asset. The paragraph is not aimed at the classes of assets in which investment can be made (save for (para 1(d) which refers to speculative investments) nor aimed at the totality of investments made by the manager. In the case of a portfolio company with more than one PFI project, the 30% limit set out in clause 1(b) was to apply to each project, not to the company, regardless of any bridging investments belonging to that company, which were not PFI assets. Similarly, when regard is had to the portfolio company with one PFI project only, bridging investments which are not PFI assets do not form part of the calculation. The reference to bridging investments in para 1(b) can only be to bridging investments in the PFI project.

127 The proviso applies to each of the tests in sub-paras (a) to (c). Thus those sub-paragraphs must refer to the position where a single company has only one PFI project, since the proviso caters for the position where there is more than one. The paragraph as a whole is concerned with diversification and the avoidance of the concentration of investment in too narrow a range of PFI assets.

128 Thus sub-para 1(a) prohibits investment of more than £30m of the total commitment (excluding any bridging investment) in the securities of

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any one single portfolio company and its associates with one such project. In such a company it is necessary to separate out PFI assets which are to be kept and those which are not to be retained (excess PFI assets which constitute bridging investments). The limit is then to be applied. Sub-para 1(b) then sets a different limit by reference to the percentage of the total commitment, rather than a monetary limit as such, again for a company with a single PFI project, where the bridging investment is included. The investment in a single portfolio company that has one PFI project must therefore comply with two different concentration tests; first the investment in the portfolio company (and the PFI project it owns), which is to be retained by the fund (i e excluding bridging investments in excess PFI which is not to be kept) must not exceed £30m (sub-para (a)); secondly, the amount of the total investment in the portfolio company (and its PFI project), including the part to be retained and the excess to be sold—the bridging investment—must not be in excess of the 30% limit by reference to total commitments: sub-para (b). The effect is to ensure diversity in PFI assets, both in the long term (with excess PFI investments excluded from the £30m limit) and in the short term (with excess PFI assets included in the 30% limit).

129 Sub-para 1(c)(i)(ii) prohibit investment of more than 20% in the securities of any portfolio company where the "underlying project" is in the construction phase or is a non-governmental project. The focus is thus on the PFI asset in which the partnership is investing, and not on any non-PFI assets.

130 The proviso itself, with its clear reference to PFI projects only, throws light on the terminology used earlier in the paragraph. This paragraph is not concerned with non-PFI assets at all, the restrictions on which appear elsewhere, as I have already held, but with PFI assets alone. Para 1(b) is consequently not aimed at limiting the total amount of bridging investments made by the fund in all projects, but is aimed at capping the combined amounts of PFI permanent and bridging investments in each project.

131 Whilst there are always dangers in saying that the draftsman could, if he had wanted to provide for a percentage limit on non-PFI assets as well as PFI assets as compared with the total commitment across the board, have done so with a provision saying exactly that, it is the fact here that it could readily have been done and that, if this paragraph were intended to achieve that result, it is opaque in the extreme. If however the paragraph is read as dealing with PFI assets alone and the reference to bridging investments is read as meaning PFI assets excess to requirements, the paragraph fits together and makes commercial sense. The defendants' construction, is in my view correct.

132 The answer to issue 5 is that the proviso does not require the tests in the sub-paragraphs of para 1 of schedule 1 to the RPA to be applied to assets which are not PFI projects, nor to the investment in Laing itself—but only to each of the PFI projects.

Issue 8

"8. Was the acquisition debt a borrowing within clause 5(3)(g) of the RPA?"

133 The acquisition debt is the sum of £220m made available by a credit facility from West LB to HIH, the company in which Fund I and Fund

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II invested and which, with those funds and the West LB loan (plus minor co-investments) then acquired Laing plc. It is not therefore a loan to the fund as such.

134 Clause 5.3(g) of the RPA (and as incorporated into the management deed) gives the manager

> "full power and authority, on behalf of the partnership and so as to bind the partnership thereby . . . to borrow money (either directly or through an investment holding company) on a short term basis . . . provided that the aggregate of borrowings . . . shall not at any time exceed 30% of total commitments."

The claimants submit that the loan to HIH is a loan to the fund through an investment holding company. The defendants say that it is not.

135 By clause 9 of the bid conduct and co-investment agreement, the manager purported to agree, on behalf of both Fund I and Fund II, that £49·5m of the term loan would be allocated to Fund I and £170·5m to Fund II. Allocation in this context meant that the cost of the loan would be deducted from revenue which would otherwise flow to the relevant fund. It is the claimants' case that, in fact, 100% of the cost of funding the loan was allocated to the partnership.

136 An "investment holding company" is defined to mean a company wholly or partly owned or acquired by the partnership for the purpose of carrying out the investment.

137 The claimants submit that HIH is an investment holding company and that the term credit facility is indirect borrowing through HIH. The fact that the clause expressly contemplates indirect borrowing through a wholly or partly owned subsidiary can only mean that it contemplated that the borrowing limits would be engaged even where the partnership was not itself the borrower, but the subsidiary was. This is, it is maintained, the only reading of the clause which makes literal sense and it is the only reading which makes commercial sense. Where the borrowing is indirect, it makes no difference how precisely it is funded if and to the extent that the cost of funding it falls ultimately on the partnership.

138 The claimants refer, in this connection to clause 9.2 of the bid conduct and co-investment agreement which states that Funds I and II have "agreed between themselves a notional allocation of the facility . . . and a priority for repayment of the respective notional allocations". Clause 9.1 however provides for an acknowledgment on the part of each fund that the borrowing will be made as part of the financing of the acquisition, and that "such borrowing is made without recourse to any undrawn capital contributions of any investor in the funds or any other investment or assets of the funds". Each also acknowledged by the terms of the agreement that the terms of the facility would prevent any distributions or repayment of subordinated borrowings prior to full repayment or satisfaction of the facility. The returns to the fund were therefore affected by the existence of the loan.

139 The claimants say that in consequence, if the effect of the allocation is that the cost of the borrowing is deducted from the moneys flowing to the fund from HIH, the partnership must be treated as liable for the loan.

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A 140 This does not follow, however. Clause 5.3(g) applies to borrowings on behalf of the partnership, which bind the partnership, albeit this includes loans made either directly or through an investment holding company. The partnership has however not borrowed any money, through HIH, or otherwise. It has invested in a company that has borrowed money but it is not liable on the borrowing (whether as a primary debtor or guarantor) and B is not liable to indemnify the borrowing company on the loan. An indirect borrowing by the partnership would be one where HIH borrowed and the partnership was liable for that borrowing, either to the original lender or to HIH. That is not the position. There is no recourse to the assets of the fund in respect of the borrowing, so that the partnership, and the general partner are not committed to any borrowing at all.

C 141 If one of the PFI companies in which the fund invested obtained a loan from the bank, the position would be comparable. The returns to the fund would be affected by that loan, but there would be no liability in respect of the borrowing itself and the borrowing limits provided by clause 5.3(g) could not apply. So also here.

142 The claimants submit that the purpose of the restriction was to protect the return on the investment of the partnership and its impairment D by excessive debt. The overall debt/equity ratio could be hugely adverse if there was no such restriction. The effect of the clause is, however, clear. It refers to borrowings and liabilities of the partnership, whether direct or indirect and not to anything else. Its purpose must be confined to that. Any restrictions on investments and the borrowings of the companies in which investments are made, would be found elsewhere, if at all, not in the limits on the manager's borrowing powers on behalf of E the fund.

143 The answer to the question posed by issue 8 is "no".

Issue 9

"9. Would it make any difference to the outcome of the preliminary issues of construction referred to above if any or all investors knew or F suspected in advance of the transaction being announced that the investment opportunity was John Laing plc?"

144 As I have found in favour of the defendants on the issues of construction which relate to the allegation of unauthorised investment in Laing, on the footing that none of the limited partners knew that Laing was the target, this issue does not arise. Any knowledge or constructive G knowledge on the part of the limited partners, could only serve to strengthen, rather than weaken the arguments in favour of the general partner and manager, but I need not decide whether they do have that effect.

Clause 5.3(y) of the RPA

H 145 Clause 5.3(y) of the RPA provides:

"The manager shall have full power and authority on behalf of the partnership and so as to bind the partnership thereby . . . (y) to do all or any other acts as are required of the managers by this agreement or as are necessary or desirable in the reasonable opinion of the manager in

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furtherance of the foregoing powers and consistent with the terms of this agreement."

146 The defendants point to a line of authorities in the corporate context which demonstrate the effectiveness of a power of this kind. I need only refer to two.

147 The first is *Bell Houses Ltd v City Wall Properties Ltd* [1966] 2 QB 656 where Danckwerts LJ gave the leading judgment, with which Sellers and Salmon LJJ agreed. There the objects clause in the memorandum of association included a sub-clause stating that one of the objects of the company was

> "to carry on any other trade or business whatsoever which can, in the opinion of the board of directors, be advantageously carried on by the company in connection with or as ancillary to any of the above businesses or the general business of the company".

The Lords Justices concluded that the result of earlier authorities was that a clause of this type was sufficient to make the bona fide opinion of the directors sufficient to decide whether an activity of the company was intra vires.

148 A later example appears in *Den Norske Creditbank v Sarawak Economic Development Corpn* [1988] 2 Lloyd's Rep 616, 620 where Phillips J applied the rationale of the *Bell Houses* case to a Malaysian public corporation which had been incorporated by statute. There the provision in section 14 of an ordinance empowered the corporation to "carry on all activities the carrying on whereof appears to the Corporation to be requisite, advantageous or convenient for or in connection with the discharge of its duties". Although obiter, the judge stated that this section defined the powers of the corporation by reference to a subjective test, which was perfectly legitimate in that context.

149 The claimants maintain that clause 5.3(y) cannot extend the powers of the manager to acts which are not "in furtherance of the foregoing powers and consistent with the terms of this agreement". If the manager has acted outside their authority, then this sub-clause cannot avail them. This submission, however, cannot stand in the light of the wording of the sub-clause and the authorities. What clause 5.3(y) does is to make the reasonable opinion of the manager the touchstone for its powers under this sub-clause. If the manager reasonably takes the view that the activities on which they embark are necessary or desirable in furtherance of the powers given to them and set out earlier in the clause, and are consistent with the terms of the agreement, what they then do is authorised. Authority is given to them on the basis of their reasonable opinion that this is the case.

150 This sub-clause does not, unlike the *Bell Houses* case or the *Den Norske* case clauses, make the subjective view of the manager determinative. Their view must be a reasonable one, so that their powers are not extended beyond the ambit of what they could reasonably conclude was in furtherance of the earlier express powers and was consistent with the RPA, but the effect is that, in grey areas, where there is room for a reasonable difference of view, the benefit of any doubt is given to the manager.

151 What this means in the context of the disputes in this action, is that, even if, contrary to my judgment, the investments or borrowings made by the manager were truly, on a correct view of the RPA and management deed,

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outwith the express powers of investment or borrowing bestowed on them or prevented by the express limitations and restrictions set out in the schedules to which I have referred, if the manager reasonably believed that they were within those powers, their authority was extended to include the activities in question. It necessarily follows, in my judgment, that if I should be wrong in my earlier conclusion on those express powers, limitations and restrictions, it would have been reasonable for the manager to conclude, as I have, that they were acting within their powers and not contrary to the RPA.

Issue 10

"10. If the answers to any of the issues in paras 4, 6 or 8 above is 'yes' or the answer to the issues in paras 5 or 7 is 'no', are the general partner and the manager entitled to the benefit of the exculpation in clause 18.1 of the RPA and/or the indemnity in clause 18.2 of the RPA (subject to any arguments that the claimants raise in respect of fraud, wilful misconduct, bad faith reckless disregard or negligence on the part of the general partner and the manager or, in the case of the manager only, in respect of the breach of any duty it may have, or any liability it may incur, to the partnership or any investor under the regulatory system (as defined in the FSA rules) applicable to it under the Financial Services and Markets Act 2000)?"

152 The questions as phrased in this issue no longer conform to the agreed format of the earlier issues 5 and 7, but distinct issues arise under clause 18 of the RPA, because of the different terms of the two sub-clauses, it being recognised that clause 18.2 which provides for an indemnity is wider in its terms than the exculpation provision in clause 18.1. The manager and general partner are "indemnified persons" within the meaning of the RPA.

153 Clause 18.1 provides:

"None of the indemnified persons shall have any liability for any loss to the partnership or the partners arising in connection with the services to be performed hereunder or pursuant hereto, or under or pursuant to any management agreement or other agreement relating to the partnership . . . or which otherwise arise in relation to the operation, business or activities of the partnership save in respect of any matter resulting from such indemnified person's fraud, wilful misconduct, bad faith or reckless disregard for their obligations and duties in relation to the partnership or . . . their negligence (provided that such negligence has had a material adverse economic effect on the partners or the partnership)."

154 Clause 18.2 provides:

"The partnership agrees to indemnify and hold harmless out of partnership assets the indemnified persons against any and all liabilities, actions, proceedings, claims, costs, demands, damages and expenses (including legal fees) incurred or threatened arising out of or in connection with or relating to or resulting from the indemnified person being or having acted as a general partner or manager in respect of the partnership or arising in respect of or in connection with any matter or other circumstance relating to or resulting from the exercise of its powers a general partner or manager or from the provision of services to or in respect of the partnership . . . or which otherwise arise in relation to the

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operation, business or activities of the partnership provided however that any indemnified person shall not be so indemnified with respect to any matter result from the fraud, wilful misconduct, bad faith or reckless disregard of their obligations and duties in relation to the partnership or . . . their negligence (provided that such negligence has had a material adverse economic effect on the partners or the partnership)."

155 The issues in relation to these provisions arise if I am wrong on the earlier issues and the manager or general partner would be, without reference to this clause, liable for investing or borrowing outside the scope of the RPA, or if the manager or general partner is liable in respect of the allocation of business, a matter which did not form part of the preliminary issues.

156 The claimants contend that, however widely clause 18 is drawn, it cannot apply to relieve the manager or general partner of liability for exceeding the authority given to them by the RPA and the management deed. The latter, by clause 5.1 expressly incorporates clause 18 of the RPA. They say moreover that the clause 18 is to be construed strictly as an exemption clause and contra proferentem, because it was produced by the manager/general partner.

157 Clause 18.1 of the RPA provides that the indemnified persons shall not have any liability for any loss

"arising in connection with the services to be performed hereunder or pursuant hereto or under or pursuant to any management agreement . . . or which otherwise arise in relation to the operation, business or activities of the partnership",

in the absence of fault of the type referred to in the clause (which at the time of the hearing was not pleaded, although an amendment was made to plead negligence whilst this judgment was in the course of preparation).

158 The claimants say that this wording is not apt to cover the making of investments or borrowings outside the scope of authority given. They submit that the commitment of funds to the general partner by the limited partners and the delegation of responsibility to the manager to manage the investments of the partnership was solely on the basis of the authority granted to them and the obligations of both the general partner and the manager to observe the limits of that authority are expressed in absolute terms in the RPA and the management deed.

159 Thus, the final sentence of clause 1.2 of the partnership agreement provides:

"The partnership (acting through the general partner or persons authorised on behalf of the partnership pursuant to this agreement) may execute, deliver and perform all contracts and other obligations and engage in all activities and transactions as may in the opinion of the manager be necessary or advisable in order to carry out the foregoing purposes and objectives, subject to and in accordance with the provisions of this agreement and the investment policy."

160 Likewise, clause 6.1 of the partnership agreement provide: "The partnership will comply with the investment restrictions and investment procedures set out in schedule 1."

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161 Equally clause 5.3 (g) provides that any borrowing "shall not at any time exceed 30% of total commitments".

162 The manager's position is no different as:

(i) Clause 1.1 of the management deed grants no greater authority to the manager than that conferred on the general partner under the partnership agreement and furthermore obliges it to carry out the duties imposed by the partnership agreement.

(ii) Clause 1.2 imposes a strict obligation "*to ensure*" that all investments fall within the investment policy.

(iii) By clause 1.3(a), the manager agreed that the investments "shall be managed" in accordance with schedule 2 to the management deed, which then provides: (a) that the partnership "may invest only in investments complying with the investment policy"; (b) "The manager *will comply* with the investment policy"; (c) and ends:

> "The following paragraphs of this schedule are subject to the provisions of this paragraph and any investment decision pursuant to any of those paragraphs must none the less comply with [it] and with [it] any restrictions in the investment policy."

(iv) Although clause 1.3(b) grants discretion to the manager, it is subject to clause 1.1 and also has to be read subject to clause 1.2 and clause 1.3(a).

(v) Likewise, the manager's obligation in para 1 of schedule 2 to manage the portfolio is to manage it on the basis that the partnership's investment objective is "as set out in the section in the PPM headed 'Investment strategy and objectives".

163 The claimants submit that these provisions mark the limits of the general partner's and manager's authority. As the obligations are expressed in absolute terms, they are obliged strictly to act only within those limits. But within those limits they will be protected from liability if they perform their duties to a non-negligent standard. By the exculpatory provision, the limited partners therefore bear the risk that the general partner and manager will innocently breach their duties in the course of performing what they were authorised to do, but not the risk that they would invest the funds in an investment which they were not authorised to make at all. Put differently, there is no scope for the exculpatory provision to apply so as effectively to extend the authority granted, nor to water down the obligations so as to constitute only obligations to take reasonable care to comply with the partnership's mandate.

164 Losses flowing from an act outside the mandate are not, on this submission losses arising in connection with the services to be performed under the RPA or management deed or pursuant thereto. Such losses are the antithesis of such losses because they stem from acts performed outside the authority bestowed by those agreements. Nor do such losses otherwise arise in relation to the "operation, business or activities of the partnership" because that phrase means the authorised operation, business or activities of the partnership.

165 At worst, the claimants say, if there is any ambiguity or lack of clarity in clause 18.1 it must be construed against the general partner and manager so as not to embrace a breach of mandate.

166 As to this latter approach, it is true to say that the agreements were produced by the manager. There was however some scope for negotiating

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variations in the form of side letters, as provided for in clause 6.6 of the RPA, in the most favoured nations clause. The parties were of equivalent bargaining powers and were sophisticated commercial entities well able to take advice and to consider the effect of the provisions of the agreements put forward for them to consider as the basis of investment and evaluate the risks undertaken.

167 It is clear that the underlying intention of the two sub-clauses of clause 18 is to cover claims by the limited partners in the first sub-clause and claims by third parties in the second. The wording of the latter is however also wide enough to cover claims made by the limited partners, but to do so would make a nonsense of the structure of the clause. Of course it is possible that if claims are made by the limited partners against the general partner or manager, so that clause 18.1 applies, those defendants might incur solicitor and client costs in defending such claims, which might not be recoverable as party and party costs in litigation, so that an indemnity could operate in the same circumstances as the exculpation, with any difference in meaning between the two sub-clauses theoretically coming into play. As however, this could only occur if the defence under clause 18.1 was successful, any difference in wording, as clause 18.2 is thought to be wider in its effect, is of no real importance. I conclude that it is clause 18.1 which is triggered by a claim by the limited partners against the general partner or the manager and clause 18.2 which covers claims by third parties against them, because it would not make sense to have two clauses which covered the same ground and for circularity of action to be created by an unsuccessful defence under clause 18.1 and a reimbursement of liabilities paid to the limited partners under clause 18.2. In the event, it makes no difference which sub-clause applies here.

168 The structure of clause 18.1 is to relieve the indemnified persons from liability for partnership losses of the kinds specified, where the indemnified persona have not been guilty of negligence or more culpable behaviour. This is not a provision which excludes negligence where special rules of construction can apply: see *HIH Casualty & General Insurance Ltd v Chase Manhattan Bank* [2003] 1 All ER (Comm) 349. Here all liability of the specified kinds is expressly included, as long as it is not negligent or worse. The clear intention is to provide protection to the indemnified persons in errors of judgment and management, where the paradigm examples are almost certain to be in decisions about investment of the fund, which give rise to contractual liability.

169 Such decisions must arise "in connection with the services to be performed" under the RPA or the management deed or "which otherwise arise in relation to the operation, business or activities of the partnership". When this phraseology is read in conjunction with the terms of clause 5.3(a)(b)(g)(y) of the RPA, it leaves no room for doubt that misjudgments in relation to investments, and what are reasonably seen to be legitimate investments by the manager, are covered by the exculpatory clause.

170 Further, the wording of clause 18.1 is drafted widely to allocate risk in respect of breaches of contractual duty of all kinds. There is nothing in the wording which suggests it should not apply to breaches of schedules 1 and 2 to the RPA or schedule 2 to the management deed. The ordinary and natural meaning of the words requires that they should apply to such

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breaches, unless there is negligence or other culpable conduct of the kinds mentioned. There is no mention of breaches of authority as a separate category of contractual breach. The loss of which complaint is made in the amended particulars of claim are losses "arising in connection with the services to be performed" under the RPA or the management deed and the losses arose "in relation to the operation, business or activities of the partnership", whether or not they were truly authorised under the terms of the RPA. The losses covered by the clause are not losses resulting from authorised services performed under the RPA or management deed but losses which arise *in connection with* the services to be performed, which is a wider category of excused loss, ruled out only in the event of negligence or worse. Similarly the losses covered by the clause are not losses resulting from the authorised operation, business or activities of the partnership, but losses *in relation to* such operation, business or activity, once again excused unless there is negligence or other specified culpable misconduct on the part of the indemnified person.

171 If clause 18.2 applies, there can be no doubt that the wider wording is apt to require an indemnity from the limited partners to the indemnified persons in respect of liabilities arising out of or in connection with circumstances relating to or resulting from the provision of services to, or in respect of, the partnership, whether the investment, borrowing or allocation of funds was authorised or not. Much the same reasoning applies as for clause 18.1, with less room for argument that the indemnity only operates for authorised activity by the indemnified person.

172 The answer to the question whether clause 18 is apt to relieve the general partner or manager, in the event of a breach by them of the RPA or management deed (and in particular a breach of schedules 1 or 2 to the former or schedule 2 to the latter), by exceeding the authorised investment or borrowing powers as alleged in the amended particulars of claim, is yes.

Issue 11

"11. If the answer to question 10 is 'yes' in respect of the indemnity, are the general partner and the manager entitled to the benefit of the indemnity in clause 18.2 of the RPA with retrospective effect and in priority to any indemnity that the claimants might be awarded pursuant to para 1(c) of the order of Teare J dated 27 January 2012."

173 There was no argument about this issue in fact, as the defendants accepted that there was no order of priorities which governed the operation of any indemnities, whether under clause 18 or any the court might order.

Conclusion

174 For the reasons given, I answer the preliminary questions in the manner set out above.

(i) The claimants are not entitled to pursue a derivative claim against the general partner. They are entitled to pursue a derivative action against the manager on the claims to which I have referred, but to do so, they must forfeit their limited liability and render themselves liable to creditors of the partnership generally, as if they were the general partner, for the period during which such claims are pursued. If they choose to do this, issues of

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costs in the pursuit of those claims will be decided as the litigation proceeds, in the ordinary way.

(ii) The other preliminary issues on questions of construction are all, save for issue 11 which turned out to be a non issue, determined in favour of the defendants.

175 Questions of costs in relation to the preliminary issues remain to be determined. Subject to submissions which the parties wish to make, my initial view is that, should the claimants decide not to pursue the derivative claim, they should pay all the costs of determining all the preliminary issues. Should they decide to pursue that derivative claim, different considerations arise, as mentioned in para 79 above. However the arguments deployed before me were arguments in principle and whilst there could be some deduction from the costs that they would otherwise be bound to pay to the defendants in respect of all the other issues upon which they lost, or some reservation until the final outcome of any litigation on such claims, since they had indicated that they would not pursue such claims in the absence of one of the declarations, it is hard to see why they should not bear all the costs. Such matters can be the subject of submission on the formal handing down of this judgment, which I anticipate will be effected on Friday, 16 November 2012.

Preliminary issues determined accordingly.

SARAH ADDENBROOKE, Barrister

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ITEM NO. 158

JA-44

Revenue and Customs Commissioners v Anson

[2013] EWCA Civ 63

COURT OF APPEAL, CIVIL DIVISION

LAWS, ARDEN AND LLOYD LJJ

17 OCTOBER 2012, 12 FEBRUARY 2013

Double taxation – Relief – Profits of trade – Taxpayer's share of profits of US limited liability company taxed in US on basis company was partnership – Whether taxpayer entitled to credit for US tax paid by him – Whether taxpayer entitled to profits as they arose – Whether partnership or corporate entity – Double Taxation Relief (Taxes on Income) (The United States of America) Order 1980, SI 1980/568 – Double Taxation Relief (Taxes on Income) (The United States of America) Order 2002, SI 2002/2848.

The taxpayer was a member of a Delaware limited liability company ('LLC'), and was entitled to, and was paid, sums which amounted to a share of the profits of LLC. The taxpayer was taxed on those profits in the United States on the basis that the LLC was 'tax transparent' so that its members paid tax on their share of its profits and the LLC paid no tax. He was resident but not domiciled in the United Kingdom for tax purposes, and was liable to pay UK tax only on income remitted to the UK; that included his share of the profits of the LLC for the fiscal years 1998 to 2004, unless any double tax relief ('DTR') was available. The Revenue and Customs Commissioners ('HMRC') sought to tax him on the footing that the income was a dividend. No credit was given for the tax already paid in the US; the LLC was treated as 'opaque' so that there was no entitlement to DTR under the terms of the Double Taxation Relief (Taxes on Income) (The United States of America) Order 1980, SI 1980/568 (applying to all the fiscal years in issue save the last) and the Double Taxation Relief (Taxes on Income) (The United States of America) Order 2002, SI 2002/2848 (in relation to 2003–04). HMRC treated the taxpayer's share of the LLC's profits as income received by him from his investment in the LLC; not as profits which the LLC made. The taxpayer appealed, contending that his share of the LLC's profits was the same profits as those by reference to which he was taxed in the US. The First-tier Tribunal ('the tribunal') held that the same profits were taxed in both the UK and the US, with the result that the taxpayer was entitled to DTR. The tribunal found that the LLC was a separate legal entity; that its business was carried on by its members; that it owned its assets and that the members did not own its assets; that the LLC was liable for its debts; that the LLC did not have anything akin to share capital and that its capital was more like the partnership capital of an English partnership; and finally that the members of the LLC had an entitlement to profits as they arose. HMRC appealed to the Upper Tribunal. They contended that the tribunal was wrong to find that the taxpayer was entitled to the profits in a proprietary sense; the taxpayer had a contractual right to an equivalent of the profits, which were owned by LLC. The Upper Tribunal allowed the appeal, holding that the First-tier Tribunal had applied the wrong test and that the profits sought to be taxed in the UK were not the same as those taxed in the US. The taxpayer appealed to the Court of Appeal.

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Held – (1) The relevant test for determining whether a person was taxed on the same profits or income in both jurisdictions was whether the source of the profits or income in each jurisdiction was the same. The court had to determine the source, for the purposes of UK tax law, of the taxpayer's income: whether it was the profits of the LLC or merely a distribution out of its profits (see [9] and [37], below).

(2) Where the taxpayer became entitled to the profit of an entity because of some contractual arrangement to which he was a party, he had to show that the contract was actually the source of the profit, rather than a mechanism to secure a right to a profit derived from another source. He had to show a proprietary right to the profits. A mere contractual right to receive a profit was not enough; it was necessary that the profit had always belonged to the party claiming DTR. If profit was earned by an entity, and the source of the profit to the taxpayer as a member of that entity was a contract as between him and other members, then in the usual case the source of his income had to be a different source of income from that entity itself. It would be unusual for an entity with a separate legal personality, such as a company, to be tax transparent for English law purposes (see [9], [39], [57] and [64], below).

(3) On the facts, the profits of the LLC did not belong to its members. The members were not entitled to the profits as they arose; they were not entitled to the profits from the beginning. The profits arose from the LLC's trading as principal, and the deductions that could be made from the profits before they were allocated were indications that confirmed that the profits did not belong to the members from the moment of their creation. The amount allocated to members was a residual amount. What the members obtained was a distribution out of the LLC's profits (see [9], [83]–[84] and [86], below).

The appeal would therefore be dismissed.

Memec plc v IRC [1998] STC 754 considered.

Notes

For double taxation relief on income for individuals, see Simon's Taxes E6.401, E6.402.

For the Double Taxation Relief (Taxes on Income) (The United States of America) Order 2002, SI 2002/2848, which revoked the Double Taxation Relief (Taxes on Income) (The United States of America) Order 1980, SI 1980/568, see Simon's Taxes F1.6.

Cases referred to in judgments

Leeming v Jones (*Inspector of Taxes*) (1929) 15 TC 333, [1930] 1 KB 279, CA.

MCC Proceeds Inc v Bishopsgate Investment Trust plc [1999] CLC 417, CA.

Memec plc v IRC [1998] STC 754, 71 TC 77, (1998) 1 ITLR 3, CA; *affg* [1996] STC 1336, 71 TC 77.

Padmore v IRC [1989] STC 493, 62 TC 352, CA.

Reed (*Inspector of Taxes*) *v Young* [1986] STC 285, [1986] 1 WLR 649, 59 TC 196, HL.

Stainer's Exors v Purchase (*Inspector of Taxes*) 32 TC 367, [1952] AC 280, [1951] 2 All ER 1071, HL.

Appeal

Mr George Anson ('the taxpayer') appealed against a decision of the Upper Tribunal (Tax and Chancery Chamber) (Mann J) dated 3 August 2011 ([2011] UKUT 318 (TCC), [2011] STC 2126), allowing an appeal by the Revenue and

Customs Commissioners ('HMRC') against a decision of the First-tier Tribunal (Judge Avery Jones and Mr Menzies-Conacher) dated 22 February 2010 (see *Swift v Revenue and Customs Comrs* [2010] UKFTT 88 (TC), [2010] SFTD 553), allowing an appeal by the taxpayer against discovery assessments on the basis that he was entitled to double taxation relief for United States tax paid on the profits of a Delaware limited liability company. The facts are set out in the judgment of Arden LJ.

Jonathan Peacock QC (instructed by *Ernst & Young LLP*) for the taxpayer.
David Ewart QC and *James Henderson* (instructed by the *Solicitor for Revenue and Customs*) for the respondent.

Judgment was reserved.

12 February 2013. The following judgments were delivered.

ARDEN LJ (giving the first judgment at the invitation of Laws LJ).

[**1**] The appellant, Mr George Anson, is a member of a Delaware limited liability company or 'LLC', known as HarbourVest LLC ('HV'). This is a very profitable entity. HV is treated as 'tax transparent' in the USA, meaning that its members pay tax on their share of its profits and the LLC pays no tax. This is because under the relevant federal and state law the profits of such entities are treated as the profits of the members for fiscal purposes unless the members have elected otherwise in the prescribed way. That election was not made in this case. At the time that these profits arose, Mr Anson was resident but not domiciled in the UK for tax purposes and he was liable to pay UK tax only on income remitted to the UK but that included his share of the profits of HV for the fiscal years 1998 to 2004, the years with which we are concerned, unless any double tax relief ('DTR') or domestic unilateral relief was available. The issue on this appeal relates only to DTR.

[**2**] The respondent, the Revenue and Customs Commissioners ('HMRC'), seeks to levy tax on Mr Anson's share of HV's profits. In its decision dated 3 August 2011, the Upper Tribunal (Tax and Chancery Chamber) (Mann J) upheld HMRC's contentions ([2011] UKUT 318 (TCC), [2011] STC 2126, (2011) 14 ITLR 131).

[**3**] Mr Anson's case is that he is entitled to DTR. Accordingly, the question to be decided on this appeal is whether Mr Anson is entitled to DTR under the terms of the Double Taxation Relief (Taxes on Income) (The United States of America) Order 1980, SI 1980/568 (applying to all the fiscal years in issue save the last) ('the 1975 Convention') and the Double Taxation Relief (Taxes on Income) (The United States of America) Order 2002, SI 2002/2848 (in relation to 2003–04) ('the 2001 Convention').

[**4**] The question in issue falls to be determined by reference to the relevant provisions of the 1975 Convention and the 2001 Convention. There is no material difference between the two Conventions.

[**5**] It is common ground that, to obtain DTR, Mr Anson must establish that his share of HV's profits is the same profits as those by reference to which he was taxed in the US. These words are set out in art 23 of the 1975 Convention, which I have set out in the annex to this judgment.

[**6**] In essence, HMRC contends that Mr Anson's share of HV's profits represents income received by him from his investment in HV, and that these

are not the same as the profits which HV made. It does not seek to levy tax on Mr Anson on the basis that profits of HV can be attributed to him for tax assessment purposes.

[**7**] The First-tier Tribunal (Judge Avery Jones and Mr Menzies-Conacher) ('FTT') ([2010] UKFTT 88 (TC), [2010] SFTD 553, (2010) 12 ITLR 658) came to a different conclusion from the Upper Tribunal ('the Upper Tribunal'). The FTT considered that the members' arrangements for automatically allocating profits to members meant that the profits of HV had belonged to Mr Anson throughout. The Upper Tribunal considered that the FTT had applied the wrong test and that the profits sought to be taxed in the UK were not the same as those taxed in the US. I examine the members' arrangements as part of the background below.

[**8**] Mr Anson has already paid federal and state tax in the US on his share of HV's profits at the rate of 45%. The practical implications of this question are that, if the Upper Tribunal's decision stands, Mr Anson will be liable to pay tax at the rate of 22% of the whole out of the remaining 55% of his income, making an effective rate of tax of 67%. If the appeal succeeds he will pay no further tax in addition to that already paid in the US.

[**9**] Having considered the submissions of counsel and the decisions of the FTT and Upper Tribunal, I conclude that the decision of the Upper Tribunal discloses no error of law. I shall amplify below my reasons in paras [57]–[86], below, but in summary they are as follows:

(i) The relevant test for determining whether a person is taxed on the same profits or income in both jurisdictions is whether the source of the profits or income in each jurisdiction is the same.

(ii) Where the taxpayer became entitled to the profits of an entity because of some contractual arrangement to which he is a party, he must show that the contract is actually the source of the profit, rather than a mechanism to secure a right to a profit derived from another source. This will in general mean that, as the judge held, he has to show a proprietary right to the profits.

(iii) The Upper Tribunal was right to conclude that the FTT erred in law in so far as it held that the profits of HV belonged to the members.

(iv) The Upper Tribunal was also right to conclude that on the facts of this case the profits of HV did not belong to its members.

[**10**] The UK/US Exchange of Notes dated 24 July 2001 is a quite separate matter. Mr Anson does not have permission to appeal on this matter and accordingly he has first to obtain that permission. I will deal with his application when I have dealt with the appeal. For the reasons given in paras [87]–[93], below, I would refuse the appellants permission to rely on the UK/US Exchange of Notes dated 24 July 2001 at this late stage.

[**11**] I have used the term 'tax transparent' in para [1], above to denote the arrangements under US federal and state law for imposing tax on certain entities. The parties to this appeal have also used this expression but without defining it. They have similarly used the expression 'opaque' as meaning the opposite state of affairs. In line with my first reason in para [9], above, I propose to use the term 'tax transparent', in relation to UK tax, to describe the income of a member of an entity which is to be regarded as having the same source for the purposes of UK tax law as that of the entity from which it is derived. For this purpose, an entity includes a partnership or a trust which does not have a separate legal personality.

[**12**] Before I explain my reasons I will set out the background and briefly summarise the reasoning of the FTT and Upper Tribunal.

BACKGROUND

(*a*) *Relevant features of an LLC*

[**13**] The FTT heard expert evidence as to foreign law and made detailed findings on this subject.

[**14**] It is common ground that an LLC is an entity which is separate from its members and that an LLC holds its undertaking and assets separately from its members. This is an indication that profits derived from its trading are those of the LLC and not those of its members. Profits are after all simply the sum which remains after an account of the results of the trading are drawn up.

[**15**] The LLC is a creature of the Delaware LLC Act.

[**16**] The principal characteristic of an LLC is that the statutory framework provides a number of default rules but otherwise enables parties to structure the internal workings of the LLC by agreement. Thus:

> (i) Profits and losses of the LLC are allocated to the members either as agreed in 'an LLC agreement' or in proportion to the agreed values of their contributions.
>
> (ii) The LLC agreement can regulate members' voting rights but in default the Delaware LLC Act specifies the voting rights of managing and non-managing members.
>
> (iii) Members have interests in the profits and assets of the LLC, which they can assign, but the LLC has no share capital.
>
> (iv) Members have capital accounts to which the LLC's profits are credited and losses debited. Members benefit rateably from any credit for tax purposes.
>
> (v) Distribution and reserving policy is controlled by the 'managing members'. Accordingly managing members could determine the timing and amount of distributions out of members' capital accounts. It follows that members cannot compel the distribution of their capital accounts to themselves.

(*b*) *HV LLC agreement* (*28 January 1997*)

[**17**] The members of HV entered into an LLC agreement dated 28 January 1997. HV is not a party to the LLC agreement. The provisions principally relevant for the purposes of this appeal are those dealing with capital contributions and capital accounts.

[**18**] The members made initial capital contributions and agreed to make additional capital contributions when required by the managing members.

[**19**] Article IV provided for the crediting to members' capital accounts of capital contributions and all gross income and capital gains, and for the debiting to such accounts of distributions and all losses and expenses. There were complex provisions for determining the basis of allocation as between different members but we are not concerned with these provisions.

[**20**] Article V then dealt with distributions of net profits. This had four parts dealing with respectively: distributions; set off of sums due from members to HV; the creation of reserves, and the withholding of taxes. The first part begins as follows:

> 'Subject to the provisions of this Article V, to the extent cash is available, distributions of all of the excess of income and gains or losses, deductions

> and expenses allocated in accordance with Section 4.2 with respect to any calendar year will be made by the Company at such time within seventy-five (75) days following the end of such calendar year and in such amounts as the Managing Members may determine in their sole discretion. The Managing Members may from time to time in their discretion make additional distributions in accordance with the provisions of this article V.'

[**21**] There were then provisions dealing with the order of priority of different types of distributions to members, but we are not concerned with the detail of these.

[**22**] The third part of art V dealt with reserves. In effect, it enabled the LLC to withhold amounts which were otherwise distributable by the company to the members to make such provision as it thought desirable to meet liabilities, including future or contingent liabilities:

> 'The Company may withhold amounts otherwise distributable by the Company to the Members, pro rata from all members in accordance with the amounts otherwise distributable, in order to make such provision as the Company, in its discretion, deems necessary or advisable for any and all reasonably anticipated liabilities, contingent or otherwise, of the Company and to maintain the Company's status as a qualified professional asset manager within the meaning of the [a statutory provision] …'

[**23**] The fourth part of art V dealt with withholding tax. HV could retain out of profits the sums which it required to pay withholding tax as a result of a member's status as a member or former member.

[**24**] Article XI dealt with dissolution and provided that surplus assets should be distributed to members in accordance with art V. We are not concerned with the detail of this provision.

DECISION OF THE FTT

[**25**] The FTT decided that the same profits were taxed in both the UK and the United States and that therefore Mr Anson was entitled to DTR. The FTT found that the LLC was a separate legal entity, that its business was carried on by its members, that it owned its assets and that the members did not own its assets, that the LLC was liable for its debts, that the LLC did not have anything akin to share capital and that its capital was more like the partnership capital of an English partnership, and finally that the members of the LLC had an entitlement to profits as they arose.

[**26**] The FTT's conclusion was expressed in the opening sentences of para [21] of its decision as follows ([2010] SFTD 553):

> 'The factor we are mainly concerned with in relation to the treaty is whether the profits belong to the members as they arise. We have concluded that this is the effect of the LLC … Agreement and the Act.'

DECISION OF THE UPPER TRIBUNAL

[**27**] The Upper Tribunal concluded that in para [21] of its decision the FTT (para [26], above) had held that the members of HV had not merely a contractual but a proprietary entitlement to profits, and that this was an error of law as the evidence did not support this conclusion. In those circumstances the Upper Tribunal held that it could address the question of the nature of the members' entitlement afresh. It concluded that the profits on which Mr Anson was taxed in the US—

> 'were in law, reality and substance the profits of [HV] … it was a contractual entitlement to money, like the plc's interest in the silent partnership in *Memec*… the profits were [HV's] and the contractual obligation to credit and distribute did not make them the members', at least for English tax purposes. The position of the members is nothing like the position of an English partner …' ([2011] STC 2126 at [52]).

[**28**] Those profits were accordingly not the same as those on which Mr Anson was liable to tax in the UK, and the Upper Tribunal allowed the appeal from the FTT.

[**29**] I now turn to the task of developing the reasons outlined in para [9], above, describing the submissions of the parties on the various points.

AMPLIFICATION OF MY REASONS OUTLINED ABOVE

(*i*) *The relevant test for determining whether a person is taxed on the same profits or income in both jurisdictions is whether the source of the profits or income in each jurisdiction is the same*

[**30**] *Memec plc v IRC* [1998] STC 754, 71 TC 77 is the leading authority on this point and on other points in this appeal. That case involved a provision similar to art 23 of the 1975 Convention appearing in the UK/Germany Double Tax Convention. A parent company (M) had entered into a stille gesellschaft, or silent partnership agreement under German law, with a subsidiary (an intermediate holding company) to receive the lion's share of the profits received by that subsidiary from its subsidiaries, in return for making a substantial investment.

[**31**] M sought to say that the profits received by the intermediate holding company (which were taxable in Germany) were the same as those received by M so that there could be DTR in the UK against the tax payable by M. M thus contended that the silent partnership created no new source of income, and that the source of the income was not the contractual provisions of the silent partnership arrangement so that the arrangement was tax transparent for the purposes of UK law.

[**32**] The special commissioners, the High Court and this court all rejected that claim.

[**33**] Robert Walker J (as he then was) accepted that, to be tax transparent, the income had to have the same source as that taxed in the foreign jurisdiction because of the schedular nature of UK income and corporation tax ([1996] STC 1336 at 1349, 71 TC 77 at 93):

> 'The schedular character of income tax (on which corporation tax is based: see s 9 of the 1988 Act) means that the court has always placed great importance on the concept of the *source* of taxable income (see for instance the anthology of citations provided by Lord Hanworth MR in *Leeming v Jones* (*Inspector of Taxes*) [1930] 1 KB 279 at 297, 15 TC 333 at 349–350)). The concept of source is a more or less coded subtext to income tax and corporation tax statutes.'

[**34**] The schedular character of income tax derives from the fact that historically the legislative approach was not to define income but to provide that income from sources specified in a number of schedules (Schs A to F) to the legislation should be subject to income tax. If income could not be brought

within the schedules, it was not taxable. Income tax is still imposed by reference to categories of income even though schedules are not generally used, and so the point made by Robert Walker J remains good.

[**35**] When M appealed to this court, this court also adopted the approach that they had to determine whether the sources of the income of M and the silent partnership were the same.

[**36**] Both parties accept that Mr Anson has to show that the profits on which he was or is sought to be taxed in the two jurisdictions had the same source, though they differ as to the identity of the source.

[**37**] In my judgment, the court has to determine the source for the purposes of UK tax law of Mr Anson's income: was the source of his income the profits of HV or merely a distribution out of its profits?

[**38**] I will explain further under the next sub-heading how the exercise of establishing the precise source of his income is to be carried out. There is no issue as to the source of HV's profits: those profits were plainly derived from its own trading.

(*ii*) *Where the taxpayer became entitled to the profit of an entity because of some contractual arrangement to which he is a party, he must show that the contract is actually the source of the profit, rather than a mechanism to secure a right to a profit derived from another source. This will in general mean that, as the judge held, he has to show a proprietary right to the profits*

[**39**] This is the proposition of law which I would distil from *Memec*. (Under this sub-heading I am dealing only with the law.) It is not enough to show a contractual right to receive a profit. The profit must always have belonged to the party claiming DTR. To explain this point, I need to examine *Memec* in more detail.

(*a*) *Memec at first instance before Robert Walker J*

[**40**] The parties in *Memec* were agreed that the formation of the silent partnership meant that there was a new source of income. The issue was whether the silent partnership was tax transparent.

[**41**] Robert Walker J reviewed the authorities on trusts. He noted that the income paid to a life tenant under an interest in possession trust would be tax transparent because the life tenant has an interest in the trust property, and the income as it comes into the trustees' hands. He further held that this could be contrasted with a discretionary trust, where no beneficiary was entitled to any income unless and until the trustees exercised their discretion in his or her favour. M challenged this point in this court and Peter Gibson LJ left it open ([1998] STC 754 at 764, 71 TC 77 at 111).

[**42**] The issue that arose in *Memec* was whether the silent partnership could be treated like an English, Jersey or Scottish partnership. The Commissioners of Inland Revenue (the Revenue) had accepted that all of these were 'tax transparent'. Indeed this court has held that the profits of an English partnership are the profits of the partners as the business is carried on by the partners as principals and as agents for each other (see per Fox LJ in *Padmore v IRC* [1989] STC 493, 62 TC 352).

[**43**] Counsel for the Revenue in *Memec* (Mr Launcelot Henderson QC, as he then was) submitted that the silent partnership did not share the important characteristics of an English partnership which made it tax transparent: those

three characteristics were (1) no separate legal personality, (2) the carrying on of a business in common with a view to profit and (3) that partnership assets are owned by the partners beneficially.

[**44**] Robert Walker J observed that the question was not whether the silent partnership was a partnership for English law purposes but whether the arrangements were tax transparent so as to make the source of M's share of the subsidiaries' profits the same as that of the profits distributed to the intermediate holding company.

[**45**] Robert Walker J held that the decisive point was that M had no proprietary right in the shares of the subsidiaries or to the distributions by them. They belonged to the intermediate holding company. Accordingly they had to be regarded as a separate source of income and the arrangement was not tax transparent. M appealed.

(*b*) *Memec in this court*

[**46**] This court came to the same conclusion that the silent partnership arrangement was a separate source for income tax purposes but emphasised different matters.

[**47**] Peter Gibson LJ, giving the first judgment, held that the task to be carried out in that case was to see to what extent the characteristics of an English or Scottish partnership were shared by a silent partnership. He carried out a detailed analysis and concluded that, unlike an English or Scottish partnership, the business was carried on by the intermediate holding company alone and the interest of M in the profits of the subsidiaries was purely contractual. Peter Gibson LJ drew an analogy with the case of a lender who makes an advance for a return varying with profits where that does not give rise to a partnership.

[**48**] He held that a silent partnership was crucially different from an English or Scottish partnership ([1998] STC 754 at 765, 71 TC 77 at 113):

> 'A silent partnership, whilst being similar to an English partnership in not being a separate legal entity, differs from both English and Scottish partnerships in a number of respects. The judge considered the decisive point to be the absence of any proprietary right, legal or equitable, enjoyed by plc in the shares of the subsidiaries or in the dividends accruing on those shares. That is certainly a strong point of distinction from an English partnership, though it is less obviously so in the case of a Scottish partnership. But even a Scottish partner has an (indirect) *interest in the profits of the partnership as they accrue* as well as in the assets of the partnership. In a real sense the profits and assets are the profits and assets of the partners, the firm, their collective alter ego, merely receiving those profits and holding those assets for the partners who are the firm. They are jointly and severally liable for the firm's debts. In contrast, though a silent partner is indirectly interested in those profits, in that his entitlement to a share of the profits (or his obligation in respect of the losses) will be computed by reference to the profits of the owner at the end of the year, his interest is purely contractual. A clearer distinction is the point advanced by Mr Henderson that unlike in an English or Scottish partnership in the silent partnership no business is carried on by plc and GmbH in common with a view to profit. The business is that of GmbH as sole owner. Plc is not jointly liable with GmbH to creditors of GmbH for the debts and obligations of GmbH. The liabilities of the business are those of GmbH

alone, though plc can be called on by GmbH to bear its share of losses computed at the end of the year to the extent of its capital contribution. To a third party, plc's role in the silent partnership is irrelevant and may not be known.' (My emphasis.)

[**49**] He agreed with the following conclusion of Robert Walker J ([1998] STC 754 at 766, 71 TC 77 at 114):

'Metaphorical language is not a substitute for analysis, but it may help to explain the conclusion: adopting Lord Asquith's phrases [in *Stainer's Exors v Purchase* (*Inspector of Taxes*) [1952] AC 280 at 291], I conclude that plc's rights under the [agreement] did have independent vitality and were not mere incidental machinery. Without those rights under the [agreement] plc would continue to receive dividends from GmbH, and nothing from the [subsidiaries].'

[**50**] Sir Christopher Staughton gave the only other reasoned judgment. He also relied on the fact that under German law the intermediate company owned the assets and ran the business.

(*c*) *Revised Revenue guidance*

[**51**] On the basis of *Memec*, the Revenue issued revised guidance (see February 1999 Tax Bulletin Issue 39). This lists six factors, which were put to the experts in this case. These factors include ownership of profits as they arose, but, as pointed out on behalf of Mr Anson, the guidance does not state that ownership of profits is a necessary precondition to claiming DTR. The guidance adopts a multi-factorial approach to determining whether an entity is opaque or transparent. Some of the factors may point in one direction and some in another. The guidance states that an overall conclusion is required.

(*d*) *Submissions*

[**52**] Mr Anson's case is that the same-source requirement is satisfied by showing that his entitlement to profits was an automatic one, not dependent on the act of any third party. Thus Mr Jonathan Peacock QC, for Mr Anson, submits that his case is supported by the fact that there is no necessary requirement in the case law or the revised Revenue guidance that there should be ownership of the assets of the business as well. He relies on the paragraph from the judgment of Peter Gibson LJ which I have set out in para [48], above, and the Revenue guidance described in para [51], above.

[**53**] On Mr Peacock's submission, there did not have to be a right to a profit; there had simply to be an entitlement to profits *as they arose*. He goes on to argue that, in the case of HV, there was no intervening entitlement in HV as there would be if there were a requirement for a directors' resolution to pay a dividend. Accordingly, he submits that the requirement of entitlement was fulfilled. (I will discuss the application of the appropriate principle separately under subheading (iv) below.)

[**54**] Mr David Ewart QC, for HMRC, submits that a mere contractual right is not enough. There has to be a right to the profits, not merely a right to receive them as they arose.

[**55**] Mr Ewart submits that in *Memec* this court essentially made the same point as Robert Walker J. The partnership in that case was not carrying on business in common. The same question arises in this case as in *Memec*: what

was the source of the income? To be the same profits they must, on Mr Ewart's submission, emanate from the same source and relate to the same period.

[**56**] Mr Ewart also submits that the source in tax terms is the taxpayer's immediate source. A shareholder gets his dividend from his shares, and in that case the shares are the source. So, in *Memec*, the dividends declared by the trading subsidiaries were the source of the income.

(*e*) *My analysis*

[**57**] In my judgment, *Memec* establishes the approach to be adopted in determining whether the profits of a member of an entity are the same as those of the entity itself. If profit is earned by an entity, and the source of the profit to the taxpayer as a member of that entity is a contract as between him and other members, then in the usual case it follows that the source of his income must be a different source of income from that of the entity itself. The fact that there is a contract generally suggests that there is a disposition of a right to the profits from one person to another. That result can be avoided if the member had a proprietary right to the profits as they arose. This would as I see it generally be the case where income accrues to a trust under which an income beneficiary has an interest in possession, or to a unit trust or collective investment scheme, if the investors have a beneficial interest in the assets that are subject to the unit trust or scheme.

[**58**] What the court is looking for is whether the member had a right to the profits when the profits were created, or, in the words of Peter Gibson LJ in *Memec*, as they accrue. In answering that question, the court will look at factors which throw light on the answer to that question, such as whether the entity is a separate legal entity, whether the entity has a share capital, whose business is actually being carried on, whether the profits depend on the decision to allocate, liability for debts of the entity and ownership of the assets of the entity. Provisions in the agreement between the members which make it possible to assign an interest may also throw light on whether the profits are those of the members. The member's interest could amount to a share of the profits from the moment they arose, or it could simply be a right to receive a share of the profits.

[**59**] I recognise that profits do not arise until an account is struck for a particular period showing that there has been a profit, and that in general an entity will not have particular assets that can be said to be assets which represent the profit which it has made. For these reasons, in order for a member of an entity to show that he was entitled to profits from the moment that the profit arose he will have to show that he has an interest in the assets to the value of the profit. This will necessarily be a proprietary interest.

[**60**] A partner in an English partnership has an equitable interest in the partnership assets and thus he will be able to show that he has a proprietary interest to the extent of his profit and share in the partnership.

[**61**] Likewise an income beneficiary under an interest in possession trust will be able to show an equitable interest in the income in question.

[**62**] It is not therefore sufficient to find that there is a contract if that contract is in reality simply the means whereby the entity transfers its right to receive or retain the profits to the member. In that event, the contract will not be the source of the profit as from the moment of its creation. To say that the member must be entitled to profits as they arise or from the moment they are created is merely the converse of this proposition.

[**63**] Mr Ewart submits that it is impossible for the profits of a business to belong to a person other than the person carrying on the business. I agree that it is difficult to think of examples where this would be the case, save perhaps in one case. That is the case of an agency company, that is, a company which carries on its own business so far as its dealings with the outside world are concerned but which in fact holds its assets as agent for another (usually another group company) and draws up its own accounts on that basis. But even in that example, the agency company may be little more than a nominee. There may be other cases.

[**64**] In my judgment, it would be unusual but not impossible for an entity with a separate legal personality, such as a company, to be tax transparent for English law purposes. One example would be the Scottish partnership where the partnership is a separate legal entity and holds the assets of the business, but the partners have an (indirect) interest in the assets and carry on business in common: this has been held by this court to be tax transparent and Mr Ewart assured the court that nothing in his submissions was intended to undermine that position.

(*iii*) *The Upper Tribunal was right to conclude that the FTT was in error in so far as it held that the profits of HV belonged to its members*

[**65**] Under this subheading I need to deal with two submissions made by Mr Peacock, one as to foreign law and one as to the scope of the FTT's holding in para [21] of its decision.

(*a*) *Threshold question—was the FTT's finding (para [21] of its decision) a finding of foreign law?*

[**66**] A threshold question arises as to the basis on which this court can review the material part of para [21] of the FTT's decision (para [26], above), which was a fundamental step in the Upper Tribunal's reasoning.

[**67**] Mr Peacock submits that the question of who is entitled to the profits of HV falls to be determined as a matter of Delaware law, and is thus a question of fact. Moreover, the FTT made its findings having heard the evidence of two experts. Accordingly, on his submission, the Upper Tribunal should not have set aside the FTT's finding in para [21] of its decision that HV's profits belonged to its members.

[**68**] Mr Peacock relies on *MCC Proceeds Inc v Bishopsgate Investment Trust plc* [1999] CLC 417. In that case, this court held that it would be slow to set aside findings as to foreign law based on oral evidence though it would do so more readily where it was a question of statutory interpretation, on which there was no evidence of particular rules of interpretation, or of a special meaning, under the foreign law.

[**69**] Mr Ewart submits that para [21] of the FTT's decision is in material part a holding on the application of English law to the features of the members' interests in HV which had been established on the evidence as to foreign law. In those circumstances, para [21] constituted a holding on domestic law, not a decision as to foreign law.

[**70**] I accept Mr Ewart's submission on this point. As to the role of foreign law, Robert Walker J (at first instance) in *Memec* summarised the effect of the authorities (including authority binding on this court) as follows ([1996] STC 1336 at 1348, 71 TC 77 at 92):

> 'When an English tribunal has to apply the provisions of an United Kingdom taxing statute to some transaction, arrangement or entity which is governed by a foreign system of law, the tribunal must take account of the rules of that foreign system (properly proved if not admitted) in order to determine the nature and characteristics of the transaction, arrangement or entity. But having informed itself in this way, the tribunal must then apply the taxing statute as part of English law.'

[**71**] Accordingly, in the present case, Delaware law governs the rights of the members of HV as the law of the place of its incorporation, and the LLC agreement is expressly made subject to that law. However, the question whether those rights mean that the income of HV is the income of the members is a question of domestic law which falls to be determined for the purposes of domestic tax law applying the requirements of domestic tax law, including those discussed under subheadings (i) and (ii), above.

(b) What was the scope of the finding in para [21] of the FTT's decision?

[**72**] Mr Peacock submits that, if it was open to the Upper Tribunal to set aside the FTT's finding as to entitlement to profits, the Upper Tribunal was wrong to hold that the FTT made a finding as to entitlement to profits in a proprietary sense. On his submission, the finding was only as to entitlement to profits in a contractual sense.

[**73**] Mr Peacock points out that the FTT reached their conclusion on the basis of the provisions in the LLC agreement providing for the allocation of profits to capital accounts (see paras [10]–[12] of the decision of the FTT).

[**74**] The FTT used the word 'belong' in paras [12] and [21] and other paragraphs of its decision but Mr Peacock submits that the FTT simply used this word in the sense of an entitlement: see for example para [18]. On his submission the FTT referred not to ownership in a proprietary sense but to the entitlement to profits as they arose and that they decided that point in Mr Anson's favour. The FTT was an expert tribunal and must be taken to know the significance of these concepts.

[**75**] This question was considered at length by the judge and he came to the conclusion that 'when the [FTT] said "belong" in para [21], it meant "belong" ': I agree. As the judge said, the comparison with partnerships (in the FTT's para [20]) is a clear indication that this is what the FTT meant. The FTT did not restrict its conclusions to entitlement or to allocation of profits, and it is difficult to think that it would confuse a right of ownership of profits with a right to have profits allocated.

(iv) The Upper Tribunal was right to conclude that the profits of HV did not belong to its members

[**76**] I now turn to the question whether the Upper Tribunal was right on the facts of this case to conclude that the profits of HV (being the gross income allocated to their capital accounts less the expenses debited thereto) did not belong to the members in a proprietary sense. In my judgment, it was. The members' right to have profits allocated to their capital accounts represented a transfer of an entitlement to the profits, and the profits as they arose belonged to HV.

[**77**] Mr Peacock's case is that HV was analogous to a partnership. However, the fact is that HV had a separate legal personality. There is nothing to suggest that it did not have unqualified ownership of its assets or that its members had any interest in those assets (see paras [14]–[16], above).

[**78**] Mr Peacock submits that the Upper Tribunal were wrong to say that the members of HV had to have a proprietary interest in the profits of HV for the following reasons:

(i) Profits are conceptually distinct from assets (*Reed (Inspector of Taxes) v Young* [1986] STC 285 at 289, [1986] 1 WLR 649 at 653–654, per Lord Oliver of Aylmerton, which was quoted by the Upper Tribunal in para [38] of its decision). This much is indeed common ground. Accordingly, the ownership of cash is not determinative of profits as they arise. Mr Peacock submits that this is so in Delaware, as well as in English, law. Thus Delaware law defines the interest of a member as including a share of profits as well as the distribution of assets.

(ii) Under Delaware law, the entitlement to profits is contractual where it is governed by the terms of the LLC agreement.

(iii) FTT interpreted the provisions in the LLC agreement as imposing an obligation to allocate profits, and was right to do so. This obligation was not undermined by the qualifications on that obligation, such as HV's right to set allocations of profits against amounts owed by the member to HV and its right to establish reserves out of profits.

[**79**] Mr Peacock further submits that HMRC's case is in effect that, once it is understood that the LLC has a separate personality and is answerable for its debts, those factors are conclusive as to entitlement to profits as they arise. That would leave the position of a Scottish partnership exposed. It would mean that Scottish partnerships are non-transparent (or 'opaque') and that would seem to have the result that all Delaware LLCs are opaque. So this court would be deciding the point for all Delaware LLCs.

[**80**] Mr Ewart submits that the crucial question is to identify the profits on which Mr Anson was taxed in the United States. The critical question was whether the United Kingdom charged tax on the same profits as the US. Mr Ewart submits that Mr Anson must establish that the charge to tax in the United Kingdom was on his share of profits, not upon a distribution by the LLC. He must also answer the question: why would he be charged in the United Kingdom to tax on those profits?

[**81**] Mr Ewart focuses on the fact that the business was carried on by the LLC and that it owned all its assets just like a company. He submits that:

- Article IV simply set out the process of deciding the amount that Mr Anson could receive in a distribution; and
- Article V deals with what each of the members receives on a distribution. There needed to be a mechanism for determining profits to be distributed.

[**82**] Mr Ewart further submits that the decision of the FTT did not depend on art V. The FTT held that art V was irrelevant to the issue which the FTT had to determine, which had to stand or fall on art IV. On his submission, profits belong to the LLC before they are allocated to members. The LLC is merely distributing its cash. Furthermore, there is no difference between a share capital company and this company with respect to dividends. The question is whether it is the same income. On his submission, it is not because it does not have the same source.

[**83**] In my judgment, the key issue is whether the members of HV were entitled to the profits as they arose. The FTT identified this as a relevant question, but was misled into thinking that the matters to which the allocation of profits was subject—the availability of cash, the absence of claims by HV

against the member which could be the subject of set off, a decision by the managing members to create reserves to meet HV's cash requirements, and the need to withhold profits to meet withholding tax payable by HV—had no substantial effect on the question whether the members were entitled to the profits from the very beginning. Those were very material reservations, like the reservation in the proverbial question to Mrs Lincoln. The fact was that the profits arose from HV's trading as principal, and the deductions that could be made from profits before they were allocated were powerful indications that confirmed that the profits did not belong to the members from the moment of their creation. The amount allocated to members was indeed a residual amount after HV had taken the sums that it needed.

[**84**] It is apparent that all that the automatic allocation provisions in art V of the LLC agreement achieved was to make it unnecessary to have a resolution of the managing members of HV before an allocation was made. Put another way, the members have agreed in advance on those matters that were to prevent or limit a restriction on the distribution of profits (for example, a need to credit profits to a reserve). Accordingly, contrary to the view of the FTT, the automatic allocation provisions did not affect the fact that the profits arose from the business of HV and were its profits. What the members obtained was a distribution out of its profits.

[**85**] Moreover, as Mr Ewart points out, it is not unknown for private companies in the UK to have articles of association that provide for the automatic distribution of profits. There is nothing unique, therefore, in the drafting of the LLC agreement in this regard.

[**86**] Accordingly, in my judgment, the Upper Tribunal came to the correct conclusion that on the facts of this case the profits of HV did not belong to its members.

Application for permission to appeal: UK/US Exchange of Notes dated 24 July 2001

[**87**] Mr Peacock relied on an exchange of notes dated 24 July 2001 between the governments of the UK and the US at the time of the entry into the 2001 Convention:

> '*With reference to Article 24 (Relief from Double Taxation):*
> it is understood that, under paragraph 4 or 8 of Article 1 (General Scope), the provisions of the Convention may permit the Contracting State of which a person is a resident (or, in the case of the United States, a citizen), to tax an item of income, profit or gain derived through another person (the entity) which is fiscally transparent under the laws of either Contracting State, and may permit the other Contracting State to tax
> a) the same person;
> b) the entity; or
> c) a third person
> *with respect to that item*. Under such circumstances, the tax paid or accrued by the entity shall be treated as if it were paid or accrued by the first-mentioned person for the purposes of determining the relief from double taxation to be allowed by the State of which that first-mentioned person is a resident (or, in the case of the United States, a citizen) …' (My emphasis.)

[**88**] Mr Peacock applies for permission to appeal with respect to the 2001 Convention of 24 July 2001 having regard to this exchange of notes.

Mr Peacock submits that it is no longer necessary to show that tax was paid on the same profits. On the contrary the exchange of notes was intended to resolve that question.

[**89**] Mr Ewart makes a number of points about this exchange of notes but his principal submission for present purposes is that the exchange of notes does not address the question of which income it is that is taxable.

[**90**] Mr Ewart further contends that these notes were incorporated into the 2001 Convention to meet a problem for the US authorities about tax-transparent vehicles. The effect he submits was not with respect to relief by the UK but with respect to relief given by the US. For example, there could be a US individual with an interest in a UK entity where the entity makes the profits and the US treats the entity as transparent whereas the UK taxes the entity. The exchange of notes states that under such circumstances the tax will be treated as paid by the first person so that the US must give relief. This is not a UK problem.

[**91**] Mr Peacock disputes this point. He submits that the explanation given by Mr Ewart does not illustrate how the clause would work the other way around when it was clearly envisaged to work both ways. It is therefore no answer to say that it was only intended to operate from the US point of view.

[**92**] Mr Peacock did not raise this point until after the Upper Tribunal had given its decision. There is clearly some dispute as to the mischief to which the exchange of notes is directed. There would have to be further evidence to resolve that dispute. Moreover, the words 'with respect to that item', which I emphasised in setting out the material part of the exchange of notes in para [87], above, are, on the face of it, consistent with Mr Ewart's principal submission that no change is made in the requirement for the profits taxed in each jurisdiction to be the same profits in order to qualify for DTR. If an alteration to art 23 was intended, it is surprising that it was dealt with in this oblique way.

[**93**] In all the circumstances I would refuse permission to appeal on this further point.

Disposal of this appeal

[**94**] For the reasons given above, I would dismiss this appeal. I would, however, like to express my gratitude to counsel for the clarity and economy of their submissions, and to pay tribute also to the helpful and skilful analysis in the Upper Tribunal's decision.

LLOYD LJ.

[**95**] I agree, for the reasons given by Arden LJ, that the application for permission to appeal on an additional ground should be refused, and that the appeal should be dismissed.

LAWS LJ.

[**96**] I also agree.

Appeal dismissed.

Katie Green Barrister.

ANNEX TO THE JUDGMENT OF ARDEN LJ

Article 23 of the US/UK Double Tax Convention of 31 December 1975

'(2) Subject to the provisions of the law of the United Kingdom regarding the allowance as a credit against United Kingdom tax of tax payable in a territory outside the United Kingdom (as it may be amended from time to time without changing the general principle hereof):

(a) United States tax payable under the laws of the United States and in accordance with the present Convention, whether directly or by deduction, on profits or income from sources within the United States (excluding in the case of a dividend, tax payable in respect of the profits out of which the dividend is paid) shall be allowed as a credit against *any United Kingdom tax computed by reference to the same profits or income by reference to which the United States tax is computed;*

(b) in the case of a dividend paid by a United States corporation to a corporation which is resident in the United Kingdom and which controls directly or indirectly at least 10 per cent of the voting power in the United States corporation, the credit shall take into account (in addition to any United States tax creditable under (a) the United States tax payable by the corporation in respect of the profits out of which such dividend is paid.' (My emphasis.)

ITEM NO. 159

JA-45

A

Chancery Division

Fibria Celulose S/A *v* Pan Ocean Co Ltd and another

Pan Ocean Co Ltd and another *v* Fibria Celulose S/A

[2014] EWHC 2124 (Ch)

B

2014 April 2, 3, 4; June 30

Morgan J

Insolvency — Cross-border insolvency — Foreign proceedings — Shipowner and charterer entering into contract of affreightment governed by English law — Contract providing right of termination by either party on insolvency of other party — Shipowner entering insolvency process in Republic of Korea — Process recognised by Companies Court as foreign main proceedings for purposes of cross-border insolvency law — Shipowner's administrator contending termination provision unenforceable under Korean insolvency law and applying for order restraining service of termination notice by charterer — Whether service of notice "commencement or continuation of individual actions or individual proceedings" allowing recognising court to grant stay — Whether court having power to apply foreign insolvency law in granting "any appropriate relief" under English Regulations — Whether court restricted to relief available in domestic insolvency proceedings — Cross-Border Insolvency Regulations 2006 (SI 2006/1030), Sch 1, art 21(1)

C

D

The shipowner, a company incorporated under the laws of the Republic of Korea, entered into a long-term contract of affreightment with the charterers. The contract was governed by English law and provided for London arbitration. Clause 28 provided for termination with immediate effect on notice in writing for default including insolvency. The shipowner became insolvent and an insolvency process of rehabilitation was commenced in the Republic of Korea, which was recognised by the Companies Court as foreign main proceedings for the purposes of the Cross-Border Insolvency Regulations 2006[1]. The charterer did not want to pay freight in excess of the then market rate and sought to rely on clause 28 to terminate the contract. The shipowner's administrator contended that, while it was admittedly valid under English law, as a matter of Korean insolvency law the contracts termination provision was unenforceable. The administrator sought an order restraining the charterer from serving a termination notice, either pursuant to the court's power to stay the "commencement or continuation of individual actions or proceedings" under article 21(1)(a) of Schedule 1 to the 2006 Regulations or, alternatively, pursuant to the power in article 21(1) to grant "any appropriate relief".

E

F

On the administrator's application—

Held, dismissing the application, that the service of a notice to terminate under clause 28.1 of the contract was not the commencement or continuation of an individual action or proceeding within article 21(1)(a) of Schedule 1 to the Cross-Border Insolvency Regulations 2006; that, accordingly, the court did not have power under article 21(1)(a) to restrain the charterer from serving a termination notice under clause 28.1; that although the words "any appropriate relief" in article 21(1) of Schedule 1 to the 2006 Regulations were capable of a very wide meaning, that width demanded caution in construing the words literally; that, in light, in particular, of the documents to which the court was directed to have regard by the 2006 Regulations, the phrase "any appropriate relief" was not intended to allow the recognising court to go beyond the relief it would grant in relation to a domestic insolvency; that, in any

G

H

[1] Cross-Border Insolvency Regulations 2006, Sch 1, art 21(1): see post, appendix.

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event, the parties had chosen English law as the governing law of the contract, and that being so, it was appropriate to apply English law to the substantive issue of whether the charterer was entitled to terminate the contract; and that, accordingly, even if the court had jurisdiction pursuant to the words "any appropriate relief" in article 21 to grant the administrator relief which would be available to him in the Korean court, it would not be appropriate to exercise it (post, paras 75, 79, 105, 107, 108, 109–113).

Bristol Airport plc v Powdrill [1990] Ch 744, CA and *In re Olympia & York Canary Wharf Ltd* [1993] BCLC 453 considered.

The following cases are referred to in the judgment:

Allied Domecq (Holdings) plc v Trustee of Jinro Co Ltd 6 September 2007, Korean Sup Ct

Atlas Bulk Shipping A/S, In re [2011] EWHC 878 (Ch); [2012] Bus LR 1124

Atlas Shipping A/S, In re (2009) 404 BR 726, US Bankruptcy Ct, Southern District of New York

AWB (Geneva) SA v North America Steamships Ltd [2007] EWHC 1167 (Comm); [2007] 1 CLC 749; [2007] EWCA Civ 739; [2007] 2 Lloyd's Rep 315, CA

Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd (Revenue and Customs Comrs intervening) [2011] UKSC 38; [2012] 1 AC 383; [2011] 3 WLR 521; [2011] Bus LR 1266; [2012] 1 All ER 505, SC(E)

Bristol Airport plc v Powdrill [1990] Ch 744; [1990] 2 WLR 1362; [1990] 2 All ER 493, CA

Cambridge Gas Transportation Corpn v Official Committee of Unsecured Creditors of Navigator Holdings plc [2006] UKPC 26; [2007] 1 AC 508; [2006] 3 WLR 689; [2006] 3 All ER 829; [2006] 2 All ER (Comm) 695, PC

Condor Insurance Ltd, In re (2010) 601 F 3d 319, US Ct of Appeals, Fifth Circuit

Doman Industries, In re 2003 BCSC 376; 41 CBR (4th) 29, Sup Ct of British Columbia

Gandi Innovations Holdings LLC, In re (unreported) 5 June 2009, US Bankruptcy Ct, Western District of Texas

Hartford Computer Hardware Inc, In re 2012 ONSC 964; 94 CBR (5th) 20, Ontario Sup Ct

Korea Real Estate Investment & Trust Co Ltd v Receiver of Poonglim Co Ltd 17 July 2013, Korean Ct

Lehman Bros Holdings Inc, In re (2010) 422 BR 407, US Bankruptcy Ct, Southern District of New York

Metcalfe & Mansfield Alternative Investments, In re (2010) 421 BR 685, US Bankruptcy Ct, Southern District of New York

Metzeler, In re (1987) 78 BR 674, US Bankruptcy Ct, Southern District of New York

Norcen Energy Resources Ltd v Oakwood Petroleums Ltd (1988) 72 CBR (2d) 1, Alberta Ct of Queen's Bench

Olympia & York Canary Wharf Ltd, In re [1993] BCLC 453

Playdium Entertainment Corpn, In re (2001) 31 CBR (4th) 302, Ontario Sup Ct

Radcliff Corpn v Receiver of Samsun Logix, 11 January 2010, Korean Ct

Rubin v Eurofinance SA [2012] UKSC 46; [2013] 1 AC 236; [2012] 3 WLR 1019; [2013] Bus LR 1; [2013] 1 All ER 521; [2013] 1 All ER (Comm) 513; [2012] 2 Lloyd's Rep 615, SC(E)

Sino-Forest Corpn, In re (2013) 501 BR 655, US Bankruptcy Ct, Southern District of New York

T Eaton Co, In re (1997) 46 CBR (3d) 293, Ontario Sup Ct

Toft, In re (2011) 453 BR 186, US Bankruptcy Ct, Southern District of New York

Tongyang Networks Co Ltd (Trustee of) v Standard Chartered Bank Ltd 24 January 2014, Korean Ct

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The following additional cases were cited in argument:

Adams v National Bank of Greece SA [1961] AC 255; [1960] 3 WLR 8; [1960] 2 All ER 421, HL(E)
ARO Co Ltd, In re [1980] Ch 196; [1980] 2 WLR 453; [1980] 1 All ER 1067, CA
Banque Indosuez SA v Ferromet Rescources Inc [1993] BCLC 112
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Exchange Securities & Commodities Ltd, In re [1983] BCLC 186
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HIH Casualty and General Insurance Ltd, In re [2008] UKHL 21; [2008] Bus LR 905; [2008] 1 WLR 852; [2008] 3 All ER 869, HL(E)
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McCarthy (J) & Sons of Prescott Ltd, In re (1916) 32 DLR 441
National Bank of Greece and Athens SA v Metliss [1958] AC 509; [1957] 3 WLR 1056; [1957] 3 All ER 608, HL(E)
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OT Africa Line Ltd v Magic Sportswear Corpn [2005] EWCA Civ 710; [2006] 1 All ER (Comm) 32; [2005] 2 Lloyd's Rep 170, CA
T & N Ltd, In re [2004] EWHC 2878 (Ch), [2005] BCC 982
United Drug (UK) Holdings Ltd v Bilcare Singapore Pte Ltd [2013] EWHC 4335 (Ch)
Vita Food Products Inc v Unus Shipping Co Ltd [1939] AC 277; [1939] 1 All ER 513, PC
WC Wood Corpn Ltd, In re Case No 09–11893 (KG) (unreported) 1 June 2009, US Bankruptcy Ct, Delaware

APPLICATIONS

On 25 June 2013 Warren J made an order recognising Korean rehabilitation proceedings in respect of the applicant shipowner, Pan Ocean Co Ltd, as the "foreign main proceeding" for the purposes of the Cross-Border Insolvency Regulations 2006 (SI 2006/1030). By an application notice issued on 15 August 2013 in the Companies Court, the charterer, Fibria Celulose S/A, sought permission to commence an arbitration against the shipowner in London, seeking a declaration that it was entitled to rely on

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an insolvency termination clause to terminate its contract with the shipower. By an application notice dated 10 February 2014, the shipowner's administrator, Mr You Sik Kim, sought relief under article 21(1) of Schedule 1 to the Cross-Border Insolvency Regulations 2006 in the form of an order restraining the charterer from relying on the insolvency termination clause in England and Wales, since it was void and unenforceable as a matter of Korean insolvency law.

The facts are stated in the judgment.

Matthew Collings QC and *Alexander Winter* (instructed by *Thomas Cooper LLP*) for the charterer.

Mark Phillips QC and *Stephen Robins* (instructed by *DLA Piper UK LLP*) for the company shipowner and the administrator.

The court took time for consideration.

30 June 2014. **MORGAN J** handed down the following judgment.

Introduction

1 This case involves the interpretation and application of the Cross-Border Insolvency Regulations 2006 ("the CBIR"). In particular, it concerns the scope of the relief that may be granted by the Companies Court on recognition of a foreign insolvency proceeding. For convenience, I have set out the relevant provisions of the CBIR in an appendix to this judgment.

2 Pan Ocean Co Ltd ("the company") is a shipping company, incorporated under the laws of the Republic of Korea on 28 May 1996. The company is undergoing an insolvency process, described as rehabilitation, in Korea. That process has been recognised by the Companies Court under the CBIR as a foreign main proceeding.

3 The company has the benefit of a long-term shipping contract with Fibria Celulose S/A ("Fibria"). Fibria is a Brazilian company described in the evidence before me as the world's largest producer of wood pulp. The administrator regards that contract as likely to be very profitable for the company and its continued existence as being important to the rehabilitation of the company. Conversely, Fibria regards the contract as onerous to it.

4 The contract is governed by English law. The express terms of the contract confer on Fibria the right to terminate it by reason of the Korean insolvency process in relation to the company. Those terms are valid and enforceable in English law. The administrator of the company contends that those terms are not valid and enforceable under Korean insolvency law. Fibria contends that the administrator is not right about that but, in any event, the position under Korean insolvency law is irrelevant.

5 Both the administrator and Fibria have made applications to the Companies Court under the CBIR. The administrator contends that the Companies Court has power to grant him relief which includes an order that Fibria must not exercise its right to terminate the contract. Fibria counters by saying that the Companies Court has no such power, alternatively that it should not exercise any such power.

6 Mr Collings QC and Mr Winter appeared on behalf of Fibria and Mr Phillips QC and Mr Robins appeared on behalf of the administrator and the company.

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The contract

7 On 31 August 2011, the company and Fibria entered into four separate contracts, on similar terms. Prior to the hearing before me, the administrator of the company elected to terminate three of those contracts and it is accepted that those three contracts have been effectively terminated. The administrator does not wish to terminate the remaining contract which is the relevant contract for present purposes. This contract was described as "contract of affreightment no 1" but as it is now the only relevant contract, I will simply refer to it as "the contract".

8 The contract was made on 31 August 2011 between Fibria as "the charterers" and the company as "the owners". By clause 2, Fibria undertook to provide for the shipment of, and the company undertook to carry, the cargoes identified in the contract. The company was to provide newly constructed vessels to enable it to perform the contract. The period of the contract was defined by reference to the dates on which the vessels were delivered; the contract was a long-term contract which was to continue for 25 years from the date on which the last such vessel was delivered from the relevant construction shipyard. The contract identified the intended loading ports as two ports in South America and it identified the intended discharging ports as various ports in the United States of America and in the Far East (one of which was in South Korea). The contract fixed the freight rates payable by Fibria to the company. Either party could assign the contract in the circumstances therein set out.

9 Clause 28 of the contract included the following provisions:

"28. *Termination for default*

"28.1 A party (the 'non-defaulting party') shall be entitled to terminate this contract with immediate effect on notice in writing to the other party (the 'defaulting party') if any of the following events shall occur:

(a) a defaulting party is in material breach of its material obligations pursuant to this contract and that breach has not been remedied by the defaulting party within a period of 60 days after the non-defaulting party first notified the defaulting party in writing of that breach; or

(b) a defaulting party is in material breach of its material obligations pursuant to this contract three times (whether consecutively or not), during any period of six months; or

(c) a defaulting party ceases wholly or substantially to carry on its business;

(d) a defaulting party becomes unable (or reasonably appears to the non-defaulting party to become unable) to pay its debts as they fall due;

(e) any formal declaration of bankruptcy or any formal statement to the effect that a defaulting party is insolvent or likely to become insolvent is made by that defaulting party or by its directors or, in any proceedings, by a lawyer acting for that defaulting party; or

(f) an administrator is appointed (whether by a court or otherwise) in respect of a defaulting party otherwise than for the purpose of a reconstruction or amalgamation without insolvency previously approved by the non-defaulting party (which approval shall not be unreasonably withheld). Whilst any application to appoint an administrator is pending or following the giving or filing of an administration notice the defaulting party must (to the extent that it may lawfully do so and it would not be in

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breach of any contractual restriction by which it is then bound) continue to carry on its business without disruption; or

(g) a provisional liquidator is appointed in respect of a defaulting party or a winding up order is made in relation to a defaulting party; or

(h) a resolution is passed, an administration notice is given or filed, an application or petition to a court is made or presented or any other step is taken by or on behalf of a defaulting party for or with a view to the winding up of a defaulting party or for the appointment of a provisional liquidator or administrator in respect of a defaulting party otherwise than for the purpose of a reconstruction or amalgamation without insolvency previously approved by the non-defaulting party (which approval shall not be unreasonably withheld); or

(i) an administration notice is given or filed, an application or petition to a court is made or presented or any other step is taken by a creditor of a defaulting party for the winding up of that defaulting party or the appointment of a provisional liquidator or administrator in respect of that defaulting party unless the proposed winding up, appointment of a provisional liquidator or an administrator is being contested in good faith with the aim to have any application or petition dismissed or withdrawn within 90 days of being presented or within 90 days of the administration notice being filed or given or other steps or actions being taken to ensure that no administration will take place and (in either such case) the party carries on its business without disruption; or

(j) an event analogous to any of the events referred to in paragraphs (b)–(i) (inclusive) occurs under the laws of any applicable jurisdiction in relation to the defaulting party."

10 By clause 32 of the contract it was agreed:

"32. *Law and arbitration*

"This contract and any non-contractual obligations arising out of or in connection with it, shall be governed by and construed in accordance with English law. Any dispute arising out of or in connection with this contract shall be referred to arbitration in London in accordance with the Arbitration Act 1996 or any statutory modification or re-enactment thereof save to the extent necessary to give effect to the provisions of this clause.

"The arbitration shall be conducted in accordance with the London Maritime Arbitrators Association ("LMAA") Terms current at the time when the arbitration proceedings are commenced . . ."

The effect of clause 28 in English law

11 Clause 28.1 may be invoked by either party to the contract if the other party is a "defaulting party". The first three events specified in the clause, in sub-paragraphs (a), (b) or (c), do not turn on the insolvency of the defaulting party. The remaining sub-paragraphs of clause 28.1, to a greater or lesser extent, define the relevant event by reference to the fact of insolvency or to the taking of some step in an insolvency process.

12 In some jurisdictions, a clause which allows a party to a contract to terminate the contract by reason of the insolvency of the counterparty is called an ipso facto clause. In certain jurisdictions in the United States of America such clauses are automatically invalid. In Canada, the court has

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power to stay the exercise of rights under such clauses. Later in this judgment, I will consider how such clauses are treated under Korean insolvency law.

13 There was no dispute before me as to the efficacy in English law of the provisions in clause 28.1 of the contract which allow termination by reason of an insolvency event. It was accepted that those provisions are valid in English law. In particular, it was accepted that the rule of insolvency law, known as the anti-deprivation rule, does not strike down those provisions.

14 Although there was no argument as to the approach of an English court to the insolvency provisions in clause 28.1 of the contract, it is helpful for present purposes to understand why those provisions do not infringe the anti-deprivation rule or any other rule of English insolvency law. The scope of the anti-deprivation rule has been considered recently by the Supreme Court in *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd (Revenue and Customs Comrs intervening)* [2011] Bus LR 1266; [2012] 1 AC 383. There were some differences in the approach taken by Lord Collins of Mapesbury (with whom Lord Phillips of Worth Matravers PSC, Lord Hope of Craighead DPSC, Lord Walker of Gestingthorpe, Baroness Hale of Richmond and Lord Clarke of Stone-cum-Ebony JJSC agreed) and Lord Mance JSC, but no difference which is relevant for present purposes.

15 Lord Collins expressed his conclusions as to the anti-deprivation rule, at paras 102–106:

> "102. It would go well beyond the proper province of the judicial function to discard 200 years of authority, and to attempt to re-write the case law in the light of modern statutory developments. The anti-deprivation rule is too well-established to be discarded despite the detailed provisions set out in modern insolvency legislation, all of which must be taken to have been enacted against the background of the rule.
>
> "103. As has been seen, commercial sense and absence of intention to evade insolvency laws have been highly relevant factors in the application of the anti-deprivation rule. Despite statutory inroads, party autonomy is at the heart of English commercial law. Plainly there are limits to party autonomy in the field with which this appeal is concerned, not least because the interests of third party creditors will be involved. But, as Lord Neuberger stressed [2010] Ch 347, para 58, it is desirable that, so far as possible, the courts give effect to contractual terms which parties have agreed. And there is a particularly strong case for autonomy in cases of complex financial instruments such as those involved in this appeal.
>
> "104. No doubt that is why, except in the case of a blatant attempt to deprive a party of property in the event of liquidation (*Folgate London Market Ltd v Chaucer Insurance plc* [2011] EWCA Civ 328; The Times, 13 April 2011), the modern tendency has been to uphold commercially justifiable contractual provisions which have been said to offend the anti-deprivation rule: *Money Markets International Stockbrokers Ltd v London Stock Exchange Ltd* [2002] 1 WLR 1150; *Lomas v JFB Firth Rixson Inc* [2011] 2 BCLC 120; and the judgments of Sir Andrew Morritt C and the Court of Appeal in these proceedings. The policy behind the anti-deprivation rule is clear, that the parties cannot, on

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bankruptcy, deprive the bankrupt of property which would otherwise be available for creditors. It is possible to give that policy a common sense application which prevents its application to bona fide commercial transactions which do not have as their predominant purpose, or one of their main purposes, the deprivation of the property of one of the parties on bankruptcy.

"105. Except in the case of well-established categories such as leases and licences, it is the substance rather than the form which should be determinant. Nor does the fact that the provision for divestment has been in the documentation from the beginning give the answer, nor that the rights in property in question terminate on bankruptcy, as opposed to being divested. Nor can the answer be found in categorising or characterising the property as 'property subject to divestment on bankruptcy'.

"106. If the anti-deprivation principle is essentially directed to intentional or inevitable evasion of the principle that the debtor's property is part of the insolvent estate, and is applied in a commercially sensitive manner, taking into account the policy of party autonomy and the upholding of proper commercial bargains, these conclusions on the present appeal follow."

16 Lord Mance said, at para 177:

"However, [counsel] advanced propositions which would mean that any provision for termination on bankruptcy, which would deprive the trustee or liquidator of the opportunity of continuing the contract and so the bankrupt estate of future potential advantage, would infringe the principle. There is in my opinion no basis for any such rule. Where a contract provides for the performance in the future of reciprocal obligations, the performance of each of which is the quid pro quo of the other, I see nothing objectionable or evasive about a provision entitling one party to terminate if the other becomes bankrupt. That is particularly so, having regard to the purpose and character of the present transaction, viewed rather more broadly than the Court of Appeal did in its detailed reasoning."

17 *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd (Revenue and Customs Comrs intervening)* [2011] Bus LR 1266 is of further interest in the present case for the following reason. The contractual provisions which were under review in that case were triggered by the relevant company filing for Chapter 11 protection in the United States Bankruptcy Court. Judge Peck sitting in the US Bankruptcy Court for the Southern District of New York made a declaration that the contractual provisions in question were ineffective because they were in breach of the United States Bankruptcy Code: see *In re Lehman Bros Holdings Inc* (2010) 422 BR 407. None the less, the contractual provisions were governed by English law and the English courts held that they were effective under English law although the relief granted was confined to declaratory relief; the position is explained by Lord Collins, at paras 30–35, and by Lord Mance JSC, at paras 173–174. The judgments in the English courts did not have to deal with any application under article 21 of the CBIR for an order

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restraining any party from relying on the contractual provisions which were effective in English law but ineffective under the US Bankruptcy Code.

The assignment

18 On 30 December 2011, the company assigned absolutely to certain Marshall Islands companies, controlled by the company, all its rights, title and interest in and to, and all benefits accruing to it under, the contract and on the same day, those Marshall Islands companies assigned to ABN AMRO Bank NV all of their rights, title and interest in and to, and all benefits accruing to it under, the contract (which had just been assigned to them by the company). Copies of these assignments were not in the evidence before me.

19 Also on 30 December 2011, the company (and the Marshall Islands companies) gave written notice to Fibria of the assignments referred to above. In this notice, the company was referred to as the "bareboat charterer", the Marshall Islands companies were referred to as the "registered owners" and ABN AMRO Bank NV was referred to as the "security agent". By this notice, the company and the registered owners requested Fibria to acknowledge the assignments. Fibria was asked to note (amongst other things): (1) until Fibria received notice to the contrary from the security agent, it was to pay all sums due under the contract to the company; (2) following notice from the security agent to do so, Fibria was to pay all sums due under the contract to the security agent; (3) the company remained liable to perform all present and future obligations assumed by it under the contract.

20 The notice of assignment contained the following further provisions (the reference to the "COA" is to the contract):

> "Further:
>
> "1. We, the bareboat charterer, the registered owners and the security agent refer to the COA and hereby request, if you intend to exercise any right to cancel, rescind or otherwise terminate the COA, in whole or in part, that you notify the security agent in writing at its address above stated . . . and that by such notice you grant the security agent the option to either maintain the COA (the 'step-in option') or to agree to the cancellation, rescission or termination of the COA in whole or in part (the 'termination option'). Following receipt of such notice the security agent may elect by notice in writing to you (an "election notice") at your address above . . . within sixty (60) days of receipt of your notice, to either maintain the COA or agree to the cancellation, rescission or termination of the COA in each case in whole or in part and, if in part, with a pro rata reduction in the cargo quantities to be shipped pursuant to the COA and the number of vessels required to service the same.
>
> "2. If the security agent elects to maintain the COA, the security agent shall have the right to either remedy the breach by the bareboat charterer which gave rise to the aforesaid cancellation, rescission or termination rights within 60 days of the date of the election notice or to replace the bareboat charterer as the disponent owner of the vessel and replace the same with a company (the 'substitute disponent owner') to assume the bareboat charterer's rights and obligations under the COA and so as to be substituted for the bareboat charterer under the COA by way of a transfer

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or novation of the COA in favour of such substitute disponent owner or by entry into of a new contract of affreightment on materially the same terms and conditions, mutatis mutandis, as the COA. Any such substitute disponent owner shall be subject to your prior written approval but such approval shall not be unreasonably withheld or delayed, provided that your rights and obligations under the COA (as transferred or novated) or under any new contract or affreightment entered into shall be on materially the same terms and conditions, mutatis mutandis, as the COA, except as may be otherwise expressly agreed by you. For the avoidance of doubt, if the proposed substitute disponent owner, or any company that is to provide in your favour a guarantee of the obligations of such substitute disponent owner on terms acceptable to you, is not (in your reasonable opinion) of similar (or better) financial standing, market reputation and of similar (or better) operational, technical, logistical and commercial capabilities as the bareboat charterer, any refusal by you to accept it as a substitute disponent owner under this provision shall be deemed reasonable.

"3. If the security agent elects to agree to the cancellation, rescission or termination of the COA in part, the COA shall remain otherwise in full force and effect with a pro rata reduction in the cargo quantities to be shipped pursuant to the COA and the number of vessels required to service the same and we request your confirmation of your agreement thereto."

21 The notice of assignment stated that the assignments of the benefit of the contract (first to the Marshall Islands companies and then to the security agent) were by way of security only. The notice further stated that the notice and any acknowledgment of it given by Fibria and any non-contractual obligations arising from or in connection therewith should be governed by and construed in accordance with the law of England and Wales.

22 On 17 January 2012, Fibria wrote to the company, and to the registered owners and the security agent, acknowledging the notice of the assignments, as requested. In particular, by its acknowledgment Fibria undertook and confirmed: (1) that Fibria agreed to comply with the instructions in the notice of assignment; (2) that Fibria agreed to the provisions in the notice of assignment which included those relating to the step-in option and the termination option and further agreed to enter into a transfer or novation agreement in relation to the contract or a new contract of affreightment on materially the same terms and conditions, mutatis mutandis, as the contract to give effect to any election by the security agent to exercise the step-in option, subject to paragraph 2 of the notice of assignment; (3) that the assignments were by way of security only.

23 The parties before me accepted that the terms of the acknowledgement were valid and enforceable in English law.

Further facts

24 By June 2013, the company had become insolvent on a cash-flow basis although it continued to be solvent on a balance sheet basis as a going concern. On 7 June 2013, the company presented a petition to the Bankruptcy Court (Fifth Division) of the Seoul Central District Court for the

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commencement of rehabilitation proceedings. The company did not seek or obtain Fibria's consent to the making of this application.

25 On 12 June 2013, Fibria wrote to the security agent referring to the contract, the assignments, the notice of assignment and the acknowledgment referred to above. Fibria stated in its letter that it was entitled to terminate the contract. It set out the text of sub-clauses (h) to (j) of clause 28.1 of the contract. It wrongly referred to the text of clause 28.1(j) as being in clause 28.1(i). By the letter, Fibria gave formal notice to the security agent: (1) of the company's application on 7 June 2013 to the Seoul Central District Court; (2) of Fibria's belief that it was entitled to terminate the contract under clauses 28.1(h) and (i) (the letter probably intended to refer to clause 28.1(j)) and/or any other application clause; (3) that Fibria granted to the security agent the step-in option and the termination option; (4) that Fibria awaited an election notice from the security agent.

26 Also on 12 June 2013, Fibria notified the company of the notice it had sent to the security agent.

27 Shortly after 12 June 2013, the company replied to Fibria stating that Korean courts did not recognise the validity of the provisions relied on by Fibria (the company's letter specified clauses 28.1(h) and (i)) and that Fibria was not entitled to terminate the contract by reason of the company's application in the rehabilitation proceedings. The company further stated that under article 119 of the Debtor Rehabilitation and Bankruptcy Act of Korea ("the DRBA") it was the custodian of the company who would have the option to elect to terminate or maintain the contract and that the custodian would certainly elect to perform the contract.

28 On 17 June 2013, the Korean court made an order commencing rehabilitation proceedings in relation to the company and appointed joint administrators. (There is now only one administrator, Mr You Sik Kim, who became the sole administrator following the resignation of the former joint administrator on or about 7 November 2013.) Mr Kim has stated that a rehabilitation process in Korea is broadly comparable to an English administration coupled with a scheme of arrangement or company voluntary arrangement. This categorisation was not the subject of any further analysis or dispute at the hearing before me.

29 On 18 June 2013, the security agent responded to Fibria's notice to it of 12 June 2013 and suggested that discussions should take place.

30 On 21 June 2013, the administrator of the company applied in the Companies Court in London for the Korean rehabilitation proceedings to be recognised as foreign main proceedings under article 17 of Schedule 1 to the CBIR.

31 On 25 June 2013, the Companies Court (Warren J) made an order under the CBIR recognising the Korean rehabilitation proceedings as foreign main proceedings in respect of the company. Warren J made further orders pursuant to articles 20(6) and 21(1)(g) of the CBIR. These orders provided that there was to be: (1) no enforcement of securities; (2) no repossession of goods; (3) no legal process against the company or its property; (4) no appointment of an administrative receiver; and (5) no winding up petition. In some cases, the prohibited matters could proceed with the consent of the administrator or of the Companies Court. At the hearing before me, it was stressed that the orders made by Warren J were not confined to the automatic effects of recognition of a foreign main proceeding which are

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provided for by article 20 of the CBIR. However, it does not seem to me to matter whether the orders simply gave effect to article 20 or modified it under article 20(6) and added relief under article 21. There was nothing in those orders which prevented the administrator applying subsequently for further relief under article 21, as the administrator has now done. Around the same time as orders were made in the Companies Court, the company obtained broadly similar recognition orders in a number of other countries.

32 On 2 July 2013, the company wrote to Fibria. The letter directly concerned another contract of affreightment which has since been terminated. However, what was said in relation to that other contract was also relevant to the contract with which I am concerned. The letter stated that Fibria was not entitled to terminate such a contract. The letter enclosed a letter of advice, dated 1 July 2013, from attorneys in Seoul. The attorneys advised that the contract was, in Korean law, a "bilateral executory contract" and the administrator of the company was entitled to elect to terminate or to continue the contract. If the administrator elected to continue the contract, the counterparty would be entitled to receive full payment or other benefit under the contract without any impairment of its position by reason of the rehabilitation. The attorneys further advised that clause 28 or parts of it were to be regarded as an ipso facto clause and that the Supreme Court of Korea had held that there may be circumstances in which such a clause might be invalidated or, at least, its operation might be restricted until the conclusion of the rehabilitation proceedings. They then advised that it was highly likely that the ipso facto clause would be deemed ineffective in Korea. Finally, they said that by reason of the rules as to cross-border insolvency, the clause would also be invalid under Brazilian law.

33 On 11 July 2013, Fibria wrote again to the security agent, without prejudice to its earlier notice of 12 June 2013. In its letter, Fibria referred to the company's application to the Korean court of 7 June 2013 and the order of the Korean court on 17 June 2013. Fibria stated that the company was unable (and/or it reasonably appeared to Fibria that the company was unable) to pay its debts as they fell due and that Fibria intended to terminate the contract pursuant to clauses 28.1(d), (f), (h) and (j) thereof. Fibria notified the security agent that Fibria granted it the step-in option and the termination option and awaited the security agents' election notice.

34 On 16 July 2013, solicitors for Fibria requested permission from the administrator of the company for Fibria to commence arbitration proceedings against the company under the contract. Such permission has not since been forthcoming.

35 On 14 August 2013, the solicitors for the administrator sent to Fibria a copy of the administrator's notice dated 13 August 2013 confirming, pursuant to article 119 of the DRBA, that the company would continue to perform the contract as an executory contract.

36 The administrator was not obliged to apply to the Korean court for its approval of his decision to elect to perform the contract but he did so apply and, on 1 October 2013, that court approved that decision.

37 On 22 November 2013, a rehabilitation plan in relation to the company was approved by the company's creditors and by the Korean court. In a witness statement dated 10 February 2014, the administrator has stated that the income and profits generated for the company under the contract are crucial to the ability of the company to perform the rehabilitation plan.

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The applications

38 On 15 August 2013, Fibria applied in the Companies Court for permission pursuant to article 20(6) of the CBIR and/or paragraph 2(3) of the order of Warren J of 25 June 2013 to commence and prosecute an arbitration against the company seeking declaratory relief as to Fibria's entitlement to terminate the contract. The evidence in support of the application drew attention to a statement made by the administrator, in his application for recognition, to the effect that the company was unable to pay its debts as they fell due and Fibria reserved its right to serve a further notice under clause 28.1 of the contract relying on clause 28.1(e). The administrator's evidence in opposition to this application included evidence that the contract is highly profitable to the company and that the administrator wishes to preserve the contract and to perform it in the interests of the company and its creditors. The administrator says that Fibria will not suffer any prejudice as a result of the insolvency process in relation to the company in that Fibria's rights under the contract will not be affected in any way by that insolvency process.

39 On 10 February 2014, the administrator of the company applied in the Companies Court for relief under article 21 of the CBIR directing that Fibria is not entitled to exercise any right of termination under clauses 28 of the contract and/or such further or other relief as the court thought fit. The administrator filed evidence in support of its application and that evidence provided detailed information as to the ongoing process of restructuring of the company.

40 On 24 March 2014, the administrator of the company applied in the Companies Court under articles 21, 25 and 27 of the CBIR for relief in the form of the Companies Court issuing a letter of request to the Korean court. An attached draft letter of request asked the Korean court to exercise its powers under article 641 of the DRBA to give its opinion to the English court as to whether clause 28 of the contract was void and unenforceable pursuant to Korean insolvency law.

41 At the hearing of these applications, the administrator put forward a draft order setting out the relief which he sought. The draft order defined clause 28 of the contract as "the insolvency termination clause". The draft order then sought a declaration as to the position under the insolvency termination clause on the assumption that that clause was void and unenforceable as a matter of Korean insolvency law. The position contended for by the administrator was that the Companies Court had jurisdiction under article 21(1) of the CBIR to make an order restraining Fibria from relying on the insolvency termination clause in England and Wales and that it would be a proper exercise of discretion for the Companies Court of make such an order. The draft order also provided for a letter of request to be issued to the Korean court in accordance with the application made on 24 March 2014. The draft order continued by seeking an order that the application dated 10 February 2014 for relief under article 21 of the CBIR be adjourned to be restored when the Korean court had responded to the letter of request. Finally, the draft order suggested that Fibria's application for permission to commence arbitration proceedings be adjourned.

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The position of the security agent

42 The security agent has not been made a party to the above applications. I was told that representatives of the security agent were present in court during the hearing before me but they took no part in that hearing. I inquired of the parties as to the position of the security agent in the light of the relief sought by the applications. As explained earlier, Fibria has given notice to the security agent pursuant to the acknowledgement of the notice of assignment. On the face of it, the result of Fibria's notice is that the security agent has a right to elect either to maintain the contract or to agree to its termination. If the security agent were to elect to maintain the contract, then the security agent would be entitled to replace the company with a substitute disponent owner by way of a transfer or novation of the contract or by the entry into a new contract. In such cases, Fibria would not be entitled to take further steps to terminate the contract with the company.

43 I was told by counsel for the administrator and for Fibria that, notwithstanding the position under the acknowledgement of the notice of assignment, it remained relevant to determine the position in relation to Fibria's ability to serve notice of termination under clause 28.1 of the contract. I was told that the security agent supported the company's attempt at restructuring and the company's stance that Fibria was not entitled to terminate the contract under clause 28.1. The security agent therefore wanted to know whether Fibria did have the ability to terminate the contract under clause 28.1. On the assumption that it is held that Fibria did not have the ability to terminate the contract under clause 28.1, then the security agent would not feel it necessary to elect to maintain the contract nor would it wish to agree to the termination of the contract but it would simply not respond to the notice served on it by Fibria. If Fibria later attempted to terminate the contract under clause 28.1, the security agent would be able to rely on the fact that (on this assumption) that Fibria was not able so to act.

44 Conversely, if it were held that Fibria was entitled to terminate the contract under clause 28.1, then the security agent would have to consider its position further and make its election under the acknowledgement of the notice of assignment. I understand that Fibria has agreed to extend the time within which the security agent is to makes its election under the acknowledgment of the notice of assignment so that the time for its election is suspended while the present applications are pending.

45 Accordingly, both Fibria and the administrator of the company ask the court to deal with the applications which have been made to it and, in particular, to decide the scope of the powers of the court to grant relief under article 21 of the CBIR.

Korean law

46 The parties did not agree on the relevant principles of Korean insolvency law. I heard expert evidence as to Korean insolvency law from two Korean lawyers. The administrator called Mr Eunjai Lee and Fibria called Mr Duk-Kyou Hyun. I have concluded that I should not myself decide the dispute between these two experts and so I do not need to describe the witnesses in greater detail nor need I set out the detailed points which divided them. I will however summarise the positions they adopted as to the relevant principles of Korean insolvency law.

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47 Mr Lee relied on article 119 of the DRBA. He also referred in passing to article 32–2 of that Act because that article was referred to in one of the cases to which he drew my attention. However, his view was essentially based on article 119. Article 119 does not apply to all contracts but only to certain unperformed bilateral contracts. It did not appear to be in dispute that the contract in the present case comes within the type of unperformed bilateral contract which is governed by article 119.

48 Under article 119, the custodian of a company undergoing rehabilitation may choose to cancel or terminate an unperformed bilateral contract. Further, article 119 appears to allow the custodian to require the other party to fulfil its obligations under such a contract. It is said that it would be inconsistent with that right for the counterparty to be able to terminate the contract by reason of the fact of the rehabilitation.

49 The statutory predecessor of article 119 was considered in *Allied Domecq (Holdings) plc v Trustee of Jinro Co Ltd*, 6 September 2007, Korean Supreme Court. Mr Lee accepted that parts of the reasoning in that decision were not wholly clear in relation to the impact of article 119 on an insolvency termination clause. The Supreme Court held that, in a case not governed by article 119, an insolvency termination clause would be valid. The Supreme Court then considered the type of contract which came within article 119 and referred to the nature of the obligations under the particular unperformed bilateral contract in that case. It then held that the contract in that case was not governed by article 119.

50 Article 119 was further considered in *Radcliff Corpn v Receiver of Samsun Logix* 11 January 2010. In that case, Samsun Logix ("Samsun") chartered a vessel under a time charterparty which was governed by English law. It then entered rehabilitation and the owner of the vessel asserted that Samsun had no intention of performing the charterparty and had repudiated it, giving the owner the right to treat the charterparty as at an end and to claim damages. The court held that the effect of article 119 was that the owner was not entitled to terminate the charterparty on the grounds of Samsum's repudiation of it because that would infringe the receiver's option to terminate, or to continue, the unperformed bilateral contract.

51 In *Korea Real Estate Investment & Trust Co Ltd v Receiver of Poonglim Co Ltd* 17 July 2013 it was held that article 119 and article 32-2 prevented a counterparty of the debtor company relying on an insolvency termination clause to terminate a building contract under which the debtor company was to build an apartment building. The court appeared to hold that such was the automatic effect of article 119 in relation to an unperformed bilateral contract.

52 The most recent decision as to the operation of article 119 is *Trustee of Tongyang Networks Co Ltd v Standard Chartered Bank Ltd* 24 January 2014. That case concerned a contract under which the debtor company was to provide services to the bank. The contract contained an insolvency termination clause and the bank gave, or purported to give, notice to terminate pursuant to that clause. The trustee of the debtor company argued that the bank's right to terminate should be considered null and void by reason of article 119 or, alternatively, the bank should refrain from terminating the contract at least during the period of the rehabilitation. The court considered the earlier decision in the *Allied Domecq* case and held that to achieve a proper balance between the purpose of rehabilitation and the

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principle of freedom of contract and the counterparty's need to be able to trust the debtor company, it was necessary to look at all the circumstances, such as the nature of the contract, the necessity to protect the debtor and the counterparty and other relevant factors. The court then conducted a detailed examination of what it regarded as the relevant factors and held that article 119 did not render the insolvency termination clause null and void. I was told that the trustee has appealed that decision to a higher court.

53 Mr Lee's view was that the decision in the *Standard Chartered Bank* case was simply wrong and that in the case of an unperformed bilateral contract which is within article 119, an insolvency termination clause is null and void and cannot be exercised by the counterparty of the debtor company. Mr Hyun relied on the decision in the *Standard Chartered Bank* case and said that the effect of article 119 would not be automatic in this case but would require the Korean court to consider all the circumstances. I suggested to Mr Hyun that if one carried out in the present case a similar exercise to that carried out in the *Standard Chartered Bank* case, then the result was likely to be that the Korean court would hold that the insolvency termination provisions in clause 28.1 of the contract were null and void or unenforceable. Mr Hyun suggested that, in the present case, the Korean court would be influenced by the fact that the contract was an international shipping contract governed by English law and that Korean court would not wish to damage Korea's position as a trading nation.

54 In the event, I do not think that it is necessary for the purposes of the present applications for me to determine the disputes as to the operation of Korean law. It is sufficient for me to say that there is a good arguable case that the insolvency termination provisions in clause 28.1 of the contract are automatically void by reason of article 119. Further, even if the insolvency termination provisions in clause 28.1 are not automatically void, there is a good arguable case that they would in fact be held to be void after a Korean court considered all of the relevant circumstances.

55 Having reached those conclusions, I note that there are potential points of Korean law which were not explained by the experts. The precise operation of article 119 is unclear. Does it make the insolvency termination clause null and void or only render it unenforceable during the rehabilitation? What if the counterparty serves a termination notice before the Korean court gives a ruling on the enforceability of the insolvency termination clause? On my own reading of the Korean decisions, it seems to me to be likely that the counterparty would not be able to rely on that notice as effective if the Korean court were later to hold that the insolvency termination clause was null and void or even just unenforceable.

56 I also note that the experts confined themselves to discussing the effect of article 119 on clause 28.1 of the contract without regard to the later arrangements which were brought into existence by the acknowledgment of the notice of assignment. I consider that it might be very relevant indeed, and it might even be determinative, in Korea to assess the position by reference to the later arrangements and not by reference to clause 28.1 alone. I can see how it might be argued that if clause 28.1, or parts of it, were invalid or unenforceable, then the later provisions which were premised on the enforceability of clause 28.1 did not have effect. However, I could also see force in an argument that whatever Korean insolvency law might make of clause 28.1, if it stood alone, it would have to evaluate the later

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A arrangements separately. The position of the company and its creditors is quite different in a case where clause 28.1 is relied on by Fibria to terminate the contract at its option and a case where clause 28.1 is relied on by Fibria and the consequence is either that the security agent exercises the step-in option so that the contract is transferred or novated or, if the contract is terminated, then it is terminated at the option of the security agent rather than at the option of Fibria.
B

The submissions for the parties

57 Mr Phillips's approach, on behalf of the administrator, was to focus on the relief which might be ordered by the court under article 21(1) of the CBIR. He concentrated on the power conferred by article 21(1) to grant "any appropriate relief". He submitted that the court was entitled to grant
C any relief which it considered to be appropriate in all the circumstances. Mr Phillips addressed me in great detail and relied on an extensive citation of decided cases in various jurisdictions, and many other materials, which he submitted were valuable when considering the meaning of "any appropriate relief" in article 21(1) and when deciding what relief was appropriate in this case. In the alternative to these submissions, he put forward a narrower
D submission that the court had power pursuant to article 21(1)(a) of CBIR to stay proceedings and that included a power to restrain Fibria from serving a termination notice under clause 28.1 of the contract. I pay tribute to the thoroughness and quality of Mr Phillips's submissions. It is not necessary for me to attempt to summarise everything which was said in the course of these wide ranging submissions as I consider that I can identify the essential
E points which were made when I discuss my approach to the issues which arise.

58 Mr Collings, for Fibria, submitted that its rights to terminate the contract were governed by English law, as to which there was no dispute. Korean insolvency law was irrelevant, certainly in the Companies Court. He submitted that the power conferred by article 21(1)(a) to grant a stay of proceedings could not be interpreted to extend to an order restraining Fibria
F from serving a notice pursuant to clause 28.1 of the contract. He further submitted that the power of the court to grant "any appropriate relief" did not permit the court to give relief in accordance with Korean insolvency law and, in any event, the relief sought was not appropriate.

Discussion: preliminary remarks

G 59 The administrator's primary object at the hearing of these applications was to obtain the determinations set out in his draft order as to the court's jurisdiction and discretion under article 21 of the CBIR in relation to clause 28.1 of the contract (or, at any rate, those parts of clause 28.1 which deal with various insolvency events). The determinations set out in the draft order are expressly on the assumption that clause 28.1 is
H void and unenforceable as a matter of Korean insolvency law. I have already described the rival opinions as to the relevant Korean insolvency law and my conclusion that the administrator has a good arguable case that the insolvency termination provisions in clause 28.1 of the contract are automatically void by reason of article 119 or, if not automatically void, he has a good arguable case that they would in fact be held to be void after a

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Korean court considered all of the relevant circumstances. Accordingly, for the sake of the following analysis, I will assume that a Korean court would regard (at least) those parts of clause 28.1 which provide for termination by notice following an insolvency event in Korea, as being inoperative or (at least) in suspense during the Korean insolvency.

60 The administrator relied, principally, on the power of the recognising court, pursuant to article 21(1), to grant "any appropriate relief" and, in the alternative, on the power, pursuant to article 21(1)(a), to order a stay of proceedings. Before dealing with the specific points which arise in relation to these two ways of putting the case, I should comment briefly on other points which are referred to in articles 21 and 22 but which were not examined at the hearing.

61 Article 21 allows the court to grant relief "where necessary to protect the assets of the debtor or the interests of the creditors". The meaning of the phrase "the assets of the debtor", and how that phrase might apply to the contract in this case, was not really explored at the hearing before me. It seemed to me that there might have been two issues in that respect. The first was as to whether the benefit of the contract had ceased to be an asset of the debtor because it had been assigned to the Marshall Islands companies and then to the security agent. If the point had been raised, it may be that the answer would have been that because the assignments were by way of security only, the company retained a right to redeem the security and it was that right (rather than the benefit of the contract) which was an asset of the debtor. However, as the point was not raised and the assignments were not put in evidence, I will say no more about that subject. The second possible question might have been whether the relevant asset of the debtor in this case is in relation to a contract which is not subject to termination (pursuant to the insolvency termination provisions in clause 28.1) or whether the asset of the debtor was the contract subject to the possibility of such termination. If the asset of the debtor was the latter, then an order of the court which prevented Fibria exercising its contractual rights under clause 28.1 would not merely "protect" the assets of the debtor but would enhance the assets of the debtor. However, as this point was not argued, I will not deal with it further. In any case, I note that article 21 allows relief to be granted to protect "the interests of the creditors", seemingly as an alternative to it being granted to protect the assets of the debtor.

62 Further, there was no real examination of the possible application of article 22 in this case. Article 22(1) provides that the court must be satisfied, when granting or denying relief under article 21, that the interests of the creditors and other interested persons must be adequately protected. It may be that it could be said that Fibria would be "adequately" protected if it were able to enjoy the benefit of the contract in all other respects even though it was prevented from taking advantage (pursuant to clause 28.1) of the insolvency of the company to free itself of a contract which was onerous from its point of view.

Article 21(1)(a) of the Cross-Border Insolvency Regulations 2006

63 Although the administrator relied on article 21(1)(a) as an alternative to his argument based on the words "any appropriate relief" in article 21(1), it is more logical for me first to consider the specific relief which is referred to in article 21(1)(a).

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64 Article 21(1)(a) allows the recognising court to grant a stay on "the commencement or continuation of individual actions or individual proceedings concerning the debtor's assets, rights, obligations or liabilities". The administrator contended that the service by Fibria of a notice to terminate under clause 28.1 would be within this wording in article 21(1)(a). Article 21(1)(a) allows the court to grant such a stay "to the extent [that] they have not been stayed under paragraph (1)(a) of article 20". The administrator accepted that the service of such a notice had not already been stayed under article 20(1)(a). Article 20(1)(a) also refers to the "commencement or continuation of individual actions or individual proceedings concerning the debtor's assets, rights, obligations or liabilities". However, article 20(2) provides that the stay which is automatically imposed by article 20(1)(a) is to be "the same in scope and effect" as if the debtor (in the case of a company) had been the subject of a winding up order under the Insolvency Act 1986. It is agreed that the scope and extent of a stay, in the case of a company ordered to be wound up, is to be found in section 130(2) of the Insolvency Act 1986. Section 130(2) provides that "no action or proceeding shall be proceeded with or commenced against the company or its property" except with the leave of the court. Accordingly, in order for the administrator in the present case to rely on article 21(1)(a), he has to accept that he cannot rely on article 20(1)(a) and that must be because the scope of article 20(1)(a) is not wider than the scope of section 130(2) of the 1986 Act and, further, that the service of a notice to terminate under clause 28.1 of the contract does not involve an "action or proceeding [being] proceeded with or commenced against the company or its property" within the meaning of section 130(2) of the 1986 Act. Thus, the administrator is in effect submitting that although the service of a notice to terminate pursuant to clause 28.1 of the contract is not "an action or proceeding" within the meaning of section 130(2) of the 1986 Act, it is "an individual action" or "an individual proceeding" within article 21(1)(a) of the UNCITRAL Model Law on Cross-border Insolvency (1997).

65 I can accept the words "action" and "proceeding" in article 21 need not have the same meaning as those words in section 130(2) of the 1986 Act. I therefore need to look at the Model Law and any matters which assist me in construing it, together with any authorities which might be relevant.

66 The first thing to note is that article 21(1)(b) refers to "execution against the debtor's assets"; this suggests that the draftsman of the Model Law considered that some forms of execution against the debtor's assets would not involve the commencement or continuation or individual actions or individual proceedings. Further, article 21(1)(g) allows the court to grant any relief of the kind provided under paragraph 43 of Schedule B1 to the Insolvency Act 1986. Paragraph 43 of Schedule B1 creates a moratorium in relation to different kinds of legal process. In particular, paragraph 43(6) provides that there may be no legal process instituted or continued against the company or the property of the company except with the consent of the administrator or the permission of court. Article 21(1)(g) refers to relief under paragraph 43 of Schedule B1 as being "additional relief", that is, additional to the relief specified in sub-paragraphs (a) to (f) of article 21(1). However, these textual points on their own do not offer much guidance as to the scope of article 21(1)(a).

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67 I have considered the UNCITRAL *Guide to Enactment* which deals with the relevant wording in articles 20 and 21 at paras 145, 146 and 155. Para 145 indicates that the reference to "an action" will cover "actions before an arbitral tribunal". Para 146 suggests that the word "proceedings" can extend to "enforcement measures initiated by creditors outside the court system". The *Guide to Enactment* does not further describe the measures it had in mind save to say that, in some states, creditors were allowed to take such "measures".

68 The provision formerly contained in section 11 of the Insolvency Act 1986, imposing a moratorium in the case of an administration of a company, referred in section 11(3)(c) to "steps" to enforce a security or to repossess goods and in section 11(3)(d) to "no other proceedings and no execution or other legal process" being "commenced or continued". These provisions were construed by the Court of Appeal in *Bristol Airport plc v Powdrill* [1990] Ch 744 and by Millett J in *In re Olympia & York Canary Wharf Ltd* [1993] BCLC 453. In the second of these cases, it was held that a notice given by a party to a contract in order to make time of the essence of the other party's contractual obligation and a notice accepting a repudiatory breach as terminating the contract were not "proceedings" or "other legal process" within section 11(3)(d).

69 In *Bristol Airport plc v Powdrill* [1990] Ch 744, 765 Sir Nicolas Browne-Wilkinson V-C said:

> "the natural meaning of the words 'no other proceedings . . . may be commenced or continued' is that the proceedings in question are either legal proceedings or quasi-legal proceedings such as arbitration . . . the reference to the 'commencement' and 'continuation' of proceedings indicates that what Parliament had in mind was legal proceedings. The use of the word 'proceedings' in the plural together with the words 'commence' and 'continue' are far more appropriate to legal proceedings (which are normally so described) than to the doing of some act of a more general nature."

70 In *In re Olympia & York Canary Wharf Ltd* [1993] BCLC 453, 457, Millett J said:

> "It is not necessary in this case to consider where the line is to be drawn between the commencement or continuation of 'proceedings' on the one hand or of 'legal process' on the other. But in my judgment both concepts are well known. Together they embrace all steps in legal proceedings from the issue of initiating process, to their final termination in the process of execution or other means of enforcement of a judgment such as the appointment of a receiver by way of equitable execution or the making of a charging order or other steps for the enforcement of the court's judgment without execution. But the phrase is not apt to describe the taking of non-judicial steps such as the service of a contractual notice in order to crystallise the liability of the party on whom the notice is served.
>
> "In my judgment, support for that conclusion can be derived from the use of the words 'commenced or continued' in section 11(3)(d) of the 1986 Act. If the service of a contractual notice is part of a legal process, I am unable to understand what legal process it is supposed to commence

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A or continue. The words 'commence or continue' indicate a process which has an independent existence of its own apart from the step by which it is commenced or continued; a process which either continues after or was in existence before the taking of the relevant step.

"Further support for my conclusion, if it were needed, may be derived from a consideration of the legislative purpose for which sections 10 and 11 were enacted. They are intended to impose a moratorium upon the B creditors of the company in order to assist the administrator in his attempts to achieve the statutory purpose for which he was appointed. They are couched in procedural terms and are designed to prevent creditors from depriving the administrator of the possession of property which may be required by him for the purpose of the administration."

C 71 Both these cases construed the particular provisions of section 11(3)(d) having regard to the other language used in section 11 and the purpose of that section. The language of article 21 is certainly not the same as the language of section 11. These two decisions of the English courts cannot therefore be determinative of the meaning of article 21(1)(a). None the less, the discussion in those cases, and particularly in the second case, is helpful in elucidating the general concepts normally involved in the D words "actions or proceedings", particularly when coupled with the words "commencement or continuation".

72 Mr Phillips did not refer me to any English authority which assisted his argument as to the meaning of article 21(1)(a). However, he referred to Canadian decisions as to section 11(4) of the Companies' Creditors Arrangement Act (RSC 1985, c C-36) ("the CCAA"), a Canadian statute. Part IV of the CCAA implemented in Canada, with modifications, the Model E Law but section 11(4) is not in Part IV. Accordingly, the Canadian decisions dealing with section 11(4) do not directly deal with the meaning of article 21 of the Model Law. The position in Canada, pursuant to section 11(4) of the CCAA, became relevant in the English case of *AWB (Geneva) SA v North America Steamships Ltd* [2007] 1 CLC 749, Field J and [2007] 2 Lloyd's Rep 315, CA. In the *AWB* case, the claimants had entered into contracts with a F Canadian company which had then entered a process of insolvency governed by the CCAA. The claimants contended that the Canadian company had committed certain events of default and, pursuant to the express terms of the contract, the claimants were not obliged to perform certain obligations otherwise imposed on them by the contracts. The office holder in the Canadian insolvency applied to the Canadian court under G section 11(4) of the CCAA for an order preventing the claimants relying on the events of default as producing the result, in accordance with the contractual provisions, that the claimants did not have to perform the contracts.

73 Section 11(4) of the CCAA gave the court power, in particular, to restrain "proceedings taken or that might be taken in respect of the company" and "the commencement of or proceeding with any other action, H suit or proceeding against the company". In *AWB*, Field J heard expert evidence as to Canadian law and he summarised the matter in this way, at paras 11 to 14:

"11. . . . in broad terms, the CCAA provides a regime that corresponds to the combined effect of the provisions of UK insolvency law relating to

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administrations (Schedule B1 of the Insolvency Act 1986) and compromises or schemes of arrangement (Part 1 of the 1986 Act providing for company voluntary arrangements, and section 425 of the Companies Act 1985).

"12. Section 11(4) of the CCAA empowers the court to make an order staying 'proceedings' taken or that might be taken in respect of the company. 'Proceedings' has been construed to include extra-judicial conduct that could impair the ability of the debtor company to continue in business. In *Norcen Energy Resources Ltd v Oakwood Petroleums Ltd* (1988) 72 CBR (2d) 1, the court restrained a joint venture party of a debtor company from relying on the insolvency of the debtor company to replace it as the operator under a petroleum operating agreement. In *In re T Eaton Co* (1997) 46 CBR (3d) 293, the court restrained tenants in shopping centres from terminating leases on the basis of co-tenancy clauses requiring the debtor company's store to stay open. And in *In re Playdium Entertainment Corpn* (2001) 31 CBR (4th) 302, the court restrained a party from relying on its contractual right to object to an assignment.

"13. In *In re Doman Industries* (2003) 41 CBR (4th) 29 Tysoe J explained the purpose of such stays in these terms: 'In my view, there are numerous purposes of stays under section 11 of the CCAA. One of the purposes is to maintain the status quo among creditors while a debtor company endeavours to reorganise or restructure its financial affairs. Another purpose is to prevent creditors and other parties from acting on the insolvency of the debtor company or other contractual breaches caused by the insolvency to terminate contracts or accelerate the repayment of the indebtedness owing by the debtor company when it would interfere with the ability of the debtor company to reorganise or restructure its financial affairs . . . [A] further purpose is to prevent the frustration of the reorganisation or restructuring plan after its implementation on the basis of events of default or breaches which existed prior to or during the restructuring period.'

"14. It is clear from the evidence of the trustee's expert on Canadian insolvency law, the Hon James M Farley QC, a former Justice of the Superior Court of Ontario, that stays are commonly granted under section 11(4) of the CCAA to restrain counterparties to contracts with the debtor company from relying on any pre-CCAA plan breaches of those contracts committed by the debtor company that would allow those counterparties to exercise remedies against the debtor company. Mr Farley gives examples of such orders in his report. In two of these the order provided that no person who is a party to any contract or lease to which the debtor company is a party may accelerate, terminate, rescind, refuse to perform or otherwise repudiate its obligations thereunder by reason of any defaults or events of default arising out of the insolvency of the applicant."

74 Mr Phillips provided me with copies of *Norcen Energy Resources Ltd v Oakwood Petroleums Ltd* (1988) 72 CBR (2d) 1, *In re T Eaton Co* (1997) 46 CBR (3d) 293, *In re Playdium Entertainment Corpn* (2001) 31 CBR (4th) 302 and *In re Doman Industries* 2003 BCSC 376. So far as I could see, the judges in those cases did not discuss the meaning of the word

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A "proceedings", much less did they attempt to define it. Accordingly, I find that any persuasive force which these decisions might otherwise have had is greatly diminished.

75 Having considered the material relied on by the parties, I conclude that I am considerably assisted by the discussion in *Bristol Airport plc v Powdrill* [1990] Ch 744 and *In re Olympia & York Canary Wharf Ltd* [1993] BCLC 453 as to the ordinary and well understood meaning of a B phrase such as "the commencement or continuation of individual actions or individual proceedings" (the wording used in article 21(1)(a)). Applying that meaning, I consider that the service of a notice to terminate under clause 28.1 of the contract is not the commencement or continuation of an individual action or proceeding within article 21(1)(a). Accordingly, I reject the argument for the administrator that the court has power C under article 21(1)(a) to restrain Fibria from serving a termination notice under clause 28.1.

76 It was not said that the service of a termination notice under clause 28.1 came within any other sub-paragraph of article 21(1). In particular, it was not said that the claimed jurisdiction was conferred by article 21(1)(g) which refers to additional relief (including relief under paragraph 43 of Schedule B1 to the Insolvency Act 1986) that might be D available to a British insolvency office holder under the law of Great Britain.

Appropriate relief

77 The principal way in which the administrator put his case in relation to article 21 was to contend that the Companies Court had jurisdiction to make an order restraining Fibria from relying on clause 28.1 pursuant to the E court's power to grant "any appropriate relief". It was submitted that the words "any appropriate relief" were not defined and that the words should be given their ordinary meaning. For the order sought to come within those words, the order must be such that it could properly be described as the grant of "relief". If it could be so described, then the court had to decide whether that relief was "appropriate". It was said that these words F deliberately gave the court very wide powers to do what it thought fit. If the court thought it was appropriate to order relief which would be available to the administrator in the Korean court applying Korean insolvency law, then the English court could grant that relief. In so doing, the English court was not applying Korean law. Article 21 of CBIR was part of English law and it was English law which was being applied when the English court granted the same sort of relief as would be available in the Korean court under Korean G insolvency law.

78 It was submitted that the phrase "any appropriate relief" was not cut down by the heads of relief specified in paragraphs (a) to (g) of article 21(1) because article 21(1) stated that any appropriate relief "included" those heads of relief; this showed that "any appropriate relief" was wider than the specified heads and that the specified heads were not intended to be an exhaustive statement of what could be ordered by way of appropriate relief. H

79 The administrator is right that the words "appropriate relief", taken on their own, are wide words. Although the argument in the present case focused on the appropriateness of the English court granting the sort of relief which a Korean court would grant, applying Korean insolvency law, it is only right to acknowledge that if the administrator is right in his approach to

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article 21, then the English court has power to grant any relief which it thinks fit, whether that relief would be available under the law of the state of the foreign proceedings or under English law or, indeed, under some other system of law. On this basis, the English court would have power to reflect the fact that Fibria is a Brazilian company and to apply Brazilian law, if the English court thought that relief under Brazilian law was appropriate. Indeed, the English court could express approval for the insolvency laws which apply in some entirely different jurisdiction and persuade itself that it was appropriate that such laws should be applied in the case before it. Further, if the court has power to do what it thinks is appropriate, it may not be necessary to find that the relief which is sought is relief which is available under any current system of law anywhere. If there were a pending proposal, for example from the Law Commission, to reform English insolvency law, then on the administrator's approach, the English court would have power to anticipate that reform and to hold that granting relief in accordance with the proposed reform would be "appropriate". Whilst some of these examples are more fanciful than others, they do indicate that the administrator's submissions result in the English court having the widest possible power to do whatever it thinks fit, whether its order is in accordance with the law of the foreign insolvency proceedings or not.

80 The administrator's argument that the scope of "any appropriate relief" is not cut down by the terms of sub-paragraphs (a) to (g) which are matters "included" in the appropriate relief but not exhaustive of the appropriate relief does reflect the ordinary meaning of the language of article 21. None the less, I consider it somewhat surprising that sub-paragraph (g) is expressed in the way in which it is if it had really been intended that the phrase "any appropriate relief" permitted the recognising court to grant relief which it would not be able to grant in an insolvency conducted in accordance with the laws of the recognising court. A power for the recognising court to grant relief in that way would be a very significant power. It is odd to think that such a power was intended without there being any specific reference to the recognising court's ability to apply the law of a foreign state, or even to do something which no system of law anywhere would allow. This is particularly so in view of the terms of sub-paragraph (g) which deliberately limit relief under that sub-paragraph to relief which would be available to a British insolvency office holder under the law of Great Britain.

81 Having made these comments on the possible literal readings of article 21, I ought not to construe article 21 without regard to the other matters which I am able to consider when determining its meaning. In that regard, regulation 2 of the CBIR provides that, for the purpose of ascertaining the meaning and effect of the CBIR, the court may consider certain documents, in particular, the UNCITRAL Model Law, the documents of the working group relating to the preparation of the Model Law and the *Guide to Enactment of the Model Law*.

82 As regards the documents of the working group relating to the preparation of the Model Law, I was asked by Mr Phillips to consider the note *Possible issues relating to judicial cooperation and access and recognition in cases of cross-border insolvency* (A/CN.9/WG.V/WP.42) dated 26 September 1995 which was prepared in advance of a meeting of the working group in October and November 1995. Para 6 of this note stated

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that it was intended to set out possible solutions that might be adopted in relation to various problems. Paras 42 to 54 of the note are material as background to the present issue. In relation to setting out the effects of recognition of a foreign proceeding, one approach was to provide a detailed and exhaustive list of all the consequences which would follow from recognition: see para 42. A second possible approach was to specify that the effect of recognition would be determined by the application of the law of one of the two countries involved. Here there could be two variants. Variant 1 would involve, essentially, the application of the law of the state in which the foreign proceedings were opened. Variant 2 would involve, essentially, the application of the law of the recognising state. The note identified earlier legislative examples of one or other of these variants being adopted. It was suggested that variant 1 could be justified from a dogmatic point of view whereas variant 2 would be more easily applied in practice. An alternative would be for the two systems of law to be applied in combination: see para 52. It was then stated at para 53 that the choice of law could be left to the recognising state and section 426(5) of the Insolvency Act 1986 was given as an example of this possibility. Finally, at para 54, it was stated that the effects of recognition could be left to judicial discretion and reference was made to section 304 of the United States Bankruptcy Code where the court was empowered to order "other appropriate relief".

83 Having met in October and November 1995, the working group reported on 1 December 1995 (*Report of the Working Group on Insolvency Law on the Work of the Eighteenth Session* (Vienna, 30 October–10 November 1995) (A/CN.9/419)). The possible legislative approaches to the effects of recognition were discussed at paras 46 to 59. The arguments for and against the application of the law of the recognising state or the application of the law of the state in which the foreign proceedings were opened were described, as was a possible approach leaving it to the recognising court to choose between the two systems of law. The report appeared to favour a list of automatic consequences of recognition followed by a power for a judge to specify additional effects of recognition involving factors which would be familiar to judges in different legal systems: see paras 56, 59. At para 134, the report set out a draft provision dealing with the effects of recognition. By para (1)(e) of that draft, a foreign representative was able to ask the recognising court to grant "other appropriate relief" under the law of the state in which the foreign proceeding was opened (unless forbidden by local law); this draft was subject to a possible further qualification which referred to the law of the jurisdiction in which a limited proceeding has been commenced. This part of the draft was then discussed at paras 154 to 166. The discussion identified competing arguments as to the law which should be available to the recognising court. Para 165 referred to the law of the foreign proceeding but subject to limitations based on the law of the recognising state. However, para 165 ended by saying that the matter needed to be returned to later.

84 Although Mr Phillips took me to these reports of the working group, no one at the hearing referred to two further reports of the working group which were dated 24 October 1996 (A/CN.9/433) and 19 February 1997 (A/CN.9/435). I find that these two later reports are more helpful as regards the final adopted version of the Model Law. The report of 24 October 1996 referred to a draft article (then numbered article 12) which identified the

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relief which could be granted by the recognising court. Article 12(2)(b) permitted the recognising court to grant "any appropriate relief including" certain specified heads of relief. Article 12(2)(b)(v) referred to "other relief which may be available under the laws of the state of the foreign proceeding or under the laws of the enacting state". This draft provision was discussed at para 133 of the report where it was stated that the provision referring to relief under the laws of the state of the foreign proceeding was widely thought to be unrealistic and so that the reference to foreign law should be deleted, although the wording might be retained as an option which the enacting state might choose to implement.

85 The report dated 19 February 1997 referred to a draft article (then numbered article 17) which came very close to the final adopted form of the Model Law. The earlier reference to the relief which was available under the laws of the state of the foreign proceeding had been removed so that the relevant provision referred only to relief available under the laws of the recognising state. At paras 51 to 52 of the report, there was discussion as to whether the draft article 17 should be amended by the addition of words such as "under the conditions of the law of this state" at appropriate places. This suggestion was objected to on the ground that it was implicit by virtue of the discretionary nature of the relief available under article 17 that the court would have regard to its own law. The report also stated that the court should not be prevented from granting relief if that was found to be useful and fair. At para 57, commenting on the provision which became article 21(1)(g), the report stated that the working group accepted the proposal to restrict the relief to that available to the insolvency administrator in the enacting state.

86 The Model Law was adopted by the United Nations General Assembly on 15 December 1997. Article 21 of the Model Law, as adopted, referred to "any appropriate relief, including" and sub-paragraph (g) of article 21(1) referred to: "(g) Granting any additional relief that may be available to [the office holder] under the laws of this state".

87 My reaction to the discussions of the working group is that it seems improbable that the working group, having deleted (from what is now article 21(1)(g)) a power for the recognising court to apply the law of the foreign proceeding, intended to bring back in such a power under the general wording which refers to "any appropriate relief".

88 I was referred to two versions of the *Guide to Enactment*, one published in 1999 and the other in 2014. It was submitted that the 1999 version was the one referred to in regulation 2 of CBIR. I will refer to that version but, in any event, the following passages from the 1999 Guide are essentially repeated in the 2014 Guide. Paras 20(b) and 154 of the 1999 Guide state:

> "20. With its scope limited to some procedural aspects of cross-border insolvency cases, the Model Law is intended to operate as an integral part of the existing insolvency law in the enacting state. This is manifested in several ways . . . (b) The Model Law presents to enacting states the possibility of aligning the relief resulting from recognition of a foreign proceeding with the relief available in a comparable proceeding in national law . . ."

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A "154. Post recognition relief under article 21 is discretionary, as is pre-recognition relief under article 19. The types of relief listed in article 21, paragraph 1, are typical or most frequent in insolvency proceedings; however, the list is not exhaustive and the court is not restricted unnecessarily in its ability to grant any type of relief that is available under the law of the enacting state and needed in the circumstances of the case."

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89 Turning to more general matters, I note that what can be called the common law of recognition proceeds on the basis that the recognising court applies its own law and not the law of the state in which the foreign proceedings were opened: see *Cambridge Gas Transportation Corpn v Official Committee of Unsecured Creditors of Navigator Holdings plc* [2007] 1 AC 508, para 22. This is to be contrasted with the position under
C section 426(5) of the Insolvency Act 1986 and article 4 of Council Regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings (OJ 2000 L 160, p 1). In those two cases, the applicable law is clearly defined so that it is not restricted to (in the case of section 426(5)) or is not (in the case of article 4) the law of the state which is asked to grant relief. The working group referred to section 426(5) and an earlier draft of Council
D Regulation No 1346/2000 but did not adopt language which is comparable to those legislative precedents.

90 The scope of article 21 of the CBIR was one of the issues raised in *Rubin v Eurofinance SA* [2013] 1 AC 236. In that case it was suggested that a judgment of a New York court should be recognised in England pursuant to article 21. I note that counsel who submitted that the judgment could be recognised under article 21 said that under the CBIR the court could grant
E "appropriate relief including any type of relief which is available under the law of the enacting state". At para 28, Lord Collins of Mapesbury referred to para 20(b) of the UNCITRAL *Guide to Enactment* and stated that enacting states could make available "the type of relief which would be available in the case of a domestic insolvency". Lord Collins dealt further with the CBIR at paras 133–144 and he said, at paras 141–143:

F "141. The respondents say that (a) the power under article 21 is to grant any type of relief that is available under the law of the relevant state, and that the fact that recognition and enforcement of foreign judgments is not specifically mentioned in article 21 as one of the forms of relief available, does not mean that such relief cannot be granted; (b) the recognition and enforcement of the judgments of a foreign court is the
G paradigm means of co-operation with that court; and (c) the examples of co-operation in article 27 are merely examples and are not exhaustive.

"142. But the CBIR (and the Model Law) say nothing about the enforcement of foreign judgments against third parties. As Lord Mance pointed out in argument, recognition and enforcement are fundamental in international cases. Recognition and enforcement of judgments in civil
H and commercial matters (but not in insolvency matters) have been the subject of intense international negotiations at the Hague Conference on Private International Law, which ultimately failed because of inability to agree on recognised international bases of jurisdiction.

"143. It would be surprising if the Model Law was intended to deal with judgments in insolvency matters by implication. Articles 21, 25 and

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27 are concerned with procedural matters. No doubt they should be given a purposive interpretation and should be widely construed in the light of the objects of the Model Law, but there is nothing to suggest that they apply to the recognition and enforcement of foreign judgments against third parties."

91 *In re Atlas Bulk Shipping A/S* [2012] Bus LR 1124 is an interesting example of the Companies Court granting relief under article 21(1)(g) but no issue arose in that case of the court granting a type of relief which was not available in the case of a domestic insolvency: see at p 1131G.

92 The textbooks appear to favour a limitation on the relief which might be granted under article 21 to relief which would be available under domestic law in relation to a domestic insolvency: see *Fletcher on Insolvency in Private International Law*, 2nd ed (2012), para 8.38 and *Sheldon on Cross Border Insolvency*, 3rd ed (2007), paras 3.91 to 3.100.

93 Mr Phillips cited a number of decisions of courts in the United States and Canada. Mr Collings did not make submissions to me in relation to those cases but I obviously need to consider them. Before doing so, I will refer to the relevant statutory provisions in the United States and in Canada.

94 Before the Model Law was implemented in the United States, cases in that jurisdiction which were ancillary to foreign insolvency proceedings were dealt with under section 304 of the former Bankruptcy Code. Under section 304(b)(3) the court was able to order "other appropriate relief" and section 304(c) set out matters which should guide the court when asked to make an order under section 304(b). The Model Law was implemented in the United States by Chapter 15 of Title 11 of the Bankruptcy Code. Sections 1519, 1520 and 1521 are similar to articles 19, 20 and 21 of the CBIR. The Model Law was implemented in Canada by Part IV (sections 44 to 61) of the CCAA. Section 48 of the CCAA gives the court power to make certain orders on recognition of a foreign proceeding. Further, by section 49(1), the court may make any order "that it considers appropriate" including certain specified orders.

95 In *In re Atlas Shipping A/S* (2009) 404 BR 726 the New York court held that many of the principles underlying section 304 of the former Bankruptcy Code remained in effect in relation to Chapter 15. It was said that the jurisdiction to grant "appropriate relief" was "exceedingly broad".

96 In *In re Gandi Innovations Holdings LLC* (unreported) 5 June 2009, the Texas court recognised a foreign proceeding in Canada. The Canadian court had made an order under the CCAA prohibiting the termination of executory contracts without the leave of the court. The Texas court acting under section 1521 of the Bankruptcy Code made its own order to the same extent as the Canadian order.

97 *In re Condor Insurance Ltd* (2010) 601 F 3d 319 is a decision of the United States Court of Appeals. The case concerned a Nevis insurance company which was the subject of a winding up order in Nevis. The United States court recognised the Nevis proceedings as foreign main proceedings. The case raised the question whether there was power under section 1521 of the Bankruptcy Code to apply foreign law (Nevis Law) for the purpose of avoiding fraudulent transfers. The alternative of opening proceedings in the United States under Chapter 7 of the Bankruptcy Code was not available because the company was a foreign insurance company. Under Chapter 7,

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A the United States court would have had extensive powers to avoid fraudulent transfers. The court held that it had the power to apply Nevis law because it could grant "appropriate relief" under section 1521. The discussion in the case is complicated by a number of provisions in section 1507 and 1521 as to the bringing of avoidance claims in the United States courts but it is not necessary to refer to those matters for present purposes. The court referred to the deliberations of the UNCITRAL Working Group:

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> "UNCITRAL's Working Group on Insolvency Law examined three potential approaches to the question of which law a recognising court should apply. The first approach would allow the recognising court to apply its own law. This was favoured by some countries concerned with the potential lack of familiarity with foreign law by recognising courts. The second approach would apply the law of the main proceeding. This
C approach was favoured by some as it 'would lead to a more consistent, harmonised result, in view of divergences among national insolvency laws' and would help 'avoid abetting debtors seeking to conceal assets behind another law that might provide a haven for those assets'. A third approach was to permit the recognising court to apply either the law of the main proceeding or its own law—a solution which might 'provide
D flexibility needed to limit insulation of assets from insolvency proceedings'. However this approach drew concern that it might raise the potential that a foreign representative 'would be enabled to exercise more powers than those that would be available to the representative under the law of the appointing jurisdiction'."

98 In the quoted passage, the United States court referred to the
E working group report dated 1 December 1995 (*Report of the Working Group on Insolvency Law on the Work of the Eighteenth Session*, paras 50–51 (A/CN.9/419)). The court did not specifically refer to the reports dated 24 October 1996 and 19 February 1997. The court then continued:

> "The final provision did not accept any of these three approaches in
F full. Rather, the Model Law permitted the recognising court to grant any appropriate relief and granted standing to the foreign representatives to bring avoidance actions under the law of the recognising state. This purposefully left open the question of which law the court should apply—in deference to the choice of law concerns expressed by the United States."

G 99 The United States court then explained that the application of foreign avoidance law in a Chapter 15 ancillary proceeding raised fewer choice of law concerns as the court was not required to create a separate bankruptcy estate. The court also stated that its decision was supported by earlier decisions as to the scope of section 304 of the former Bankruptcy Code and cited *In re Metzeler* (1987) 78 BR 674. The court added that
H Congress had intended that the case law in relation to section 304 should apply unless contradicted by Chapter 15.

100 In *In re Hartford Computer Hardware Inc* (2012) 94 CBR (5th) 20, the Canadian court recognised United States Chapter 11 proceedings. Under section 49 of the CCAA, the Canadian court was asked to recognise and make effective in Canada an order made in the United States court. It was

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pointed out that one part of the United States order could not be made by a Canadian court in relation to a Canadian insolvency under its domestic insolvency provisions: see section 11(2) of the CCAA. The Canadian court held that under section 49 of the CCAA it could make any order which it considered appropriate and it concluded that the order requested was indeed appropriate. It also held that the provisions of the CCAA which gave effect to the public policy restrictions in article 6 of the Model Law should be construed restrictively and that the order sought did not raise any public policy issues.

101 *In re Sino-Forest Corpn* (2013) 501 BR 655 concerned section 1507, rather than section 1521 of the United States Bankruptcy Code: see footnote 3 to the judgment. Section 1507 allows the United States court to provide "additional assistance" to a foreign representative. The court was asked to recognise an order made by the Canadian court in a Canadian insolvency proceeding. It was held, following, *In re Metcalfe & Mansfield Alternative Investments* (2010) 421 BR 685, that the United States court should apply its ordinary principles as to enforcement of foreign judgments and comity pursuant to Chapter 15 and it did not need to ask itself whether it could or would have made the same order if the insolvency had been proceeding before a United States court under its own Chapter 11.

102 I was also shown a number of decisions of the American and Canadian courts where the recognising court granted relief which was available under the domestic law of the recognising state in a case of a domestic insolvency. These decisions are not of any assistance as to the present debate about the scope of "appropriate relief" in article 21.

103 Mr Phillips argued that article 6 of CBIR demonstrated that the reference to "appropriate relief" must include relief that was not available under English law. It was submitted that relief which was available under English law could not be "manifestly contrary to the public policy of Great Britain or any part of it". It was then submitted that if the court held that appropriate relief under article 21(1)(a) was confined to relief which was available under English law, then article 6 could never apply and would be otiose. Therefore to prevent article 6 being otiose, the court should hold that "appropriate relief" could include relief only available under foreign law and in such a case the court could ask itself whether it would be "manifestly contrary to the public policy of Great Britain or any part of it" to give effect to foreign law.

104 This argument as to the significance of article 6 ignores the fact that article 6 is not restricted to dealing with cases which might involve the grant of "appropriate relief" within article 21(1). Article 6 deals with all of the provisions of the CBIR, which include many specific provisions. It may therefore be the case that an application is made to the court to take action under such a specific provision, where the court may have to consider whether the action in question would be contrary to public policy in English law. The operation of article 6 in this way is illustrated by *In re Toft* (2011) 453 BR 186, a decision of a New York bankruptcy court. In that case, Dr Toft was the subject of insolvency proceedings in Germany. The German court made an order permitting the administrator in the insolvency to intercept Dr Toft's postal and electronic mail. The English court granted recognition and enforcement of that order. The administrator applied in the United States for a similar order relying on the express power to order the

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A delivery of information contained in section 1521(a)(4) of the Bankruptcy Code. The New York court held that the order sought was contrary to United States public policy within section 1506 of the Bankruptcy Code (which implemented article 6 of the Model Law).

Conclusion on "any appropriate relief"

B 105 The non-exhaustive words "any appropriate relief" are capable of being given a wide literal meaning. However, the very width of their literal meaning, which is illustrated in para 79 above, makes me somewhat cautious about construing the words literally. Those considerations suggest to me that it was not intended that the words should be given such a wide literal meaning.

106 The decision in *In re Condor Insurance Ltd* 601 F 3d 319 appears to C support an interpretation of those words which would allow the recognising court to give effect to an order of the court of the foreign proceedings even if the recognising court could not itself have made such an order in its own domestic proceedings. I recognise that article 8 of the CBIR directs the Companies Court to have regard to the need to promote uniformity in the application of the Model Law. However, I have concerns about applying D the decision in *In re Condor Insurance Ltd* to article 21 of the CBIR for two separate reasons. The first is that, with respect to the judges in that case, I do not think that their description of the various reports of the working group on the Model Law was accurate. Secondly, their reasoning relied on the position which pertained under section 304 of the former US Bankruptcy Code before the implementation of the Model Law. I can see that if the position under section 304 of the former Code was that the US court could grant "any E appropriate relief" and that it had been established that those words allowed the US court to apply the law of the foreign proceedings, then the same words should have the same effect in section 1521 of the Bankruptcy Code, which implemented the Model Law. However, there is no comparable legislative history in Great Britain and it is open to me to conclude that the United States have implemented the Model Law in a way which is not identical to the way F in which it has been implemented in Great Britain.

107 I am directed by regulation 2 of the CBIR to consider the documents relating to the working group on the Model Law. On my reading of the reports of the working group, it was not intended that "any appropriate relief" would allow the recognising court to go beyond the relief it would grant in relation to a domestic insolvency. I do not think that there is sufficient in the discussion in those reports which would allow me to G conclude (as the court concluded in *In re Condor Insurance Ltd*) that the words "any appropriate relief" were intended to replicate the position under section 304 of the former US Bankruptcy Code. I also note that whenever the legal position under article 21 has been described in an English case or in a textbook on the CBIR, the discussion proceeds on the basis that "any appropriate relief" allows the court to grant the same sort of relief as it H would grant in relation to a domestic insolvency.

108 Accordingly, I am not persuaded that the words "any appropriate relief" allow me to grant relief which would not be available to the court when dealing with a domestic insolvency.

109 I have also considered whether I would be prepared to grant to the administrator the relief which he seeks in this case, even if I held that I had

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power to do so pursuant to the words "any appropriate relief" in article 21. I have concluded that I would not have been prepared to do so.

110 The contract in this case was made between a Korean company and a Brazilian company. The parties chose the law which was to govern their contract. They chose English law rather than Korean or Brazilian law. Under English law, in the events which have happened, if the security agent does not elect to transfer or novate the contract, then the contract can be brought to an end, either by an election to that effect on the part of the security agent, or by a termination notice given by Fibria. If the contract is brought to an end, under English law, then Fibria is not committed to the contract for the remainder of the 25-year term. If the company claims freight from Fibria, then Fibria will not be obliged to pay. Conversely, if Fibria is restrained from terminating the contract, then it will be committed to the contract for the remainder of the 25-year term and will be obliged to pay freight for that period.

111 *Rubin v Eurofinance SA* [2013] 1 AC 236 supports the view that the relief available under article 21 is of a procedural nature and that the article should be given a wide interpretation in relation to matters of procedure. There is considerable scope for argument as to whether the relief sought in a particular case is of a procedural or of a substantive nature. I will not attempt to define which matters are procedural and which are substantive. However, having explained the difference between Fibria being entitled to terminate the contract and not being so entitled, it seems to me that this difference goes well beyond matters of procedure and affects the substance of the parties' rights and obligations under the contract.

112 In some cases, it can be argued that anyone who does business with a foreign company which might thereafter enter a process of insolvency, governed by the insolvency law of its country of registration, should expect that the insolvency will be governed by that law. Indeed, statements to that effect have been made in *In re Atlas Bulk Shipping A/S* [2012] Bus LR 1124, para 26 and *AWB (Geneva) SA v North America Steamships Ltd* [2007] 1 CLC 749, para 31. However, in the present case, the parties had deliberately chosen English law as the law of the contract. Whereas the parties might have expected that a Korean court would apply Korean insolvency law to the insolvency of the company, they might have been very surprised to find that an English court would apply Korean insolvency law to the substantive rights of the parties under a contract which they had agreed should be governed by English law.

113 Different jurisdictions adopt different approaches to ipso facto clauses. I have referred earlier to the position in the United States, Canada and Korea. As it happens, the position in English law has been recently reviewed by the Supreme Court in *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd (Revenue and Customs Comrs intervening)* [2011] Bus LR 1266. The Supreme Court took full account of the policy considerations behind the choice which is to be made as to the enforceability of such provisions. If Korean law is as the administrator contends, then Korea views these policy questions differently from this jurisdiction. If I have a free hand, as the administrator contends, to do what I consider to be appropriate in this case, I am not tempted to prefer the policy choice which is made in Korean law over the policy choice recently reaffirmed by the Supreme Court in relation to English law. In this case, I consider that it is

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A appropriate for the Companies Court to apply English law and to give effect to the parties' choice of English law.

114 Even if the decision in *In re Condor Insurance Ltd* 601 F 3d 319 were a persuasive authority in this jurisdiction, it is readily distinguishable from the present case. In that case, the US court had extensive powers to set aside avoidance transactions in a domestic insolvency. The issue for the court was much more to do with matters of procedure than of substance.
B The present case is more to do with matters of substance than of procedure. Further, in that case, the US court was applying its established principles of comity to the order of the foreign court. There is no comparable order of the Korean court in this case.

The effect of my conclusion on the applications

C

115 I do not have power under article 21(1)(a) to order a "stay" in relation to Fibria's entitlement to serve a termination notice under clause 28.1 of the contract. I do not have power under article 21(1) to make an order restraining Fibria from serving such a notice; if I had such power, I would not exercise it as I would hold such an order was not "appropriate relief". In any case, if it is said that I should do what a Korean court would
D do in this case, then I am not persuaded that a Korean court would make an order restraining the service of a termination notice. On my understanding of the expert evidence, what the Korean court would do would be to hold that a termination notice, if served, would be ineffective to determine the contract. Thus, it is not necessary or appropriate to make an order restraining Fibria from serving a termination notice.

116 I have reached the above decisions on the assumptions as to Korean
E law contended for by the administrator. On those assumptions, I am not prepared to grant the relief sought by the administrator under article 21. Accordingly, I do not need to know the answer to the questions of Korean law that arise and I will not therefore send a request to the Korean court to give me the answers to such questions.

117 As to Fibria's application for permission to commence an
F arbitration, I raised at the hearing the question whether it was necessary for there to be an arbitration between Fibria and the company as to the enforceability of clause 28.1 in English law. I understood at the hearing there was no issue about that. It may be any question as to the enforceability of clause 28.1 in English law would also affect the various assignees of the benefit of the contract. Those persons are not parties to the present
G proceedings but, in any event, as they are not the subject of the Korean insolvency, and are not the subject of Warren J's order of 25 June 2013, Fibria does not need permission to bring any relevant proceedings to determine such an issue (if there is one) between Fibria and those persons.

118 I will hear counsel as to the appropriate orders to make to give effect to this judgment.

H

Appendix

1. The Cross-Border Insolvency Regulations 2006 were made pursuant to section 14 of the Insolvency Act 2000 and came into force on 4 April 2006.

2. By regulation 1(2), "the UNCITRAL Model Law" is defined to mean the Model Law on cross-border insolvency as adopted by the United Nations Commission on International Trade Law on 30 May 1997.

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3. Regulation 2 provides for the UNCITRAL Model Law to have the force of law in the following way:

"(1) The UNCITRAL Model Law shall have the force of law in Great Britain in the form set out in Schedule 1 to these Regulations (which contains the UNCITRAL Model Law with certain modifications to adapt it for application in Great Britain).

"(2) Without prejudice to any practice of the courts as to the matters which may be considered apart from this paragraph, the following documents may be considered in ascertaining the meaning or effect of any provision of the UNCITRAL Model Law as set out in Schedule 1 to these Regulations—

"(a) the UNCITRAL Model Law;

"(b) any documents of the United Nations Commission on International Trade Law and its working group relating to the preparation of the UNCITRAL Model Law; and

"(c) the *Guide to Enactment of the UNCITRAL Model Law* (UNCITRAL document A/CN.9/442) prepared at the request of the United Nations Commission on International Trade Law made in May 1997."

4. Regulation 3 provides:

"(1) British insolvency law (as defined in article 2 of the UNCITRAL Model Law as set out in Schedule 1 to these Regulations) and Part 3 of the Insolvency Act 1986 shall apply with such modifications as the context requires for the purpose of giving effect to the provisions of these Regulations.

"(2) In the case of any conflict between any provision of British insolvency law or of Part 3 of the Insolvency Act 1986 and the provisions of these Regulations, the latter shall prevail."

5. The form of the Model Law which is given effect is set out in Schedule 1 to the Regulations.

6. By article 1(1) it is provided that the Model Law applies where assistance is sought in Great Britain by a foreign court or a foreign representative in connection with a foreign proceeding.

7. Article 2 contains relevant definitions, which include the following:

"For the purposes of this Law—

"(a) 'British insolvency law' means—"

"(i) in relation to England and Wales, provision extending to England and Wales and made by or under the Insolvency Act 1986 (with the exception of Part 3 of that Act) or by or under that Act as extended or applied by or under any other enactment (excluding these Regulations);"

"(g) 'foreign main proceeding' means a foreign proceeding taking place in the state where the debtor has the centre of its main interests;

"(h) 'foreign non-main proceeding' means a foreign proceeding, other than a foreign main proceeding, taking place in a state where the debtor has an establishment within the meaning of sub-paragraph (e) of this article;

"(i) 'foreign proceeding' means a collective judicial or administrative proceeding in a foreign state, including an interim proceeding, pursuant to a law relating to insolvency in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganisation or liquidation;

"(j) 'foreign representative' means a person or body, including one appointed on an interim basis, authorised in a foreign proceeding to administer the reorganisation or the liquidation of the debtor's assets or affairs or to act as a representative of the foreign proceeding;"

"(q) references to the law of Great Britain include a reference to the law of either part of Great Britain (including its rules of private international law)."

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8. Articles 6, 7 and 8 provide:

"6. *Public policy exception*

"Nothing in this Law prevents the court from refusing to take an action governed by this Law if the action would be manifestly contrary to the public policy of Great Britain or any part of it.

"7. *Additional assistance under other laws*

"Nothing in this Law limits the power of a court or a British insolvency officeholder to provide additional assistance to a foreign representative under other laws of Great Britain.

" 8. *Interpretation*

"In the interpretation of this Law, regard is to be had to its international origin and to the need to promote uniformity in its application and the observance of good faith."

9. Chapter II (articles 9 to 14) provides for foreign representatives and creditors to have access to courts in Great Britain.

10. Chapter III (articles 15 to 24) provides for recognition of a foreign proceeding and relief. Articles 19 to 23 provide:

"19. *Relief that may be granted on application for recognition of a foreign proceeding*

"1. From the time of filing an application for recognition until the application is decided upon, the court may, at the request of the foreign representative, where relief is urgently needed to protect the assets of the debtor or the interests of the creditors, grant relief of a provisional nature, including—

"(a) staying execution against the debtor's assets;

"(b) entrusting the administration or realisation of all or part of the debtor's assets located in Great Britain to the foreign representative or another person designated by the court, in order to protect and preserve the value of assets that, by their nature or because of other circumstances, are perishable, susceptible to devaluation or otherwise in jeopardy; and

"(c) any relief mentioned in paragraph 1(c), (d) or (g) of article 21.

"2. Unless extended under paragraph 1(f) of article 21, the relief granted under this article terminates when the application for recognition is decided upon.

"3. The court may refuse to grant relief under this article if such relief would interfere with the administration of a foreign main proceeding.

"20. *Effects of recognition of a foreign main proceeding*

"1. Upon recognition of a foreign proceeding that is a foreign main proceeding, subject to paragraph 2 of this article—

"(a) commencement or continuation of individual actions or individual proceedings concerning the debtor's assets, rights, obligations or liabilities is stayed;

"(b) execution against the debtor's assets is stayed; and

"(c) the right to transfer, encumber or otherwise dispose of any assets of the debtor is suspended.

"2. The stay and suspension referred to in paragraph 1 of this article shall be—

"(a) the same in scope and effect as if the debtor, in the case of an individual, had been adjudged bankrupt under the Insolvency Act 1986 or had his estate sequestrated under the Bankruptcy (Scotland) Act 1985, or, in the case of a debtor other than an individual, had been made the subject of a winding up order under the Insolvency Act 1986; and

"(b) subject to the same powers of the court and the same prohibitions, limitations, exceptions and conditions as would apply under the law of Great Britain in such a case, and the provisions of paragraph 1 of this article shall be interpreted accordingly.

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"3. Without prejudice to paragraph 2 of this article, the stay and suspension referred to in paragraph 1 of this article, in particular, does not affect any right—

"(a) to take any steps to enforce security over the debtor's property;

"(b) to take any steps to repossess goods in the debtor's possession under a hire-purchase agreement;

"(c) exercisable under or by virtue of or in connection with the provisions referred to in article 1(4); or

"(d) of a creditor to set off its claim against a claim of the debtor, being a right which would have been exercisable if the debtor, in the case of an individual, had been adjudged bankrupt under the Insolvency Act 1986 or had his estate sequestrated under the Bankruptcy (Scotland) Act 1985, or, in the case of a debtor other than an individual, had been made the subject of a winding up order under the Insolvency Act 1986.

"4. Paragraph 1(a) of this article does not affect the right to—

"(a) commence individual actions or proceedings to the extent necessary to preserve a claim against the debtor; or

"(b) commence or continue any criminal proceedings or any action or proceedings by a person or body having regulatory, supervisory or investigative functions of a public nature, being an action or proceedings brought in the exercise of those functions.

"5. Paragraph 1 of this article does not affect the right to request or otherwise initiate the commencement of a proceeding under British insolvency law or the right to file claims in such a proceeding.

"6. In addition to and without prejudice to any powers of the court under or by virtue of paragraph 2 of this article, the court may, on the application of the foreign representative or a person affected by the stay and suspension referred to in paragraph 1 of this article, or of its own motion, modify or terminate such stay and suspension or any part of it, either altogether or for a limited time, on such terms and conditions as the court thinks fit.

"21. *Relief that may be granted on recognition of a foreign proceeding*

"1. Upon recognition of a foreign proceeding, whether main or non-main, where necessary to protect the assets of the debtor or the interests of the creditors, the court may, at the request of the foreign representative, grant any appropriate relief, including—

"(a) staying the commencement or continuation of individual actions or individual proceedings concerning the debtor's assets, rights, obligations or liabilities, to the extent they have not been stayed under paragraph 1(a) of article 20;

"(b) staying execution against the debtor's assets to the extent it has not been stayed under paragraph 1(b) of article 20;

"(c) suspending the right to transfer, encumber or otherwise dispose of any assets of the debtor to the extent this right has not been suspended under paragraph 1(c) of article 20;

"(d) providing for the examination of witnesses, the taking of evidence or the delivery of information concerning the debtor's assets, affairs, rights, obligations or liabilities;

"(e) entrusting the administration or realisation of all or part of the debtor's assets located in Great Britain to the foreign representative or another person designated by the court;

"(f) extending relief granted under paragraph 1 of article 19; and

"(g) granting any additional relief that may be available to a British insolvency officeholder under the law of Great Britain, including any relief provided under paragraph 43 of Schedule B1 to the Insolvency Act 1986.

"2. Upon recognition of a foreign proceeding, whether main or non-main, the court may, at the request of the foreign representative, entrust the distribution of all or part of the debtor's assets located in Great Britain to the foreign

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representative or another person designated by the court, provided that the court is satisfied that the interests of creditors in Great Britain are adequately protected.

"3. In granting relief under this article to a representative of a foreign non-main proceeding, the court must be satisfied that the relief relates to assets that, under the law of Great Britain, should be administered in the foreign non-main proceeding or concerns information required in that proceeding.

"4. No stay under paragraph 1(a) of this article shall affect the right to commence or continue any criminal proceedings or any action or proceedings by a person or body having regulatory, supervisory or investigative functions of a public nature, being an action or proceedings brought in the exercise of those functions.

"22. *Protection of creditors and other interested persons*

"1. In granting or denying relief under article 19 or 21, or in modifying or terminating relief under paragraph 3 of this article or paragraph 6 of article 20, the court must be satisfied that the interests of the creditors (including any secured creditors or parties to hire-purchase agreements) and other interested persons, including if appropriate the debtor, are adequately protected.

"2. The court may subject relief granted under article 19 or 21 to conditions it considers appropriate, including the provision by the foreign representative of security or caution for the proper performance of his functions.

"3. The court may, at the request of the foreign representative or a person affected by relief granted under article 19 or 21, or of its own motion, modify or terminate such relief.

"23. *Actions to avoid acts detrimental to creditors*

"1. Subject to paragraphs 6 and 9 of this article, on recognition of a foreign proceeding, the foreign representative has standing to make an application to the court for an order under or in connection with sections 238, 239, 242, 243, 244, 245, 339, 340, 342A, 343, and 423 of the Insolvency Act 1986 and sections 34, 35, 36, 36A and 61 of the Bankruptcy (Scotland) Act 1985.

"2. Where the foreign representative makes such an application ("an article 23 application"), the sections referred to in paragraph 1 of this article and sections 240, 241, 341, 342, 342B to 342F, 424 and 425 of the Insolvency Act 1986 and sections 36B and 36C of the Bankruptcy (Scotland) Act 1985 shall apply—

"(a) whether or not the debtor, in the case of an individual, has been adjudged bankrupt or had his estate sequestrated, or, in the case of a debtor other than an individual, is being wound up or is in administration, under British insolvency law; and

"(b) with the modifications set out in paragraph 3 of this article.

"3. The modifications referred to in paragraph 2 of this article are as follows—

"(a) for the purposes of sections 241(2A)(a) and 342(2A)(a) of the Insolvency Act 1986, a person has notice of the relevant proceedings if he has notice of the opening of the relevant foreign proceeding;

"(b) for the purposes of sections 240(1) and 245(3) of that Act, the onset of insolvency shall be the date of the opening of the relevant foreign proceeding;

"(c) the periods referred to in sections 244(2), 341(1)(a) to (c) and 343(2) of that Act shall be periods ending with the date of the opening of the relevant foreign proceeding;

"(d) for the purposes of sections 242(3)(a), (3)(b) and 243(1) of that Act, the date on which the winding up of the company commences or it enters administration shall be the date of the opening of the relevant foreign proceeding; and

"(e) for the purposes of sections 34(3)(a), (3)(b), 35(1)(c), 36(1)(a) and (1)(b) and 61(2) of the Bankruptcy (Scotland) Act 1985, the date of sequestration or granting of the trust deed shall be the date of the opening of the relevant foreign proceeding.

"4. For the purposes of paragraph 3 of this article, the date of the opening of the foreign proceeding shall be determined in accordance with the law of the state

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in which the foreign proceeding is taking place, including any rule of law by virtue of which the foreign proceeding is deemed to have opened at an earlier time.

"5. When the foreign proceeding is a foreign non-main proceeding, the court must be satisfied that the article 23 application relates to assets that, under the law of Great Britain, should be administered in the foreign non-main proceeding.

"6. At any time when a proceeding under British insolvency law is taking place regarding the debtor—

"(a) the foreign representative shall not make an article 23 application except with the permission of—(i) in the case of a proceeding under British insolvency law taking place in England and Wales, the High Court; or (ii) in the case of a proceeding under British insolvency law taking place in Scotland, the Court of Session; and

"(b) references to 'the court' in paragraphs 1, 5 and 7 of this article are references to the court in which that proceeding is taking place.

"7. On making an order on an article 23 application, the court may give such directions regarding the distribution of any proceeds of the claim by the foreign representative, as it thinks fit to ensure that the interests of creditors in Great Britain are adequately protected.

"8. Nothing in this article affects the right of a British insolvency officeholder to make an application under or in connection with any of the provisions referred to in paragraph 1 of this article.

"9. Nothing in paragraph 1 of this article shall apply in respect of any preference given, floating charge created, alienation, assignment or relevant contributions (within the meaning of section 342A(5) of the Insolvency Act 1986) made or other transaction entered into before the date on which this Law comes into force."

11. Chapter IV (articles 25 to 27) provides for co-operation with foreign courts and foreign representatives. Article 25 provided:

"25. *Co-operation and direct communication between a court of Great Britain and foreign courts or foreign representatives*

"1. In matters referred to in paragraph 1 of article 1, the court may co-operate to the maximum extent possible with foreign courts or foreign representatives, either directly or through a British insolvency officeholder.

"2. The court is entitled to communicate directly with, or to request information or assistance directly from, foreign courts or foreign representatives."

12. Article 27 provides:

"27. *Forms of co-operation*

"Co-operation referred to in articles 25 and 26 may be implemented by any appropriate means, including—

"(a) appointment of a person to act at the direction of the court;

"(b) communication of information by any means considered appropriate by the court;

"(c) co-ordination of the administration and supervision of the debtor's assets and affairs;

"(d) approval or implementation by courts of agreements concerning the co-ordination of proceedings;

"(e) co-ordination of concurrent proceedings regarding the same debtor."

Application dismissed.

ISABELLA CHEEVERS, Barrister

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ITEM NO. 160

JA-46

Privy Council

Singularis Holdings Ltd *v* PricewaterhouseCoopers

[2014] UKPC 36

[on appeal from the Court of Appeal for Bermuda]

2014 April 29, 30; Nov 10

Lord Neuberger of Abbotsbury PSC, Lord Mance, Lord Clarke of Stone-cum-Ebony, Lord Sumption JJSC, Lord Collins of Mapesbury

Bermuda — Insolvency — Jurisdiction — Company wound up in Cayman Islands — Liquidators seeking order in Bermuda requiring auditors to produce information relating to company's affairs — Judge purporting to exercise common law power to order production of information which could have been ordered under statute in domestic insolvency — Whether power at common law to assist foreign court of insolvency jurisdiction by making order — Whether order appropriate in circumstances where foreign court could not make equivalent order — Whether court able to exercise powers analogous to statutory powers which were exercisable in domestic insolvency but did not apply to foreign insolvency — Companies Act 1981 (No 59 of 1981), s 195

A Cayman Islands company was wound up in the Cayman Islands and liquidators were appointed. In order to trace the company's assets, the liquidators wished to obtain information relating to the company's affairs from the company's auditors, a Bermuda registered partnership. They obtained from the Cayman Islands court an order requiring the auditors to transfer or deliver up certain documents but, under Cayman Islands law, that order only extended to material belonging to the company. In order to obtain material belonging to the auditors themselves, the liquidators made an application in Bermuda for an order requiring the auditors to produce all documents in their possession relating to the affairs of the company. Under section 195 of the Bermudan Companies Act 1981[1], the Supreme Court of Bermuda had power to make such an order but only in relation to a company which that court had ordered to be wound up. However, the Chief Justice, sitting in the Supreme Court of Bermuda, exercised what he termed a common law power to order the auditors to produce information which they could have been ordered to produce under section 195 if the company had been wound up in Bermuda. On the auditors' appeal, the Court of Appeal for Bermuda doubted whether there was jurisdiction to make such an order in circumstances where section 195 did not apply but set aside the order on the basis that, in any event, it was not an appropriate exercise of discretion because it was an order made in support of a Cayman Islands liquidation which could not have been made by the Cayman Islands court.

On the liquidators' appeal—

Held, advising that the appeal be dismissed, (1) (Lord Neuberger of Abbotsbury PSC and Lord Mance JSC dissenting) that there was a power at common law to assist the officers of a foreign court of insolvency jurisdiction or equivalent public officers by ordering the production of information in oral or documentary form which was necessary for the administration of a foreign winding up, but the power was not available to enable them to do something which they could not do under the law by which they had been appointed; and that, although the fact that express provision was made in Bermuda for the powers exercisable on the winding up of companies to which the Companies Act 1981 applied did not exclude the use of

[1] Companies Act 1981, s 195: see post, para 4.

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common law powers in relation to other companies which lay outside the scope of the statute altogether, it was not a proper exercise of the power of assistance for the Bermudan court to make the order sought by the liquidators since the material which they sought in Bermuda was not obtainable under the domestic law of the court which had appointed them (post, paras 19, 25, 28–29, 31, 33, 109–115).

Norwich Pharmacal Co v Customs and Excise Comrs [1974] AC 133, HL(E), *In re HIH Casualty and General Insurance Ltd* [2008] 1 WLR 852, HL(E) and *Rubin v Eurofinance SA (Picard intervening)* [2013] 1 AC 236, SC(E) applied.

(2) That the common law power of the court to recognise and grant assistance to foreign insolvency proceedings was primarily exercised through the existing powers of the court; that, although those powers could be extended or developed through the traditional judicial law-making techniques of the common law, the judiciary could not, by analogy, extend the scope of insolvency legislation to cases where it did not apply, and a domestic court did not have power to assist a foreign court by doing anything which it could properly have done in a domestic insolvency and could not acquire jurisdiction by virtue of any such power; and that, accordingly, the Bermudan court could not, by analogy, apply the statutory powers under the Companies Act 1981 as if the foreign insolvency were a domestic insolvency (post, paras 18, 32, 36, 38, 64, 82–83, 94, 108, 109, 122, 134, 149, 162).

Dicta of Lord Walker of Gestingthorpe in *Al Sabah v Grupo Torras SA* [2005] 2 AC 333, para 35, PC applied.

Cambridge Gas Transportation Corpn v Official Committee of Unsecured Creditors of Navigator Holdings plc [2007] 1 AC 508, PC and *In re Phoenix Kapitaldienst GmbH* [2013] Ch 61 not followed.

Quaere. Whether information which the auditors acquired solely in their capacity as the company's auditors can be regarded as belonging exclusively to them simply because the documents in which they recorded that information are their working papers and as such their property (post, para 30).

Decision of the Court of Appeal for Bermuda [2013] CA (Bda) 7 Civ affirmed.

The following cases are referred to in the judgments:

African Farms, In re [1906] TS 373
Al Sabah v Grupo Torras SA [2005] UKPC 1; [2005] 2 AC 333; [2005] 2 WLR 904; [2005] 1 All ER 871, PC
Arab Monetary Fund v Hashim (No 5) [1992] 2 All ER 911
Ashworth Hospital Authority v MGN Ltd [2002] UKHL 29; [2002] 1 WLR 2033; [2002] 4 All ER 193, HL(E)
Ayerst v C & K (Construction) Ltd [1976] AC 167; [1975] 3 WLR 16; [1975] 2 All ER 537, HL(E)
Banco Nacional de Cuba v Cosmos Trading Corpn [2000] 1 BCLC 813, CA
Bank of Credit and Commerce International SA (No 10), In re [1997] Ch 213; [1997] 2 WLR 172; [1996] 4 All ER 796
Banque Indosuez SA v Ferromet Resources Inc [1993] BCLC 112
Bent v Young (1838) 9 Sim 180
CCIC Finance Ltd v Guangdong International Trust & Investment Corpn [2005] 2 HKC 589
Cambridge Gas Transportation Corpn v Official Committee of Unsecured Creditors of Navigator Holdings plc [2006] UKPC 26; [2007] 1 AC 508; [2006] 3 WLR 689; [2006] 3 All ER 829; [2006] 2 All ER (Comm) 695, PC
Colonial Government v Tatham (1902) 23 Natal LR 153
Crédit Suisse Fides Trust SA v Cuoghi [1998] QB 818; [1997] 3 WLR 871; [1997] 3 All ER 673, CA
Deutsche Morgan Grenfell Group plc v Inland Revenue Comrs [2006] UKHL 49; [2007] 1 AC 558; [2006] 3 WLR 781; [2007] 1 All ER 449, HL(E)
Dreyfus v Peruvian Guano Co (1889) 41 Ch D 151
England v Smith [2001] Ch 419; [2000] 2 WLR 1141, CA

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A *Gurr v Zambia Airways Corpn Ltd* [1998] ZASCA 16; [1998] 2 All SA 479 (A)
HIH Casualty and General Insurance Ltd, In re [2008] UKHL 21; [2008] 1 WLR 852; [2008] Bus LR 905; [2008] 3 All ER 869, HL(E)
Impex Services Worldwide Ltd, In re [2004] BPIR 564
Incorporated Council of Law Reporting for England and Wales v Attorney General [1972] Ch 73; [1971] 3 WLR 853; [1971] 3 All ER 1029, CA
International Tin Council, In re [1987] Ch 419; [1987] 2 WLR 1229; [1987] 1 All ER
B 890
Jones v Kaney [2011] UKSC 13; [2011] 2 AC 398; [2011] 2 WLR 823; [2011] 2 All ER 671, SC(E)
Kleinwort Benson Ltd v Lincoln City Council [1999] 2 AC 349; [1998] 3 WLR 1095; [1998] 4 All ER 513, HL(E)
McKerr, In re [2004] UKHL 12; [2004] 1 WLR 807; [2004] 2 All ER 409, HL(NI)
Masri v Consolidated Contractors International (UK) Ltd (No 4) [2009] UKHL 43;
C [2010] 1 AC 90; [2009] 3 WLR 385; [2009] Bus LR 1269; [2009] 4 All ER 847; [2010] 1 All ER (Comm) 220; [2009] 2 Lloyd's Rep 473, HL(E)
Matheson Bros Ltd, In re (1884) 27 Ch D 225
Modern Terminals (Berth 5) Ltd v States Steamship Co [1979] HKLR 512
Moolman v Builders & Developers (Pty) Ltd [1989] ZASCA 171; [1990] 2 All SA 77 (A)
Norwich Pharmacal Co v Customs and Excise Comrs [1974] AC 133; [1973] 3 WLR 164; [1973] 2 All ER 943, HL(E)
D *Orr v Diaper* (1876) 4 Ch D 92; 25 WR 23
P & O Nedlloyd BV v Arab Metals Co (No 2) (The UB Tiger) [2006] EWCA Civ 1717; [2007] 1 WLR 2288; [2007] 2 All ER (Comm) 401; [2007] 2 Lloyd's Rep 231, CA
Perpetual Trustee Co Ltd v BNY Corporate Trustee Services Ltd [2009] EWHC 1912 (Ch); [2009] 2 BCLC 400; *(Revenue and Customs Comrs intervening)* [2011] UKSC 38; [2012] 1 AC 383; [2011] 3 WLR 521; [2011] Bus LR 1266; [2012]
E 1 All ER 505, SC(E)
Phoenix Kapitaldienst GmbH, In re [2012] EWHC 62 (Ch); [2013] Ch 61; [2012] 3 WLR 681; [2012] 2 All ER 1217
Picard v Primeo Fund 2013 (1) CILR 164, Grand Ct (Jones J); 2014 (1) CILR 379, CA (Cayman Islands)
Prest v Prest [2013] UKSC 34; [2013] 2 AC 415; [2013] 3 WLR 1; [2013] 4 All ER 673, SC(E)
F *PricewaterhouseCoopers v Saad Investments Co Ltd* [2014] UKPC 35; [2014] 1 WLR 4482, PC
R v Bourne [1939] 1 KB 687; [1938] 3 All ER 615, CCA
R (Child Poverty Action Group) v Secretary of State for Work and Pensions [2010] UKSC 54; [2011] 2 AC 15; [2011] 2 WLR 1; [2011] PTSR 185; [2011] 1 All ER 729, SC(E)
R (Mohamed) v Secretary of State for Foreign and Commonwealth Affairs (No 1)
G [2008] EWHC 2048 (Admin); [2009] 1 WLR 2579, DC
R (Nicklinson) v Ministry of Justice (CNK Alliance Ltd intervening) [2014] UKSC 38; [2015] AC 657; [2014] 3 WLR 200; [2014] 3 All ER 843, SC(E)
R (Omar) v Secretary of State for Foreign and Commonwealth Affairs [2011] EWCA Civ 1587, CA
R (Omar) v Secretary of State for Foreign and Commonwealth Affairs [2012] EWHC 1737 (Admin); [2013] 1 All ER 161, DC; [2013] EWCA Civ 118; [2014] QB 112;
H [2013] 3 WLR 439; [2013] 3 All ER 95, CA
Rubin v Eurofinance SA (Picard intervening) [2012] UKSC 46; [2013] 1 AC 236; [2012] 3 WLR 1019; [2013] Bus LR 1; [2013] 1 All ER 521; [2013] 1 All ER (Comm) 513; [2012] 2 Lloyd's Rep 615, SC(E)
Seagull Manufacturing Co Ltd, In re [1993] Ch 345; [1993] 2 WLR 872; [1993] 2 All ER 980, CA

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Smith Kline and French Laboratories Ltd v Global Pharmaceutics Ltd [1986] RPC 394, CA

Test Claimants in the FII Group Litigation v Revenue and Customs Comrs (formerly Inland Revenue Comrs) [2012] UKSC 19; [2012] 2 AC 337; [2012] 2 WLR 1149; [2012] Bus LR 1033; [2012] 3 All ER 909, SC(E)

Tucker (RC) (A Bankrupt), In re, Ex p Tucker (KR) [1990] Ch 148; [1988] 2 WLR 748; [1988] 1 All ER 603, CA

Turners & Growers Exporters Ltd v The Ship "Cornelis Verolme" [1997] 2 NZLR 110

Upmann v Elkan (1871) LR 12 Eq 140; LR 7 Ch App 130

Williams v Central Bank of Nigeria [2014] UKSC 10; [2014] AC 1189; [2014] 2 WLR 355; [2014] 2 All ER 489, SC(E)

The following additional case was cited in argument:

Atlas Bulk Shipping A/S, In re; Larsen v Navios International Inc [2011] EWHC 878 (Ch); [2012] Bus LR 1124

APPEAL from Court of Appeal for Bermuda

On 4 March 2013 Kawaley CJ in the Supreme Court of Bermuda made an order (i) recognising the status of the joint official liquidators of Singularis Holdings Ltd, a Cayman Islands company ordered by the Grand Court of the Cayman Islands to be wound up, and (ii) requiring the company's auditors, PricewaterhouseCoopers, a Bermuda registered partnership, to produce all documents in their possession relating to their affairs.

The auditors appealed against the production order. On 18 November 2013 the Court of Appeal for Bermuda (Zacca P, Auld JA and Bell AJA) [2013] CA (Bda) 7 Civ allowed the appeal against the production order.

The liquidators appealed pursuant to permission granted on 21 March 2014 by the Court of Appeal for Bermuda (Zacca P, Evans and Scott Baker JJA). The issues for the Privy Council, as set out in the parties' statement of agreed facts and issues, were (1) whether the court had power at common law to make an order by way of judicial assistance under or in terms analogous to section 195 of the Bermudan Companies Act 1981 in respect of a company in liquidation in the Cayman Islands; (2), if so, whether assistance should be granted or refused, as a matter of discretion; and (3) in particular, whether the liquidators were entitled to relief which would not be available to them in the Cayman Islands under Cayman Islands law.

The facts are stated in the judgment of Lord Sumption JSC.

Gabriel Moss QC, Felicity Toube QC, Stephen Robins and *Rod Attride-Stirling* (of the Bermudan Bar) (instructed by *Blake Morgan LLP*) for the liquidators.

The Supreme Court of Bermuda's common law power to grant judicial assistance in cross-border insolvencies supplies the jurisdiction to require the auditors to disclose documents relating to the company. The fact that the liquidators cannot obtain the relevant documents from the auditors in the Cayman Islands is no basis for refusing to provide such assistance as a matter of discretion. It is necessary to distinguish between (1) "recognition" and "judicial assistance" and (2) "recognition of insolvency proceedings" and "recognition of judgments". In its strict narrow sense, "recognition" refers to mandatory rules by which one jurisdiction gives direct effect in its

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own jurisdiction to a legal act in another. Thus if a winding up order is made in the Cayman Islands as the place of the company's registration, Bermuda in accordance with its common law conflicts rules gives effect to that to the extent of recognising the Cayman Islands liquidators as the sole authorised agents of the company under Cayman Islands law, able to act on behalf of the company in Bermuda: see *Dicey, Morris & Collins, The Conflict of Laws*, 15th ed (2012), vol 2, rule 179. Bermudan conflicts rules do not however recognise mandatory "effects" of the Cayman Islands winding up proceedings, such as the statutory stay: see *Banque Indosuez SA v Ferromet Resources Inc* [1993] BCLC 112, 117. Beyond mandatory common law recognition rules, the case law has developed discretionary judicial assistance: see *Dicey, Morris & Collins*, 15th ed, paras 30-107, 30-108. Common law judicial assistance has two key differences from recognition: (1) recognition is mandatory, whereas judicial assistance is discretionary; (2) recognition gives effect to foreign law, whereas judicial assistance applies domestic law: see *Cambridge Gas Transportation Corpn v Official Committee of Unsecured Creditors of Navigator Holdings plc* [2007] 1 AC 508. It is also important to distinguish between recognising foreign insolvency proceedings and recognising judgments arising from foreign insolvency proceedings. Common law mandatory conflicts rules make entirely different provision for each. Thus a winding up proceeding in the Cayman Islands for a company registered there must be recognised in Bermuda to the extent of the appointment and authority of the liquidators. However, a judgment in personam is only recognised if certain criteria such as submission to jurisdiction are met: see *Rubin v Eurofinance SA (Picard intervening)* [2013] 1 AC 236. Where a foreign winding up proceeding is recognised, in the sense that the authority of the liquidators is accepted, the recognising court is not obliged to offer any assistance. However, absent good reason not to assist, such as the need to protect local creditors, such assistance should be given: see *Rubin v Eurofinance SA*, para 29.

Outside the European Union and in countries where the UNCITRAL Model Law has not been enacted, judicial assistance in cross-border insolvencies may be classed as of two different types. Model 1 involves the provision of assistance through the commencement of an ancillary insolvency proceeding such as liquidation. The doctrine of ancillary liquidations is one by which the court has a common law power to assist a foreign liquidator by granting relief governed by the local law alone, even if that local law gives rise to the right to obtain relief of a type or character not available in the primary liquidation; conversely, there may be relief available under the law of the main proceedings which is not available under the law of the ancillary winding up: see *In re Matheson Bros Ltd* (1884) 27 Ch D 225 and *In re Bank of Credit and Commerce International SA (No 10)* [1997] Ch 213. Model 2 involves the provision of assistance without the commencement of an ancillary liquidation. Relief of this type is available where the relief sought is the examination of individuals and the production of documents: see *Rubin v Eurofinance SA* [2013] 1 AC 236, paras 29, 31, 33. Two alternative conceptual foundations for the model 2 power emerge from the authorities. Route A involves a common law hypothesis by which the court may grant assistance as if the foreign company were being wound up locally—on that basis, the foreign company is treated as if it were a company to which the local winding up legislation applies, even if it could

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not in fact fall within the definitions required to make it such a company: see *In re African Farms* [1906] TS 373; *Moolman v Builders & Developers (Pty) Ltd* [1990] 2 All SA 77 (A) and *Cambridge Gas Transportation Corpn v Official Committee of Unsecured Creditors of Navigator Holdings plc* [2007] 1 AC 508, para 22. Route B involves the provision of assistance through the exercise of the assisting court's general, non-statutory powers, including inherent equitable and common law powers, or non-insolvency statutory powers, without any reliance on any particular provision of the local winding up legislation. On either basis, in the present case, the liquidators were able to obtain the assistance of the Bermudan Supreme Court, and it is right for them to have that assistance.

The most authoritative statement of the common law assumption in route A continues to be the *Cambridge Gas* case, para 22. The judgment has two distinct limbs. Firstly, the ordinary rules of private international law relating to the enforcement of foreign judgments do not apply to insolvency—this limb of the judgment was disapproved in *Rubin v Eurofinance SA* [2013] 1 AC 236 but it is of no relevance to the present appeal, which is not concerned with recognition of a judgment. Secondly, route A means that a domestic court can provide assistance by doing whatever it could have done in the case of a domestic insolvency. This second limb has been followed widely: see *In re Phoenix Kapitaldienst GmbH* [2013] Ch 61, para 62; *Perpetual Trustee Co Ltd v BNY Corporate Trustee Services Ltd* [2009] 2 BCLC 400, para 48; *In re Atlas Bulk Shipping A/S* [2012] Bus LR 1124, paras 30–32 and *Picard v Primeo Fund* 2013 (1) CILR 164, para 41. The development of this common law jurisdiction is a legitimate and typical example of the necessary evolution of the common law to meet the changing needs of the times: see *Jones v Kaney* [2011] 2 AC 398, para 112. The ability of the common law to adapt itself to new circumstances and changing needs is one of its strengths. Such changes are not necessarily incremental but may be radical: see *Kleinwort Benson Ltd v Lincoln City Council* [1999] 2 AC 349, 377–379. The role of the common law is to cover those areas which are not governed by statute. Those considerations are particularly relevant in the field of cross-border insolvency. Commercial necessity in the modern globalised world requires judicial assistance to be given to foreign insolvency proceedings, particularly where large sums are involved and assets or documents are missing: see *Crédit Suisse Fides Trust SA v Cuoghi* [1998] QB 818, 827, and *Turners & Growers Exporters Ltd v The Ship "Cornelis Verolme"* [1997] 2 NZLR 110, 126. It is also essential for offshore jurisdictions to be able to ensure that they can apply their laws and procedures to make sure that the use of their jurisdiction in cross-border business does not facilitate fraud or the hiding of assets or documents. Such policies have led to the development of the principle of modified universalism: see the *Cambridge Gas* case [2007] 1 AC 508; *In re HIH Casualty and General Insurance Ltd* [2008] 1 WLR 852 and *Rubin v Eurofinance SA* [2013] 1 AC 236. Where there is a local proceeding, such as ancillary liquidation, the court having control over that local proceeding is required to assist the main proceeding. Where there is no local proceeding, the argument for judicial assistance is even more compelling, since there is no alternative insolvency proceeding. Whatever needs to be done in the local jurisdiction can only be done by way of judicial assistance. Common law judicial assistance does not require reciprocity. Local creditors and policies

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A are protected by the fact that the giving of judicial assistance is discretionary. The provision of such assistance at common law is not inconsistent with *Al Sabah v Grupo Torras SA* [2005] 2 AC 333. The observations, at para 35, in relation to the position at common law are obiter. Further and in any event, the views expressed are not persuasive, since the point was not fully developed in argument. Moreover, para 35 was superseded by the
B *Cambridge Gas* case [2007] 1 AC 508, in which the Privy Council set out detailed views on the question of common law assistance having heard full argument. There is nothing in the local legislation in the present case to forbid the court from granting assistance in this way in cross-border insolvencies. Accordingly, as a matter of jurisdiction, route A enables the court to make an order under section 195 of the Bermudan Companies Act 1981 on the basis of the common law hypothesis identified in the *Cambridge*
C *Gas* case [2007] 1 AC 508, para 22, as if the company were in ancillary liquidation in Bermuda.

Alternatively, route B involves the provision of assistance through the exercise of the assisting court's general and non-statutory powers (including inherent and common law powers), without any reliance on any specific provisions of the local winding up legislation: see *In re Impex Services*
D *Worldwide Ltd* [2004] BPIR 564 and *Perpetual Trustee Co Ltd v BNY Corporate Trustee Services Ltd (Revenue and Customs Comrs intervening)* [2012] 1 AC 383. Those powers are present in the instant case. There is an inherent and/or common law and/or equitable power to compel discovery or a power in a statutory provision which is not limited in application to local liquidations. The inherent powers of a court of equity are vested in the Supreme Court of Bermuda: see section 12 of the Supreme Court Act 1905.
E As a consequence, the equitable jurisdiction to compel discovery in aid of proceedings in some other court remains exercisable by the Supreme Court of Bermuda. A non-statutory power to compel discovery can be exercised by way of judicial assistance in a cross-border insolvency case: see *In re Impex Services Worldwide Ltd* [2004] BPIR 564 and *Rubin v Eurofinance SA* [2013] 1 AC 236. The power to order discovery under Ord 24, r 12 of the
F Bermudan Rules of the Supreme Court 1985 applies only to cases falling within that rule, outside its scope the court's general equitable power to compel discovery continues to apply. Accordingly, route B enables the court to make an order under Ord 24, r 12, if it is applicable, or, if it is not, under the court's general equitable jurisdiction to compel discovery, which is preserved by section 12 of the Supreme Court Act 1905. [Reference was
G made to *Dreyfus v Peruvian Guano Co* (1889) 41 Ch D 151 and *In re Atlas Bulk Shipping A/S; Larsen v Navios International Inc* [2012] Bus LR 1124.]

As a matter of discretion, such assistance should be provided to the liquidators. The documents sought are in the possession of the auditors, are not available from any other source and will be crucial to the recovery of assets for the benefit of the company's creditors and to the ascertainment of the company's liabilities. The fact that the Cayman Islands court could not
H itself make an order for production of the documents provides no basis for refusing assistance. First, the objection does not apply to assistance through the commencement of an ancillary liquidation in which local statutory provisions are applied without any such restriction and there is no principled reason why it should apply to assistance without an ancillary liquidation, which will apply only domestic law. Secondly, to withhold assistance on

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that basis would largely undermine the concept of assistance. If the Grand Court of the Cayman Islands were able to make an effective order in those terms, the liquidators would not require assistance from the Supreme Court of Bermuda. The requested court providing common law judicial assistance can only apply its own law. That law will invariably differ in some respects from the courts having jurisdiction over the applicant who seeks judicial assistance. It cannot be unfair or unreasonable vis-à-vis the auditors to apply the law of its own country of incorporation in requiring disclosure. Accordingly, the court has jurisdiction at common law to assist the liquidators by requiring the auditors to disclose relevant documents and there is no reason for declining to assist as a matter of discretion.

David Chivers QC, *Paul Smith* and *Scott Pearman* (of the Bermudan and English Bars) (instructed by *Herbert Smith Freehills LLP*) for the auditors.

The Bermudan court has no jurisdiction at common law to grant assistance to a foreign liquidator by ordering the disclosure of documents or the examination of witnesses. Developments in the common law of Bermuda may be modelled upon equivalent developments in England or in other common law jurisdictions but it is essential to understand why any particular development is necessarily to be incorporated as part of the common law of Bermuda and special care must be taken where the statutory landscape is different. The common law principle identified in *In re Bank of Credit and Commerce International SA (No 10)* [1997] Ch 213 was that there had developed a practice whereby the English court permitted an English liquidator to transmit to a foreign liquidator funds to enable a pari passu distribution to worldwide creditors to be made. Subject to that principle, an English liquidator was bound by English law, including English insolvency law. Indeed, an English ancillary liquidation might, due to the overriding requirement of English rules of set-off, prevent rather than promote the worldwide parri passu distribution of assets. Where there is an English liquidation of a foreign company there is no additional "assistance" given to a foreign liquidator. Any remedies sought in the winding up will have to be through the actions of the English liquidator. Further, the common law consequence of the English winding up may either assist or not assist the foreign liquidator depending upon the provisions under consideration. The "long arm" reach of the English winding up jurisdiction has meant that English courts have considered assistance from the perspective of an English liquidation. The only common law intervention was to suspend the operation of the English statutory scheme in favour of the foreign liquidation by "disapplying" the statutory scheme and directing the remission of assets: see *In re HIH Casualty and General Insurance Ltd* [2008] 1 WLR 852, para 9. Beyond that, English law has not developed a general common law power of assistance. The analysis of common law powers in *Cambridge Gas Transportation Corpn v Official Committee of Unsecured Creditors of Navigator Holdings plc* [2007] 1 AC 508 was undertaken in the context of an English jurisprudence based upon the disapplication of English statutory law in the context of a "long arm" jurisdiction to wind up. In countries which have not adopted that model of winding up the question of assistance is very different. The issue is the source—indeed the very existence—of a power which a foreign liquidator seeks to be exercised by a local court. That cannot be resolved by reference

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to the existence of a very different English common law power in the context of a very different English juridical position, but if anything can be taken from the English common law position it is that the common law is recognising a single system of distribution under the principles of universalism.

The principles of universalism, modified or not, provide no juridical basis to credit the Bermudan court with the power to make an order in terms of section 195 of the Companies Act 1981 in respect of a foreign entity not the subject of its winding up jurisdiction. The principle is concerned with the collection and distribution of assets: see *In re HIH Casualty and General Insurance Ltd* [2008] 1 WLR 852, para 6 and *Rubin v Eurofinance SA (Picard intervening)* [2013] 1 AC 236, paras 11–20. However, it says nothing, and can say nothing, about the powers of different local courts around the world to make collateral orders as regards how assets are to be collected, let alone what coercive powers of the local court may be exercised in favour of the foreign liquidator. The principle can provide no justification for recognising common law powers to provide assistance to foreign liquidators beyond those which are necessary to give effect to the principle, viz, the powers to ensure that there is a unitary system for the collection and distribution of assets. Neither *In re African Farms* [1906] TS 373 nor the principle of modified universalism leads to the conclusion that the assisting court has common law powers to treat a foreign liquidator as if he were a domestic liquidator of a domestic company. *In re African Farms* was concerned with enforcing foreign rights as a matter of comity. It was no part of its ratio that the court had common law powers beyond those involving the collection and distribution of assets. There is no principle brought into play by *Moolman v Builders & Developers (Pty) Ltd* [1990] 2 All SA 77 (A) which requires local powers to be given to a foreign liquidator where those powers do not exist in the liquidator's home jurisdiction. The case is not authority for the proposition that assistance at common law may include making orders for examination which could not be ordered in a foreign jurisdiction. *Cambridge Gas Transportation Corpn v Official Committee of Unsecured Creditors of Navigator Holdings plc* [2007] 1 AC 508 concerns the enforcement of a foreign judgment. The question of what would happen if the foreign liquidation involved a company which could not be wound up in the domestic court was not addressed. It does not stand as authority for the proposition that a domestic court has a common law power to make orders in favour of a foreign liquidator simply because had the company been a domestic company such an order could have been made in favour of a domestic liquidator. It did not directly address the application of a statutory provision at all. *Al Sabah v Grupo Torras SA* [2005] 2 AC 333 was cited in the *Cambridge Gas* case [2007] 1 AC 508 but the analysis at para 35 of the *Al Sabah* case of the limits on the power of the courts to give assistance was not questioned. The Board should follow its own decision in the *Al Sabah* case since para 35 is directly on point and should be determinative of the appeal. *In re Phoenix Kapitaldienst GmbH* [2013] Ch 61 was wrongly decided and was in any case prior to the decision in *Rubin v Eurofinance SA* [2013] 1 AC 236. Accordingly, the court has no jurisdiction at common law to grant assistance to a foreign liquidator by ordering the disclosure of documents or the examination of witnesses. The court has no inherent power or equitable power or power under its rules of court to give such

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disclosure. There are no grounds for extending the common law to give such powers to a foreign liquidator. The application of Cayman law in Bermuda was a universalist principle, but the liquidators' claim to the application of a law which went beyond Cayman law was not. Principles of universalism do not require or justify such an extension and any such extension and the circumstances in which such powers may be exercised are matters to be considered by the legislature of Bermuda. [Reference was made to *Bent v Young* (1838) 9 Sim 180.]

Moss QC replied

The Board took time for consideration.

10 November 2014. The following judgments were handed down.

LORD SUMPTION JSC

Introduction

1 This appeal is closely connected with the concurrent appeal in *PricewaterhouseCoopers v Saad Investments Co Ltd* ("SICL") [2014] 1 WLR 4482. The two appeals concern related companies incorporated in the Cayman Islands, both of which have been ordered by the Grand Court of the Cayman Islands to be wound up. Hugh Dickson, Stephen Akers and Mark Byers of Grant Thornton Special Services (Cayman) Ltd were appointed by that court as the joint official liquidators of both companies. The background to both appeals is set out in the advice of the Board on that appeal, delivered by Lord Neuberger of Abbotsbury PSC, and it need not be repeated here.

2 The common feature of both appeals is that they concern attempts on the part of the liquidators to obtain from the companies' former auditors PricewaterhouseCoopers ("PwC"), information, whether in oral or documentary form, relating to the companies' affairs. The evidence is that the liquidators have been unable to trace certain assets which they consider must have existed, and that relevant information about those assets is likely to be in the possession of PwC. This has not been accepted in terms, but neither has it been disputed. The Board will proceed on the footing that it is correct.

3 The Grand Court of the Cayman Islands has power under section 103 of the Cayman Islands Companies Law to order any person, whether or not resident in the Islands, who has a relevant connection to a company in liquidation (including its former auditor) to "transfer or deliver up to the liquidator any property or documents belonging to the company." The Grand Court has made such an order against PwC, and the Board was told that PwC has complied with it. Consistently with the provision conferring the power, it extends only to material belonging to the companies.

4 Both the SICL and the Singularis appeals concern attempts by the liquidators to obtain material belonging to the auditors themselves, principally their working papers, by invoking the corresponding powers conferred on the Supreme Court of Bermuda. They are in wider terms, which are not limited to information belonging to the company. Section 195 of the Companies Act 1981 of Bermuda provides:

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A "*Power to summon persons suspected of having property of company etc*

"(1) The court may, at any time after the appointment of a provisional liquidator or the making of a winding up order, summon before it any officer of the company or persons known or suspected to have in his possession any property of the company or supposed to be indebted to the company, or any person whom the court deems capable of giving information concerning the promotion, formation, trade, dealings, affairs or property of the company.

"(2) The court may examine such person on oath, concerning the matters aforesaid, either by word of mouth or on written interrogatories, and may reduce his answers to writing and require him to sign them.

"(3) The court may require such person to produce any books and papers in his custody or power relating to the company, but, where he claims any lien on books or papers produced by him, the production shall be without prejudice to that lien, and the court shall have jurisdiction in the winding up to determine all questions relating to that lien."

5 The power of the Bermuda court under section 195 is exercisable only in respect of a company which that court has ordered to be wound up. It was therefore dependent in this case on the existence of a power to wind up a company incorporated outside Bermuda. In the case of SICL the Supreme Court of Bermuda made a winding up order, and then made an order for production and oral examination against PwC in the winding up. However, in the SICL appeal the Board has advised Her Majesty [2014] 1 WLR 4482 that the winding up order must be stayed because (with immaterial exceptions) the court had no jurisdiction to wind up a company incorporated outside Bermuda. The consequence is that all proceedings in the winding up of SICL have ceased to be effective, including the order made under section 195.

6 In the case of Singularis a different procedure was adopted. No winding up order was ever sought or made in Bermuda. Instead, Kawaley CJ made an order recognising in Bermuda the status of the liquidators by virtue of their appointment by the Grand Court of the Cayman Islands, and exercising what he termed a common law power "by analogy with the statutory powers contained in section 195 of the Companies Act" to order PwC and Paul Suddaby (an officer of PwC) to produce the same documents which they could have been ordered to produce under section 195. PwC were also ordered to have a partner, employee or agent acceptable to the liquidators available to answer oral or written interrogatories. The liquidators were given leave to serve the proceedings on Mr Suddaby and any other "partners or officers" of PwC out of the jurisdiction.

7 The Court of Appeal (Bell AJA, Zacca P and Auld JA) [2013] CA (Bda) 7 Civ set aside the Chief Justice's order. Bell AJA and Zacca P doubted whether there was jurisdiction to make a section 195 order at common law in circumstances where section 195 did not apply. But the ground of their decision was that it was not in any event an appropriate exercise of discretion, because the court should not make an order in support of a Cayman liquidation which could not have been made by the Cayman court itself. They regarded the liquidators' claim as "unjustifiable forum shopping". Auld JA agreed with this, but went further. In his view, there

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was no jurisdiction because the Bermuda court could not disregard the limitation of section 195 of the Bermuda Act to cases where a winding up order could be and had been made.

8 Accordingly two issues arise on the present appeal. The first is whether the Bermuda court has a common law power to assist a foreign liquidation by ordering the production of information (in oral or documentary form), in circumstances where (i) the Bermuda court has no power to wind up an overseas company such as Singularis and (ii) its statutory power to order the production of information is limited to cases where the company has been wound up in Bermuda. The second issue is whether, if such a power exists, it is exercisable in circumstances where an equivalent order could not have been made by the court in which the foreign liquidation is proceeding.

A common law power?

9 The common law of Bermuda is the same, in every relevant respect, as that of England. The difficulty is that in England the common law concerning cross-border insolvencies has developed to fill the interstices in what is essentially a statutory framework, and the statutory framework differs in significant respects in Bermuda. The main difference is that the English courts have jurisdiction to wind up unregistered companies, including those incorporated outside the United Kingdom. This jurisdiction has existed since it was first conferred by section 199 of the Companies Act 1862 (25 & 26 Vict c 89). It is currently conferred by section 221 of the Insolvency Act 1986. The Bermuda courts have no equivalent power.

10 The English courts have for at least a century and a half exercised a power to assist a foreign liquidation by taking control of the English assets of the insolvent company. The power was founded partly on statute and partly on the practice of judges of the Chancery Division. Its statutory foundation was the power to wind up overseas companies. The exercise of this power generated a body of practice concerning what came to be known as ancillary liquidations. The English court would order the winding up in England of a company already in liquidation or likely to go into liquidation under the law of its incorporation, provided that there was a sufficient connection with England and a reasonable possibility of benefit to the petitioners. In theory, the effect of the winding up order was to create a statutory trust of the worldwide assets of the company to be dealt with in accordance with English statutory rules of distribution: *Ayerst v C & K (Construction) Ltd* [1976] AC 167, *Banco Nacional de Cuba v Cosmos Trading Corpn* [2000] 1 BCLC 813, 819–820 (Sir Richard Scott V-C). In practice, as Millett J pointed out in *In re International Tin Council* [1987] Ch 419, 446–447, "Although a winding up in the country of incorporation will normally be given extra-territorial effect, a winding up elsewhere has only local operation." The English courts recognised the limits of the international reach of their own proceedings by treating the English winding up as ancillary to the principal winding up in the country of the company's incorporation. They exercised their power of direction over the liquidator by limiting his functions to getting in the English assets and to dealing with them in such a way as to bring about a distribution of the company's worldwide assets on as uniform a basis as was consistent with certain overriding principles of English insolvency law. The earliest reported case in which the practice was

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recognised is the decision of Kay J in *In re Matheson Bros Ltd* (1884) 27 Ch D 225, but it is likely to have been older than that. In these cases, the court is exercising the ordinary powers of the English court to control the winding up of a company, which are wholly statutory. But the court was using them for a purpose which differed from that for which they were conferred, and on principles which departed from those applicable by law in the winding up of an English company. To that extent only, the English courts were exercising a common law power.

11 In Bermuda, the court has no jurisdiction to conduct an ancillary liquidation, except in the (irrelevant) case of a company to which Part XIII of the Companies Act is expressly applied. The question what if any power the court has to assist a foreign liquidation without conducting an ancillary liquidation of its own, must depend on the nature of the assistance sought. Winding up proceedings have at least four distinct legal consequences, to which different considerations may apply. First, the proceedings are a "mechanism of collective execution against the property of the debtor by creditors whose rights are admitted or established", to use the expression of Lord Hoffmann in *Cambridge Gas Transportation Corpn v Official Committee of Unsecured Creditors of Navigator Holdings plc* [2007] 1 AC 508, para 14. Inherent in this function of a winding up is the statutory trust of the company's assets, to which I have already referred, and an automatic stay of other modes of execution. Second, it provides a procedural framework in which to determine what are the provable rights of creditors in cases where they are disputed. Third, it brings into play statutory powers to vary the rights of persons dealing with the company or its assets by impugning certain categories of transaction. These powers are less extensive in Bermuda than they are in England, but include the avoidance of dispositions after the commencement of the winding up and fraudulent preferences. Fourth, it brings into play procedural powers, generally directed to enabling the liquidator to locate assets of the company or to ascertain its rights and liabilities. In Bermuda these include the power under section 195 of the Companies Act to order the production of information. In England, the corresponding statutory powers would all be exercisable in an ancillary liquidation.

12 The main purpose of the winding up order in England is usually to enable the court to take control of the English assets of the company, so as to remove them from the free-for-all which would have resulted if creditors were entitled to gain priority by levying execution on them. But, even without a winding up, the court could, on ordinary principles of private international law, have recognised as a matter of comity the vesting of the company's assets in an agent or office-holder appointed or recognised under the law of its incorporation. For many years before a corresponding rule was recognised for the winding up of foreign companies, the principle had been applied in the absence of any statutory powers to the English moveable assets of a foreign bankrupt which had been transferred to an office-holder in an insolvency proceeding under the law of his domicile. Moreover, while the same rule did not apply to immovable property, the court would ordinarily appoint the foreign office-holder a receiver of the rents and profits: see *Dicey, Morris & Collins, The Conflict of Laws*, 15th ed (2012), vol 2, rules 216 and 217. The more difficult question in such cases was whether the court, in the absence of winding up proceedings, could impose a

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stay on creditors trying to levy execution against the English assets equivalent to the automatic stay that would by statute have followed the initiation of winding up proceedings.

13 That question appears to have been first addressed in the common law world in the important decision of the full court of the Supreme Court of the Transvaal in *In re African Farms Ltd* [1906] TS 373. African Farms Ltd was an English company with substantial assets in the Transvaal. It was in liquidation in England. There was no power to wind it up in the Transvaal because the number of members had fallen below the minimum required to qualify it as a "company" for the purpose of the statutory power of winding up. The leading judgment was given by the great South African judge Sir James Rose Innes, then Chief Justice of the Transvaal. Having recognised the absence of a statutory power to wind up the company, he continued, at p 377:

> "It only remains to consider whether we are justified in recognising the position of the English liquidator. And by that expression I do not mean a recognition which consists in a mere acknowledgment of the fact that the liquidator has been appointed as such in England, and that he is the representative of the company here; I mean a recognition which carries with it the active assistance of the court. A declaration, in effect, that the liquidator is entitled to deal with the Transvaal assets in the same way as if they were within the jurisdiction of the English courts, subject only to such conditions as the court may impose for the protection of local creditors, or in recognition of the requirements of our local laws. If we are able in that sense to recognise and assist the liquidator, then I thin[k] we should do so; because in that way only will the assets here be duly divided and properly applied in satisfaction of the company's debts. If we cannot do so, then this result follows, that the directors cannot deal with the property here, and that the liquidator cannot prevent creditors seizing it in execution of their judgments. Unnecessary expenses will be incurred, and the estate will be left to be scrambled for among those creditors who are in a position to enforce their claims."

Innes CJ then considered (p 378) the objection that "the grant of assistance to the English liquidator, in a case where the court could not wind up itself, may possibly be open to the objection that we are doing by indirect means what the law has given us no power to do directly." He rejected the submission because its acceptance would have prevented the court from recognising the power of the liquidator to dispose of property or rights of the company under the law of its incorporation, contrary to ordinary principles of private international law: see pp 378–380. He went on, at pp 381–382:

> "The true test appears to me to be not whether we have the power to order a similar liquidation here, but whether our recognising the foreign liquidation is actually prohibited by any local rules; whether it is against the policy of our laws, or whether its consequences would be unfair to local creditors, or on other grounds undesirable . . . So far from such circumstances being present here, the case before us is one in which every consideration of equity and convenience demands that the position of the English liquidator should be recognised. Unless that can be done then, as

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A already pointed out, the Transvaal assets are at the mercy of the first creditor who can manage to secure a writ of execution."

In the result, the court recognised the liquidator by virtue of his appointment in England as being entitled to the sole administration of the company's assets in the Transvaal, on terms that the liquidator:

B "recognise the right of all creditors in this colony to prove their claims against the company before the master; and that the admission or rejection of such claims, the liability of the company therefor to the extent of its assets in the Transvaal, and all questions of mortgage or preference in respect of such assets, shall be regulated by the laws of this colony, as if the company had been placed in liquidation here."

C The proved claims of local creditors were ordered to be satisfied rateably from the local assets and the balance made available for distribution to other creditors. Execution of the local judgment creditor's judgment was stayed to enable this to be done.

14 It is right to point out (i) that the recognition of the English liquidator's power of disposition over the company's assets in the Transvaal was no more than what he was entitled to as a matter of private international
D law; (ii) that the conduct of what amounted to an ancillary liquidation in the Transvaal was expressed as a discretionary condition of the court's recognition order; and (iii) that the Transvaal court no doubt had the same inherent power as the English court to stay enforcement of its own judgments. But the decision is nevertheless a significant one, because in substance what the court was doing was to direct the assets of the company
E to be dealt with as if it was in liquidation in the Transvaal, when there was no power to conduct a liquidation there. It also deprived an existing judgment creditor of what was on the face of it an accrued and absolute right under his judgment and exposed him to having his debt written down to a figure consistent with the rateable distribution of assets in the Transvaal. The court therefore unquestionably modified the rights of the company and its creditors. Moreover, the sole basis on which it did so was the inherent
F power of the court to assist the orderly liquidation of the company's affairs pursuant to a foreign winding up order. As Innes CJ put it, at p 377, "recognition . . . carries with it the active assistance of the court." Or, in the words of the concurring judgment of Smith J (at p 390), the basis of the order was the recognition and enforcement of rights and the recognition of a status acquired under a foreign law, unless they conflict with the law or policy of
G the jurisdiction in which they were sought to be enforced.

15 The flexibility and breadth of the English court's powers in an ancillary liquidation, together in more recent times with the incorporation into English law of a number of international schemes of judicial co-operation, have had the effect of arresting the development of the common law in England in this area. However, the issue returned in 2006
H with the decision of the Privy Council in *Cambridge Gas Transportation Corpn v Official Committee of Unsecured Creditors of Navigator Holdings plc* [2007] 1 AC 508. In this case the Privy Council, affirming the decision of the Staff of Government Division in the Isle of Man, held that effect should be given in the Isle of Man to the judicial reorganisation by a Federal Bankruptcy Court in the United States of a group of Liberian ship-owning

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companies. The effect of the reorganisation was to vest the shares of an Isle of Man company in the committee of creditors, in circumstances where the US court had neither jurisdiction in rem over the shares (because they were rights situated outside its territorial jurisdiction) nor jurisdiction in personam over the shareholders (because they were not present in the US and took no part in the US proceedings). The principal shareholder, Cambridge Gas, objected on the ground that it was not bound by the decision of the US court. The advice of the Board was given by Lord Hoffmann. He discerned in the English case law a consistent "aspiration" to produce a result equivalent to that which would obtain if there were a single universal bankruptcy jurisdiction. He regarded this "principle of universality" as having been the foundation of the decision in *In re African Farms* [1906] TS 373, and considered that it justified the Isle of Man courts in giving effect to the US reorganisation plan [2007] 1 AC 508, paras 16–21. In his view, and that of the Board, the absence of jurisdiction in rem or in personam in the US court was irrelevant, because the jurisdiction was founded not on any obligation on the part of Cambridge Gas to comply with the judgments of the Federal Bankruptcy Court but on the duty of the Isle of Man court to assist a foreign principal liquidation so as to achieve a universal distribution of the assets on, as far as possible, a common basis. At paras 13–14, he said:

> "13. . . . Judgments in rem and in personam are judicial determinations of the existence of rights: in the one case, rights over property and in the other, rights against a person. When a judgment in rem or in personam is recognised by a foreign court, it is accepted as establishing the right which it purports to have determined, without further inquiry into the grounds on which it did so. The judgment itself is treated as the source of the right.
>
> "14. The purpose of bankruptcy proceedings, on the other hand, is not to determine or establish the existence of rights, but to provide a mechanism of collective execution against the property of the debtor by creditors whose rights are admitted or established."

The essence of the decision and the reasoning which supported it is to be found, at paras 20–22:

> "20. . . . But the underlying principle of universality . . . is given effect by recognising the person who is empowered under the foreign bankruptcy law to act on behalf of the insolvent company as entitled to do so in England. In addition, as Innes CJ said in the Transvaal case *In re African Farms Ltd* [1906] TS 373, 377, in which an English company with assets in the Transvaal had been voluntarily wound up in England, 'recognition which carries with it the active assistance of the court' . . .
>
> "21. Their Lordships consider that these principles are sufficient to confer on the Manx court jurisdiction to assist the committee of creditors, as appointed representatives under the Chapter 11 order, to give effect to the plan . . .
>
> "22. . . . At common law, their Lordships think it is doubtful whether assistance could take the form of applying provisions of the foreign insolvency law which form no part of the domestic system. But the domestic court must at least be able to provide assistance by doing

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whatever it could have done in the case of a domestic insolvency. The purpose of recognition is to enable the foreign office holder or the creditors to avoid having to start parallel insolvency proceedings and to give them the remedies to which they would have been entitled if the equivalent proceedings had taken place in the domestic forum."

The provisions of the domestic system of insolvency of the Isle of Man, which were relevant in *Cambridge Gas*, were the statutory provisions for sanctioning a scheme of arrangement in the course of a winding up. Because the Isle of Man courts would have had power to wind up Navigator and sanction a scheme of arrangement on terms substantially the same as those of the judicial reorganisation approved by the Federal Bankruptcy Court, it could give effect to the reorganisation plan at common law. "Why therefore," asked Lord Hoffmann (para 25), "should the Manx court not provide assistance by giving effect to the plan without requiring the creditors to go to the trouble of parallel insolvency proceedings in the Isle of Man?" *Cambridge Gas* is authority, if it is correct, for three propositions. The first is the principle of modified universalism, namely that the court has a common law power to assist foreign winding up proceedings so far as it properly can. The second is that this includes doing whatever it could properly have done in a domestic insolvency, subject to its own law and public policy. The third (which is implicit) is that this power is itself the source of its jurisdiction over those affected, and that the absence of jurisdiction in rem or in personam according to ordinary common law principles is irrelevant.

16 The first and second propositions were revisited by Lord Hoffmann in *In re HIH Casualty and General Insurance Ltd* [2008] 1 WLR 852. HIH was an Australian insurance company in liquidation in Australia. A winding up petition had been presented in England and provisional liquidators appointed to conduct an ancillary liquidation. The question at issue was whether the English court should accede to a letter of request from the Australian court inviting it to direct the English provisional liquidators to remit the assets in their hands to the Australian liquidators, in circumstances where they would be distributed there in accordance with statutory priorities which differed from those applicable in a domestic winding up in England. At paras 6–7, Lord Hoffmann said:

"6. Despite the absence of statutory provision, some degree of international co-operation in corporate insolvency had been achieved by judicial practice. This was based on what English judges have for many years regarded as a general principle of private international law, namely that bankruptcy (whether personal or corporate) should be unitary and universal. There should be a unitary bankruptcy proceeding in the court of the bankrupt's domicile which receives worldwide recognition and it should apply universally to all the bankrupt's assets.

"7. This was very much a principle rather than a rule. It is heavily qualified by exceptions on pragmatic grounds; elsewhere I have described it as an aspiration: see *Cambridge Gas Transportation Corpn v Official Committee of Unsecured Creditors of Navigator Holdings plc* [2007] 1 AC 508, 517, para 17. Professor Jay Westbrook, a distinguished American writer on international insolvency has called it a principle of 'modified universalism': see also *Fletcher, Insolvency in Private*

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International Law, 2nd ed (2005), pp 15–17. Full universalism can be attained only by international treaty. Nevertheless, even in its modified and pragmatic form, the principle is a potent one."

Reviewing the English case law, Lord Hoffmann discerned in it a "golden thread running through English cross-border insolvency law since the 18th century" which, adopting a label devised by Professor Jay Westbrook, he called the "principle of (modified) universalism" (para 30):

> "That principle requires that English courts should, so far as is consistent with justice and UK public policy, co-operate with the courts in the country of the principal liquidation to ensure that all the company's assets are distributed to its creditors under a single system of distribution."

17 The Committee in *HIH* was unanimous in holding that the assets should be remitted to Australia, but they were divided in some aspects of their reasoning. Lord Hoffmann, with whom Lord Walker of Gestingthorpe agreed, considered that the court had an inherent power to direct the remittal of the assets at common law. However, that view was not adopted by the rest of the Committee. Lord Scott of Foscote and Lord Neuberger of Abbotsbury considered that the power was wholly derived from section 426 of the Insolvency Act 1986. Lord Phillips of Worth Matravers held that the statutory power was a sufficient jurisdictional basis for the proposed direction, and declined to decide whether jurisdiction could have been established at common law. It is, however, important to appreciate that this difference of opinion related not to the principle of universalism itself, nor to the juridical basis of the power to assist a foreign liquidation in general. The difference was about whether that power could be exercised in a manner which would deprive creditors proving in England of their statutory right under section 107 of the Insolvency Act 1986 to a pari passu distribution according to English rules of priority. The principle justifying judicial assistance in a foreign insolvency which was stated in *In re African Farms* [1906] TS 373 and affirmed in *Cambridge Gas* was [1906] TS 373, 377 subject to "such conditions as the court may impose for the protection of local creditors, or in recognition of the requirements of our local laws" or, as it was put more broadly in *HIH* itself [2008] 1 WLR 852, para 30, "justice and UK public policy". The division in the Committee in *HIH* was about whether this meant that it was subject to the mandatory requirements of section 107 of the Insolvency Act 1986. The relevance of section 426 in the view of Lord Scott and Lord Neuberger was that on their construction of that section it authorised the treatment of the assets in accordance with the law of the foreign jurisdiction notwithstanding its inconsistency with mandatory rules of English law: see Lord Scott, at para 61, and Lord Neuberger, at para 68. Absent that provision, the remittal of the assets to Australia would have been contrary to English law. Lord Phillips did not, any more than Lord Scott and Lord Neuberger, question the principle of modified universalism. Indeed, he regarded it as determinative of the manner in which the discretion should be exercised, albeit leaving open the question of its juridical source: see para 44.

18 *Cambridge Gas* [2007] 1 AC 508 marks the furthest that the common law courts have gone in developing the common law powers of the

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court to assist a foreign liquidation. It has proved to be a controversial decision. So far as it held that the domestic court had jurisdiction over the parties simply by virtue of its power to assist, it was subjected to fierce academic criticism and held by a majority of the Supreme Court to be wrong in *Rubin v Eurofinance SA (Picard intervening)* [2013] 1 AC 236. So far as it held that the domestic court had a common law power to assist the foreign court by doing whatever it could have done in a domestic insolvency, its authority is weakened by the absence of any explanation of whence this common law power came and by the direct rejection of that proposition by the Judicial Committee in *Al Sabah v Grupo Torras SA* [2005] 2 AC 333, a case cited in argument in *Cambridge Gas* but not in the advice of the Board. Lord Walker, giving the advice of the Board in *Al Sabah*, had expressed the view that there was no inherent power to set aside Cayman trusts at the request of a foreign court of insolvency, in circumstances where a corresponding statutory power existed under the Cayman Bankruptcy Law but did not apply in the circumstances. The Board considers it to be clear that although statute law may influence the policy of the common law, it cannot be assumed, simply because there would be a statutory power to make a particular order in the case of domestic insolvency, that a similar power must exist at common law. So far as *Cambridge Gas* suggests otherwise, the Board is satisfied that it is wrong for reasons more fully explained in the advice proposed by Lord Collins of Mapesbury. If there is a corresponding statutory power for domestic insolvencies there will usually be no objection on public policy grounds to the recognition of a similar common law power. But it cannot follow without more that there is such a power. It follows that the second and third propositions for which *Cambridge Gas* [2007] 1 AC 508 is authority cannot be supported.

19 However, the first proposition, the principle of modified universalism itself, has not been discredited. On the contrary, it was accepted in principle by Lord Phillips, Lord Hoffman and Lord Walker in *HIH* [2008] 1 WLR 852, and by Lord Collins of Mapesbury (with whom Lord Walker and Lord Sumption JJSC agreed) in *Rubin v Eurofinance SA* [2013] 1 AC 236. Nothing in the concurring judgment of Lord Mance JSC in that case casts doubt on it. At paras 29–33, Lord Collins summarised the position in this way:

> "29. Fourth, at common law the court has power to recognise and grant assistance to foreign insolvency proceedings. The common law principle is that assistance may be given to foreign office-holders in insolvencies with an international element. The underlying principle has been stated in different ways: 'recognition . . . carries with it the active assistance of the court': *In re African Farms Ltd* [1906] TS 373, 377; 'This court . . . will do its utmost to co-operate with the US Bankruptcy Court and avoid any action which might disturb the orderly administration of [the company] in Texas under Chapter 11': *Banque Indosuez SA v Ferromet Resources Inc* [1993] BCLC 112, 117.
>
> "30. In *Crédit Suisse Fides Trust v Cuoghi* [1998] QB 818, 827, Millett LJ said: 'In other areas of law, such as cross-border insolvency, commercial necessity has encouraged national courts to provide assistance to each other without waiting for such co-operation to be sanctioned by international convention . . . It is becoming widely

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accepted that comity between the courts of different countries requires mutual respect for the territorial integrity of each other's jurisdiction, but that this should not inhibit a court in one jurisdiction from rendering whatever assistance it properly can to a court in another in respect of assets located or persons resident within the territory of the former.'

"31. The common law assistance cases have been concerned with such matters as the vesting of English assets in a foreign office-holder, or the staying of local proceedings, or orders for examination in support of the foreign proceedings, or orders for the remittal of assets to a foreign liquidation, and have involved cases in which the foreign court was a court of competent jurisdiction in the sense that the bankrupt was domiciled in the foreign country or, if a company, was incorporated there . . .

"33. One group of cases involved local proceedings which were stayed or orders which were discharged because of foreign insolvency proceedings. Thus in *Banque Indosuez SA v Ferromet Resources Inc* [1993] BCLC 112 an English injunction against a Texas corporation in Chapter 11 proceedings was discharged; cf *In re African Farms Ltd* [1906] TS 373 (execution in Transvaal by creditor in proceedings against English company in liquidation in England stayed by Transvaal court), applied in *Turners & Growers Exporters Ltd v The Ship 'Cornelis Verolme'* [1997] 2 NZLR 110 (Belgian shipowner in Belgian bankruptcy: ship released from arrest); *Modern Terminals (Berth 5) Ltd v States Steamship Co* [1979] HKLR 512 (stay in Hong Kong of execution against Nevada corporation in Chapter 11 proceedings in United States federal court in California), followed in *CCIC Finance Ltd v Guangdong International Trust & Investment Corpn* [2005] 2 HKC 589 (stay of Hong Kong proceedings against Chinese state-owned enterprise in Mainland insolvency). Cases of judicial assistance in the traditional sense include *In re Impex Services Worldwide Ltd* [2004] BPIR 564, where a Manx order for examination and production of documents was made in aid of the provisional liquidation in England of an English company."

In the Board's opinion, the principle of modified universalism is part of the common law, but it is necessary to bear in mind, first, that it is subject to local law and local public policy and, secondly, that the court can only ever act within the limits of its own statutory and common law powers. What are those limits? In the absence of a relevant statutory power, they must depend on the common law, including any proper development of the common law. The question how far it is appropriate to develop the common law so as to recognise an equivalent power does not admit of a single, universal answer. It depends on the nature of the power that the court is being asked to exercise. On this appeal, the Board proposes to confine itself to the particular form of assistance which is sought in this case, namely an order for the production of information by an entity within the personal jurisdiction of the Bermuda court. The fate of that application depends on whether, there being no statutory power to order production, there is an inherent power at common law do so.

20 The fundamental question is whether a power of compulsion of this kind requires a statutory basis. For this purpose, it is important to distinguish between evidence and information. By evidence, the Board

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means evidence to prove facts in legal proceedings. The power to compel a person to give evidence in legal proceedings was not originally statutory. Like the power to order discovery, it was an inherent power of the Court of Chancery, devised by judges to remedy the technical and procedural limitations associated with the proof of fact in courts of common law. In England, it was first put on a statutory basis by the Perjury Act 1563 (5 Eliz 1, c 9), which extended the power to issue a subpoena ad testificandum to all courts of record. In Bermuda, its basis is now section 4 of the Evidence Act 1905. The origins of these powers in the procedural history of the English courts go some way to explain why those courts have always disclaimed any inherent power to compel the furnishing of evidence for use in foreign proceedings: see *Bent v Young* (1838) 9 Sim 180, 192 (Shadwell V-C); *Dreyfus v Peruvian Guano Co* (1889) 41 Ch D 151; *R (Omar) v Secretary of State for Foreign and Commonwealth Affairs* [2013] 1 All ER 161 (Divisional Court), paras 58–63. No such power existed in England until it was created by statute, initially by the Foreign Tribunals Evidence Act 1856 (19 & 20 Vict c 113).

21 What is sought in this case, however, is not evidence for use in forensic proceedings but information required for the performance of the liquidators' ordinary duty of identifying and taking possession of assets of the company. In *R (Omar) v Secretary of State for Foreign and Commonwealth Affairs* [2014] QB 112, para 12 the Court of Appeal doubted whether the distinction between evidence and information was helpful, and their doubt was probably justified in that case, where information was being sought for use in foreign proceedings. But the distinction is of broader legal significance. The courts have never been as inhibited in their willingness to develop appropriate remedies to require the provision of information when a sufficiently compelling legal policy calls for it.

22 The classic modern illustration is the jurisdiction recognised by the House of Lords in *Norwich Pharmacal Co v Customs and Excise Comrs* [1974] AC 133. The House, drawing mainly on the earlier decisions in *Orr v Diaper* (1876) 4 Ch D 92; 25 WR 23 and *Upmann v Elkan* (1871) LR 12 Eq 140; LR 7 Ch App 130, recognised a common law power to order the production of information about the identity of a wrongdoer where the defendant had been involved, even innocently, in the wrong. Such an order, as they recognised, would not have been available to compel the giving of evidence, because of the long-standing objection of courts of equity to a bill of discovery against a "mere witness": see, in particular, pp 173–174 (Lord Reid). In *Smith Kline and French Laboratories Ltd v Global Pharmaceutics Ltd* [1986] RPC 394 the Court of Appeal in England applied the same principle to information about the identity of a wrongdoer outside the jurisdiction. These decisions were founded not on the procedural requirements for proving facts in English litigation, but on the recognition of a duty to provide the information in certain circumstances. The duty of a person who had become involved in another's wrongdoing was held [1974] AC 133, 175 (Lord Reid) to be to "assist the person who has been wronged by giving him full information and disclosing the identity of the wrongdoers"; cf p 195 (Lord Cross of Chelsea). It is, however, clear that this duty was of a somewhat notional kind. It was not a legal duty in the ordinary sense of the term. Failure to supply the information would not give

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rise to an action for damages. The concept of duty was simply a way of saying that the court would require disclosure. Indeed, Lord Morris of Borth-y-Gest (pp 181–182) thought that the duty would not arise until the court had held that the conditions were satisfied. Viscount Dilhorne (p 190) agreed and so, it seems, did Lord Cross: p 198. Lord Kilbrandon, citing with apparent approval the South African decision in *Colonial Government v Tatham* (1902) 23 Natal LR 153, observed (p 205) that the duty lay "rather on the court to make an order necessary to the administration of justice than on the respondent to satisfy some right existing in the plaintiff."

23 The present case is not a *Norwich Pharmacal* case. The significance of *Norwich Pharmacal* in the present context is that it illustrates the capacity of the common law to develop a power in the court to compel the production of information when this is necessary to give effect to a recognised legal principle. In the Board's opinion, an analogous power arises in the present case. Relief is not being sought by way of assistance to a litigant who can rely on ordinary forensic procedures for the purpose. It is being sought by the officers of a foreign court. The principle of modified universalism is a recognised principle of the common law. It is founded on the public interest in the ability of foreign courts exercising insolvency jurisdiction in the place of the company's incorporation to conduct an orderly winding up of its affairs on a worldwide basis, notwithstanding the territorial limits of their jurisdiction. The basis of that public interest is not only comity, but a recognition that in a world of global businesses it is in the interest of every country that companies with transnational assets and operations should be capable of being wound up in an orderly fashion under the law of the place of their incorporation and on a basis that will be recognised and effective internationally. This is a public interest which has no equivalent in cases where information may be sought for commercial purposes or for ordinary adversarial litigation. The courts have repeatedly recognised not just a right but a duty to assist in whatever way they properly can. The Bermuda court has properly recognised the status of the liquidators as officers of that court. The liquidators require the information for the performance of the ordinary functions attaching to that status. Their acknowledged right to take possession of the company's worldwide assets is of little use without the ability to identify and locate them, if necessary with the assistance of the court. The information is unlikely to be available in any other way. None of the reasons which account for the common law's inhibition about the compulsory provision of evidence have any bearing on the present question. The right and duty to assist foreign office-holders which the courts have acknowledged on a number of occasions would be an empty formula if it were confined to recognising the company's title to its assets in the same way as any other legal person who has acquired title under a foreign law, or to recognising the office-holder's right to act on the company's behalf in the same way as any other agent of a company appointed in accordance with the law of its incorporation. The recognition by a domestic court of the status of a foreign liquidator would mean very little if it entitled him to take possession of the company's assets but left him with no effective means of identifying or locating them.

24 There are two reported cases in which an order for the production of documents or information has been made by way of common law assistance to a foreign court. The first is *Moolman v Builders & Developers (Pty) Ltd*

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A [1990] 2 All SA 77 (A), a decision of the Supreme Court of South Africa. The appeal arose out of the winding up in the Transkei of a company incorporated there, at a period of South African history when the Transkei was in law a foreign country. The liquidator sought an order of the South African court for the examination of certain persons in South Africa with a view to locating assets of the company. Such an order would have been
B available to him by statute if there had been an ancillary liquidation in South Africa, but there was no statutory power to wind up this particular company in South Africa. The court held that a power to make such an order at common law was within the principle of *In re African Farms Ltd* [1906] TS 373. The second case is *In re Impex Services Worldwide Ltd* [2004] BPIR 564, a decision of the High Court of the Isle of Man. Section 206 of the Isle of Man Companies Act 1931 conferred a power to order an examination but
C only in relation to a Manx company. Deemster Doyle nevertheless gave effect by way of common law judicial assistance to a letter of request of the High Court in England seeking the examination of persons in the Isle of Man on behalf of the liquidator of an English company. The Board would not wish to endorse all of the reasoning given in these judgments, in particular those parts which appear to support the concept of applying statutory
D powers by mere analogy in cases outside their scope. But the Board considers that the decisions themselves were correct in principle.

25 In the Board's opinion, there is a power at common law to assist a foreign court of insolvency jurisdiction by ordering the production of information in oral or documentary form which is necessary for the administration of a foreign winding up. In recognising the existence of such a power, the Board would not wish to encourage the promiscuous creation
E of other common law powers to compel the production of information. The limits of this power are implicit in the reasons for recognising its existence. In the first place, it is available only to assist the officers of a foreign court of insolvency jurisdiction or equivalent public officers. It would not, for example, be available to assist a voluntary winding up, which is essentially a private arrangement and although subject to the directions of the court is not
F conducted by or on behalf of an officer of the court. Secondly, it is a power of assistance. It exists for the purpose of enabling those courts to surmount the problems posed for a worldwide winding up of the company's affairs by the territorial limits of each court's powers. It is not therefore available to enable them to do something which they could not do even under the law by which they were appointed. Thirdly, it is available only when it is necessary for the performance of the office-holder's functions. Fourth, the power is
G subject to the limitation in *In re African Farms Ltd* [1906] TS 373 and in *HIH* [2008] 1 WLR 852 and *Rubin* [2013] 1 AC 236, that such an order must be consistent with the substantive law and public policy of the assisting court, in this case that of Bermuda. It follows that it is not available for purposes which are properly the subject of other schemes for the compulsory provision of information. In particular, as the reasoning in *Norwich*
H *Pharmacal* [1974] AC 133 and *R (Omar) v Secretary of State for Foreign and Commonwealth Affairs* [2013] 1 All ER 161; [2014] QB 112 (at both levels) shows, common law powers of this kind are not a permissible mode of obtaining material for use in actual or anticipated litigation. That field is covered by rules of forensic procedure and statutory provisions for obtaining evidence in foreign jurisdictions which liquidators, like other litigants or

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potential litigants, must accept with all their limitations. Moreover, in some jurisdictions, it may well be contrary to domestic public policy to make an order which there would be no power to make in a domestic insolvency. Finally, as with other powers of compulsion exercisable against an innocent third party, its exercise is conditional on the applicant being prepared to pay the third party's reasonable costs of compliance.

26 Order 11, rule 1(2) of the Rules of the Bermuda Supreme Court (as applied by order 11, rule 9(1)) authorises the service of an originating summons, petition, notice of motion or similar originating process out of the jurisdiction without leave in respect of any "claim which by virtue of any enactment the court has power to hear and determine". Because the common law power of the court to compel the production of information in aid of a foreign liquidation is not statutory nor derived from any analogy with the statute, this rule had no application to it. There is a more general power to serve originating process (other than a writ) out of the jurisdiction with the leave of the court under Order 11, rule 9(4), but it is not exercisable against persons whose engagement in the affairs of a foreign company has no connection with Bermuda and there is no implicit statutory authority for such a course: see *In re Seagull Manufacturing Co Ltd* [1993] Ch 345. It follows that on any view the Chief Justice had no power to authorise the service out of the jurisdiction on Mr Suddaby or other partners or officers of PwC who were not within the jurisdiction of the court. The most that he could do, in a case within the ambit of the power, was order PwC, as the only party present within the jurisdiction, to comply for their own part and to take reasonable steps to procure the co-operation of others.

Application to the present case

27 The Board has summarised the limitations on the common law power to compel the production of information. Of these limitations, two are potentially relevant in the case of Singularis.

28 The first arises from PwC's argument that the order sought against them is not consistent with the law or public policy of Bermuda, because the statutory power to compel the production of information under section 195 of the Bermuda Companies Act impliedly excludes the possibility of an equivalent power at common law. The argument is that because section 195 is limited to cases where the company is being wound up in Bermuda, it would be inconsistent with the statutory scheme to recognise a common law power which, if it existed, would be subject to no such limitation. The Board is not persuaded by this. The existence of a statutory power covering part of the same ground may impliedly exclude a common law power covering the whole of it. But it does not necessarily do so. An implied exclusion of non-statutory remedies arises only where the statutory scheme can be said to occupy the field. This will normally be the case if the subsistence of the common law power would undermine the operation of the statutory one, usually by circumventing limitations or exceptions to the statutory power which are an integral part of the underlying legislative policy: see *Deutsche Morgan Grenfell Group plc v Inland Revenue Comrs* [2007] 1 AC 558, para 19 (Lord Hoffmann); *R (Child Poverty Action Group) v Secretary of State for Work and Pensions* [2011] 2 AC 15, paras 27–34 (Lord Dyson JSC). There is, however, no reason to suppose that the limitation of the power under section 195 of the Companies Act to

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companies in the course of winding up in Bermuda reflects a legislative policy adverse to assisting foreign courts of insolvency jurisdiction. It simply reflects the limits of the ambit of the Act. The relevant provisions of the Act have been analysed in the advice of the Board in *PricewaterhouseCoopers v Saad Investments Co Ltd* [2014] 1 WLR 4482. In summary, the effect of section 4 is that it applies to companies incorporated in Bermuda or authorised to carry on business there. However, the fact that express provision is made for the powers exercisable on the winding up of companies to which the Act applies, does not in the Board's opinion exclude the use of common law powers in relation to other companies which lie outside the scope of the statute altogether.

29 The second limitation which is relevant presents more formidable problems for the joint liquidators. The material which they seek in Bermuda would not be obtainable under the law of the Cayman Islands pursuant to which the winding up is being carried out there. Where a domestic court has a power to grant ancillary relief in support of the proceedings of a foreign court, it is not necessarily an objection to its exercise that the foreign court had no power to make a corresponding order itself. Thus in *Crédit Suisse Fides Trust SA v Cuoghi* [1998] QB 818, the English court made a worldwide *Mareva* injunction in support of Swiss proceedings against Mr Cuoghi in circumstances where the Swiss court could not have made such an order. But that decision cannot be taken to reflect a universal principle. The critical factors which justified the order in that case were that there was an unqualified statutory power to give ancillary relief and that the Swiss court's inability to make the order was due to the fact that Mr Cuoghi was not resident in Switzerland whereas he was resident in England. Rather different considerations apply to the common law power with which the Board is presently concerned. Its whole juridical basis is the right and duty of the Bermuda court to assist the Cayman court so far as it properly can. It is right for the Bermuda court, within the limits of its own inherent powers, to assist the officers of the Cayman court to transcend the territorial limits of that court's jurisdiction by enabling them to do in Bermuda that which they could do in the Cayman Islands. But the order sought would not constitute assistance, because it is not just the limits of the territorial reach of the Cayman court's powers which impede the liquidators' work, but the limited nature of the powers themselves. The Cayman court has no power to require third parties to provide to its office-holders anything other than information belonging to the company. It does not appear to the Board to be a proper use of the power of assistance to make good a limitation on the powers of a foreign court of insolvency jurisdiction under its own law. This was in substance the ground on which the liquidators failed in the Court of Appeal when they characterised the present application as "forum shopping". In the opinion of the Board it is correct.

30 The liquidators have not contended at any stage of this litigation that the order which they seek can be justified at common law independently of the power of the Bermuda court to assist a foreign court of insolvency jurisdiction. Moreover, they have accepted before the Board that the information which they seek belongs to PwC and was therefore properly excluded from the order made by the Grand Court of the Cayman Islands. Whether this was correct was not therefore a point argued before the Board. None the less, the Board would not wish to part with this case without

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expressing their doubts about whether information which PwC acquired solely in their capacity as the company's auditors can be regarded as belonging exclusively to them simply because the documents in which they recorded that information are their working papers and as such their property.

Conclusion

31 The Board will humbly advise Her Majesty that this appeal should be dismissed.

LORD COLLINS OF MAPESBURY

Introduction

32 In my opinion the appeal should be dismissed because the ground on which the joint liquidators based their appeal is unsupportable, namely that the court has at common law the ability to exercise powers which are analogous to statutory powers which would have been exercisable in the case of a domestic insolvency, but which do not apply in the international context. This opinion is intended to explain why that conclusion is inescapable in the light of the relationship between the judiciary and the legislature.

33 As the Supreme Court confirmed in *Rubin v Eurofinance SA (Picard intervening)* [2013] 1 AC 236 the court has a common law power to assist foreign winding up proceedings so far as it properly can. In my view, in common with Lord Sumption JSC and despite Lord Mance JSC's powerful opinion to the contrary, the Bermuda court has the power to make an order against persons subject to its personal jurisdiction in favour of foreign liquidators for production of information for the purpose of identifying and locating assets of the company, provided they have a similar right under the domestic law of the court which appointed them. I therefore agree with Lord Sumption JSC that this was not a proper case for exercise of that power.

34 The existence of a common law power to order information (otherwise than by analogy with local statutory powers) was not pursued by the liquidators on the appeal, and it was virtually disclaimed by them until questioning by the Board (quoted in Lord Mance JSC's opinion at para 128) may have led them to adopt it as a subsidiary basis for their appeal.

35 Consequently the parties are entitled to have the views of the Board on the argument which was actually put before it, in essence whether *Cambridge Gas Transportation Corpn v Official Committee of Unsecured Creditors of Navigator Holdings plc* [2007] 1 AC 508 ("*Cambridge Gas*") correctly decided that the court has a common law power to assist foreign winding up proceedings by exercising powers which are analogous to statutory powers which would have been exercisable in the case of a domestic insolvency, but do not apply to the international insolvency.

36 The primary way in which the case was put by the liquidators was that the common law develops to meet changing circumstances and that in international insolvencies the common law should be developed by the adoption of a principle that where local legislation does not provide for relevant assistance to a foreign office holder, the legislation should be applied by analogy "as if" the foreign insolvency were a local insolvency.

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A This argument was accepted by the Chief Justice. But it involves a fundamental misunderstanding of the limits of the judicial law-making power, and should not go unanswered.

37 A second reason for dealing with the main point of the liquidators' appeal was that the question whether local legislation could be applied by analogy arose in an appeal in the Cayman Islands Court of Appeal, and that court gave only an interim judgment pending the decision of this Board on B this appeal: *Picard v Primeo Fund* 2013 (1) CILR 164. That case, as will appear below, involved anti-avoidance proceedings for the recovery of assets, and not (as in the present case) proceedings to obtain information to recover assets. On the principal argument of the liquidators, there is no material difference between this case and the Cayman Islands case. In each case the argument was that the local legislation should, if it does not apply C according to its terms (and there is a question about this in the Cayman Islands case), be applied by analogy or on an "as if" basis. The Board took the view that it would be failing in its duty if it did not reach this question on this appeal, and simply left the Cayman Islands Court of Appeal to decide the matter with a possible further appeal to the Privy Council. That appeal has recently been settled, but the point of principle may still arise.

38 In my judgment the answer to the present appeal is to be found in the D following propositions. First, there is a principle of the common law that the court has the power to recognise and grant assistance to foreign insolvency proceedings. Second, that power is primarily exercised through the existing powers of the court. Third, those powers can be extended or developed from existing powers through the traditional judicial law-making techniques of the common law. Fourth, the very limited application of legislation by E analogy does not allow the judiciary to extend the scope of insolvency legislation to cases where it does not apply. Fifth, in consequence, those powers do not extend to the application, by analogy "as if" the foreign insolvency were a domestic insolvency, of statutory powers which do not actually apply in the instant case.

The practical issue

F

39 Both the Cayman Islands and Bermuda have statutory provisions for the examination of persons connected with an insolvent company. In England the statutory power is contained in the Insolvency Act 1986, section 236.

40 This is an exclusively statutory power, which goes back a very long way. As early as the Statute of Bankrupts Act 1542 (34 & 35 Hen 8, c 4), the G authorities (including, among others, the lord chancellor and the chief justices) were given power to examine on oath persons who were suspected of having property (including debts) belonging to the debtor. The Joint Stock Companies Act 1844 (7 & 8 Vict c 110) gave a similar power to the court in the case of companies, and there is a continuous line of statutory authority in both corporate and personal insolvency confirming (and H extending) the power thereafter to the present day.

41 The provisions of neither the Cayman Islands nor Bermuda statutes apply to the material sought by the liquidators in this case. That is because: (1) the power in section 103 of the Cayman Islands Companies Law to order any person, whether or not resident in the Cayman Islands, who has a relevant connection with a company in liquidation (including its former

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auditor) to "transfer or deliver up to the liquidator any property or documents belonging to the company" extends only to material belonging to the companies (subject to what Lord Sumption JSC says at para 29); and (2) the "power to summon persons suspected of having property of company etc" in section 195 of the Companies Act 1981 of Bermuda does not apply because the power is exercisable only in respect of a company which that court has ordered to be wound up, and in the SICL appeal the Board has advised that the winding up order must be stayed because the court has no jurisdiction to wind up a company incorporated outside Bermuda, to which Part XIII of the Companies Act is not expressly applied: *PricewaterhouseCoopers v Saad Investments Co Ltd* [2014] 1 WLR 4482.

42 The problem in this and other similar or analogous cases has arisen largely in relation to those British colonies, dependencies, and overseas territories, such as Bermuda, and the Isle of Man, which do not have the statutory powers to assist foreign office-holders which exist under United Kingdom law. Consequently, except in a rare situation to which I will revert, the practical result of this appeal is largely confined to such countries, or those countries (such as the Cayman Islands) where the extent of the statutory powers is controversial.

43 Some of these territories do have such powers. The British Virgin Islands has given effect to the UNCITRAL Model Law in the Insolvency Act 2003, Part XIX, which contains powers to assist foreign office-holders, but only from countries or territories which are designated by the Financial Services Commission. There are nine such countries or territories, including the United States and the United Kingdom. Section 470 of the Insolvency Act 2003 preserves the power of the court to provide assistance under any other rule of law.

44 The Cayman Islands Companies Law, section 241, gives the court power to make orders ancillary to a foreign bankruptcy proceeding (including the power to require a person in possession of information relating to the business or affairs of a bankrupt: section 241(1)(d)). But the application of these powers to anti-avoidance proceedings has been controversial. The Cayman Islands Court of Appeal reserved pending the outcome of this appeal the question whether the anti-avoidance provisions of its law can be used at common law (in addition to, or alternatively to, its statutory power to do so) in aid of a US bankruptcy proceeding: *Picard v Primeo Fund* 2014 (1) CILR 379. As mentioned above, the appeal has recently been settled.

45 In the United Kingdom, except where the EU Insolvency Regulation (Council Regulation (EC) 1346/2000 of 29 May 2000 on insolvency proceedings (OJ 2000 L160, p 1)) applies, the English court has a very wide power to wind up foreign companies, and where a foreign company is being wound up in England the liquidator is generally free to invoke the relevant provisions of the Insolvency Act 1986 in discharge of his functions, which would include the power to ask for examination under the Insolvency Act 1986, section 236.

46 Where the foreign company is not being wound up in England, under the Cross-Border Insolvency Regulations 2006 (SI 2006/1030), which give effect to the UNCITRAL Model Law, the court may co-operate to the maximum extent possible with foreign courts or foreign representatives: article 25(1). By article 21(1) of the 2006 Regulations, on recognition of a

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A foreign proceeding, the English court may grant appropriate relief, including the examination of witnesses, and the taking of evidence or the delivery of information concerning (inter alia) the debtor's assets. Secondary proceedings may be opened in the United Kingdom, but only where the debtor has an establishment in the United Kingdom and only as regards assets in the United Kingdom.

B 47 Under section 426 of the Insolvency Act 1986 the English court with jurisdiction in relation to insolvency is to assist the courts having the corresponding jurisdiction in any other part of the United Kingdom "or any relevant country or territory" (section 426(4)) by applying the law of either jurisdiction (section 426(5), a very difficult section: see *Dicey, Morris & Collins, Conflict of Laws*, 15th ed (2012), vol 2, para 30-110 et seq). These powers apply to only a limited numbers of countries (including Australia,
C the Bahamas, and the Isle of Man).

48 An order for examination may be made under this section in aid of a foreign liquidation. In *England v Smith* [2001] Ch 419 it was held, in a case of an order for examination under Australian law of a person concerned with the affairs of a company, that application of the law of the requesting state should not be circumscribed by limitations to be found in the
D corresponding provisions of section 236 of the 1986 Act unless some principle of English public policy were infringed.

49 Where the EU Insolvency Regulation applies, a foreign officeholder may exercise all the powers conferred on him by the law of the state of the opening of proceedings: article 18(1).

50 Accordingly the statutory powers of the UK courts to assist foreign office-holders to trace assets are very extensive. It follows that the existence
E of a common law power to order examination will almost certainly never arise in England, and the same is true of the other statutory powers of which foreign office-holders may wish to take advantage. This is subject to what is said below about *In re Phoenix Kapitaldienst GmbH* [2013] Ch 61, where clawback under the Insolvency Act 1986, section 423 (transactions at an undervalue) was sought and granted, in a case where the EU Insolvency
F Regulation did not apply because the German company involved was an investment undertaking; the UNCITRAL Model Law did not apply because the 2006 Regulations were not in effect at the relevant time; and Germany was not a relevant country for the purposes of section 426(4).

Assistance at common law in international insolvency

G 51 The UK Supreme Court accepted, and re-confirmed, in *Rubin v Eurofinance SA* [2013] 1 AC 236 that at common law the court has power to recognise and grant assistance to foreign insolvency proceedings: para 29.

52 In my judgment in *Rubin v Eurofinance SA*, at para 29, I quoted what Millett LJ had said in *Crédit Suisse Fides Trust v Cuoghi* [1998] QB 818, 827:

H "In other areas of law, such as cross-border insolvency, commercial necessity has encouraged national courts to provide assistance to each other without waiting for such co-operation to be sanctioned by international convention . . . It is becoming widely accepted that comity between the courts of different countries requires mutual respect for the territorial integrity of each other's jurisdiction, but that this should not

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inhibit a court in one jurisdiction from rendering whatever assistance it properly can to a court in another in respect of assets located or persons resident within the territory of the former."

53 The common thread in those cases in which assistance has been given is the application or extension of the existing common law or statutory powers of the court.

54 Most of the cases fall into one of two categories. The first group consists of cases where the common law or procedural powers of the court have been used to stay proceedings or the enforcement of judgments. Several of these cases were mentioned in *Rubin v Eurofinance SA* [2013] 1 AC 236, para 33. They include (subject to what is said below) *In re African Farms Ltd* [1906] TS 373, where execution in Transvaal by a creditor in proceedings against an English company in liquidation in England was stayed by the Transvaal court, which was applied in *Turners & Growers Exporters Ltd v The Ship "Cornelis Verolme"* [1997] 2 NZLR 110 (Belgian shipowner in Belgian bankruptcy: ship released from arrest); and *Banque Indosuez SA v Ferromet Resources Inc* [1993] BCLC 112, where an English injunction against a Texas corporation in Chapter 11 proceedings was discharged; and two cases in Hong Kong: *Modern Terminals (Berth 5) Ltd v States Steamship Co* [1979] HKLR 512 (stay in Hong Kong of execution against Nevada corporation in Chapter 11 proceedings in United States federal court in California), followed in *CCIC Finance Ltd v Guangdong International Trust & Investment Corpn* [2005] 2 HKC 589 (stay of Hong Kong proceedings against Chinese state-owned enterprise in Mainland insolvency).

55 In my judgment too much has been read into *In re African Farms Ltd* [1906] TS 373. It was not mentioned in any English case until it was cited in argument in *In re Bank of Credit and Commerce International SA (No 10)* [1997] Ch 213, 219, for the proposition that the English court will not allow funds to be transmitted to the jurisdiction of the foreign court of the principal winding up without first making provision for the local secured, preferential and statutory creditors, and then subsequently approved in *Cambridge Gas*. It had never been mentioned in the classic company law texts, *Buckley*, *Gore-Browne*, and *Palmer* (nor in *Williams on Bankruptcy*), nor in *Fletcher, Insolvency in Private International Law*, 2nd ed (2005). It received only a passing mention in the successive editions of *Forsyth* on South African private international law now called *Private International Law: The Modern Roman-Dutch Law* (now 5th ed (2012), p 456), although it has been mentioned (obiter) with approval by the Supreme Court of Appeal of South Africa: *Gurr v Zambia Airways Corpn Ltd* [1998] 2 All SA 479 (A).

56 Apart from the stay of execution ordered against a secured creditor (Standard Bank) which had obtained a judgment, the only part of the order in *In re African Farms Ltd* [1906] TS 373 which is relevant for present purposes is the order that all questions of mortgage or preference be regulated by Transvaal law as if the company had been placed in liquidation in the Transvaal. It is not stated how that was to be achieved, but it is significant that Innes CJ said, at p 382: "Such conditions are not easy to devise; and it is possible that to place the foreign liquidator in such a position as to ensure beyond doubt a distribution such as I have indicated would require reciprocal legislation in the two countries". Even though the company could not have been wound up in the Transvaal, the decision is

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A certainly not authority for the proposition that local statutory law may be applied by analogy.

57 *In re Impex Services Worldwide Ltd* [2004] BPIR 564 also falls into the category of the use or extension of the existing powers of the court. In that case a Manx order for examination and production of documents was made in aid of the provisional liquidation in England of an English company. That was referred to in *Rubin v Eurofinance SA* [2013] 1 AC 236, para 33 as a case of judicial assistance in the traditional sense because the order was based on a request by the English court, but the decision was not the subject of examination before the Supreme Court and cannot be said to have been approved by it. The request could not be accommodated under the Manx Companies Act 1931, or under the inherent jurisdiction of the court, but the order was made at common law without articulation of its basis.

58 A second group of cases is where the statutory powers of the court have been used in aid of foreign insolvencies. The best known example is the use of the long-standing power to wind up foreign companies which are being wound up (or even have been dissolved) in the country of incorporation. In *In re Bank of Credit and Commerce International SA (No 10)* [1997] Ch 213 Sir Richard Scott V-C conducted an exhaustive analysis of the cases on ancillary liquidations, and concluded (at p 246): (1) Where a foreign company was in liquidation in its country of incorporation, a winding up order made in England would normally be regarded as giving rise to a winding up ancillary to that being conducted in the country of incorporation. (2) The winding up in England would be ancillary in the sense that it would not be within the power of the English liquidators to get in and realise all the assets of the company worldwide: they would necessarily have to concentrate on getting in and realising the English assets. (3) Since in order to achieve a pari passu distribution between all the company's creditors it would be necessary for there to be a pooling of the company's assets worldwide and for a dividend to be declared out of the assets comprised in that pool, the winding up in England would be ancillary in the sense, also, that it would be the liquidators in the principal liquidation who would be best placed to declare the dividend and to distribute the assets in the pool accordingly. (4) None the less, the ancillary character of an English winding up did not relieve an English court of the obligation to apply English law, including English insolvency law, to the resolution of any issue arising in the winding up which was brought before the court.

59 *In re HIH Casualty and General Insurance Ltd* [2008] 1 WLR 852 also falls within this category because the majority in the House of Lords decided that the power of the English court to accede to the letter of request from the Australian court, inviting it to direct the English provisional liquidators to remit the assets in their hands to the Australian liquidators derives from section 426 of the Insolvency Act 1986.

60 As part of the majority in *HIH* Lord Scott of Foscote (at para 59) re-affirmed what he had said in *In re Bank of Credit and Commerce International SA (No 10)* [1997] Ch 213:

> "The English courts have a statutory obligation in an English winding up to apply the English statutory scheme and have, in my opinion, in respectful disagreement with my noble and learned friend Lord

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Hoffmann, no inherent jurisdiction to deprive creditors proving in an English liquidation of their statutory rights under that scheme." A

See also Lord Neuberger of Abbotsbury at para 72.

The liquidators' argument and the Chief Justice's decision

61 The primary argument of the liquidators before the Board, which had found favour with the Chief Justice as the principal ground of his decision (which he described as "more principled" at para 49), was that the Bermuda court should apply directly the examination provisions of section 195 of the Companies Act 1981 by analogy. B

62 That was said to be based on what Lord Hoffmann had said in *Cambridge Gas* [2007] 1 AC 508, para 22:

"What are the limits of the assistance which the court can give? . . . At common law, their Lordships think it is doubtful whether assistance could take the form of applying provisions of the foreign insolvency law which form no part of the domestic system. But the domestic court must at least be able to provide assistance by doing whatever it could have done in the case of a domestic insolvency. The purpose of recognition is to enable the foreign office holder or the creditors to avoid having to start parallel insolvency proceedings and to give them the remedies to which they would have been entitled if the equivalent proceedings had taken place in the domestic forum." C D

63 In the Court of Appeal in the present case Auld JA had described the development of the common law jurisdiction to grant assistance to a foreign liquidator as if the foreign company were being wound up locally as amounting to impermissible "legislation from the bench." In answer, the liquidators in their argument to the Board relied on many dicta to the effect that the common law develops to meet changing circumstances. E

64 In my view to apply insolvency legislation by analogy "as if" it applied, even though it does not actually apply, would go so far beyond the traditional judicial development of the common law as to be a plain usurpation of the legislative function. F

Judicial law-making

65 The liquidators are plainly right to say that the common law develops, sometimes radically, to meet changing circumstances. It hardly requires citation of authority to make that point. No one now doubts that judges make law, although English and Scottish judges were slow to acknowledge it until the seminal writings by Lords Reid, Denning and Devlin, citation of which is unnecessary. But there are limits to their power to make law. In *Kleinwort Benson Ltd v Lincoln City Council* [1999] 2 AC 349, 378 Lord Goff of Chieveley said: G

"When a judge decides a case which comes before him, he does so on the basis of what he understands the law to be. This he discovers from the applicable statutes, if any, and from precedents drawn from reports of previous judicial decisions. Nowadays, he derives much assistance from academic writings in interpreting statutes and, more especially, the effect of reported cases; and he has regard, where appropriate, to decisions of H

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judges in other jurisdictions. In the course of deciding the case before him he may, on occasion, develop the common law in the perceived interests of justice, though as a general rule he does this 'only interstitially,' to use the expression of OW Holmes J in *Southern Pacific Co v Jensen* (1917) 244 US 205, 221. This means not only that he must act within the confines of the doctrine of precedent, but that the change so made must be seen as a development, usually a very modest development, of existing principle and so can take its place as a congruent part of the common law as a whole. In this process, what Maitland has called the 'seamless web,' and I myself (*The Search for Principle*, Proc Brit Acad vol LXIX (1983) 170, 186) have called the 'mosaic,' of the common law, is kept in a constant state of adaptation and repair . . ."

66 What Justice Holmes said in the passage to which Lord Goff referred was: ". . . I recognise without hesitation that judges do and must legislate, but they can do so only interstitially." The point was developed by Justice Cardozo in *The Nature of the Judicial Process* (1921), at pp 103, 113:

> "We must keep within those interstitial limits which precedent and custom and the long and silent and almost indefinable practice of other judges through the centuries of the common law have set to judge-made innovations . . . We do not pick our rules of law full-blossomed from the trees . . . [The judge] legislates only between gaps. He fills the open spaces in the law . . ."

67 More recently similar points have been made by eminent judges of our time. Judge Richard Posner said in *How Judges Think* (2008), p 86: "The amount of legislating that a judge does depends on the breadth of his 'zone of reasonableness'—the area within which he has discretion to decide a case either way without disgracing himself."

68 And Lord Bingham of Cornhill said, in *The Business of Judging* (2000), p 32: "On the whole, the law advances in small steps, not by giant bounds."

69 The approach which is articulated by Lord Sumption JSC is itself an example of the development of the common law since, as Lord Mance JSC's opinion clearly shows, it goes beyond what has previously been understood to be the power of the court to order information.

The judiciary and legislation

70 But that is not the issue on this part of the appeal, which is whether, as the liquidators argue, legislation may be extended by the judiciary to apply to cases where the legislature has not applied it. It raises a much more radical question than the familiar question whether a common law rule should be extended or developed or whether the extension or development should be left to Parliament.

71 The latter question arises frequently and yields different answers. In the human rights context, it was the subject of intense debate in the recent case on assisted suicide: *R (Nicklinson) v Ministry of Justice (CNK Alliance Ltd intervening)* [2015] AC 657. In the private law area, for example, the majority in *Jones v Kaney* [2011] 2 AC 398 decided to remove immunity from expert witnesses. The minority thought that that was a question which should be left to consideration by the Law Commission and reform by Parliament.

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72 By contrast, in *Rubin v Eurofinance SA* [2013] 1 AC 236 the majority considered that a change in the law relating to foreign judgments to apply a different rule (removing the need for a jurisdictional basis) in the context of insolvency was a matter for the legislature. Similarly members of the present Board have at various times made the same point in other contexts: *Prest v Prest* [2013] 2 AC 415, para 83 (Lord Neuberger of Abbotsbury PSC); *Test Claimants in the FII Group Litigation v Revenue and Customs Comrs (formerly Inland Revenue Comrs)* [2012] 2 AC 337, para 200 (Lord Sumption JSC); *Perpetual Trustee Co Ltd v BNY Corporate Trustee Services Ltd (Revenue and Customs Comrs intervening)* [2012] 1 AC 383, para 174 (Lord Mance JSC).

73 But I emphasise that that is not the issue here. Nor is the issue the question whether legislation may influence the development of a common law rule. A famous early example where that was regarded as legitimate was *R v Bourne* [1939] 1 KB 687, where a direction was given that the eminent obstetrician Aleck Bourne was entitled as a defence to an abortion charge to rely by analogy on the provision of the Infant Life (Preservation) Act 1929 that infanticide could be justified to preserve the life of the mother.

74 The question of the extent to which statutes may influence the development of the common law is a well known and controversial one. Professor Atiyah addressed the questions in this way ("Common Law and Statute Law" (1985) 48 MLR 1, 6):

> "is [it] possible for the courts to take account of statute law, in the very development of the common law itself? Can the courts, for instance, use statutes as analogies for the purpose of developing the common law? Can they justify jettisoning obsolete cases, not because they have been actually reversed by some statutory provision, but because a statute suggests that they are based on outdated values? Could the courts legitimately draw some general principle from a limited statutory provision, and apply that principle as a matter of common law?"

75 In each of those situations it is not difficult to find cases which justify the forms of reasoning which Professor Atiyah identifies. But none of them comes anywhere near what the Board is asked to do in this case.

76 Nor is the issue whether a statutory rule may be taken into account in the exercise of a discretion. An example is the use of statutory limitation periods in the exercise of the equitable doctrine of laches: *P & O Nedlloyd BV v Arab Metals Co (No 2)* [2007] 1 WLR 2288; *Williams v Central Bank of Nigeria* [2014] AC 1189, para 12.

77 Nor is the issue whether the courts may develop the common law by entering or re-entering a field regulated by legislation. As Lord Nicholls of Birkenhead said in *In re McKerr* [2004] 1 WLR 807, para 30, the courts have been slow to do that because "otherwise there would inevitably be the prospect of the common law shaping powers and duties and provisions inconsistent with those prescribed by Parliament."

The equity of a statute

78 What the liquidators propose is very much more radical. It is that the court should apply legislation, which ex hypothesi does not apply, "as if" it applied.

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79 That proposition is reminiscent of the concept of the "equity of a statute". When used properly today, it means no more than interpreting a statute by reference to its purpose or the mischief which it was designed to cure: e g *Incorporated Council of Law Reporting for England and Wales v Attorney General* [1972] Ch 73, 88.

80 But it once meant something which "has been relegated to the limbo of legal antiquities" (Loyd, "The Equity of a Statute" (1909) 58 U Pa L Rev 76), and had been formulated in this way: "Equitie is a construction made by the judges that cases out of the letter of a statute yet being within the same mischief or cause of the making of the same, shall be within the same remedy that the statute provideth . . ." (Co Litt Lib I, Ch II, para 21, quoting Bracton).

81 Under that doctrine the courts felt themselves free to enlarge a statute so as to apply it to situations which were not covered by the words of the statute but were regarded by the courts as within its spirit and analogous: Burrows, "The Relationship between Common Law and Statute in the Law of Obligations" (2012) 128 LQR 232, 241; Atiyah, "Common Law and Statute Law" (1985) 48 MLR 1, 7–8. That concept of the "equity of a statute" fell into disfavour in the 18th century and was abandoned by the beginning of the 19th century, and the judges were no longer able in effect to exercise a direct legislative function.

82 The liquidators' argument is that the common law rule of assistance in insolvency matters extends to the application of local legislation even though as a matter of its legislative scope it does not apply to the case in hand. In the present case the argument is that, even if section 195 of the Companies Act 1981 does not apply to foreign companies, it should be applied by analogy or "as if" the Cayman Islands company were a Bermuda company.

83 In my judgment, that argument is not only wrong in principle, but also profoundly contrary to the established relationship between the judiciary and the legislature. To the extent that it depends on some part of the opinion in *Cambridge Gas* [2007] 1 AC 508, that decision was not only wrong in its recognition of the New York order regulating the title to Manx shares, as decided in *Rubin v Eurofinance SA* [2013] 1 AC 236, it was also wrong to apply the Manx statutory provisions for approval of schemes of arrangement by analogy or "as if" they applied.

Cambridge Gas

84 The essence of the decision in *Cambridge Gas* [2007] 1 AC 508 was that the New York order would be recognised, and would be given effect because a similar scheme could have been sanctioned as a scheme of arrangement under the Isle of Man law.

85 The facts of *Cambridge Gas* are set out in *Rubin* [2013] 1 AC 236, paras 36 et seq. For present purposes it is only necessary to recall that a gas transport shipping business venture ended in failure, and resulted in a Chapter 11 proceeding in the US Bankruptcy Court in New York. The question for the Privy Council on appeal from the Isle of Man was whether an order of the New York court was entitled to implementation in the Isle of Man. The New York court had rejected the investors' plan and accepted the bondholders' plan.

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86 The corporate structure of the business was that the investors owned, directly or indirectly, a Bahaman company called Vela Energy Holdings Ltd ("Vela"). Vela owned (through an intermediate Bahaman holding company) Cambridge Gas, a Cayman Islands company. Cambridge Gas owned directly or indirectly about 70% of the shares of Navigator Holdings plc ("Navigator"), an Isle of Man company. Navigator owned all the shares of an Isle of Man company which in turn owned companies which each owned one ship.

87 The New York order vested the shares in Navigator (the Isle of Man company) in the creditors' committee, which subsequently petitioned the Manx court for an order vesting the shares in their representatives. The Manx Staff of Government Division acceded to this petition by making an order under the Manx Companies Act 1931, section 101, rectifying the share register by entering the creditors' committee as shareholders. In the Privy Council [2007] 1 AC 508, para 23, Lord Hoffmann rejected this solution on this basis: the power was exercisable when "the name of any person is, without sufficient cause, entered in or omitted from the register". But for that purpose it was necessary to show that by the law of the Isle of Man the company was obliged to do so. The source of such an obligation could be found only in an order of the court, pursuant to its common law power of assistance, which required the company to make such an entry. Consequently, the argument based on section 101 was therefore circular. The prior question was whether the court has power to declare that the Chapter 11 plan should be carried into effect.

88 The Privy Council held that the plan could be carried into effect in the Isle of Man. The reasoning was as follows. First, if the judgment had to be classified as in personam or in rem the appeal would have to be allowed, but bankruptcy proceedings did not fall into either category. Second, the principle of universality underlay the common law principles of judicial assistance in international insolvency, and those principles were sufficient to confer jurisdiction on the Manx court to assist, by doing whatever it could have done in the case of a domestic insolvency. Third, exactly the same result could have been achieved by a scheme of arrangement under the Isle of Man Companies Act 1931, section 152.

89 In *Rubin* [2013] 1 AC 236, a majority of the Supreme Court (Lord Collins of Mapesbury with whom Lords Walker of Gestingthorpe and Sumption JJSC agreed) decided that *Cambridge Gas* was wrongly decided because the shares in Navigator owned by Cambridge Gas (a Cayman Islands company) were, on ordinary principles of the conflict of laws, situated in the Isle of Man, and the shareholder relationship between Navigator and Cambridge Gas was governed by Manx law. Consequently the property in question, namely the shares in Navigator, was situate in the Isle of Man, and therefore also not subject to the in rem jurisdiction of the US Bankruptcy Court. There was therefore no basis for the recognition of the order of the US Bankruptcy Court in the Isle of Man. Lord Mance JSC, in his concurring judgment, left the correctness of the decision open, and Lord Clarke of Stone-cum-Ebony JSC, dissenting, thought that it was correctly decided.

90 I have already quoted the passage in *Cambridge Gas* [2007] 1 AC 508, para 22 in which Lord Hoffmann said that "the domestic court must at least be able to provide assistance by doing whatever it could have done in

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the case of a domestic insolvency" and that the purpose of recognition of the foreign office-holders was to "to give them the remedies to which they would have been entitled if the equivalent proceedings had taken place in the domestic forum."

91 The effect of this part of the opinion in *Cambridge Gas* was to make an order equivalent to one which could have been made under a Manx scheme of arrangement without going through the statutory procedures for approval of a scheme. The passages in the opinion which are relevant are these:

> "24. In the present case it is clear that the New York creditors, by starting proceedings to wind up the Navigator companies and then proposing a scheme of arrangement under section 152 of the Companies Act 1931, could have achieved exactly the same result as the Chapter 11 plan. The Manx statute provides: '(1) Where a compromise or arrangement is proposed between a company and its creditors . . . the court may on the application in a summary way of the company or of any creditor or member of the company, or, in the case of a company being wound up, of the liquidator, order a meeting of the creditors . . . to be summoned in such manner as the court directs. (2) If a majority in number representing three-fourths in value of the creditors . . . agree to any compromise or arrangement, the compromise or arrangement shall, if sanctioned by the court, be binding on all the creditors . . . and also on the company or, in the case of a company in the course of being wound up, on the liquidator and contributories of the company.'
>
> "25. The jurisdiction is extremely wide. All that is necessary is that the proposed scheme should be a 'compromise or arrangement' and that it should be approved by the appropriate majority. Why, therefore, should the Manx court not provide assistance by giving effect to the plan without requiring the creditors to go to the trouble of parallel insolvency proceedings in the Isle of Man? . . .
>
> "26. . . . as between the shareholder and the company itself, the shareholder's rights may be varied or extinguished by the mechanisms provided by the articles of association or the Companies Act. One of those mechanisms is the scheme of arrangement under section 152. As a shareholder, Cambridge is bound by the transactions into which the company has entered, including a plan under Chapter 11 or a scheme under section 152. It is the object of such a scheme to give effect to an arrangement which varies or extinguishes the rights of creditors and shareholders. Thus, in the case of an insolvent company, in which the shareholders have no interest of any value, the court may sanction a scheme which leaves them with nothing . . . The scheme may divest the company of its assets and leave the shareholders with shares in an empty shell. It may extinguish their shares and recapitalise the company by issuing new shares to others for fresh consideration. Or it may, as in this case, provide that someone else is to be registered as holder of the shares. Whatever the scheme, it is, by virtue of section 152, binding on the shareholders when it receives the sanction of the court. The protection for the shareholders is that the court will not sanction a scheme, even if adopted by the statutory majority, if it appears unfair. And no doubt the discretion to refuse assistance in the implementation of an equivalent plan

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which has been confirmed in a foreign jurisdiction would be exercised on similar lines. But no such question arises in this case. Although it must be accepted that Cambridge did not technically submit to the jurisdiction in New York, it had no economic interest in the proceedings and ample opportunity to participate if it wished to do so. It would therefore not be unfair for the plan to be carried into effect. Their Lordships therefore consider that the Court of Appeal was right to order its implementation."

92 It is to be noted that Lord Hoffmann said that the New York creditors *could have achieved* exactly the same result as the Chapter 11 plan by a scheme of arrangement under the Companies Act 1931, section 152, and asked why the Manx court could not provide assistance by giving effect to the plan without requiring the creditors to go to the trouble of parallel insolvency proceedings in the Isle of Man.

93 Those proceedings required the calling of meetings and the passage of appropriate resolutions. The majority of the UK Supreme Court decided in *Rubin v Eurofinance SA* [2013] 1 AC 236 that *Cambridge Gas* was wrongly decided on the ground that the New York court did not have jurisdiction over title to shares in a Manx company. The question whether there was any lawful basis for applying the legislation on an "as if" basis, or of dispensing with the statutory procedure, did not therefore arise in *Rubin v Eurofinance SA*. But for the reasons I have given, in my judgment there can be no doubt that, unless Manx law allowed the relaxation of the statutory procedures for the approval of schemes of arrangement, the judiciary was not entitled to apply those procedures by analogy at common law.

The application of Cambridge Gas

94 It follows in my view that those courts which have relied on these passages to apply legislation which the legislature had not itself seen fit to apply are wrong, including the decision of the Chief Justice in the present case.

95 That conclusion also applies to the decision in *In re Phoenix Kapitaldienst GmbH* [2013] Ch 61. In that case a company incorporated in Germany for the apparent purpose of investing individuals' funds in futures trading was used as a vehicle for a worldwide fraud. The German administrator applied for relief pursuant to the Insolvency Act 1986, section 423 (transactions at an undervalue) against former investors of the company who were resident in England, claiming back initial investment funds and fictitious profits for the benefit of the company's creditors by setting aside transactions entered into at an undervalue.

96 As I have said, the EU Insolvency Regulation did not apply because the German company involved was an investment undertaking; the UNCITRAL Model Law did not apply because the 2006 Regulations were not in effect at the relevant time; and Germany was not a relevant country for the purposes of section 426(4).

97 Proudman J decided that the court had the power at common law to recognise a foreign administrator and to provide him with the same assistance as it was entitled to provide in a domestic insolvency; and that since proceedings to set aside antecedent transactions were central to the purpose of an insolvency the court therefore had jurisdiction to authorise the administrator to invoke section 423. Applying *Cambridge Gas* Proudman J

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held that the power to use the common law to recognise and assist an administrator appointed overseas "includes doing whatever the English court could have done in the case of a domestic insolvency": para 62.

98 In my judgment that decision is wrong because it involved an impermissible application of legislation by analogy.

99 In *Picard v Primeo Fund* 2013 (1) CILR 164 the US bankruptcy trustee of the principal Bernard Madoff company sought to claw back payments made by the company to a Cayman Islands company. The claims were based on US law (fraudulent transfers and preferential payments) and on Cayman law (preferential payments). The Cayman Islands have mutual assistance provisions (Companies Law (2012 Revision), sections 241–242), but the judge (Jones J) held that they did not apply because the power to make orders "ordering the turnover to a foreign representative of any property belonging to a debtor" did not apply to property which was only recoverable under transaction avoidance provisions.

100 The judge then went on to decide that the Cayman court was able to apply the Cayman voidable preferences provision of its law (section 145) to the payments made by the US company to the Cayman company, by applying *Cambridge Gas* and *In re Phoenix Kapitaldienst GmbH* [2013] Ch 61.

101 On 16 April 2014 the Court of Appeal of the Cayman Islands (consisting of Sir John Chadwick P and Mottley and Campbell JJA)2014 (1) CILR 379, reversed Jones J on the first part of the case and held that the Cayman court was entitled to apply the Cayman anti-avoidance provisions under the assistance provisions of Cayman company law, because the making of a transaction avoidance order restores to the debtor the property which is the subject of that order, and so enables the court to order the "turnover" of that restored property to the foreign representative: para 45.

102 The Court of Appeal did not reach the question whether Jones J was entitled to apply the Cayman anti-avoidance provision at common law. The court had been informed that an issue central to that question, namely whether *Cambridge Gas* should be followed, was before the Court of Appeal for Bermuda. Because the matter was before this Board and shortly to be heard, the Court of Appeal was invited to hand down an interim judgment dealing only with the issues on the mutual assistance statutory provisions. The appeal has now been settled. It follows from what I have said that the decision of Jones J on the present aspect of the case was wrong.

Al Sabah v Grupo Torras SA

103 There was also a prior opinion of the Privy Council, in which what was said is directly contrary to the approach in *Cambridge Gas* advocated by the liquidators. In *Al Sabah v Grupo Torras SA* [2005] 2 AC 333 the trustee in bankruptcy of a debtor in The Bahamas obtained from the Bahaman court a letter of request directed to the Grand Court of the Cayman Islands seeking its aid in setting aside two Cayman trusts established by the debtor. The Grand Court (affirmed by the Court of Appeal of the Cayman Islands) held that it had jurisdiction to provide such assistance under either section 156 of the Bankruptcy Law of the Cayman Islands or section 122 of the Bankruptcy Act 1914 (which provided for mutual assistance between bankruptcy courts throughout the UK and the Empire) or under the court's inherent jurisdiction, and that it should as a

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matter of discretion grant the Bahaman trustee powers under section 107 of the Cayman Bankruptcy Law to enable him to set aside the trusts. The Privy Council held that (i) section 156 of the Cayman Bankruptcy Law did not apply, but that (ii) section 122 had not been repealed in its application to the Cayman Islands and did apply, so that there was jurisdiction to authorise the Bahaman trustee to exercise the statutory power even though it might not have been available to him if the trusts had been governed by Bahaman law.

104 But the Board in an opinion given through Lord Walker of Gestingthorpe said, at para 35:

> "The respondents relied in the alternative . . . on the inherent jurisdiction of the Grand Court. This point was not much developed in argument and their Lordships can deal with it quite shortly. If the Grand Court had no statutory jurisdiction to act in aid of a foreign bankruptcy it might have had some limited inherent power to do so. But it cannot have had inherent jurisdiction to exercise the extraordinary powers conferred by section 107 of its Bankruptcy Law in circumstances not falling within the terms of that section. The non-statutory principles on which British courts have recognised foreign bankruptcy jurisdiction are more limited in their scope [citing what is now *Dicey, Morris & Collins, Conflict of Laws*, 15th ed (2012), vol 2, paras 31R-059 et seq] and the inherent jurisdiction of the Grand Court cannot be wider."

105 The Board plainly considered that the court had no power to apply the Bankruptcy Law "in circumstances not falling within" the Law. In *In re Phoenix Kapitaldienst GmbH* [2013] Ch 61, above, Proudman J distinguished this clear statement on the basis that she should follow what she described as "the later and more considered views expressed by Lord Hoffmann and approved by Lord Walker" in the *HIH* case [2008] 1 WLR 852, namely that the court was able, if consistent with justice and UK public policy, to achieve the aim of a unitary and universal bankruptcy law. In *Picard v Primeo Fund* 2013 (1) CILR 164 Jones J explained the dictum in *Al Sabah* as meaning that the common law cannot be invoked to apply provisions of the Bankruptcy Law to achieve an objective outside its scope.

106 Neither of these supposed distinctions is valid. There is nothing in *HIH* to support Proudman J's suggestion that Lord Walker had changed his view, and Jones J's suggestion that Lord Walker was only directing his intention to objectives outside the scope of the Bankruptcy Law is wholly inconsistent with Lord Walker's plain words that the court does not have an inherent jurisdiction to exercise the powers conferred by the Bankruptcy Law "in circumstances *not falling within the terms* of that section." (Emphasis added.)

107 In my judgment Lord Walker's dictum in the opinion in *Al Sabah v Grupo Torres* [2005] 2 AC 333, para 35 (in which, among others, Lords Hoffmann and Scott concurred) was plainly right, and, to the extent it is inconsistent with the passage in *Cambridge Gas* applying the Isle of Man scheme of arrangement provisions on an "as if" basis, it is to be preferred to *Cambridge Gas*.

108 I would therefore humbly advise Her Majesty not only that the appeal should be dismissed, but also that to have allowed it on the basis of the liquidators' primary argument would have involved Her Majesty's judges in a development of the law and their law-making powers which

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A would have been wholly inconsistent with established principles governing the relationship between the judiciary and the legislature and therefore profoundly unconstitutional.

LORD CLARKE OF STONE-CUM-EBONY JSC

109 I agree that this appeal should be dismissed for the reasons given by Lord Sumption JSC. I add a short judgment of my own on the first issue
B raised by Lord Sumption JSC in para 8, namely whether the Bermuda court has a common law power to assist a foreign liquidation by ordering the production of information (in oral or documentary form) in circumstances where (i) the Bermuda court has no power to wind up an overseas company such as Singularis and (ii) its statutory power to order the production of information is limited to cases where the company has been wound up in
C Bermuda. The second issue is whether, if such a power exists, it is exercisable in circumstances where an equivalent order could not have been made by the court in which the foreign liquidation is proceeding.

110 I have reached the conclusion that, for the reasons given by Lord Sumption JSC, the answer to the first issue is that the Bermuda court does have such a power. The steps which lead me to that conclusion are these.
D While the recognition of such a power in an ancillary liquidation has not thus far been recognised at common law, it is common ground that the common law has developed step by step and that it may be extended or developed in appropriate circumstances. It follows that the question is whether the circumstances are appropriate to justify the recognition of such a power in this class of case.

111 As Lord Sumption JSC demonstrates in para 20, significant
E developments have been made by the common law in the past. They included the power to compel a person to give evidence, which was not originally statutory. As Lord Sumption JSC puts it, like the power to order discovery, it was an inherent power of the Court of Chancery devised by judges to remedy the technical and procedural limitations associated with the proof of facts in courts of common law. I agree with Lord Sumption JSC
F (at para 23) that the significance of the *Norwich Pharmacal* case [1974] AC 133 in the present context is that it illustrates the capacity of the common law to develop a power in the court to compel the production of information when it is necessary to do so in order to give effect to a recognised legal principle.

112 The recognised legal principle in the present case is the principle of modified universalism derived from *Cambridge Gas* [2007] 1 AC 508: see
G paras 19 and 23 in Lord Sumption JSC's judgment. I agree with him that it is founded on the public interest in the ability of foreign courts exercising insolvency jurisdiction in the place of the company's incorporation to conduct an orderly winding up of its affairs on a worldwide basis notwithstanding the territorial limits of their jurisdiction. An important aspect of that public interest is a recognition that in a world of global
H businesses it is in the interest of every country that companies with transnational assets and operations should be capable of being wound up in an orderly fashion under the law of the place of their incorporation and on a basis that will be recognised and effective internationally. I also agree with Lord Sumption JSC at para 23 (i) that this is a public interest which has no equivalent in cases where information may be sought for commercial

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purposes or for ordinary adversarial litigation; (ii) that the Bermuda court has properly recognised the status of the liquidators as officers of that court; (iii) that the liquidators require the information for the performance of the ordinary functions attaching to that status; (iv) that the information is unlikely to be available in any other way; (v) that none of the reasons which account for the common law's inhibition about the compulsory provision of evidence have any bearing on the present question; (vi) that the right and duty to assist foreign office-holders which the courts have acknowledged on a number of occasions would be an empty formula if it were confined to recognising the company's title to its assets in the same way as any other legal person who has acquired title under a foreign law, or to recognising the office-holder's right to act on the company's behalf in the same way as any other agent of a company appointed in accordance with the law of its incorporation; and (vii) that the recognition by a domestic court of the status of a foreign liquidator would mean very little if it entitled him to take possession of the company's assets but left him with no effective means of identifying or locating them.

113 These are powerful factors. What then are the limits? I agree with Lord Sumption JSC that, as he puts it at para 25, the Board would not wish to encourage the promiscuous creation of other common law powers to compel the production of information but that the limits of this power are implicit in the reasons for recognising its existence. He gives four reasons. (1) It is available only to assist the officers of a foreign court of insolvency jurisdiction or equivalent public officers. It would not, for example, be available to assist a voluntary winding up, which is essentially a private arrangement and although subject to the directions of the court is not conducted by or on behalf of an officer of the court. (2) It is a power of assistance and exists for the purpose of enabling those courts to surmount the problems posed for a worldwide winding up of the company's affairs by the territorial limits of each court's powers; so that it is not available to enable them to do something which they could not do even under the law by which they were appointed. (3) It is available only when it is necessary for the performance of the office-holder's functions. (4) It is subject to the limitation that such an order must be consistent with the substantive law and public policy of the assisting court, in this case that of Bermuda. I further agree with Lord Sumption JSC that it follows that it is not available for purposes which are properly the subject of other schemes for the compulsory provision of information. Common law powers of this kind are not a permissible mode of obtaining material for use in actual or anticipated litigation. That field is covered by rules of forensic procedure and statutory provisions for obtaining evidence in foreign jurisdictions which liquidators, like other litigants or potential litigants, must accept with all their limitations. Moreover, in some jurisdictions, it may well be contrary to domestic public policy to make an order which there would be no power to make in a domestic insolvency.

114 I further agree with Lord Sumption JSC, for the reasons he gives in para 28, that the common law power is not impliedly excluded by reason of section 195 of the Bermuda Companies Act but that it cannot be applied on the facts of this case because there is no similar power in the Cayman Islands and it would not be a proper use of the power of assistance to make good a

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limitation on the powers of a foreign court of insolvency jurisdiction under its own law.

115 Like Lord Sumption JSC, I appreciate that it is important that this development should not open the floodgates to different unrelated classes of case. However, I see no reason why it should. I appreciate that Lord Mance JSC has reached a different conclusion. I do not pretend that it is possible to predict precisely how the development of the principle, which has been identified by Lord Sumption JSC and which both Lord Collins of Mapesbury and I support, will proceed. I agree with Lord Mance JSC that it is a step forward but do not agree that it is a step leap. I also agree with him (at para 137) that courts have tended to confine remedies of the kind we are discussing to situations where there is a recognisable legal claim to protect, based either on a title or right to property or on some wrongdoing supported by appropriate evidence. However, there is no reason why the common law should not be developed, provided that the development is measured and supports a recognised principle.

116 It will not always be easy to draw the line between permissible applications and impermissible applications. However, Lord Sumption JSC has identified, not only the policy, but also the principle derived from the policy and some of the limitations to its exercise, which to my mind provide a sensible approach for the future. I respectfully disagree with Lord Mance JSC when he says at para 146 that this is a development which is neither permissible nor appropriate. In doing so, I express no view on Lord Mance JSC's concerns (expressed in paras 120 and 121) as to the breadth of the terms of the order and as to the lack of safeguards to protect against costs or loss. These may well be sound and can be investigated in a case where such issues fall for decision. That is not this case because of the narrow ground on which the appeal must be dismissed.

LORD MANCE JSC

117 There are two potential issues of importance on this appeal: (a) whether the common law power to assist a foreign (Cayman Islands) liquidation enables the Bermudan courts to order anyone within its jurisdiction who may have relevant information or documentation about the company's assets (or, possibly also, its affairs generally) to attend for questioning about and disclose the same; (b) whether, if this power exists, it should be exercised by ordering such disclosure and questioning when the Cayman Islands courts have no equivalent power over persons within their jurisdiction.

118 I agree with Lord Sumption JSC that the short answer to the second question is negative. So it is unnecessary on this appeal to answer the first question, although Lord Sumption JSC has devoted the major part of his opinion to this question. I understand why it might be helpful if the Board could give a clear answer to it, but I think it unfortunate that it should try to do so on this appeal, bearing in mind the limitations in the way in which the question has been argued at all lower stages (see para 122 below) and its largely unexplored ramifications: see generally paras 130–145 below.

119 Before addressing the second issue in detail, it is relevant—and in my view important—to note three points. The first is the Chief Justice's order which the Court of Appeal set aside, and which the liquidators ask the

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Board to restore. The respondents, PwC, were (by clause 3a) ordered within 14 days to provide to the joint official liquidators ("JOLs")

> "all information they may have, including information and documentation in their possession, power, custody or control, concerning the promotion, formation, trade, dealings, affairs or property of the company [and] for the avoidance of doubt, such information and documentation to be provided is not to be limited to audit information . . ."

In addition PwC was (by clause 3d)

> "required to have a partner and/or employee or agent acceptable to the JOLs, examined on oath forthwith, within ten (10) days of being called on to meet by the JOLs, concerning the matters aforesaid, by word of mouth and on written interrogatories, and be required to reduce his/her answer to writing and require him/her to sign this . . ."

By clause 3e the JOLs were given leave to serve "Paul Suddaby and any other partners or officers of PwC . . . out of the jurisdiction", specific liberty was given to examine Paul Suddaby and he was specifically ordered to produce information in accordance with clause 3a. Clause 3f provided that

> "If PwC . . . does refuse to comply with any of the orders set out herein, it and its partners and officers shall be in contempt of court and they may be imprisoned, fined or their assets seized."

120 No doubt in case clause 3 did not go far enough, clause 4 provided:

> "Further and without limiting the generality of the foregoing, that the documentation referred to in Exhibit HD-7 of Hugh Dickson's third affidavit dated 7 February 2013 be produced within seven days by PwC . . . , in relation to [Singularis] . . . That the JOLs be able to obtain all information and documentation described herein that is in the possession, power, custody, or control of PwC . . . , whether this be in Bermuda, Dubai, or wherever it may be located."

Redaction was only to be permitted where necessary to protect information of a confidential nature belonging to third parties, and clause 4b required that:

> "the relevant partners and officers of PwC . . . do confirm on oath that all the documents requested have been produced."

The only exempt documents were to be those required to be produced in the Cayman Islands—that is documents actually belonging to Singularis.

121 No provision was made for the JOLs to meet, still less secure, any costs that PwC or its partners, officers or agents would incur complying with such an order, and no undertaking was given to meet any such costs or any other loss or liability that might result from doing so—even though PwC had asked the Chief Justice to deal with this aspect. This omission was raised in the Court of Appeal, where it remained relevant in relation to the order against SICL which that court upheld. PwC suggested that costs could be in the order of $500,000 and the JOLs argued that management time spent in compliance could not be recovered. The Court of Appeal declined to make any order or require any undertaking "in the absence of authority" and "particularly in circumstances where the cost of compliance is far from

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clear". "Absence of authority" is hardly surprising in relation to an order which was itself effectively unprecedented. PwC's costs of compliance would clearly be likely to be very substantial. Whether or not they were or could be quantified when the order was made, PwC should have been protected in respect of them. Common justice and established practice relating to freezing injunctions, *Anton Pillar* orders and *Norwich Pharmacal* relief should have confirmed the need for an appropriate order or undertaking in that respect.

122 The second point is that, in respect of Singularis, the only basis of Kawaley CJ's order against PwC and its officers was that the Bermudan courts have a common law power to grant assistance in aid of the Cayman Islands liquidation by applying local procedural remedies, in particular either "by directly applying" or "by analogy with" section 195 of the Bermudan Companies Act 1981, although it was common ground that this section does not in terms apply. This was also the only case put by the JOLs' written submissions to or adjudicated on by the Court of Appeal as well as the only basis on which permission was sought to appeal to the Board. Kawaley CJ considered that he could none the less rely directly on section 195 by virtue of inter alia *In re African Farms* [1906] TS 373, *Cambridge Gas Transportation Corpn v Official Committee of Unsecured Creditors of Navigator Holdings plc* [2007] 1 AC 508 and *Rubin v Eurofinance SA (Picard intervening)* [2013] 1 AC 236 (paras 8, 49–74), or alternatively that he could proceed "by analogy with" it: paras 8, 36–48. The Court of Appeal held the contrary: see para 52, per Bell AJA, para 1, per Zacca P, and paras 4–59, per Auld JA. There is a hint in paras 49(1) and 50 of Auld JA's case that the JOLs may have begun to put their case more widely in oral submissions by suggesting some wider power based on "modified universalism" and independent of the Bermudan statutory power. But, if this is so, it can have received little prominence. Only before the Board has focus been directed to such an argument. As to the submission which was pursued below and accepted by Kawaley CJ, I agree with Lord Sumption JSC and Lord Collins of Mapesbury that there is no basis for judicial re-fashioning of, or action outside the bounds of but by analogy with, domestic legislation such as section 195. The Chief Justice's order cannot therefore be justified on the basis on which he made it. But it is perhaps ironic that so firm a rejection of any possibility of the domestic court exercising the powers conferred on domestic liquidators should be replaced by an embrace of the possibility of the domestic court giving effect to the wishes and/or powers of foreign liquidators: see paras 130 et seq below.

123 Neither court below addressed any observations to the question whether any jurisdiction existed or, if it existed, could properly be exercised to make orders against and serve Paul Suddaby and other partners or officers of PwC outside the jurisdiction of the Bermudan court. As paras 119 and 120 above show, the Chief Justice's order did that, though without joining Mr Suddaby or any other officer or partner in their personal capacities. In their written submissions before the Court of Appeal, the JOLs submitted that section 195 gave jurisdiction to serve abroad and relied on the English authority of *In re Seagull Manufacturing Co Ltd* [1993] Ch 345 (decided under a section of the Insolvency Act 1986 using similar terms to section 195). Once one concludes, as the Board has, that section 195 is applicable neither directly nor by analogy, the question becomes whether there can be

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any such common law jurisdiction to order service out, on pain of sanctions, as that for which the JOLs argue.

124 Approaching the matter on that basis, it is clear that the Chief Justice's order must on any view have gone well beyond any jurisdiction which exists at common law in relation to PwC's partners and officers outside the Bermudan jurisdiction, as opposed to PwC itself which was within such jurisdiction. The area was examined in *Masri v Consolidated Contractors International (UK) Ltd (No 4)* [2010] 1 AC 90, para 12, where the House of Lords (in a judgment given by myself with which all other members of the House concurred) spoke in these terms of:

> "the limitation of the court's power to enforce the attendance of witnesses or fine defaulting witnesses. From the Statute of Elizabeth 1562 (5 Eliz 1, c 9) onwards, this had been regulated by statute and had never extended beyond the United Kingdom. The procedure enacted in relation to other jurisdictions involves the taking of evidence, on commission or otherwise, with the assistance of the foreign court. The service of a writ of subpoena is still only possible under section 36 of the Supreme Court Act 1981 in respect of persons in one of the parts of the United Kingdom. The limitation of the court's power in this respect corresponds with the principle of international law, summarised robustly by Dr Mann in his Hague lecture 'The Doctrine of Jurisdiction in International Law', *Recueil des Cours*, 1964-I, *The Definition of Jurisdiction*, p 137): 'Nor is a state entitled to enforce the attendance of a foreign witness before its own tribunals by threatening him with penalties in case of non-compliance. There is, it is true, no objection to a state, by lawful means, inviting or perhaps requiring a foreign witness to appear for the purpose of giving evidence. But the foreign witness is under no duty to comply, and to impose penalties on him and to enforce them either against his property or against him personally on the occasion of a future visit constitutes an excess of criminal jurisdiction and runs contrary to the practice of states in regard to the taking of evidence as it has developed over a long period of time.'"

125 The issue in *Masri* was whether a power under rules (CPR r 71) made under statutory authority extended to enable an order for examination of an officer of a judgment creditor company, who was out of the jurisdiction. The House held that, in view of the presumption against extra-territoriality, it did not. In the course of so doing, it considered prior authority on other powers with a statutory basis. In *In re Tucker (RC) (A Bankrupt), Ex p Tucker (KR)* [1990] Ch 148, section 25(1) of the Bankruptcy Act 1914 gave the court power to summon before it for examination "any person whom the court may deem capable of giving information respecting the debtor, his dealings or property". But the Court of Appeal set aside an order obtained by a trustee in bankruptcy for the examination of the debtor's brother, a British subject resident in Belgium. Dillon LJ, after noting the limitations of the powers to serve out of the jurisdiction (then contained in RSC Ord 11) and to subpoena witnesses, said against this background that he "would not expect section 25(1) to have empowered the English court to haul before it persons who could not be served with the necessary summons within the jurisdiction of the English court": p 158E–E.

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126 In contrast, in *In re Seagull Manufacturing Co Ltd* [1993] Ch 345, section 133 of the Insolvency Act 1986 authorised the public examination of a narrower category of persons, viz

> "any person who— (a) is or has been an officer of the company; or (b) has acted as liquidator or administrator of the company or as receiver or manager . . . or (c) not being a person falling within paragraph (a) or (b), is or has been concerned, or has taken part, in the promotion, formation or management of the company",

and rule 12.12 of the Insolvency Rules 1986 (SI 1986/1925) gave the court express authority to order service out of the jurisdiction of any process or order requiring to be so served for the purposes of insolvency proceedings. The Court of Appeal upheld an order made for the public examination of a former director living in Alderney. Peter Gibson J, with whose judgment the other members of the court concurred, said (p 354F–H) that:

> "Where a company has come to a calamitous end and has been wound up by the court, the obvious intention of this section was that those responsible for the company's state of affairs should be liable to be subjected to a process of investigation and that investigation should be in public. Parliament could not have intended that a person who had that responsibility could escape liability to investigation simply by not being within the jurisdiction. Indeed, if the section were to be construed as leaving out of its grasp anyone not within the jurisdiction, deliberate evasion by removing oneself out of the jurisdiction would suffice."

127 Although the House in *Masri* [2010] 1 AC 90 regarded impracticability of enforcement as a factor of greater significance than Peter Gibson J had suggested, it acknowledged the public interest served by section 133, and referred (in para 23) to "The universality of a winding up order, in the sense that it relates at least in theory to all assets wherever situate". That factor being absent in *Masri*, it could lend no assistance to the argument that CPR r 71 extended extra-territorially. But the important feature of all these cases is that they turned on express statutorily conferred powers. There was no suggestion in any of them of any relevant common law power in any of the areas discussed.

128 The third point is that the JOLs' case has been at all times and is advanced solely on the basis that PwC have documents and information which it would help the JOLs to inspect and about which it would be helpful for them to be able to question PwC and its officers. The basis is not that PwC have property or assets of Singularis (beyond the documents which they have already been ordered by the Cayman Islands court to produce); nor is it that PwC have themselves done anything wrong or that they have been or are mixed up in any third party's wrongdoing. The House of Lords authority *Norwich Pharmacal Co v Customs and Excise Comrs* [1974] AC 133 was not relied upon, or even among the authorities put, before the Supreme Court. It was mentioned in passing during the final oral submissions in reply of Mr Moss QC for the JOLs, when the transcript records this exchange:

> "*Lord Mance JSC.* If they are accountants, as you told me earlier that they were, then on the face of it there is an advisory relationship and if

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you wish to know something which you yourself have mislaid or don't have from your accountant advisers one might think there was quite a good case for saying they owed a duty to disclose it to you, to help you.

"*Mr Moss.* There might be an arguable case relating to that advice, but what we're interested in are these audit documents which go to the assets of the company. I don't know whether the accounting had anything to do with that at all.

"*Lord Collins.* Is there nowhere a *Norwich Pharmacal* order can be obtained?

"*Mr Moss.* Well, yes. We've had a discussion about this. The problem with *Norwich Pharmacal* is that it is based on fraud.

"*Lord Collins.* Any wrongdoing, I think.

"*Lord Sumption JSC.* It is based on wrongdoing generally.

"*Mr Moss.* Yes, but it does involve alleging wrongdoing. You would have to allege that PwC became innocently mixed up in that wrongdoing—

"*Lord Clarke JSC.* They only have to be innocently mixed up.

"*Mr Moss.* Yes.

"*Lord Sumption JSC.* That's a fairly low threshold, after all the Customs and Excise were about as innocent mixed up people almost that you could probably want.

"*Mr Moss.* Yes. The result of that would be if we can get *Norwich Pharmacal* relief, then the Bermuda courts do have common law powers to give us exactly the type relief that we have here. It actually comes to the same thing. It wouldn't make much sense to send us right back to the Chief Justice to then ask for *Norwich Pharmacal* relief—

"*Lord Mance JSC.* It may not be as easy as that. You haven't formulated it as *Norwich Pharmacal*.

"*Mr Moss.* Yes, it would have to be abandoned and reformulated as a *Norwich Pharmacal*, but in substance it comes to the same sort of end. What that perhaps illustrates is that what we have and what we seek to maintain, or rather we have at one stage and the Court of Appeal have taken it away on a rather narrow ground, but we seek to have back is not something that radical in these types of circumstances, where there is a gigantic deficit, there has clearly been wrongdoing, documents have been taken and not available. It's exactly the kind of context in which one would expect relief to be given. It's not extravagant in any shape or form."

129 Contrary to Mr Moss's submission, the JOLs are seeking to do something very radical, and there is a deep dividing line between the basis on which they put their case and *Norwich Pharmacal*. The JOLs are seeking (a) to justify a far wider and more stringent order than could ever be obtained in *Norwich Pharmacal* proceedings and (b) to do so on the basis of an unverified assertion that they would, if they had tried, have been able to obtain a *Norwich Pharmacal* and without exposing themselves to the trouble and difficulty of showing that PwC were mixed up in any sort of wrongdoing about which they have any relevant information or documentation. I see neither force nor attraction in Mr Moss's invitation to prejudge the outcome of normal procedures by short-cutting them.

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A 130 In the light of these points, I come to the substance of the argument now presented. That is that a common law power exists to assist any foreign liquidation by ordering any person (whether or not an officer or agent of the company) to attend and be interrogated and produce documentation and information, on pain of contempt, in the manner which the JOLs advocate. The only explicit limits to the jurisdiction for which the JOLs now contend is that it should not be inconsistent with the law or policy of the forum. The B negative answer which the Board is giving to the second issue on this appeal means that there would exist a further limitation, that the jurisdiction would not exist or be exercisable to enable an order which could not be made against a person within the jurisdiction of the country of the insolvency.

131 Lord Sumption JSC now suggests that the principle should be further limited to any court-ordered liquidation (though that, in turn, leaves C uncertain the status of any winding up under supervision in any jurisdiction where that possibility, which existed formerly under section 311 of the English Companies Act 1948, still exists). Although Lord Sumption JSC speaks at one point of this as a "means of identifying or locating" assets (para 23), elsewhere he speaks of "enabling [foreign] courts to surmount the problems posed for a worldwide winding up of the company's affairs by the territorial limits of each court's powers": para 25. The order in fact made by D the Chief Justice was, as noted, of great width. The scope of the proposed common law jurisdiction is therefore uncertain.

132 The suggested jurisdiction is said to follow from the principle of "modified universalism". This is a principle developed in English common law over the last 20 years with the strong support of Lord Hoffmann, though recognised over a 100 years ago in a Transvaal case which was itself until E recently lost in (unfair) obscurity. *In re African Farms* [1906] TS 373, was decided by Sir James Innes, who in addition to his own great legal distinction was grandfather of the distinguished wartime humanitarian lawyer Helmuth James von Moltke. The essence of the principle consists, as Lord Sumption JSC notes in his para 14(i), in the recognition by one court of the foreign liquidator's power of disposition over the company's assets in the domestic jurisdiction. That justified an order restraining their disposition or F seizure inconsistently with the foreign liquidation. The novelty of this decision lay in the making of such an order in circumstances where there was no power to wind up the company in the domestic forum. In this respect, therefore, the co-operation extended in *In re African Farms* went a step further than that demonstrated in *In re Matheson Bros Ltd* (1884) 7 Ch D 225, where Kay J was, in the light of the fact that the English courts would G have had power to wind the relevant foreign company up in England, prepared to secure English assets to prevent English creditors executing against them, pending steps in the company's winding up in its country of incorporation to make the assets available for the company's English creditors pari passu with its foreign creditors.

133 The principle may also justify an order for the remission of the assets out of the jurisdiction to the foreign liquidator, if the foreign H liquidation rules would distribute them in the same way as the domestic jurisdiction. Even if the foreign liquidation rules would distribute them differently, but there is express statutory power enabling the remission to take place none the less, the principle may lend support to the exercise of that express statutory power. Beyond that, I do not read the majority of the

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House in *In re HIH Casualty and General Insurance Ltd* [2008] 1 WLR 852 as going, and anything that any of its members did say more widely about the existence or scope of a common law power was on any view obiter, since the appeal was decided on the basis that there existed express statutory authority for a remission although the assets would be distributed in the Australian liquidation differently from the way in which they would have been distributed in the English liquidation.

134 I agree with Lord Sumption JSC and Lord Collins that the second and third propositions for which *Cambridge Gas Transportation Corpn v Official Committee of Unsecured Creditors of Navigator Holdings plc* [2007] 1 AC 508 stands cannot be supported. A domestic court does not have power to assist a foreign court by doing anything which it could properly have done in a domestic insolvency; and it cannot acquire jurisdiction by virtue of any such power. As to the first proposition, for reasons which I explained in *Rubin v Eurofinance SA* [2013] 1 AC 236, *Cambridge Gas* can, if correct, stand for no more than the proposition that a domestic court should, so far as it can consistently with its own law, recognise a foreign bankruptcy order and deal with identifiable assets within its jurisdiction consistently with the way in which the foreign insolvency would deal with them. In another earlier decision of the Board, *Al Sabah v Grupo Torras SA* [2005] 2 AC 333, para 35, Lord Walker said, aptly in my view, that the Cayman court "might have had some limited inherent power" to act in aid of the Bahaman winding up, but that it could not have the suggested power to set aside a voidable disposition modelled on a section in the Cayman Island bankruptcy legislation governing domestic liquidation which did not in terms apply in relation to a Bahaman winding up.

135 Where I part company with Lord Sumption JSC is in his assertion that the hitherto limited principle of modified universalism which I have just described extends to or justifies (or would be "an empty formula" without) the assumption or exercise of a common law power to "haul" anyone before the court (to use Dillon LJ's word in *Ex p Tucker* [1990] Ch 148), to be interrogated and to produce documentation on pain of being in contempt, simply because it would be useful for the foreign liquidator to be able to do so and might enable him to locate some assets (or better understand the company's affairs). There is a step leap between enforcing rights to identifiable assets and obliging third parties to assist with documentation and information in order to discover a company's assets (or, still more widely, in order to enable insolvency practitioners to understand a company's affairs). Lord Sumption JSC relies in para 23 on the House of Lords' decision in *Norwich Pharmacal Co v Customs and Excise Comrs* [1974] AC 133 as illustrating "the capacity of the common law to develop a power in the court to compel the production of information when this is necessary to give effect to a recognised legal principle." But the reference to "a recognised legal principle" begs the question whether the principle of modified universalism extends beyond the protection of identifiable assets within the jurisdiction, to enable orders to be made compelling third parties to assist with the provision of information and documentation which may assist the tracing of such assets (or otherwise assist the insolvency practitioners in their understanding of the company's affairs).

136 Information is a precious commodity, but it is not one which is generally capable of being extracted in court from private individuals

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without special reason; and the potentially intrusive, vexatious and costly nature of the exercise of any power to do so is apparent from the form of the Chief Justice's order in this case. The common law has not hitherto accepted any such jurisdiction. The existence of foreign insolvency proceedings, conducted for the benefit of creditors, does not appear to me to provide any justification for doing so now. The mere fact that insolvency practitioners are, at least in a compulsory liquidation, officers of the foreign court charged with winding up its affairs seems quite insufficient at common law, though it may be a factor which assists determine the scope of Parliament's likely intention where relevant legislation exists. There are many ordinary creditors, litigants and other persons who would like a facility to gather information to discover or trace assets or to assist them to pursue claims or to conduct their affairs generally. It is unclear what the logic is or would be for restricting the suggested common law power to foreign insolvencies. However much it may be intended, by using adjectives like "promiscuous", to discourage attempts to bring within this new jurisdiction either domestic insolvencies (if and where no complete common law scheme exists) or situations entirely outside the insolvency context, such attempts seem bound to occur. In the absence of any clear justification for giving insolvency practitioners the unique common law privilege which the JOLs now claim, such attempts may well be difficult to resist. Although I disagree with it, such attempts can only be encouraged by the statement at the end of para 21 of Lord Sumption JSC's opinion that "The courts have never been as inhibited in their willingness to develop appropriate remedies to require the provision of information when a sufficiently compelling legal policy calls for it."

137 In reality, far from displaying uninhibited willingness to develop appropriate remedies requiring the provision of information, courts have in my view been careful to confine such remedies to situations where there is a recognisable legal claim to protect, based either on a title or right to property or on some wrongdoing supported by appropriate evidence. Thus: (i) A court has jurisdiction to protect identifiable property rights, which would include ordering a person shown to be likely to have property belonging to the company to deliver it up or disclose its whereabouts. (ii) A sustainable case of wrongdoing is the basis for the well-established jurisdiction to order the disclosure of information by or in conjunction with the making of an asset freezing (formerly *Mareva*) order or a search (*Anton Pillar*) order. (iii) The legal principle recognised in *Norwich Pharmacal* is that persons innocently mixed up in wrongdoing could be expected to disclose a limited amount of information and documentation about it to assist the victims.

138 On this appeal, no case has been advanced under any of these heads. The first could cover the disclosure by an agent of information which he held for, or owed a duty to pass to, his principal. As the transcript extract quoted in para 128 above confirms, no case is advanced on any such basis. Moreover, auditors are not agents, they are independent contractors engaged to review a company's accounts and report in accordance with statutory and professional requirements—in which connection there has been no suggestion of any failure or shortcoming on PwC's part. The second and third situations depend on evidence of wrongdoing, which has again not been asserted or attempted to be established. The third situation in particular bears no resemblance to the present case, in which it is said that

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innocent third parties can be compelled to produce information and documentation, without any allegation or evidence of wrongdoing, on insolvency practitioners showing that this could be useful to enable them to locate assets or better to understand the company's affairs.

139 It is notable that, even in the context of wrongdoing, the courts have been at pains to emphasise the narrow scope of the *Norwich Pharmacal* jurisdiction. It is "an exceptional one": *Ashworth Hospital Authority v MGN Ltd* [2002] 1 WLR 2033, para 57, per Lord Woolf CJ. It depends on the existence of wrongdoing. The person with information must have been mixed up, however innocently in wrongdoing: *R (Omar) v Secretary of State for Foreign and Commonwealth Affairs* [2014] QB 112. Originally the jurisdiction was confined to discovery of the identity of the wrongdoer: *Ashworth Hospital Authority*, para 26, per Lord Woolf CJ; *Arab Monetary Fund v Hashim (No 5)* [1992] 2 All ER 911, 914, per Hoffmann J, emphasising that it was "no authority for imposing on 'mixed up' third parties a general obligation to give discovery or information when the identity of the defendant is already known."

140 More recently, the Divisional Court has said that *Norwich Pharmacal* may extend beyond the discovery of the identity of a wrongdoer or of a "missing piece of the jigsaw", but under the strict caveat that "the action cannot be used for wide ranging discovery or the gathering of evidence and is strictly confined to necessary information": *R (Mohamed) v Secretary of State for Foreign and Commonwealth Affairs (No 1)* [2009] 1 WLR 2579, para 133, cited by the Court of Appeal in *R (Omar) v Secretary of State for Foreign and Commonwealth Affairs* [2011] EWCA Civ 1587 at [4].

141 Lord Sumption JSC suggests (para 20) that it will be possible in the present situation to draw a distinction between information which can permissibly be sought and evidence which cannot. At least two problems arise in this connection. First, it is, as I have noted, unclear whether any distinction or limitation is proposed between on the one hand information and documentation relating to assets and on the other hand information and documentation relating more generally to the company's affairs. Any such distinction or limitation seems likely in any event to be in practice illusory. An insolvency practitioner is ultimately only interested in assets and their distribution. Any questioning put, or information or documentation sought, will be scrutinised with a view to identifying assets, in whatever form, even if they only consist of potential claims for maladministration or negligence.

142 The second problem is that the distinction between information and evidence seems likely also to be illusory. Evidence is at least confined to the issues in identified litigation, domestic or foreign. In contrast, the proposed relief sought against PwC is completely unconfined, in nature and scope. The later *Omar* case [2014] QB 112 highlights (para 12) a justified scepticism about maintaining a distinction between information and evidence which gives cause for caution about further extension by analogy of the *Norwich Pharmacal* jurisdiction to circumstances where identifiable wrongdoing is not in issue. The Chief Justice's remark in para 80 that "PwC . . . is not an overt target for adverse litigation brought by the JOLs at this stage" was I think also shrewd. Who can doubt that the JOLs would, in their examination both of the working papers and other documents and information disclosed by PwC and in their questioning of the partners and

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officers attending under an order such as that made by the Chief Justice, have a close eye on the possibility that this might show some possible claim against PwC as auditors? The Chief Justice's ensuing comment that the court should take "a healthily sceptical approach in evaluating the complaints made about the validity and scope of the ex parte orders", because "it seems clear that a combative and sophisticated defensive strategy has been engaged" appears to me in contrast unjustified. The jurisdiction to make or justification for such an order cannot depend on the defensive strategy adopted to resist it.

143 The principle now advanced by the JOLs lacks any substantial authority. The two first instance authorities cited by Lord Sumption JSC in para 24 offer the weakest of encouragement for the novel jurisdiction now proposed. *Moolman v Builders & Developers (Pty) Ltd* [1990] 2 All SA 77 (A) treats the issue as one of applying *In re African Farms* [1906] TS 373, giving as the only reason that information is necessary if the ultimate aim of recovery of assets is to be realised. The court then in fact applied the statutory provisions of the forum on an "as if" basis [1990] 2 All SA 77 (A), sub-paragraph (d) on pp 4–5 and p 16. That I agree with Lord Sumption JSC and Lord Collins is not a sustainable approach.

144 The judgment in *In re Impex Services Worldwide Ltd* [2004] BPIR 564 suggests a breadth of common law power which would again be completely unlimited in its scope, enabling the Manx court "if it thinks fit" to make "an order summoning before it any person whom the court deems capable of giving information concerning the promotion, formation, trade, dealings and affairs or property of the company": para 106(8). Deemster Doyle explained this on the basis that (para 107):

> "Friendly and sophisticated jurisdictions which respect the rule of law and human rights need to be aware that if things go wrong in their jurisdiction and entities in the Isle of Man have information, documentation and evidence in their possession custody control or power that would assist them, then the Manx courts, in a proper case and subject to suitable safeguards and protections where necessary, will offer judicial co-operation and assistance where that is reasonably requested by the judicial authority in that friendly jurisdiction. When the call for help comes the Manx courts will, in proper cases, answer the call positively and provide the necessary co-operation and assistance."

English liquidators were the beneficiary of the far reaching principle thus promulgated, but I cannot accept that it represents English or Bermudan common law. If there might seem to be a hint in the Deemster's phrase "if things go wrong" that the reasoning and order may have been based on wrongdoing, that does not appear to be borne out by the full account of the background and proposed questions given earlier in his judgment. Like the order made by the Chief Justice in the present case, the Deemster's ready acceptance of the scope of the assistance which might be provided as extending to any information about the company's promotion, formation, trade, dealings and affairs or property as well as to evidence once again indicates the difficulty that there could be in keeping this novel power within bounds.

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145 Lord Collins's approving dictum in *Rubin v Eurofinance SA* [2013] 1 AC 236, para 33, quoted by Lord Sumption JSC in his para 19, is found in a paragraph listing a series of authorities on modified universalism, in circumstances where there was no examination in argument or in the Board's opinion of differences between them, or between situations where identifiable assets were in issue and other situations. But another dictum of Lord Collins in that case is in my view relevant. At para 129, he said that:

> "The law relating to the enforcement of foreign judgments and the law relating to international insolvency are not areas of law which have in recent times been left to be developed by judge-made law. As Lord Bridge of Harwich put it in relation to a proposed change in the common law rule relating to fraud as a defence to the enforcement of a foreign judgment, 'if the law is now in need of reform, it is for the legislature, not the judiciary, to effect it': *Owens Bank Ltd v Bracco* [1992] 2 AC 443, 489."

That stands in stark contrast with the development of common law powers which the majority on this appeal supports.

146 The description of *In re Impex* [2004] BPIR 564 as a case of "judicial assistance in the traditional sense" can be seen now to be on any view unsustainable, and Lord Sumption JSC himself says (para 24) that he "would not wish to endorse all of the reasoning given" in the judgments in either *Moolman* [1990] All SA 77 (A) or *In re Impex*. He instances "in particular" those parts which appear to support the concept of applying statutory powers by mere analogy. That leaves open—in the context of the JOLs' present case that the Bermudan court can assist the Cayman Islands' liquidation without relying on Bermudan law—how far his approach accepts or disapproves the breadth of the reasoning and orders in *In re Impex* (see the previous paragraph)—or indeed in the present case: see paras 119–120 above. That is another of the unresolved uncertainties about the scope of the proposed new jurisdiction.

147 In these circumstances, and although anything said may be obiter, I am not at present persuaded that it is appropriate to extend the common law power to assist by ordering the provision of information beyond categories which have some recognisable basis in current law, that is cases where there is (a) evidence that the person ordered to provide the information or documentation has property belonging to the insolvent company, or (b) evidence of some wrongdoing by the person so ordered or (c) evidence of some wrongdoing by another person in which the person so ordered was or is innocently mixed up. A general common law power to order the disclosure of information and documentation by, and the questioning of, anyone, either because a foreign liquidator shows that this may assist him identify or recover assets anywhere in the world or, a fortiori, because it would enable him understand the company's affairs, goes not only beyond anything which it is necessary to contemplate on this appeal, but is also beyond anything that I can, as at present advised, regard as permissible or appropriate.

148 I therefore consider that the appeal must be dismissed, because of the negative answer given to the second issue. But I would, if necessary, also have considered that it should be dismissed on the ground that a negative answer should be given on the first issue.

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A LORD NEUBERGER OF ABBOTSBURY PSC

149 I agree with the other members of the Board that we should humbly advise Her Majesty that this appeal should be dismissed. However, there is an issue which divides the members of the Board. It is whether, as Lord Sumption and Lord Clarke of Stone-cum-Ebony JJSC and Lord Collins of Mapesbury consider, the appeal should only be dismissed on the grounds
B (i) that there is no common law power to apply legislation which applies to domestic insolvencies by analogy to foreign insolvencies, and (ii) that the Bermudan courts should not exercise a common law power ("the Power") described by Lord Sumption JSC in para 25, because, as he explains in paras 29–30, the Cayman Islands courts have no such power, or whether, as Lord Mance JSC concludes, the appeal should also be dismissed on the ground (iii) that the common law power in question does not exist. On that
C issue, if it is appropriate to decide whether the alleged power exists, I would be in agreement with Lord Mance JSC.

150 As this is a judgment which dissents from the majority view on ground (iii), and there is little which I wish to add to the judgment of Lord Mance JSC, I can express my reasons relatively shortly.

151 It is unnecessary to decide whether the Power exists, because we are
D all agreed that, even if it does, it should not be exercised. I accept, of course, that we can decide (albeit, at least arguably, strictly only obiter) whether the Power exists. However, as it is not necessary for us to rule on that issue in order to dispose of this appeal, we should, in my opinion, be very cautious of doing so. While judges in a final court of appeal, perhaps particularly in a common law system, should give as much guidance as they can as to the substantive and procedural law in any area, they must always bear in mind
E the risks inherent in determining issues which do not have to be decided in order to dispose of the case before them.

152 As new problems arise, and as societal values and practices, technological techniques and business practices change, it is inevitable that judges can and should introduce new common law principles or procedures or make alterations to established common law principles and procedures.
F However, such developments should always be adopted cautiously, not least because, even with the benefit of submissions from advocates and consideration of previous cases, textbooks and articles, the wider implications of any new principle or alteration to an existing principle are very hard to assess. The need for caution in this connection is, in my view, supported by the judicial observations cited by Lord Collins in paras 65–68, although those observations were made in relation to a different aspect of
G the need for caution.

153 In the present case, there is obvious force in the point that the Board should determine whether the common law power alleged by the liquidators exists, as it is an important issue on which the sooner an authoritative decision is given the better, especially in the light of the somewhat confused state of the law as revealed in the judgments in this case.

H 154 However, that very confusion underlines the need for caution. The extent of the extra-statutory powers of a common law court to assist foreign liquidators is a very tricky topic on which the Board, the House of Lords and the Supreme Court have not been conspicuously successful in giving clear or consistent guidance: see the judgment of Lord Hoffmann on behalf of the Board in *Cambridge Gas Transportation Corpn v Official Committee of*

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Unsecured Creditors of Navigator Holdings plc [2007] 1 AC 508, all five opinions in the House of Lords in *In re HIH Casualty and General Insurance Ltd* [2008] 1 WLR 852, and the judgment of Lord Collins of Mapesbury for the majority of the Supreme Court in *Rubin v Eurofinance SA (Picard intervening)* [2013] 1 AC 236, discussed by Lord Sumption JSC at paras 16–19, and the judgment of Lord Collins in this case.

155 The message I take from those cases is that, at least in this area, it would be better for the Board to approach any case in this field with a view to deciding it on a relatively minimalist basis, rather than by seeking to lay down general principles which it is not necessary to determine, particularly when those principles involve extending the court's powers in a way which may have substantial ramifications. While Lord Sumption JSC's explanation of the nature and extent of this alleged common law power appears very attractive, I think it could lead to all sorts of problems and uncertainties, as is implicit in the qualifications which Lord Sumption JSC makes, at para 25. It is all very well saying that they can be dealt with when they arise, but the fact that it is apparent that there will be problems and complications if the law is developed in a certain way suggests to me that the development should not be adopted unless it is necessary to do so. Accordingly, as it is unnecessary to decide whether the common law power exists, I would have preferred to leave the issue to be decided when it needs to be—with the benefit of the powerful arguments either way contained in the judgments on this appeal, which, with all respect to counsel, range more widely and deeply than the arguments which the Board heard during the hearing.

156 If, however, it is incumbent on me to express a view, I would conclude, in agreement with Lord Mance JSC, that the alleged common law power does not exist. He has set out the grounds for that conclusion convincingly, and they include reasons both of principle and of practicality. Accordingly, I do not propose to repeat those reasons, but there are one or two points I would like to emphasise.

157 The extreme version of the "principle of universality", as propounded by Lord Hoffmann in *Cambridge Gas*, has, as Lord Sumption JSC explains, effectively disappeared, principally as a result of the reasoning of Lord Collins speaking for the majority in *Rubin*, and speaking for the Board in this appeal. However, as with the Cheshire Cat, the principle's deceptively benevolent smile still appears to linger, and it is now invoked to justify the creation of this new common law power. It is almost as if the Board is suggesting that, while we went too far in *Cambridge Gas* and should pull back as indicated in *Rubin*, we do not want to withdraw as completely as we logically ought. In my view, the logic of the withdrawal from the more extreme version of the principle of universality is that we should not invent a new common law power based on the principle.

158 The limitation of the Power to insolvency cases may be seen by many to be questionable. More specifically, the limitation to liquidations which are being conducted by officers of a foreign court seems to me to be potentially arbitrary. Companies may be in court-imposed liquidation in many jurisdictions when it is "just and equitable" to wind them up, even if they are solvent: I do not see why liquidators in such a case should be able to invoke the Power when other people running solvent companies could not do so. Further, there is no reason why a statutory regime should not provide

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that voluntary liquidations are to be conducted under the aegis of the court, and, if so, the Power would seem to apply in such cases. And the status of administrators in administrations may be unclear in this connection.

159 The need to make subtle distinctions also concerns me. Thus, the distinction between information and documentation which is obtainable under this power, and "material for use in actual or anticipated litigation", appears very likely to give rise to difficult practical problems. I appreciate that these problems can arise in other circumstances, but that is not a reason for extending the circumstances in which these problems may arise; and, as the facts of this case suggest, I suspect that they are particularly likely to arise in relation to the exercise of the Power. Similarly, the question what is necessary for the performance of a liquidator's functions, which is said to be a prerequisite for the exercise of the Power, seems to be a fertile area for uncertainty and dispute.

160 More broadly, these distinctions seem to me to embody the sort of requirements one would expect to see in a statutory code rather than in judge-made law. As the judicial observations cited by Lord Collins suggest, judge-made law should be limited to "very modest development[s] . . . of existing principle", and should be made "in small steps" or "within . . . interstitial limits". Although I accept that the United Kingdom courts have been prepared to recognise a new common law right in *Norwich Pharmacal Co v Customs and Excise Comrs* [1974] AC 133, the right involved was only exercisable in very specific circumstances where a serious wrong had been committed. I do not consider that that decision alters the fact that the creation of the Power would represent a development in the law which is, as Lord Mance JSC puts it, "radical". It may not seem radical in the sense that it can be said to be a fairly routine feature of the extreme "principle of universality" enunciated by Lord Hoffmann in *Cambridge Gas* [2007] 1 AC 508, but that view is no longer maintainable given that extreme principle has now been rejected by Lord Collins, speaking for the majority of the House of Lords in *Rubin* [2013] 1 AC 236 and for the Board on this appeal.

161 The contention that judges should not be creating the Power is reinforced when one considers the extent of domestic statutory law and international convention law in the area of international insolvency. Examples of such laws are described and discussed in paras 40–50 of Lord Collins's judgment. In this highly legislated area, I consider that the Power which is said to arise in this case is one which should be bestowed on the court by the legislature, and not arrogated to the court of its own motion.

162 I acknowledge the force of the arguments the other way, which are so clearly set out by Lord Sumption JSC. However, as already intimated, while I agree with the judgment of Lord Collins and otherwise agree with the judgment of Lord Sumption JSC, I would for my part reject the existence of the Power, if it is appropriate to decide that issue at all.

JILL SUTHERLAND, Barrister

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JOINT LIQUIDATORS OF GRAMPIAN MACLENNAN'S DISTRIBUTION SERVICES LTD v CARNBROE ESTATES LTD

No 2
4 December 2019
[2019] UKSC 57

Lord Reed of Allermuir DPSC,
Lord Wilson of Culworth, Lord Hodge,
Lord Briggs of Westbourne and Lord Sales

STEWART MACDONALD AND PAMELA COYNE, THE JOINT LIQUIDATORS OF GRAMPIAN MACLENNAN'S DISTRIBUTION SERVICES LTD,
Pursuers and Respondents—*McBrearty QC, Ower*
CARNBROE ESTATES LTD, Defender and Appellant—
Lord Davidson of Glen Clova QC, JA Brown

Company – Liquidation – Gratuitous alienation – Property sold for substantial undervalue – Relevance of financial circumstances of insolvent company selling property at undervalue – Whether adequate consideration – Insolvency Act 1986 (cap 45), sec 242(4)

Company – Liquidation – Gratuitous alienation – Remedies – Discretion of court to grant remedy of reduction – Insolvency Act 1986 (cap 45), sec 242(4)

The Insolvency Act 1986 (cap 45) ('the 1986 Act'), sec 242(1), provides that, when the winding up of a company has commenced, an alienation of its property may be challengeable by the liquidator or by a creditor in certain circumstances. Section 242(4) provides, *inter alia*, ''On a challenge being brought under subsection (1), the court shall grant decree of reduction or for such restoration of property to the company's assets or other redress as may be appropriate; but the court shall not grant such a decree if the person seeking to uphold the alienation establishes– . . . (b) that the alienation was made for adequate consideration''.

A distribution service company sold its premises shortly before entering liquidation. At the time of the sale, the company was in significant financial difficulty. The sale was necessary in order to prevent a standard security over the site being called up by the company's heritable creditor. The premises were sold for £550,000 without being put on the open market. At the time of the sale, the open market value of the site, assuming a proper period of marketing, was between £740,000 and £820,000. The respondents were appointed as joint liquidators and sought reduction of the disposition as a gratuitous alienation within the meaning of sec 242 of the 1986 Act.

At first instance, the commercial judge held that the sale price was adequate consideration, in view of the company's perilous financial position and the need for a quick sale. The respondents reclaimed. The Inner House allowed the reclaiming motion and held that the achievement of a quick sale would not have saved the company's business. An entity which was insolvent owed a fiduciary duty to its creditors, and, as a result, required to obtain full consideration for property alienated. Where a business was about to come to an end, there was no need to maintain liquidity and the interests of creditors were paramount. The appellant appealed to the UK Supreme Court.

The appellant argued that: (i) the central issue had been whether the company's financial distress justified an urgent sale and that the Inner House had erred in interfering with the Lord Ordinary's findings at first instance by requiring too strict an approach to the question of departure from open market value; (ii) the test of adequate consideration required analysis of whether the transaction was satisfactory in all the circumstances, including the facilitation of commercial transactions and certainty, rather than taking an overly strict approach; and (iii) the approach of the Inner House had failed to take account of the commercial reality that a purchaser of property from a distressed company could not know whether that company had a realistic prospect of preserving its business.

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In relation to the power contained in sec 242(4) of the 1986 Act to grant a remedy in cases of gratuitous alienation, the appellant contended that an interpretation of the provision which gave the court no discretion but to order reduction of a disposition could give rise to anomalous and unjust results. The respondents contended that the absence of a discretion was supported by the relevant provisions of the Insolvency (Scotland) Rules 1986 (SI 1986/1915) and the Scottish Parliament's intention in re-enacting the provisions of sec 242 of the 1986 Act as sec 98(5) of the Bankruptcy (Scotland) Act 2016 (asp 21) in respect of personal insolvency.

Held that: (1) adequate consideration meant the giving of consideration which might objectively be described as reasonable had the transaction taken place between the parties acting at arm's length in the circumstances including, in an appropriate case, the seller's need to obtain a prompt sale to protect its cash flow in a liquidity crisis, but that where there was no question of a sale to preserve liquidity, adequate consideration was to be measured by the standard which would be imposed upon an insolvency practitioner or holder of a standard security in disposing of the property (paras 31–34, 39); (2) in the present case, the company's financial circumstances at the time of sale were such that the sale constituted an informal winding up of the business and there was accordingly no justification for the sale of the property at so far below market value on the ground of urgency, absent evidence that the sum obtained was one which a liquidator or holder of a standard security would have achieved following deduction of expenses and costs (paras 40, 42); (3) the language of sec 242 of the 1986 Act was broad enough in an appropriate case where justice required it to devise a remedy to protect a *bona fide* purchaser of property from a reversal of its purchase which would otherwise give the creditors of the insolvent entity a substantial windfall at the purchaser's expense, and in the circumstances of the case it would be necessary to afford the Inner House an opportunity to consider whether it would be appropriate to qualify the remedy of reduction to take account of all or part of the consideration paid by the appellant for the site (paras 63, 69); and appeal *allowed* to the extent of remitting the case to the Inner House to consider the appropriate remedy under sec 242(4).

Lafferty Construction Ltd v McCombe 1994 SLT 858 and *Kerr v Aitken* [2000] BPIR 278 *considered* and *Short's Tr v Chung (No 1)* 1991 SLT 472 and *Cay's Tr v Cay* 1998 SC 780 *disapproved*.

STEWART MACDONALD and PAMELA COYNE, the JOINT LIQUIDATORS OF GRAMPIAN MACLENNAN'S DISTRIBUTION SERVICES LTD, brought an action under the commercial cause rules (Act of Sederunt (Rules of the Court of Session 1994) 1994 (SI 1994/1443 (S 69)), Ch 47) in the Court of Session against Carnbroe Estates Ltd seeking reduction of a disposition granted in favour of the defender on the grounds that it was a gratuitous alienation. Following sundry procedure, the cause called before the commercial judge (Lord Woolman) for a proof before answer. At advising, on 18 January 2017, the commercial judge put the case out by order to discuss final orders ([2017] CSOH 8). At the hearing by order, on 26 January 2017, the commercial judge granted decree of absolvitor in favour of the defender. The pursuers reclaimed.

The reclaiming motion called before the First Division (the Lord President (Carloway), Lord Drummond Young and Lord Malcolm) for a hearing on the summar roll, on 5 October 2017. At advising, on 23 January 2018, the First Division allowed the reclaiming motion ([2018] CSIH 7; 2018 SC 314). The defender appealed to the UK Supreme Court.

Cases referred to:
Abram Steamship Co Ltd and the Liquidator v Abram 1925 SLT 243; 21 Ll L Rep 167
Accountant in Bankruptcy v Walker [2017] CSOH 78; 2017 SLT 890; [2017] BPIR 803
Baillie Marshall Ltd (in liquidation) v Avian Communications Ltd 2002 SLT 189
Bank of Scotland v RW Forsyth Ltd 1988 SC 245; 1988 SLT 690; 1988 SCLR 487; 4 BCC 457

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Barras v Aberdeen Steam Trawling and Fishing Co Ltd 1933 SC (HL) 21; 1933 SLT 338; [1933] AC 402; [1933] All ER Rep 52; 45 Ll L Rep 199
Boyd and Forrest v Glasgow and South-Western Rly 1915 SC (HL) 20; 1915 1 SLT 114; [1915] AC 526
Cay's Tr v Cay 1998 SC 780; 1999 SLT 321; 1998 SCLR 456
Charnley Davies Ltd (No 2) (Re) [1990] BCC 605; [1990] BCLC 760; Financial Times, 15 June 1990
Farrell v Alexander [1977] AC 59; [1976] 3 WLR 145; [1976] 2 All ER 721; 32 P & CR 292; 120 SJ 451
Glencairn (Earl of) v Birsbane (1677) Mor 1011
Gorrie's Tr v Gorrie (1890) 17 R 1051
Hague v Nam Tai Electronics Inc [2008] UKPC 13; [2008] BCC 295; [2008] BPIR 363; [2008] PNLR 27
Haigh v Charles W Ireland Ltd 1974 SC (HL) 1; 1974 SLT 34; [1974] 1 WLR 43; [1973] 3 All ER 1137; 15 KIR 283; 117 SJ 939; The Times, 23 November 1973
Harrison (Raymond) & Co's Tr v North West Securities Ltd 1989 SLT 718
Johnston's Tr v Baird [2012] CSOH 117; 2012 GWD 25-514
Kerr v Aitken sub nom Aitken's Tr v Aitken [2000] BPIR 278; 1999 GWD 39-1898
Lafferty Construction Ltd v McCombe 1994 SLT 858
McCowan v Wright (1852) 14 D 968
McCowan v Wright (1853) 15 D 494
MacMillan v T Leith Developments Ltd [2017] CSIH 23; 2017 SC 642; 2017 SLT 415; 2017 SCLR 477
Miller's Tr v Shield (1862) 24 D 821
Oldham v Kyrris [2003] EWCA Civ 1506; [2004] BCC 111; [2004] 1 BCLC 305; [2004] BPIR 165; [2004] PNLR 18; (2003) 100 (48) LSG 17; 147 SJLB 1306; [2003] NPC 133; The Times, 7 November 2003
R (on the application of Belhaj) v Director of Public Prosecutions (No 1) [2018] UKSC 33; [2019] AC 593; [2018] 3 WLR 435; [2018] 4 All ER 561; [2018] 2 Cr App R 33; [2018] Crim LR 1012; The Times, 17 July 2018
R (on the application of N) v Lewisham London Borough Council [2014] UKSC 62; [2015] AC 1259; [2014] 3 WLR 1548; [2015] 1 All ER 783; [2015] HLR 6; [2014] BLGR 842; [2015] 1 P & CR 13; (2014) 158 (45) SJLB 37; The Times, 1 December 2014
Rae (John E) (Electrical Services) Linlithgow Ltd v Lord Advocate 1994 SLT 788
Short's Tr v Chung (No 1) 1991 SLT 472; 1991 SCLR 629
Silven Properties Ltd v Royal Bank of Scotland plc [2003] EWCA Civ 1409; [2004] 1 WLR 997; [2004] 4 All ER 484; [2003] BCC 1002; [2004] 1 BCLC 359; [2003] BPIR 1429; [2003] 3 EGLR 49; [2003] 50 EG 96; [2003] 44 EG 168 (CS); 100 (44) LSG 33; [2003] NPC 121; [2004] 1 P & CR DG6; The Times, 7 October 2003
Spence v Crawford 1939 SC (HL) 52; 1939 SLT 305; [1939] 3 All ER 271
Tennant v Miller (1897) 4 SLT 318
Thomas v Thomson (1866) 5 M 198
West Mercia Safetywear Ltd (Liquidator of) v Dodd (1988) 4 BCC 30; [1988] BCLC 250; [1988] PCC 212

Textbooks etc referred to:
Bell, GJ, *Commentaries on the Laws of Scotland and on the Principles of Mercantile Jurisprudence* (7th McLaren ed, T & T Clark, Edinburgh, 1870), ii, 171, 172, 179, 217
Goudy, H, *A Treatise on the Law of Bankruptcy in Scotland* (4th ed, T & T Clark, Edinburgh, 1914), pp 25, 47
Lightman, G, and Moss, GS, *The Law of Administrators and Receivers of Companies* (6th ed, Sweet and Maxwell, London, 2017), para 12.042
Scottish Law Commission, *Report on Bankruptcy and Related Aspects of Insolvency and Liquidation* (Scot Law Com no 68, 1982), vol 2, Ch 12, para 12.19 (Online: www.scotlawcom.gov.uk/files/6813/1186/5432/rep68_2_ch_12-24_appendices_1-5.pdf (15 February 2020))

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Scottish Law Commission, *Report on the Consolidation of Bankruptcy Legislation in Scotland* (Scot Law Com no 232, 2013) (Online: www.scotlawcom.gov.uk/files/7713/6853/1118/Report_on_the_Consolidation_of_Bankruptcy_Legislation_in_Scotland.pdf (15 February 2020))
St Clair, JB, and Drummond Young (Lord), *The Law of Corporate Insolvency in Scotland* (4th ed, W Green, Edinburgh, 2011), para 3.10

The appeal was heard in the UK Supreme Court before Lord Reed of Allermuir DPSC, Lord Wilson of Culworth, Lord Hodge, Lord Briggs of Westbourne and Lord Sales, on 2 May 2019.

At advising, on 4 December 2019, the opinion of the Court was delivered by Lord Hodge—

LORD HODGE (with whom Lord Reed of Allermuir DPSC, Lord Wilson of Culworth, Lord Briggs of Westbourne and Lord Sales agree)— [1] This appeal concerns the Scots law of gratuitous alienations on insolvency. It raises three principal questions. First, there is a question as to the interpretation of the term 'adequate consideration' in sec 242(4)(b) of the Insolvency Act 1986 (cap 45) ('the 1986 Act'). Secondly, there is the question whether the Inner House was entitled to interfere with the Lord Ordinary's evaluation that the consideration given by Carnbroe Estates Ltd ('Carnbroe') amounted to adequate consideration under that statutory provision. Thirdly, a question arose during the hearing as to the interpretation of the words in sec 242(4) that empower the court to grant a remedy. The court invited and received written submissions from counsel for both parties. The question is whether the court has any discretion as to the remedy it may give.

Factual background

[2] Grampian Maclennan's Distribution Services Ltd ('Grampian') was, as its name suggests, a distribution services company. It carried on business from a site at 9 Stroud Road, Kelvin Industrial Estate, East Kilbride ('the property'). The property, which was Grampian's principal asset and centre of operations, consisted of a warehouse, a vehicle workshop and a yard with a gatehouse. Grampian purchased the property in August 2005 for £630,000. The buildings on the property had been constructed in the 1970s and by 2014 were in need of further maintenance, repair and upgrading. Grampian's shareholders until June 2014 were Derek and Hazel Hunter, and Derek Hunter was the sole director.

[3] In March 2013 DM Hall, chartered surveyors, valued the property at £1.2 million on the open market with the valuation falling to £800,000 if one were to assume a restricted marketing period of 180 days. By early 2014 Grampian was in financial difficulty. In May 2014 Mr Hunter consulted an insolvency practitioner to obtain advice as to whether he should put Grampian in members' voluntary liquidation. At that time Mr Hunter believed that the sale of the property would enable Grampian to pay all its creditors and make a distribution to the shareholders. His belief was supported by the DM Hall valuation of March 2013. Shortly before the consultation in May 2014, Carnbroe had intimated through its solicitors an interest in purchasing the property for £950,000. In mid-2014, another company, Bullet Express Ltd, also expressed an interest in acquiring the property at a price of £900,000.

[4] Mr and Mrs Hunter chose not to pursue those expressions of interest in the property but instead sold their shares in Grampian to Kevan Quinn, who became its sole shareholder and director with effect from about 16 June 2014. At this time,

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Grampian's total liabilities marginally exceeded £1 million. Sums in excess of £500,000 were due to HM Revenue and Customs ('HMRC') and sums over £500,000 were due to National Westminster Bank plc ('NatWest'), which together were Grampian's principal creditors. NatWest held a standard security over the property in respect of a London inter-bank offered rate ('LIBOR') loan, which I mention below. It also held a bond and floating charge over Grampian's property and undertaking. Grampian had to pay monthly loan payments to NatWest of about £4,600.

[5] In his witness statement, which was accepted as his evidence in chief and truthful and on which he was not cross-examined, Mr Quinn explained that he had taken over Grampian in the hope that he could save it and make money out of it. He narrated that shortly after his takeover, Grampian's invoice factor withdrew its factoring facility which caused the company's cash flow to collapse. He was not able to obtain alternative funding. He explained that once he realised how bad Grampian's position was, he tried to deal with it in as responsible a way as he could. He sold off the company's trucks, which were on hire purchase, to reduce outgoings, and then sought to sell Grampian's only other asset, the property. With the collapse in its cash flow, Grampian could not pay the loan payments to NatWest, which fell into arrears. He sought to sell the property to prevent it from being repossessed by NatWest.

[6] Mr Quinn entered into discussions to sell the property with James Gaffney who was a successful businessman whom he had known for over 30 years and with whom he had had business dealings throughout that time. Mr Gaffney tried to 'chisel' the price by pointing out that the electrical system of the building needed immediate attention, and that there was an issue about the presence of asbestos which would have to be addressed at some time. Mr Gaffney was aware of Grampian's predicament and mentioned that he could buy the property after it had been repossessed.

[7] Mr Gaffney also gave evidence in a written witness statement which was accepted as truthful. He stated that Carnbroe was one of his family companies and that he negotiated with Mr Quinn on its behalf. Mr Quinn had explained to him Grampian's financial difficulties on a number of occasions. Mr Quinn was looking for a quick sale because of mortgage arrears and the risk that the property would be repossessed. The price of £550,000 reflected the quick sale. The buildings needed repairs and refurbishment, including re-wiring and asbestos removal.

[8] That is all the direct factual evidence that was led about the circumstances which led up to the sale of the property to Carnbroe. The parties sought to adopt an economical and proportionate approach to the proof, which is to be commended. In a joint minute of admissions the parties agreed as true the contents of the affidavits of the liquidators and two other witnesses to fact on their behalf. The reports of and other documents prepared by the two expert valuation witnesses, Mr Iain Prentice of Colliers International Valuation UK LLP, whom the liquidators called as a witness, and Mr Alastair Buchanan of J & E Shepherd, who gave evidence at Carnbroe's request, were admitted as their evidence in chief. Both expert witnesses gave brief oral evidence in chief and were cross-examined in a succinct manner. The joint minute of admissions also proposed detailed findings of fact on matters which were not in dispute. No evidence was led as to the likely price which NatWest could be expected to obtain if it had called up its standard security and sold the property or which a liquidator of Grampian would be likely to have obtained on its sale in a winding up.

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[9] Grampian transferred the property to Carnbroe by a disposition dated 24 July 2014 in which the consideration was stated to be £550,000, having agreed an off-market sale. Entry was given to the property on that date. Immediately before the sale, Grampian owed NatWest £473,604.68 under the LIBOR loan which was secured over the property. Carnbroe did not pay the agreed consideration of £550,000 but instead, on 18 August 2014, its solicitors paid the sum of £473,604.68 to NatWest in repayment of the LIBOR loan to Grampian and to obtain a discharge of the standard security over the property. Carnbroe did not pay the balance of the stated purchase price to Grampian until 9 June 2016, after the completion of the proof before the Lord Ordinary in this case.

[10] Carnbroe funded the purchase of the property by a loan of £600,000 from the Bank of Scotland plc ('the bank'). In support of its lending, the bank obtained a report from DM Hall dated 23 June 2014, which confirmed the valuation in its March 2013 report, namely £1.2 million on the open market and £800,000 on the assumption of a restricted marketing period of 180 days. On 28 July 2014, solicitors for the bank questioned the discrepancy between the purchase price of £550,000 and the DM Hall valuation. Carnbroe's solicitor replied by email to the effect that because NatWest were calling for payment under threat of enforcing their securities, there was no willing seller and no willing buyer for the property and that Grampian did not have the option of a 180-day marketing period. The solicitor stated that he had spoken with DM Hall who had confirmed that, as a result, the assumptions made in their valuation did not apply. The bank then made a loan of £600,000 to Carnbroe which was secured over the property.

[11] The sale of the property and the repayment of NatWest's LIBOR loan left the other principal creditor, HMRC, unpaid. HMRC wrote to Grampian on 6 August 2014 requiring payment of tax that was due. On Grampian's failure to pay, HMRC presented a petition for winding up Grampian founding on that debt. Mr Macdonald was appointed provisional liquidator on 12 September 2014 and on 21 November 2014 he and Ms Coyne were appointed as joint liquidators at a meeting of Grampian creditors. The liquidators raised the present proceedings on 28 November 2014.

[12] I can summarise the valuation evidence shortly. Mr Prentice's evidence was that the open market value of the property at the date of the transaction was £820,000. Mr Buchanan's evidence of the open market value at that date was £740,000. The experts both made their valuations on the assumption that the bargain was between a willing seller and a willing buyer at arm's length. They both assumed a proper period of marketing, which Mr Prentice thought would take between 12 and 24 months and Mr Buchanan thought would be 24 months. Both advised that it was appropriate to apply a discount of between 25 and 30 per cent if there were a restricted marketing period of six months. Neither considered that a consideration of £550,000 was inappropriate if there were an immediate off-market sale by a financially distressed vendor, in accordance with the factual assumptions which Mr Buchanan was requested to address and addressed in his report.

[13] The question which has become of central importance in this case is whether there was an objective justification for such an urgent off-market sale, which caused so radical a reduction in the value of the property in comparison with the open market value.

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Judgments of the Scottish courts

[14] After a two-day proof, the Lord Ordinary held, in an opinion dated 18 January 2017 ([2017] CSOH 8), that Carnbroe had established that the sale of the property was made for adequate consideration. He recorded the submission which counsel made on behalf of Carnbroe that Grampian was fighting for its survival and that Mr Quinn had to make a quick decision. He continued:

> '[30] While the purchase price fell short of the open market value, Grampian had very limited options. It was in a perilous financial position. It could not afford the leisure of a lengthy marketing period. NatWest was threatening to call up the standard security and to use other diligence against it in terms of the bond and floating charge it held. There was no other offer on the table. The earlier expressions of interest were just that. There was no solid proposal to accept.
>
> [31] Carnbroe's offer presented an opportunity to obtain a quick sale. To place the property on the open market would have involved significant expense. There would have been advertising costs and an estate agency fee of 1.0 to 1.5 per cent. There was no clear indication that a sale would be achieved within the standard marketing period of 12 to 24 months. According to the surveyors' evidence, a stigma can attach to a property that remains on the market too long. It might be the subject of vandalism.'

He went on to state that Mr Quinn and Mr Gaffney were not 'associates' in terms of the relevant legislative definition, but their long business relationship justified close scrutiny of the transaction. The expert surveyors had agreed that a price of £550,000 was not inappropriate if the property had been marketed on a closed basis for six months.

[15] The liquidators appealed to the Inner House. In an opinion and interlocutor, dated 23 January 2018, the First Division (the Lord President (Carloway), Lord Drummond Young and Lord Malcolm) ([2018] CSIH 7) allowed the reclaiming motion, reduced the disposition of the property and ordered Carnbroe to execute a disposition of the property in favour of the liquidators. In the opinion of the court, which Lord Drummond Young delivered, the First Division recorded its view (para 11) that the most important issue in the appeal was whether it was correct to assert that a quick sale was justified because Grampian had an immediate need for funds. The First Division concluded that it was not. Analysing the facts found by the Lord Ordinary, the court identified four factors which were of central importance, namely Grampian's severe financial difficulties when the finance house withdrew its invoice factoring facility, Grampian's balance sheet insolvency, the sale of the trucks on which Grampian depended to provide its distribution service, and the sale of the property which was its principal place of business and depot (paras 27–29). The First Division concluded that on an objective analysis there was no realistic prospect that Grampian's business could continue in existence after the sale of those assets (para 30). In consequence, this was not a case in which the achievement of a quick sale of the property would save the company's business.

[16] In its legal analysis of the principles of insolvency law the First Division (paras 12–20) stated that a person, once he or she became insolvent, owed a fiduciary duty to have regard to the interests of his or her creditors and as a result, if a debtor alienates property once he or she is insolvent, he or she must obtain full consideration for the property alienated. The First Division pointed out that under the current and prior statutory provisions relating to gratuitous alienations the

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burden of proving that full consideration had been given rested on the recipient of the insolvent debtor's property. The same principles applied to a corporate insolvency in which directors of an insolvent company owed analogous fiduciary duties to have regard to the interests of the company's creditors as a body. As a result, the courts should take a relatively strict view of the adequacy of consideration (para 24).

[17] The First Division distinguished balance sheet insolvency (ie an excess of liabilities over assets) with cash flow insolvency (ie the inability of a trading entity to meet its debts as they fall due). It recognised both that an urgent forced sale, necessitated by a trading entity's need for cash to maintain liquidity in order to continue to trade, would generally result in a lower price than a sale in ordinary market conditions and that the need to maintain liquidity and stay in business could be a relevant factor in deciding whether the consideration paid was adequate. But if an insolvent trading entity's business was about to come to an end, there was no need to maintain liquidity and the paramount importance of the interests of the creditors prevailed over any need to pay debts as they fall due. The First Division stated (para 25):

> 'For these reasons we are of opinion that the need for a forced sale to provide immediate liquidity is not normally a factor that should be taken into account in determining the adequacy of consideration obtained for a sale of the debtor's assets in any case where the debtor has ceased business or is about to cease business.'

As a result, if a trading entity sold its principal asset, such as its principal place of business, the court would have to scrutinise the company's commercial situation in order to determine whether it was realistic for it to continue to trade (para 26).

[18] Carnbroe appeals to this court with this court's permission. In presenting Carnbroe's appeal, senior counsel makes three submissions. He submits that the central issue is whether the insolvent company's financial distress justified an urgent sale and that the Lord Ordinary reached a conclusion which was open to him on the evidence. The First Division therefore erred in interfering with his evaluation. It erred in placing a gloss on the statutory words and requiring a strict approach to the assessment of any departure from open market value when the alternative facing Grampian was a sale by the standard security holder or a sale by a liquidator, both of which could be categorised as a forced sale. The Lord Ordinary made no findings as to the likely outcome of such sales, which were the appropriate comparators. Secondly, the First Division erred in identifying the applicable legal policy. Senior counsel does not challenge the proposition that an insolvent company is in substance a trustee for its creditors but submits that a countervailing consideration is that the law should facilitate commercial transactions and promote commercial certainty. What the statute requires is the striking of a just balance between the creditors' interests and the interests of those contracting at arm's length with an insolvent company. The test of 'adequate consideration' takes account of both interests. He refers by way of analogy to statutory provisions in English law (1986 Act, sec 238) and in Australian law (Corporations Act 2001 (Act no 50 of 2001), secs 588FB, 588FC, 588FF) and submits that the test is whether the transaction was a commercial one which was satisfactory in all the circumstances rather than, as the First Division held, a strict approach to the words 'adequate consideration'. Thirdly, he submits that the First Division's judgment lacks commercial practicability: a purchaser in a commercial deal looks after its own

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interests and is entitled to exploit a vendor's financial distress to obtain a favourable price in an arm's length transaction. Sales at less than open market value are the norm where there are problems with liquidity. But the purchaser cannot know whether the vendor in pursuing an urgent sale has a realistic possibility of preserving its business or is otherwise acting in the interests of its creditors. If the First Division's analysis were correct, prudence would require the purchaser to refuse to deal with a company in distress and instead wait to see if a formal insolvency eventuated which would enable it safely to purchase from a liquidator.

Discussion

(i) Statutory provisions

[19] Section 242 of the 1986 Act enables among others the liquidator of a company to challenge a gratuitous alienation in Scotland if the alienation took place not earlier than two years before the commencement of the winding up or not earlier than five years before that date if the alienation favours an associate of the company. Subsection (4) provides:

> 'On a challenge being brought under subsection (1), the court shall grant decree of reduction or for such restoration of property to the company's assets or other redress as may be appropriate; but the court shall not grant such a decree if the person seeking to uphold the alienation establishes–
>
> (a) that immediately, or at any other time, after the alienation the company's assets were greater than its liabilities, or
> (b) that the alienation was made for adequate consideration, or . . .
>
> Provided that this subsection is without prejudice to any right or interest acquired in good faith and for value from or through the transferee in the alienation.'

[20] Several points may be made about the sec 242. First, the liquidator or creditor is entitled to make the challenge if the alienation occurs at a date not less than two years before the commencement of the winding up or five years before that date if the transferee is an associate of the insolvent company (sec 242(3)). Secondly, subject to the next point, the court must give at least one of the remedies specified (sec 242(4)). Thirdly, to prevent the court from giving such remedies, the transferee of the alienation must establish one of the listed circumstances (sec 242(4)(a)–(c)). In this case the circumstance which Carnbroe asserts is that the alienation was made for adequate consideration. The burden is thus placed on the transferee to establish that the consideration given for the alienation was 'adequate'. Fourthly, as I shall show when I discuss case law below, the test as to whether the consideration is adequate is an objective test. Fifthly, where a remedy is given against the transferee, the subsection protects any right or interest which a third party has acquired in good faith and for value from or through the transferee (the proviso in sec 242(4)). This is relevant to the interest of the bank in this case.

[21] Section 242(7) preserves the Scots common law of challenges to gratuitous alienations by providing that a liquidator and an administrator have the same right as a creditor has under any rule of law to challenge an alienation of a company made for no consideration or no adequate consideration.

[22] Section 242 of the 1986 Act applies to corporate insolvency a regime for challenging gratuitous alienations which was introduced in sec 34 of the Bankruptcy (Scotland) Act 1985 (cap 66), which governs the bankruptcy of

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natural persons and partnerships in Scotland, following a recommendation of the Scottish Law Commission in its 1982 report on bankruptcy and related aspects of insolvency and liquidation (no 68). The relevant provision in bankruptcy is now sec 98 of the Bankruptcy (Scotland) Act 2016 (asp 21) ('the 2016 Act'), but I will focus on the predecessor statute in discussing the genesis of the relevant provisions. Essentially the same regime was introduced into corporate insolvency by sec 75 of, and para 20 of sch 7 to, the Bankruptcy (Scotland) Act 1985 which inserted sec 615A into the Companies Act 1985 (cap 6). Thereafter, it was replaced by the provision in the 1986 Act. I therefore refer to the new regime for gratuitous alienations as 'the 1985 statutory reforms'. In Ch 12 of the report which led to the 1985 statutory reforms, the Scottish Law Commission set out its proposals to make more consistent the rules of Scots law, both common law and statutory, in relation to the challenges to gratuitous alienations and unfair preferences to creditors on insolvency.

[23] Scots common law has built on the principle of the *actio Pauliana* in Roman law which allowed a challenge to a gift made by an insolvent donor on the basis that the gift was a fraud upon his or her creditors. Under Scots common law it is not necessary to prove an intention to defraud if the creditor mounting the challenge can show three things: (i) the debtor was absolutely (ie balance sheet) insolvent at the time of the challenge and was either insolvent (in that sense) at the time of the alienation or was made insolvent by it, (ii) the alienation was made without onerous consideration, and (iii) the alienation prejudiced the challenging creditor. As it was difficult for a creditor to prove such insolvency at the date of the alienation, the Scottish Parliament by the Act of 1621(APS c 18) ('the 1621 Act') strengthened the creditor's position in challenges to alienations which an insolvent made to a 'conjunct and confident person' (ie a close relative, business partner, employee etc to whom money or assets were often secretly transferred) 'without true, just and necessary causes' by creating factual presumptions which the transferee had to rebut. The 1621 Act, which the Scottish courts interpreted liberally, had the effect that, if the creditor could establish that the debtor was insolvent at the date of the challenge, it was presumed both that the debtor had been insolvent at the date of the alienation and that the alienation was made without onerous consideration. It was not necessary that the alienation be wholly gratuitous as the challenge could be made to an alienation which was for a materially inadequate consideration in money or money's worth. Under both the common law and the 1621 Act the challenger of the transaction did not have to prove that the debtor or the transferee was aware of the debtor's insolvency or that the debtor was seeking to harm his creditors (*McCowan v Wright* (1852), per Lord Justice Clerk (Hope), p 970). Under the 1621 Act the challenger had to prove only the debtor's insolvency at the date of challenge and that the challenger was prejudiced by the transaction if it was at an undervalue. Nor is it necessary when alleging fraud at common law, as a general rule, to prove that there was fraud or complicity on the part of the recipient of the alienation (*McCowan v Wright* (1853), per Lord Justice Clerk (Hope), pp 496–504, per Lord Cockburn, p 509, per Lord Wood, pp 512–515). A successful challenge led to the annulment of the alienation; where there had been a purchase at an undervalue there was no requirement that the retransfer of the property to the debtor's estate was conditional upon the repayment of the consideration which the transferee had paid (*Tennant v Miller*).

[24] Both Scots common law and the 1621 Act protected a third party who took the alienated property from the transferee in good faith and for value; in

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such a circumstance the only remedy for the creditor or insolvency practitioner was to claim the sale proceeds from the transferee. The common law and the statutory provisions have been applied to companies as well as other debtors (*Abram Steamship Co Ltd and the Liquidator v Abram*; *Bank of Scotland v RW Forsyth Ltd*).

[25] Alongside these provisions concerning gratuitous alienations, Scots common law allowed creditors of an insolvent to challenge as fraudulent preferences voluntary preferences which the insolvent granted to a creditor during insolvency. Such fraudulent preferences could take the form of a grant of security for a prior debt or facilitating a creditor's attempt to execute diligence or obtain a decree to enforce the debt. The common law was reinforced by another Act of the Scottish Parliament in the Act of 1696 (Act for Declaring Nottour Bankrupt) (APS c 5) ('the 1696 Act'), which nullified all deeds which a bankrupt granted within 60 days before or during his insolvency and which gave a preference to a creditor over other creditors. Like the 1621 Act, the courts gave this Act a broad interpretation.

[26] The Scottish Law Commission's expressed aim in promoting the reform proposals was to achieve a consistent and logical scheme for the annulment of alienations and unfair preferences. There is no suggestion of an intention fundamentally to alter the law in relation to gratuitous alienations on the repeal of the 1621 Act. Section 242 of the 1986 Act reflects many of the Commission's recommendations. The wording of the remedies which the court was empowered to give in sec 242(4) tracks the Commission's recommendation in para 12.19 of the report but there is no discussion in the report of any prior case law on the nature of the remedy or remedies open to the court and no statement of policy to explain the recommendation. The report thus gives no guidance as to whether it was envisaged that the court would enjoy a discretion in devising a remedy. I return to this matter below (paras 44–69).

[27] Both before and after the 1985 statutory reforms, the consequence of the annulment of an alienation by reduction was and is that the property is transferred back to the insolvent's estate. If the court is not empowered to or does not impose conditions on the reduction, the transferee who has paid a substantial but inadequate consideration may only have a claim in unjustified enrichment against the insolvent's estate for repayment of the consideration paid. In making that claim the transferee ranks as an ordinary creditor and may receive only a dividend or nothing at all, depending upon the balance between the insolvent's assets and the debts due to secured creditors and other creditors. A claim for the recovery of the transferred asset itself or the proceeds of its sale ranks as a postponed debt (Insolvency (Scotland) Rules 1986 (SI 1986/1915), r 4.66(2)(a), which has now been replaced by the Insolvency (Scotland) (Receivership and Winding Up) Rules 2018 (SSI 2018/347), r 7.27).

[28] There are three principal innovations in the 1985 statutory reforms which are relevant in this case. The first is that the presumptions in the 1621 Act which applied only to alienations to 'conjunct and confident persons' have been extended to all gratuitous alienations, including those in which a purchaser at arm's length buys an asset from the insolvent at an undervalue. The second is the introduction of new time-limits for the challenge: the difference between associates and other transferees now lies only in the provision of different time-limits isec 242(3) of the 1986 Act (see para 20). The third is the specification in sec 242(4) of the different remedies available to the court in place of a statutory statement that the transaction was a nullity.

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(ii) Adequate consideration

[29] As I have said, before the 1985 statutory reforms to the Scottish law of insolvency, an alienation could be challenged not only if it was wholly gratuitous but also if it was at an undervalue. What amounted to a relevant undervalue before 1985? The leading Scottish textbook on bankruptcy before the 1985 statutory reforms was Goudy, *A Treatise on the Law of Bankruptcy in Scotland*, which provided a commentary on both the common law and the Bankruptcy (Scotland) Act 1913 (3 & 4 Geo 5 cap 20), which was repealed in 1985. Goudy answered the question by explaining what was not an undervalue. His analysis of the prior case law was that at common law consideration for an alienation was not an undervalue if it was 'fairly equivalent to what is received' (p 25) and similarly, under the 1621 Act if, it was 'fairly adequate for what was given' (p 47). Support for Goudy's view can be found in Bell, *Commentaries on the Laws of Scotland* (ii, 179) which, in a commentary on the 1621 Act, stated:

> 'In proving the consideration of the deed, every case must depend on its own circumstances. It may be observed, however, in general, 1. That it is not in all cases necessary to prove that the highest price possible has been got for the subject; but quite sufficient if what is commonly called a fair price has been received, ie a price, which, in the whole circumstances of the case, indicates a fair and *bona fide* transaction.'

The Lord Justice Clerk (MacDonald) in the Second Division of the Inner House used the concept of 'fair consideration' in *Gorrie's Trs v Gorrie* (p 1054). See also *Earl of Glencairn v Birsbane* in which a defence that adequate consideration had been given was held to be relevant in the face of an assertion by the pursuer that he would have paid more, and *Miller's Tr v Shield* (per Lord Curriehill, p 828) in which, in a challenge to an allegedly unfair preference under the 1696 Act, the First Division treated the transfer of goods for an 'adequate' sum as causing no prejudice to the insolvent's creditors.

[30] The courts have adopted a similar approach to adequate consideration since the 1985 statutory reforms. The leading Scottish authority on the meaning of 'adequate consideration' in sec 242 of the 1986 Act is the opinion of Lord Cullen, when he was a Lord Ordinary, in *Lafferty Construction Ltd v McCombe*. Both the appellant and the respondents accepted his statement as the proper approach to adequacy under sec 242(4)(b). He stated (p 861):

> 'In considering whether alienation was made for ''adequate consideration'', I do not take the view that it is necessary for the defender to establish that the consideration for the alienation was the best which could have been obtained in the circumstances. On the other hand, the expression ''adequate'' implies the application of an objective standpoint. The consideration should be not less than would reasonably be expected in the circumstances, assuming that persons in the position of the parties were acting in good faith and at arm's length from each other.'

[31] Lord Eassie expressed a similar opinion in relation to the identical term in the equivalent provision in sec 34(4) of the Bankruptcy (Scotland) Act 1985 in *Kerr v Aitken* (p 282), in which he stated:

> 'In my opinion the expression ''adequate consideration'' means the giving of a consideration which might objectively be described as being a reasonable prestation for the property conveyed by the bankrupt to the transferee had the

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transaction taken place between parties acting at arm's length in ordinary commercial circumstances.'

The only qualification which I would make to Lord Eassie's formulation is that I would not speak of 'ordinary commercial circumstances', but, like Lord Cullen, would look to the circumstances of the case, which might (as I discuss in para 34) in an appropriate case include the seller's need to obtain a prompt sale to protect its cash flow in a liquidity crisis.

[32] Both judges correctly emphasise the objective nature of the test and that regard must be had to the commercial justification of the transaction in all the circumstances on the assumption that hypothetical people in the position of the insolvent and the transferee would be acting in good faith and at arm's length. In my view, the requirement that the hypothetical parties are acting at arm's length means that the hypothetical purchaser would not have knowledge of the seller's financial distress unless the insolvent's financial embarrassment was known in the relevant market. It would not be a relevant consideration that the actual vendor had disclosed its financial embarrassment to the purchaser and that the purchaser had exploited that disclosure in its negotiation of the purchase price. There is nothing to suggest that the 1985 statutory reforms sought to innovate in this regard. As a result, the statutory provisions apply during the specified period before formal insolvency (in this case liquidation) whether or not the insolvent is aware of his, her or its insolvency and whether or not the transferee or purchaser is so aware.

[33] One of the relevant circumstances is the fact of the bankrupt's insolvency. As Lord Drummond Young records in para 13 of the Inner House's opinion, by reference to Bell, *Commentaries* (ii, 171–172), the restoration to the bankrupt's estate of assets gratuitously alienated is based on the principle that on the occurrence of insolvency, it is the creditors who have the real interest in the bankrupt's assets and the bankrupt must manage those assets in such a way as to protect their interests. There is an analogous principle in UK company law which, on the occurrence of insolvency, requires company directors to have regard to and act in the interests of the company's creditors as part of their fiduciary duties owed to the company as a whole (*Liquidator of West Mercia Safetywear Ltd v Dodd*; Companies Act 2006 (cap 46), sec 172(3). The mischief which led to the enactment of the 1621 Act was the practice of bankrupts of creating secret trusts in favour of family members or close associates to protect their assets from their creditors. That mischief remains relevant. But the current statutory regime and the common law extend to business transactions at arm's length and require the insolvent vendor to obtain an adequate consideration for its assets in the interests of its creditors, if a successful challenge is to be avoided.

[34] Another relevant consideration, as the Inner House states, is the objective purpose of the sale. As is clear from the expert evidence in this case, there is generally a close relationship between the time which is spent on marketing a commercial property and the price at which it will sell. Such property, if sold in a hurry, will usually obtain a significantly lower price than if it were exposed to the market for a longer period. On the occurrence of insolvency, the requirement that the insolvent has regard to the interest of creditors points towards the hypothetical vendor in the objective assessment having to carry out an adequate marketing exercise to obtain a good price for the property. If the insolvent's property is not exposed to the market but is disposed of by private sale, there is an obvious risk of an inadequate price. But there may be circumstances in which an insolvent, acting

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in the interests of its creditors, needs to achieve a quick sale. An example of such a sale is where the insolvent is facing a liquidity problem and needs to obtain cash to pay its debts promptly in the hope of trading out of insolvency and preserving its business as a going concern. In such a circumstance, it may be objectively reasonable for the insolvent to accept the lower price from a quick sale of an asset in order to gain the chance of saving the business, as that outcome is likely to be in the interests of its creditors.

[35] An analogous example is *John E Rae (Electrical Services) Linlithgow Ltd v Lord Advocate* in which an insolvent company, in order to continue to trade, needed certificates from the Inland Revenue that exempted it from the requirement that persons who employed it as a contractor or subcontractor should deduct tax from payments made to it. To obtain those certificates from the Inland Revenue the company granted a bond in respect of past tax liabilities of an associated company, whose business had been transferred to the company, arising from underpayments of income tax and national insurance contributions in respect of payment made to subcontractors. The liquidator raised an action under sec 242 of the 1986 Act in which he sought reduction of the bond and repayment of sums which had been paid to the Revenue under it on the basis that it was an alienation in favour of the associated company. But Lord Clyde rejected the liquidator's challenge. Adequate consideration had been given because the company, in return for undertaking to pay the associated company's debt, had obtained in effect the right to continue trading and had thus staved off its imminent demise. That approach may be questioned where there is no evidence to show that the projected cash flow advantage, which the certificates gave the company, was measurable in money or money's worth and, as so measured, was adequate as Lord Cullen's formulation envisages. But if there is such evidence, that approach accords with the section.

[36] Where there is no question of a sale to preserve a company's liquidity or otherwise in the hope of enabling it to remain in business, and where the insolvent company is ceasing or has ceased to carry on business and is, in reality, winding up its business in an informal way without the involvement of a liquidator or an administrator, what is an adequate consideration?

[37] The answer, in the context of the objective exercise which the law mandates, will depend upon the circumstances of the insolvency. The aim of the common law and sec 242 is to make sure that the creditors of the insolvent company are not prejudiced by an alienation by that company which brings into the insolvent estate materially less than would be obtained in an arm's length transaction between *bona fide* commercial parties in the circumstances of the case. Where the directors of the insolvent company, mindful of their duty to creditors, have an opportunity to place a property on the market and carry out a proper marketing exercise to enhance the price which the property will command, 'adequate consideration' should be measured against the likely result of such an exercise. Where the insolvent company is not able to support such a marketing exercise, the adequacy of the consideration achieved on a sale is to be measured by comparing the consideration which the insolvent company has accepted against the likely outcomes which a formal insolvency would achieve through the sale or other disposal of the asset by a liquidator or administrator, taking into account the fees which the insolvency practitioner would charge for effecting the sale. Where the asset in question is the subject of a security with a power of sale, it would be relevant also to consider the likely outcome of that sale. The aim of the common law and sec 242 in that context is to make sure that the creditors of the insolvent

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company are not prejudiced by an alienation by that company which brings into the insolvent estate materially less than would be obtained by the formal insolvency process or the sale by the security holder.

[38] A liquidator is under a fiduciary duty to the company, and possibly its creditors as a class, to exercise the professional care and skill of an insolvency practitioner in realising the assets of an insolvent company (*Hague v Nam Tai Electronics Inc*; *Oldham v Kyrris*; see by analogy Lightman and Moss, *The Law of Administrators and Receivers of Companies*, para 12.042). The liquidator must take reasonable care in choosing the time at which to sell the property and must also take reasonable care to obtain the best price that the circumstances of the case, as he reasonably perceives them, permit (*Re Charnley Davies Ltd (No 2)*, per Millett J, pp 775, 776; *Silven Properties Ltd v Royal Bank of Scotland plc*, per Lightman J, para 25). The holder of a standard security is under a statutory duty when selling the security subjects:

> '[T]o advertise the sale and take all reasonable steps to ensure that the price at which all or any of the subjects are sold is the best that can reasonably be obtained.' (Conveyancing and Feudal Reform (Scotland) Act 1970 (cap 35), sec 25.)

[39] In my view, where the directors of an insolvent company are conducting an informal winding up by disposing of the company's assets and are unable as a result of circumstances beyond their control to carry out a full marketing exercise, the sale should be measured against that standard. Senior counsel for Carnbroe accepts the approach of comparing a private sale with a sale in a winding up or a sale by the holder of the standard security in his submission to the court that the Inner House has erred in adopting a comparison with the open market value. But it is necessary to have regard to these duties imposed on the insolvency practitioner and the holder of a standard security when making the comparison which he advocates.

(iii) Application of the law to the facts of this case

[40] It is clear from the evidence of Mr Quinn that after Grampian's invoice factor withdrew its factoring facility, he was not able to obtain alternative funding and so disposed of the assets by which Grampian carried on its business. The sale of the property, which was Grampian's distribution centre, following the sale of its vehicles was in effect part of an informal winding up of the business. There is no justification for the off-market sale of the property at a price so far below market value on the ground of urgency. There was no evidence that Grampian had sought NatWest's agreement that it should place the property on the open market. Even if one can infer from Mr Quinn's evidence that such a marketing exercise was not possible, Carnbroe has not established that there was adequate consideration as it led no evidence to support the view that a sale by NatWest or a sale by the liquidator with NatWest's consent would have been likely to achieve a price net of expenses which was comparable to or less than the sale price which Grampian accepted. The Inner House was therefore entitled to interfere with the Lord Ordinary's assessment as to whether there had been adequate consideration.

[41] In reaching this view, I have sympathy for the predicament of the Lord Ordinary as Carnbroe ran its defence on the basis that an urgent sale was required to preserve Grampian's business and it does not appear from the pleadings and written submissions which were provided to this court that the

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liquidators' legal team challenged this submission. It does not appear that they argued, as they did in the Inner House, that the evidence did not support the justification of the discounted price on the basis of urgency because Grampian's business was at an end. If there were such a failure, it might in other circumstances have justified a modification of an award of expenses. But in this case Carnbroe's failure to pay the whole of the contracted purchase price until after the proof had been completed caused the Lord Ordinary to award expenses in favour of the liquidators, notwithstanding that they lost before him. There is, therefore, no basis for interfering in the award of expenses at first instance.

[42] Absent evidence that the £550,000 which Carnbroe eventually paid for the property was equivalent to the price which NatWest or a liquidator would be likely to obtain for the property after deduction of the likely expenses of sale and other costs incurred as a result of a delay in achieving the sale, Carnbroe failed to establish that the property had been sold for adequate consideration. I therefore agree with the conclusion of the Inner House, albeit for reasons which are not precisely the same.

[43] That would be sufficient to dispose of the appeal if the question of remedies had not arisen in debate. I therefore turn to that question.

(iv) Statutory remedies

[44] To provide context for discussing the remedies which the court can give to reverse a gratuitous alienation, it may be useful to summarise the position. First, at common law and under the 1986 Act it is not a condition of a challenge to a transaction that either the transferor or the transferee has knowledge of the transferor's insolvency. Where the alienation that is wholly gratuitous is made by an insolvent to his or her family or to a close business associate one would expect in the normal course that the insolvent transferor and the transferee would have some knowledge of the transferor's financial difficulty. But no such knowledge need be proved. Secondly, the 1985 statutory reforms for the first time have imposed on a transferee, who is not an associate of the insolvent transferor, the burden of establishing the circumstances in sec 242(4) which exclude the court's power to reverse the alienation. This is a point to which I will return below (para 62). Thirdly, the test for 'adequate consideration' is an objective test which takes account of all the circumstances, including circumstances of which one or both of the parties to the transaction may not have been aware, such as the transferor's insolvency and the objective purpose of the transaction.

[45] There is therefore a significant risk that a *bona fide* purchaser without knowledge of the seller's insolvency or the reason why the seller is willing to sell at a price substantially below open market value may be exposed to a challenge which he or she cannot defend. It is not realistic in a commercial negotiation to expect a purchaser to ask a seller why he or she is not demanding a higher price. It was this concern that caused the court during the hearing to raise the question of the court's discretion in giving a remedy under sec 242(4) of the 1986 Act. In response, counsel referred the court to three cases which addressed the equivalent provision in personal bankruptcy (Bankruptcy (Scotland) Act 1985, sec 34(4)), which provided that on a challenge being brought 'the court shall grant decree of reduction or for such restoration of property to the debtor's estate or other redress as may be appropriate'.

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[46] In the first, *Short's Tr v Chung (No 1)*, a man purchased two flats at a significant undervalue from an insolvent and conveyed them for no consideration to his wife. The insolvent's permanent trustee successfully challenged the sales as gratuitous alienations. Before the Lord Ordinary and on a reclaiming motion to the Second Division the wife, whose husband had died before the challenge, submitted that the court had a discretion under sec 34(4) to make an appropriate order, which, she submitted, was not a reduction of the dispositions but an order for payment of the difference between the price which her husband had paid and the market value of the flats at the date of the alienation. It does not appear that the wife, who as the ultimate transferee was the defender of the action, argued that it was inequitable to reduce the dispositions because she would not be able to recover the (inadequate) consideration paid. This may be because her husband had paid the consideration and she had been a gratuitous disponee of the flats from him. It is not clear from the report that she had title to seek repetition of the price which he had paid. The argument of her counsel was that it was inequitable to reduce the dispositions (a) because the wife would rank as a postponed creditor in the insolvency under sec 51(3)(c) of the Bankruptcy (Scotland) Act 1985, which governed her right to recover the properties or the proceeds of their sale and (b) because the properties had increased in value significantly since the date of the alienation. The Second Division (the Lord Justice Clerk (Ross), Lord McCluskey and Lord Sutherland) upheld the trustee's contention that the section did not give the court a general equitable discretion and that the statutory words, 'or other redress as may be appropriate', were designed to enable the court to make an appropriate order in a case where reduction or restoration of the property was not available as a remedy. In the opinion of the court, which Lord Sutherland delivered, it is stated (p 476):

> 'The starting point in a case of this nature for interpretation of section 34(4) [of the Bankruptcy (Scotland) Act 1985] is that the original alienation has been avoided and the transaction has been vitiated. This is not a good starting point for an argument which is based solely on equity. It is in our opinion clear from a reading of section 34(4) that the general purpose is to provide that as far as possible any property which has been improperly alienated should be restored to the debtor's estate. In the case of a disposition of heritable property this can easily be done by reduction of that disposition. We consider that the reference to ''other redress as may be appropriate'' is not intended to give the court a general discretion to decide the case on equitable principles but is designed to enable the court to make an appropriate order in a case where reduction or restoration of the property is not a remedy which is available.'

[47] The Second Division (the Lord Justice Clerk (Cullen), Lord McCluskey and Lord Morison) confirmed this approach in the second case, *Cay's Tr v Cay*. In that case an insolvent transferred to his wife £34,885.11, which were the proceeds of sale of his share of a fishing licence. In response to a challenge by the insolvent's permanent trustee, she argued that she had given adequate consideration because she had undertaken in return to pay and had paid certain of his debts amounting to over £20,000 and had undertaken to use the balance of the sum transferred to pay household bills. The court accepted that the undertaking to pay £20,000 towards the insolvent's debts was consideration but rejected the submission that the use of the balance to pay household bills could be treated as consideration as she was under a pre-existing statutory duty to aliment her insolvent husband. The court held that the undertaking to pay and payment of £20,000 was not adequate consideration and rejected her alternative argument that she was entitled to set off that sum

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against the demand for repayment of the sum which she had received, holding that sec 34(4) did not confer a general equitable jurisdiction on the court. The court stated (p 788):

> 'We consider the court in *Short's Trustee v Chung* correctly held that the section did not create any general discretion to decide on equitable principles to order something less than a full return of the alienated property.'

[48] The third case, *Baillie Marshall Ltd (in liquidation) v Avian Communications Ltd*, is an opinion of Lord Kingarth in the Outer House on a challenge to an unfair preference under sec 243 of the 1986 Act, in which subsec (5), providing for remedies, is in substantially the same terms as sec 34(4) of the Bankruptcy (Scotland) Act 1985 and sec 242(4) of the 1986 Act. In this case an insolvent company transferred its assets and business to the defender for a consideration which included the payment of the debts of the transferor company's trade creditors but not its other creditors. The liquidator did not seek to annul the alleged unfair preferences to recover funds from the trade creditors who had been paid their debts but concluded for payment by the defender of damages measured by the alleged loss to the remainder of the unsecured creditors. Lord Kingarth held that such a remedy was not available under sec 243. Referring to *Short's Tr v Chung (No 1)* and *Cay's Tr v Cay*, he stated (para 22):

> 'It seems to me to be reasonably clear, notwithstanding the apparent width of the language of [section 243(5)] (in particular ''or other redress as may be appropriate'') that the purpose of the section as a whole is to enable the liquidator (amongst others) to undo, so far as possible, what was done when the preference was created ... and, so far as possible, to restore the asset position of the company, diminished by the transaction which created the preference, for the benefit of the general body of creditors. There would appear to be no doubt that the primary remedies envisaged are reduction and restoration of property, and ... that the words ''or other redress as may be appropriate'' properly fall to be construed as relating to redress of the same character, and do not give the court a general equitable jurisdiction.'

[49] I am satisfied that the provisions in the 1986 Act providing remedies against gratuitous alienations (sec 242(4)) and unfair preferences (sec 243(5)) and the equivalent provisions in the bankruptcy legislation do not confer a general equitable jurisdiction. It is clear from the law before the 1985 statutory reforms that the principal remedy available in challenges to both gratuitous alienations and unfair preferences was the annulment of the impugned transaction. That remains the primary remedy after the 1985 statutory reforms. There is a strikingly contrasting juxtaposition in the Bankruptcy (Scotland) Act 1985 of the remedies made available to reverse gratuitous alienations and unfair preferences (secs 34(4) and 36(5) respectively) and the wider power which sec 35 conferred on the court to recall an order made against the insolvent on divorce for the payment of a capital sum. In contrast with secs 34(4) and 36(5), the court was enabled under sec 35, when deciding whether to order the repayment of the whole or part of a sum paid or property transferred, to have regard to the whole circumstances including the financial and other circumstances of the person against whom the order would be made. This conferred a general equitable jurisdiction which the statutory remedies for gratuitous alienations and unfair preferences do not entail.

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[50] It is also well established that the transferee of a gratuitous alienation or the recipient of an unfair preference cannot set off sums due to it by the insolvent for different purposes as that would defeat the purpose of secs 242 and 243 of the 1986 Act (*Raymond Harrison & Co's Tr v North West Securities Ltd*, p 724E; *John E Rae (Electrical Services) Linlithgow Ltd v Lord Advocate*, p 791; *Cay's Tr v Cay*, pp 787, 788).

[51] But commentators on the statutory provisions have criticised the disproportionate consequence of annulling the transaction when the transferee has paid a significant albeit inadequate sum for the alienated property and is made to rank as an ordinary creditor in relation to his claim for unjustified enrichment (St Clair and Drummond Young, *The Law of Corporate Insolvency in Scotland*, para 3.10). An order for the restoration of the property to the insolvent company, which leaves the transferee to prove in competition with other creditors for the price which it originally paid, not only is harsh on the transferee but also gives the general body of creditors an uncovenanted windfall as the company would not have received the price but for the impugned sale.

[52] Counsel in their written submission for Carnbroe point out the anomalous results to which *Short's Tr v Chung (No 1)* can give rise. They set out four circumstances. First, if an insolvent dispones heritable property gratuitously to a transferee, who holds it when the liquidator mounts a challenge under sec 242 of the 1986 Act, reduction is available and the company receives back the property but obtains no windfall at the transferee's expense. Secondly, if the gratuitous transferee sells the property to a *bona fide* third party for full value before the liquidator's challenge, the court would grant 'other redress' which would be an order to account to the liquidator for the value of the alienated property obtained in that sale. This would achieve essentially the same financial outcome as reduction in the first example. If, thirdly, the transferee paid a consideration for the property which was substantial but was not 'adequate consideration', reduction of the disposition would have the effects which I discussed above (para 51): the creditors receive a windfall and the transferee is significantly worse off than if it had declined to purchase the property or if it had paid full value. Fourthly, if the purchaser/transferee in the third example has sold on to a *bona fide* third party for full value before the liquidator mounts a challenge, the court could only order 'other redress'. The court would have the power to order the payment to the insolvent estate of the shortfall of consideration in the original sale; the court would not have to order the purchaser/transferee to disgorge the whole of the onward sale price and rank as an unsecured creditor for the repayment of the price which it had paid in the original sale.

[53] Is the court constrained to interpret sec 242 of the 1986 Act so as to compel such a harsh and anomalous result as mentioned in para 51 when there is a sale at an undervalue? In my view it is not. The words themselves ('the court shall grant decree of reduction or for such restoration of property to the company's assets or other redress as may be appropriate') do not compel such an interpretation. The statutory phrase does not speak of the court granting 'remedy X, which failing remedy Y'. I do not see the *ejusdem generis* principle as a helpful tool in this case where the list comprises only two specific decrees. Further, the use of 'or' cannot have been intended to be exclusively disjunctive as there will be cases where an insolvency practitioner seeks the restoration of different types of property in the same action and may have conclusions for the reduction of dispositions and the reconveyance of heritable property as well as for payment of money which has

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been alienated. I would read 'or' in its context as being both conjunctive and disjunctive (ie 'and/or'). In my view the statutory words are broad enough to allow the court to take account of the consideration which a *bona fide* purchaser has paid the insolvent in devising an appropriate remedy.

[54] Counsel for the liquidators in their post-hearing written submissions advance two principal arguments against this conclusion. First, they rely on r 4.66 of the Insolvency (Scotland) Rules 1986, which has been re-enacted as r 7.27 of the Insolvency (Scotland) (Receivership and Winding Up) Rules 2018 for the contention that the transferee, which is subjected to a reduction of a disposition under sec 242 of the 1986 Act, is penalised by the designation of its claim for repetition of the purchase price which it has paid as a postponed debt, giving it the lowest priority in the distribution of an insolvent estate. In my view this assertion is misconceived. Paragraph 2(i) of the relevant rule provides that a postponed debt includes:

> '[A] creditor's right to any alienation which has been reduced or restored to the company's assets under section 242 or to the proceeds of sale of such an alienation.'

It is clear from the plain words of this provision that the postponed debt is the transferee's right to reclaim the property which had been alienated or the proceeds of sale of that property. It addresses the right of a transferee to reclaim the property, which had been alienated and restored to the insolvent estate, if a surplus emerged in a winding up. It does not address the claim in unjustified enrichment of a transferee which has paid an inadequate consideration for the repetition of the sums which it has paid which is inconsistent with any right to a reconveyance of the property to the transferee. The provision therefore does not support a contention that Parliament intended to penalise the gratuitous alienee in relation to a claim for unjustified enrichment.

[55] Secondly, they submit that the Scottish Parliament has re-enacted the equivalent of sec 242 of the 1986 Act in personal insolvency (Bankruptcy (Scotland) Act 1985, sec 34(4)), which was the subject of the decisions in *Short's Tr v Chung (No 1)* and *Cay's Tr v Cay*, in sec 98(5) of the 2016 Act. Section 98(5) provides:

> 'On a challenge being brought under subsection (2), the court must grant decree–
>
> (a) of reduction, or
> (b) for such restoration of property to the debtor's estate, or such other redress, as may be appropriate.'

The 2016 Act is a consolidation Act which follows on the Scottish Law Commission's report on the consolidation of bankruptcy legislation in Scotland (no 232). It is intended to restate the law but not change it. Counsel for the liquidators submit that by re-enacting sec 34(4) of the 1985 Act in these terms the Scottish Parliament should be presumed to have endorsed the Inner House's approach in *Short's Tr* and *Cay's Tr* They refer in this regard to the '*Barras* principle' (*Barras v Aberdeen Steam Trawling and Fishing Co Ltd*; *R (N) v Lewisham London Borough Council*).

[56] The *Barras* principle is only a presumption and it is not without controversy. Lord Wilberforce and Lord Simon of Glaisdale doubted the validity of the principle in *Farrell v Alexander* (pp 74F–G, 90E–91C), Lord Neuberger of Abbotsbury has expressed strong reservations as to its propriety and its operation in *R (N) v Lewisham London Borough Council* (paras 143-148), and Lord Lloyd-Jones has

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expressed similar reservations in *R (Belhaj) v Director of Public Prosecutions (No 1)* (para 46). In any event, the principle cannot apply in this case as the 2016 Act is a consolidation Act (*Haigh v Charles W Ireland Ltd*, per Lord Diplock, p 40; *MacMillan v T Leith Developments Ltd*, per Lord Drummond Young, para 109). In para 109, Lord Drummond Young stated:

> 'If all that Parliament is doing in a consolidation statute is to reproduce the existing law, with no scope for significant change, it cannot be said that there is any genuine endorsement of any cases interpreting the statutes concerned. There is no power to do so.'

I agree with that statement; the representation of the same statutory phrase in two sub-paragraphs in sec 98(5) of a consolidation statute cannot amount to a parliamentary endorsement of prior case law.

[57] Even if such a presumption applied, I am not persuaded that it would be sufficient to support the liquidators' case. It would be necessary to put in the balance against it both the harsh and anomalous results which I have mentioned and the mismatch between the interpretation in *Short's Tr v Chung (No 1)* and *Cay's Tr v Cay* on the one hand and the established principled approach of Scots common law on the other, both of which are matters which the senior courts have not addressed.

[58] The general approach of the law is that when a person seeks to annul a transaction, for example, on the basis that a contract was induced by fraudulent or innocent misrepresentation, the court will only grant decree of reduction if it is able to place the defender substantially in the position it would have been in if the parties had not entered into the impugned contract (*Boyd and Forrest v Glasgow and South-Western Rly*, per Lord Atkinson, p 28, per Lord Shaw of Dunfermline, pp 36, 37). In *Spence v Crawford* the House of Lords made it clear that the court has power to order monetary adjustments to restore the defender to its pre-contract position. Lord Wright stated (p 77):

> '[R]estoration is essential to the idea of restitution. To take the simplest case, if a plaintiff who has been defrauded seeks to have the contract annulled and his money or property restored to him, it would be inequitable if he did not also restore what he had got under the contract from the defendant. Though the defendant has been fraudulent, he must not be robbed nor must the plaintiff be unjustly enriched, as he would be if he both got back what he had parted with and kept what he had received in return. The purpose of the relief is not punishment, but compensation.'

[59] It appears from the limited authorities that are available that the law before the 1985 statutory reforms provided as the only remedy the annulment of the gratuitous alienation if such annulment was possible. Where the alienation was wholly gratuitous, the question of restitution of the defender did not arise. But where the insolvent had sold at an undervalue the law did not provide for a general *restitutio in integrum* (*Tennant v Miller*). Similarly, in relation to fraudulent preferences, Bell, Commentaries (ii, 217), in addressing the 1696 Act (see para 25), stated:

> 'It may be questioned whether the success of the reduction is to be accompanied by a *restitutio in integrum*, so that the defender shall hold the same advantages when deprived of the security, which he would have enjoyed had he never accepted it. The answer seems to be, that a *restitutio in integrum* is no

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> part of the reduction on the Act 1696, nor necessarily implied as a condition of it; but that as the creditors are entitled to reduce only in so far as the deed is prejudicial to them, their success will be limited to the effect of restoring them to the full benefit of the rights they would have enjoyed had the deed never been granted.'

Bell went on to state, as an example, that if a creditor had renounced a security which he had held over any part of the insolvent's estate in exchange for the impugned security, he would be entitled to the full benefit of the old security when the new security was annulled, because it was only to the extent of the difference that the new security could be said to be prejudicial to prior creditors.

[60] Further, in *Thomas v Thomson*, which concerned an application by a trustee in bankruptcy to annul a security in the form of an *ex facie* absolute disposition on the ground that it was a fraudulent preference, the court ordered a partial reduction only, which preserved the security in so far as it secured a debt which was not a preference. The prior law was thus not wholly inflexible and allowed a partial *restitutio in integrum* in the context of the annulment of the document which effected the preference.

[61] Reduction was also not the only remedy under the prior law. Where the transaction could not be nullified, for example where property which an insolvent company had purchased from one of its directors at an overvalue had been sold to a third party in good faith and for value, the court allowed the liquidator to recover from the director a sum of money representing the difference between the inflated price paid and the true value of the property at the date of the transaction (*Abram Steamship Co Ltd and the Liquidator v Abram*). In that context the remedy reflected the disadvantage which the company's creditors had suffered as a result of the impugned transaction and gave them no windfall.

[62] The law before the 1985 statutory reforms appears to have been a partial exception to the general principle that the annulment of a transaction necessarily involved restoring the defender to its pre-transaction position. But there is only very limited case law on the point, which the Scottish Law Commission (no 68) did not discuss. The 1985 statutory reforms, by imposing on a purchaser, who is not an associate of the insolvent, the burden of proving adequate consideration was paid, have increased the risk that a *bona fide* purchaser may suffer injustice if there is no flexibility in the remedies which the court can give. Such an outcome would also deter rescue transactions involving the purchase of assets from distressed businesses and hamper the rescue culture which statutory insolvency law has sought to promote. These considerations point towards a more flexible interpretation of the remedies provided in sec 242(4) of the 1986 Act. But, as I have said, there is nothing in the Scottish Law Commission's report which explains the policy behind its recommendation which has found its way into sec 242.

[63] The court must therefore fall back on the statutory words, which are broad enough to allow the court in an appropriate case, and if justice requires it, to devise a remedy to protect the *bona fide* purchaser of property from a reversal of its purchase which would otherwise give the creditors of the insolvent a substantial windfall at its expense. The general approach to the annulment of transactions requires no more from a fraudster than that he or she compensate the victim, as Lord Wright stated in *Spence v Crawford* (see para 58). Section 242(4) does not mandate *restitutio in integrum* in every case. But neither does it exclude such restitution as part of the appropriate remedy.

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[64] It is not open to doubt that an insolvency operates adversely on the insolvent's unsecured creditors who have paid for goods or services which they have not received or have provided goods or services and not been paid. Gratuitous alienations or unfair preferences by an insolvent can cause further harm to unsecured creditors. The pre-1985 law, by not requiring full *restitutio in integrum*, had the benefit of discouraging transferees from entering into transactions by which an insolvent person transfers his or her assets gratuitously or at an undervalue. Since the 1985 statutory reforms, there may be circumstances in which the court considers it appropriate to annul a transaction which was a gratuitous alienation without also ordering the repayment of the inadequate consideration, thus leaving the transferee to rank an unsecured claim for unjustified enrichment in the insolvency. For example, business associates of an insolvent might knowingly seek to obtain property at an undervalue to the prejudice of the insolvent's creditors. The words of sec 242(4) of the 1986 Act leave open that option to the court. But there would in my view need to be clear statutory words to require the court in all circumstances to penalise the purchaser of property who had no knowledge or incomplete knowledge of the circumstances of the insolvent and who was not colluding to remove assets from the reach of the insolvent's creditors. There are no such words in the subsection.

[65] There will be cases in which, as the commentators have suggested, it would be wholly disproportionate and unfair to annul the property transfer without giving the *bona fide* purchaser credit for the consideration which it has paid. In my view, sec 242(4) gives the court sufficient power to devise an appropriate remedy. This does not involve a general equitable jurisdiction to take account of the personal and financial circumstances of the defender such as was envisaged by sec 35 of the Bankruptcy (Scotland) Act 1985 (now 2016 Act, sec 100). Nor does this approach call into question Lord Kingarth's conclusion that sec 243 of the 1986 Act (and by analogy sec 242) does not allow a liquidator to seek what was in substance damages from a defender. The question for the court is simply whether in devising a remedy for the gratuitous alienation by restoring property or value to the insolvent's estate in a particular case it should order that credit be given in some way for the consideration which a *bona fide* purchaser has paid. In so far as *Short's Tr v Chung (No 1)* and *Cay's Tr v Cay* held that the court did not have this power, I respectfully conclude that they were wrongly decided and should not be followed.

[66] The question of whether the subsection is consistent with Art 1 of Protocol 1 to the European Convention on Human Rights and Fundamental Freedoms does not arise in this context. This is because there is no need to read down the words of sec 242(4) to avoid a disproportionate result as there is nothing to prevent the court in a particular case from taking account of the consideration paid by the transferee in devising the remedy. Because of that determination, I also see no reason to question the conclusion which was reached in cases in the Outer House that Parliament acted within its wide margin of appreciation in providing for remedies against gratuitous alienations and unfair preferences in the 1985 statutory reforms without creating a general equitable jurisdiction that takes account of the defender's personal and financial circumstances (*Accountant in Bankruptcy v Walker*; *Johnston's Tr v Baird*).

[67] There may also be cases where the purchase of the alienated property is wholly funded by borrowings and the *bona fide* third-party lender's security is protected by the proviso to sec 242(4), enabling it to recover its lending by calling up its security or by allowing the liquidator to realise the secured asset in the

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winding up without pursuing recovery from its borrower other than as a formality. In such case there would be no call for the court to qualify in any way its annulment of the transfer as the interested parties themselves can achieve substantive *restitutio in integrum*.

[68] Counsel for the liquidators inform the court that the liquidators have recognised the validity of the bank's security by virtue of the proviso to sec 242(4). As a result, if the bank still had a claim for the sums it had lent to Carnbroe, Grampian's creditors would receive no windfall through the reduction of the disposition of the property. But in written submissions since the hearing, backed by supporting documents, counsel for Carnbroe inform the court that Carnbroe repaid its borrowings for the purchase of the property in July 2016. Counsel also explain that Carnbroe has recently refinanced and consolidated its borrowings by taking out a facility from Together Commercial Finance Ltd. Counsel state that the bank's securities over the property have been discharged and that there are now no securities covering the property. But these are not, as yet, agreed facts, in part because Carnbroe's lawyers have not authorised the bank to confirm the position to the liquidators' lawyers and in part because the refinancing by Together Commercial has occurred very recently. It ought to be straightforward for Carnbroe to provide documents to vouch these assertions to the liquidators and for the liquidator's advisers to search in the Land Register and at Companies House to avoid further dispute about these facts.

[69] In the light of this judgment and the absence of agreed facts, it is necessary to afford the First Division an opportunity to consider whether it is appropriate in the circumstances of this case to qualify the remedy of reduction which it has given to take account of all or part of the consideration which Carnbroe gave for the purchase, for example, by requiring the liquidators to pay a specified sum to Carnbroe as a condition of the reduction.

Conclusion

[70] I would allow the appeal but only to the extent that I would remit the case to the First Division to consider what is the appropriate remedy under sec 242(4) of the 1986 Act in the light of the court's power to give appropriate redress.

THE COURT allowed the appeal and remitted the case to the Inner House to consider appropriate remedy under sec 242(4) of the Insolvency Act 1986.

Harper Macleod LLP, Glasgow – Levy and McRae Solicitors LLP, Glasgow

ITEM NO. 162

JA-48

Privy Council

*Lau v Chu

[On appeal from the Court of Appeal of the Eastern Caribbean Supreme Court (Territory of the Virgin Islands)]

[2020] UKPC 24

2020 July 29, 30; Oct 12

Lord Hodge DPSC, Lord Briggs, Lady Arden, Lord Leggatt, Lord Burrows JJSC

Company — Winding up — "Just and equitable" ground for — Applicant and respondent each owning one of company's two issued shares in quasi-partnership — Breakdown in relationship between applicant and respondent — Applicant seeking company's winding up on grounds of functional deadlock and irretrievable breakdown of trust and confidence — Principles to be applied by judge when determining application — Whether judge entitled to take account of wider commercial dispute between applicant and respondent or limited to assessing ability to work together in relation to company subject of winding up application — Insolvency Act 2003 (Virgin Islands Act No 5 of 2003), s 162(1)(b)

The applicant and the respondent were Hong Kong-based businessmen who, having become friends and business colleagues, invested in a number of jointly-owned commercial enterprises including OSL, a Virgin Islands company in which they each owned one of the two issued shares and were its only directors. OSL had a wholly-owned subsidiary, PBM, a Hong Kong company, with the applicant and respondent again being its only directors. OSL and PBM were used as corporate vehicles for a joint venture with a state-owned entity of the People's Republic of China through a joint-venture company in which PBM was 49% shareholder and of which the applicant and respondent were directors. After their previously constructive relationship had broken down, and following abortive attempts to sever their business relationship by agreement, the applicant applied to the Eastern Caribbean Supreme Court for the winding up of OSL on the ground that it was "just and equitable" to do so for the purposes of section 162(1)(b) of the Insolvency Act 2003[1], alleging an irretrievable breakdown of trust and confidence between him and the respondent and functional deadlock in the management of OSL. The judge made the order sought. The Court of Appeal allowed the respondent's appeal on the grounds that the judge had: (i) wrongly taken into account disagreements between the applicant and respondent in relation to the joint-venture company when assessing whether there was deadlock in OSL; (ii) assessed the factual position at the date of trial rather than the date of the filing of the application; (iii) failed to take into account the applicant's freedom to sell his shares in OSL as a means of avoiding deadlock; and (iv) failed to consider alternative legal remedies reasonably available to the applicant before ordering a winding up as a last resort.

On appeal by the applicant—

Held, (1) that the principles set out in United Kingdom case law on statutory winding up on the "just and equitable" ground were applicable to an application made under section 162(1)(b) of the Insolvency Act 2003; that pursuant to those principles, properly understood, a just and equitable winding up could be ordered not only to resolve a functional deadlock, where an inability of members to co-operate in the management of the company's affairs led to an inability of the company to function at board or shareholder level, but also, if the company was a corporate

[1] Insolvency Act 2003, s 162: see post, para 10.

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A quasi-partnership, where there was an irretrievable breakdown in trust and confidence between the participating members such as would justify the dissolution of a true partnership; that although, when addressing the question of functional deadlock, it was the management of the company sought to be wound up that had to be addressed, in cases where the subject company was a corporate quasi-partnership no aspect of the business relationship between the quasi-partners was likely to be irrelevant, since what mattered was that relationship and the extent to which the B necessary basis of trust and confidence had evaporated; that although a quasi-partnership would normally be found where there was (i) a relationship of mutual confidence, (ii) an understanding that both shareholders would be involved in management and (iii) a restriction upon the ability of a member to transfer his interest in the company, it was not necessary to show all three of those indicia in every case; that, further, an applicant for a just and equitable winding up was not barred from that remedy merely because the breakdown or deadlock upon which he C relied had been caused to some extent by his own fault, or because of the availability of some other remedy, save where the respondent could show that the applicant unreasonably had failed to pursue some other available remedy; that where it was claimed that it was open to the applicant to avoid functional deadlock by selling his shares to a third party, the court would be alive to the possibility that the applicant might be unable to do so upon fair terms, so making the freedom to sell purely theoretical; and that there was no rule that an application for winding up on the just and equitable ground had to be justified solely by reference to the position as at the D date of the filing of the application (post, paras 9, 14–15, 17–21, 23, 25, 31, 39, 49, 72, 94).

In re Westbourne Galleries Ltd [1973] AC 360, HL(E) applied.

Eshelby v Federated European Bank [1932] 1 KB 254, DC disapproved.

(2) Allowing the appeal, that, applying those principles, there had been sufficient evidence before the judge to have allowed him to find there to have been a corporate quasi-partnership notwithstanding the absence of any restriction upon the ability of E the applicant to transfer his interest in the company; that the judge's finding that OSL was a quasi-partnership company had entitled him to take account of the disagreements between the applicant and the respondent in relation to the joint venture company; that the judge had also been entitled to assess whether the application was well-founded by reference to the factual situation as at the date of trial, although in any event he had also found deadlock and irretrievable breakdown of trust and confidence as at the date when the application was filed; that although F the judge had not in terms addressed the possibility that the applicant could have disengaged from his association with the respondent simply by selling his shares, the unlikelihood of his being able to secure a fair price for them in the circumstances had allowed the judge properly to ignore that question; that it had not been unreasonable for the applicant to confine himself to seeking a winding up rather than seeking other forms of relief; and that, accordingly, there had been no basis for the Court of Appeal to set aside the judge's order (post, paras 26–37, 39, 49–51, 56–61, 70–71, 72).

G *Per* Lady Arden JSC. I would allow the appeal also on the ground that the applicant was wrongly excluded from participation in the management of OSL, its subsidiaries and affiliates. There is no basis for confining exclusion from management to the case where a quasi-partner is removed from office as a director as opposed to making it effectively impossible in some other way for him to take part in the management of the company's businesses (post, paras 72, 85).

Decision of the Court of Appeal of the Eastern Caribbean Supreme Court H reversed.

The following cases are referred to in the judgments:

Asia Pacific Joint Mining Pty Ltd v Allways Resources Holdings Pty Ltd [2018] QCA 48; [2018] ACSR 227

Atwood v Maude (1868) LR 3 Ch App 369, CA

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Baird (James) & Co v Gimbel Bros Inc (1933) 64 F 2d 344
Bessounian v Australian Wholesale Mortgages Pty Ltd [2007] NSWSC 35
Blisset v Daniel (1853) 10 Hare 493
Cheung Hon Wah v Cheung Kam Wah [2005] 2 HKLRD 599
Company (No 2567 of 1982), In re a [1983] 1 WLR 927; [1983] 2 All ER 854
Cooper (Cuthbert) & Sons Ltd, In re [1937] Ch 392; [1937] 2 All ER 466
Eshelby v Federated European Bank [1932] 1 KB 254, DC
Fage UK Ltd v Chobani UK Ltd [2014] EWCA Civ 5; [2014] FSR 29, CA
Fildes Bros Ltd, In re [1970] 1 WLR 592; [1970] 1 All ER 923
Geoglobal Partners llc v Peaktop Technologies (USA) Hong Kong Ltd [2007] HKCFI 1286
Harrison v Tennant (1856) 21 Beav 482
Hawkes v Cuddy (No 2) [2009] EWCA Civ 291; [2009] 2 BCLC 427, CA
Hendry v Chartsearch Ltd [1998] CLC 1382, CA
Jacob (Walter L) & Co Ltd, In re [1989] BCLC 345, CA
Jenkins v Supscaf Ltd [2006] 3 NZLR 264
Loch v John Blackwood Ltd [1924] AC 783, PC
Lu Jun v Yu Qi [2011] HKCFI 1516
Maridive & Oil Services (SAE) v CNA Insurance Co (Europe) Ltd [2002] EWCA Civ 369; [2002] 1 All ER (Comm) 653; [2002] 2 Lloyd's Rep 9, CA
Moosa v Mavjee Bhawan (Pty) Ltd 1966 (3) SA 131
Ng Eng Hiam v Ng Kee Wei (1965) 31 MLJ 238, PC
Pease v Hewitt (1862) 31 Beav 22
Rackind v Gross [2004] EWCA Civ 815; [2005] 1 WLR 3505; [2005] 4 All ER 735, CA
Sailing Ship Kentmere Co, In re [1897] WN 58
Sim Yong Kim v Evenstar Investments Pte Ltd [2006] SGCA 23; [2006] 3 SLR 827
Strahan v Wilcock [2006] EWCA Civ 13; [2006] 2 BCLC 555, CA
Symington v Symington's Quarries Ltd (1905) 8 F 121, Ct of Sess
Wang Zhongyong v Union Zone Management Ltd (Claim No BVIHCMAP 2013/0024) (unreported) 12 January 2015
Westbourne Galleries Ltd, In re [1973] AC 360; [1972] 2 WLR 1289; [1972] 2 All ER 492, HL(E)
Wondoflex Textiles Pty Ltd, In re [1951] VLR 458
Yenidje Tobacco Co Ltd, In re [1916] 2 Ch 426, CA

The following additional cases were cited in argument:

American Pioneer Leather Co Ltd, In re [1918] 1 Ch 556
Chow Kwok Chuen v Chow Kwok Chi [2008] SGCA 37; [2008] 4 SLR 362
Company (No 709 of 1992), In re A [1999] 1 WLR 1092; [1999] 2 All ER 961, HL(E)
Company (No 3843 of 1986), In re A (1987) 3 BCC 624
Dalkeith Investments Pty Ltd, In re (1984) 9 ACLR 247
Davis & Co Ltd v Brunswick (Australia) Ltd [1936] 1 All ER 299, PC
Hendry v Chartsearch Ltd [1998] CLC 1382
Insurance Commission of Western Australia v Woodings [2018] WASC 44
Kam Leung Sui Kwan v Kam Kwan Lai (2015) 18 HKCFAR 501
Lawrence v Lawrich Motors (1948) (2) SA 1029
Mineralogy Pty Ltd v Sino Iron Pty Ltd [2017] WASC 340
Outram Societies Hall Co, In re (1914) 33 NZLR 1249
Paramount Powders (UK) Ltd, In re; Badyal v Badyal [2019] EWCA Civ 1644; [2020] BCC 152, CA
Roban Jig and Tool Co Ltd v Taylor [1979] FSR 130, CA
Rowe v Briant (unreported) 15 June 1995, Judge Weeks QC
Upper Hutt Town Hall Co, In re [1920] NZLR 125

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A *Vax Appliances Ltd v Hoover plc* (1990) RPC 656
Vujnovich v Vujnovich (1989) 5 BCC 740, PC

APPEAL from the Court of Appeal of the Eastern Caribbean Supreme Court

On 29 June 2017, in the Eastern Caribbean Supreme Court (High Court of Justice (Commercial Division)), sitting in the Territory of the Virgin Islands, Roger Kaye QC J (Ag) granted an application by the applicant, Lau
B Wing Yang, as against Ocean Sino Ltd ("the first respondent") and Chu Kong ("the second respondent") under section 162(1)(b) of the Insolvency Act 2003 for the appointment of liquidators over the first respondent on the ground that it was just and equitable that it should be wound up. On 17 January 2020 the Court of Appeal of the Eastern Caribbean Supreme Court (Blenman, Michel and Thom JJA) allowed an appeal by the second
C respondent and set aside the order for winding up and appointment of liquidators. Pursuant to leave granted by the Judicial Committee of the Privy Council (Lord Reed PSC, Lord Hodge DPSC and Lord Briggs JSC) on 23 June 2020 the applicant appealed.

The issues for the Board, as stated in the parties' agreed statement of facts and issues, were as follows. (1) Whether the Court of Appeal had been correct to hold that the trial judge had erred in taking into account, when
D making his finding that the first respondent was deadlocked, matters that were not directly related to the management of that company or its subsidiary, PBM Asset Management Ltd, and/or (b) matters occurring after the proceedings had been commenced. (2) Whether the Court of Appeal had been correct to hold that the absence of restrictions in the first respondent's constitutional documents on the transfer of its shares precluded a finding of
E deadlock. (3) Whether the Court of Appeal had been entitled, by reference to all the relevant evidence, to reverse the trial judge's finding that the first respondent was deadlocked (a) at the time that the proceedings were commenced and/or (b) at the time of the trial. (4) As an additional or alternative ground for allowing the appeal, whether the Court of Appeal should (or could) have determined that the degree of responsibility borne by
F the applicant for the state of affairs that existed between the parties was such that it was a wrongful exercise of the trial judge's discretion to wind up the first respondent. (5) Whether the Court of Appeal had been entitled to hold that there were alternative remedies reasonably available to the applicant, including but not limited to a court ordered buy-out. (6) Whether the Court of Appeal had been entitled to reverse the trial judge's exercise of his discretion to appoint liquidators.

G The facts are stated in the judgment of the Board, post, paras 1–4.

Philip Jones QC, *Rosalind Nicholson* (of the Virgin Islands Bar), *Daniel Warents*, *Renell Benjamin* (of the Virgin Islands Bar) and *Sparsh Garg* (instructed by *Walkers, Tortola, Virgin Islands* and by *Blake Morgan llp*) for the applicant.

H *Richard Hacker QC*, *John Carrington QC* (of the Virgin Islands Bar), *William Wong SC* (of the Hong Kong Bar) and *Michael Lok* (of the Hong Kong Bar) (instructed by *Charles Russell Speechlys llp*) for the second respondent.

The court took time for consideration.

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12 October 2020. The following judgments were handed down.

LORD BRIGGS JSC (giving the judgment of the Board)

1 Lau Wing Yan ("Mr Lau") and Chu Kong ("Mr Chu") are experienced Hong Kong based businessmen with complementary skills and experience. They became friends and business colleagues, investing in a number of jointly owned commercial enterprises, mainly in shipping and logistics. In November 2009 they together set up Ocean Sino Ltd ("OSL"), a British Virgin Islands ("BVI") company in which they each owned one of the two issued shares. They were its only directors. OSL has a wholly owned subsidiary, PBM Asset Management Ltd ("PBM"), a Hong Kong company. Again, Mr Lau and Mr Chu were its only directors.

2 OSL and PBM were Mr Lau's and Mr Chu's corporate vehicles for a joint venture with a state-owned entity of the People's Republic of China ("PRC"). The joint venture company was Beibu Gulf Ocean Shipping (Group) Ltd ("Beibu Gulf"), in which PBM held 49% of the shares. The remaining, and controlling, 51% was held by the PRC's corporate vehicle Beibu Gulf Holding (Hong Kong) Co Ltd ("PRC Holdco"). Both Mr Lau and Mr Chu were executive directors of Beibu Gulf, but a majority of the directors were appointees of PRC Holdco. Both Beibu Gulf and PRC Holdco were Hong Kong companies, and the intended business of Beibu Gulf was ship-owning, commodity trading and supply chain services all for dry bulk commodities.

3 In 2010 Beibu Gulf ordered a fleet of eight dry bulk carriers from shipbuilders. Four were delivered in 2012–13 but the orders for the remainder were cancelled. The purchase prices had been funded by contributions from PBM and PRC Holdco and from bank lending.

4 From (at the latest) early 2014 the previously constructive relationship between Mr Lau and Mr Chu broke down. That led first to an ultimately abortive attempt to sever their many business relationships by agreement and then to multiple legal claims and cross-claims, mainly in the courts of Hong Kong. In May 2015 Mr Lau applied to the BVI High Court for the winding up of OSL on the just and equitable ground, alleging (i) an irretrievable breakdown of trust and confidence between him and Mr Chu, and (ii) functional deadlock in the management of OSL (and therefore PBM) both at board and shareholder level.

5 After a six-day trial in May and June 2017, at which both Mr Lau and Mr Chu were cross-examined at length, (Acting) Justice Roger Kaye QC granted the relief sought, finding that both Mr Lau's main allegations had been proved. At the end of a careful (and prompt) reserved judgment he said:

> "I have no hesitation in finding that OSL (and thereby PBM) is in a completely hopeless state of irretrievable deadlock at board and shareholder level. Having seen and heard the two of them in the witness box and having regard to the evidence as a whole I can see absolutely no real prospect of Mr Lau and Mr Chu ever getting on together again in the future. They are hardly on speaking terms (save perhaps with a grimace). It is a true irretrievable breakdown. All trust and confidence between them has gone."

On the order of Wallbank J made on 28 July 2017 liquidators were appointed over OSL.

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A 6 In January 2020, on Mr Chu's appeal, the Court of Appeal of the Eastern Caribbean Supreme Court (Blenman, Michel and Thom JJA) unanimously reversed the judge and discharged the winding up order made by Wallbank J. They held that the judge had made the following four errors:

(a) He had wrongly taken into account aspects of the dissension between Mr Lau and Mr Chu which occurred at the Beibu Gulf level, which ought not to be taken into account in assessing whether there was deadlock in B OSL.

(b) He had failed to concentrate on the question whether OSL was deadlocked at the date of the filing of the application, rather than at the time of the hearing, and thereby failed to take into account evidence that Mr Lau and Mr Chu were able to negotiate and agree matters after May 2015, so that their breakdown in co-operation was not then irretrievable.

C (c) He had failed to take into account the freedom of Mr Lau and Mr Chu to sell their shares in OSL as a means of avoiding deadlock.

(d) He had failed to consider alternative remedies reasonably available to Mr Lau, such as a buy-out, before ordering a winding up as a last resort. The Court of Appeal therefore concluded that there had been no deadlock. Even if there had been, a winding up was not the appropriate remedy.

D 7 Mr Lau appealed to the Board. In outline, he claims that there had been no basis for the Court of Appeal to interfere either with the essentially factual finding of deadlock by the judge, or with his exercise of discretion to make a winding up order, rather than leave Mr Lau to some alternative remedy. On the specific errors identified by the Court of Appeal, Mr Lau submits as follows:

(a) The judge never lost sight of the need to examine whether OSL (and E PBM) rather than Beibu Gulf were deadlocked, and the matters arising at the Beibu Gulf level on which the judge relied were relevant to the management (or lack of it) of the affairs and interests of OSL and PBM.

(b) There is no rule that grounds for a just and equitable winding up must be established as at the date of filing the application, separately from the date of the hearing. Even if there is such a rule, the judge had found that the grounds (deadlock and irretrievable breakdown of trust and confidence) F were established as at the earlier date, and that there was ample evidence from which he did so.

(c) The judge had been aware that Mr Lau and Mr Chu were free to sell their shares in OSL, but that this was unlikely to secure for Mr Lau a fair price for his interest in the company.

(d) The judge had properly assessed alternative remedies available to G Mr Lau and concluded that he was not acting unreasonably in pursuing a winding up instead.

8 Mr Lau added a separate appeal against the costs order made against him by the Court of Appeal. For his part Mr Chu sought to support the decision of the Court of Appeal on four additional grounds. Both parties presented their cases by distinguished teams of counsel, led for Mr Lau by Mr Philip Jones QC and for Mr Chu by Mr Richard Hacker QC. OSL was H joined as a respondent but took no active part in the appeal.

Just and equitable winding up in the BVI

9 The jurisdiction to wind up a BVI company on the just and equitable ground is entirely statutory. It closely follows the similar jurisdiction in the

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UK, which dates back to the mid-19th century. The result is that the UK case law is the primary source of authority for the scope of the jurisdiction, and for the principles upon which it is to be exercised, although the Board was helpfully referred to a wealth of additional authority from around the common law world, in jurisdictions which have broadly followed the same model.

10 Jurisdiction to wind up in the BVI is expressed in terms of a power of the court to appoint a liquidator, in the Insolvency Act 2003. By section 159(1) the court may appoint the official receiver or an eligible insolvency practitioner as liquidator of a BVI company, on an application under section 162. That section provides, so far as is relevant, as follows:

> "(1) The court may, on application by a person specified in subsection (2), appoint a liquidator of a company under section 159(1) if . . . (b) the court is of the opinion that it is just and equitable that a liquidator should be appointed . . .
>
> "(2) Subject to subsections (3), (4) and (5), an application under subsection (1) may be made by one or more of the following: . . . (c) a member; . . ."

11 Section 167(3) of the 2003 Act provides as follows:

> "Where an application to appoint a liquidator is made by a member under section 162(1)(b), if the court is of the opinion that (a) the applicant is entitled to relief either by the appointment of a liquidator or by some other means; and (b) in the absence of any other remedy it would be just and equitable to appoint a liquidator; it shall appoint a liquidator unless it is also of the opinion that some other remedy is available to the applicant and that he is acting unreasonably in seeking to have a liquidator appointed instead of pursuing that other remedy."

12 By section 160 of the same Act a liquidation commences upon the appointment of a liquidator rather than, as in the UK, upon the date of the presentation of the petition to wind up, if an order to wind up is subsequently made.

13 Remedies in the alternative to a just and equitable winding up include relief for the company itself, available by means of a derivative action and relief available on proof of unfairly prejudicial conduct, under Part XA of the BVI Business Companies Act 2004. Relief for unfair prejudice includes a court order for a buy-out, the appointment of a receiver or the appointment of a liquidator under section 159 of the 2003 Act, on the just and equitable ground in section 162(1)(b).

14 A just and equitable winding up may be ordered where the company's members have fallen out in two related but distinct situations, which may or may not overlap. First, a winding up may be ordered to resolve what may conveniently be labelled a functional deadlock. This is where an inability of members to co-operate in the management of the company's affairs leads to an inability of the company to function at board or shareholder level. Functional deadlock of this paralysing kind was first clearly recognised as a ground for a just and equitable winding up by Vaughan Williams J in *In re Sailing Ship Kentmere Co* [1897] WN 58, a decision on the jurisdiction conferred by section 79 of the (UK) Companies Act 1862 (25 & 26 Vict c 89).

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A 15 Secondly, where the company is a corporate quasi-partnership, an irretrievable breakdown in trust and confidence between the participating members may justify a just and equitable winding up, essentially on the same grounds as would justify the dissolution of a true partnership. This jurisprudence was developed as an aspect of the law of partnership in England in the mid-19th century, and is exemplified in the following passage B from the judgment of Sir John Romilly MR in *Harrison v Tennant* (1856) 21 Beav 482, 496–497:

> "I do not base my decision upon any particular reported case, but upon the principle that the circumstances under which the parties entered into the partnership have, by matters over which they have no control, materially altered, that these altered circumstances have, combined with C the conduct of the parties themselves, produced a mistrust which the court cannot say is unreasonable; and that, taking all these things together, it is impossible that the partnership can be conducted upon the footing on which it was originally contemplated, without injury to all these persons concerned, and that taking all these matters together, it makes this a case in which, in my opinion, it is the duty of the court to pronounce a decree for the dissolution of the partnership." D

It is clear, for example from *Pease v Hewitt* (1862) 31 Beav 22 and *Atwood v Maude* (1868) LR 3 Ch App 369, 373, that a dissolution of a partnership might be ordered even where both parties were to blame for the breakdown in mutual trust and confidence.

16 This ground for the dissolution of a partnership was developed as the basis for the just and equitable winding up of a company in the UK in the early E 20th century, where the relationship between the members approximated to that of partners. Landmark cases include *Symington v Symington's Quarries Ltd* (1905) 8 F 121, a decision of the Scottish Court of Session, and in *In re Yenidje Tobacco Co Ltd* [1916] 2 Ch 426, a decision of the English Court of Appeal. In the latter case, at p 432, speaking of two businessmen holding equal shares in the company who had spectacularly fallen out, Lord Cozens-F Hardy MR said:

> "If ever there was a case of deadlock I think it exists here; but, whether it exists or not, I think the circumstances are such that we ought to apply, if necessary, the analogy of the partnership law and to say that this company is now in a state which could not have been contemplated by the parties when the company was formed and which ought to be terminated G as soon as possible."

17 The important potential distinction between the two types of breakdown case is this. If there is a complete functional deadlock, then a winding up may be ordered regardless whether the company is a corporate quasi-partnership. But if the company is of that type, then a breakdown of trust and confidence may justify a winding up even where there may not be a H complete functional deadlock. In the former case winding up is a remedy for paralysis. In the latter it is the response of equity to a state of affairs between individuals who agreed to work together on the basis of mutual trust and confidence where that trust and confidence has completely gone. But of course both may exist together, and a complete breakdown in trust and

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confidence may well be the cause of functional deadlock, in a two party quasi-partnership like the present.

18 The well-known leading case on whether a company is a quasi-partnership is *In re Westbourne Galleries Ltd; Ebrahimi v Westbourne Galleries Ltd* [1973] AC 360 ("the *Ebrahimi* case"). It contains a summary of the circumstances in which the relationship between the members of a company may cause their strict legal rights to be subjected to equitable considerations which has stood the test of time. At pp 379–380 Lord Wilberforce said:

> "The foundation of it all lies in the words 'just and equitable' and, if there is any respect in which some of the cases may be open to criticism, it is that the courts may sometimes have been too timorous in giving them full force.
>
> "The words are a recognition of the fact that a limited company is more than a mere legal entity, with a personality in law of its own: that there is room in company law for recognition of the fact that behind it, or amongst it, there are individuals, with rights, expectations and obligations inter se which are not necessarily submerged in the company structure.
>
> "That structure is defined by the Companies Act and by the articles of association by which shareholders agree to be bound. In most companies and in most contexts, this definition is sufficient and exhaustive, equally so whether the company is large or small. The 'just and equitable' provision does not, as the respondents suggest, entitle one party to disregard the obligation he assumes by entering a company, nor the court to dispense him from it. It does, as equity always does, enable the court to subject the exercise of legal rights to equitable considerations; considerations, that is, of a personal character arising between one individual and another, which may make it unjust, or inequitable, to insist on legal rights, or to exercise them in a particular way.
>
> "It would be impossible, and wholly undesirable, to define the circumstances in which these considerations may arise. Certainly the fact that a company is a small one, or a private company, is not enough. There are very many of these where the association is a purely commercial one, of which it can safely be said that the basis of association is adequately and exhaustively laid down in the articles. The superimposition of equitable considerations requires something more, which typically may include one, or probably more, of the following elements: (i) an association formed or continued on the basis of a personal relationship, involving mutual confidence—this element will often be found where a pre-existing partnership has been converted into a limited company; (ii) an agreement, or understanding, that all, or some (for there may be 'sleeping' members), of the shareholders shall participate in the conduct of the business; (iii) restriction upon the transfer of the members' interest in the company—so that if confidence is lost, or one member is removed from management, he cannot take out his stake and go elsewhere.
>
> "It is these, and analogous, factors which may bring into play the just and equitable clause, and they do so directly, through the force of the words themselves. To refer, as so many of the cases do, to 'quasi partnerships' or 'in substance partnerships' may be convenient but may

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also be confusing. It may be convenient because it is the law of partnership which has developed the conceptions of probity, good faith and mutual confidence, and the remedies where these are absent, which become relevant once such factors as I have mentioned are found to exist: the words 'just and equitable' sum these up in the law of partnership itself. And in many, but not necessarily all, cases there has been a pre-existing partnership the obligations of which it is reasonable to suppose continue to underlie the new company structure. But the expressions may be confusing if they obscure, or deny, the fact that the parties (possibly former partners) are now co-members in a company, who have accepted, in law, new obligations.

"A company, however small, however domestic, is a company not a partnership or even a quasi-partnership and it is through the just and equitable clause that obligations, common to partnership relations, may come in."

19 The *Ebrahimi* case reinforces the principle that an applicant for a just and equitable winding up is not barred from his remedy merely because the breakdown or deadlock upon which he relies has been caused to some extent by his own fault. As Lord Cross put it, at pp 383–384:

"People do not become partners unless they have confidence in one another and it is of the essence of the relationship that mutual confidence is maintained. If neither has any longer confidence in the other so that they cannot work together in the way originally contemplated then the relationship should be ended—unless, indeed, the party who wishes to end it has been solely responsible for the situation which has arisen."

20 It is well established that winding up is a shareholders' remedy of last resort. But this does not mean that winding up is unavailable to members if they have any other remedy. The member retains a significant element of choice in the remedy to be sought, even though the court has the last word. As is clearly enshrined in section 167(3) of the 2003 Act, the court carries out a three stage analysis, asking:

(a) Is the applicant entitled to some relief?

(b) If so, would a winding up be just and equitable if there were no other remedy available?

(c) If so, has the applicant unreasonably failed to pursue some other available remedy instead of seeking winding up?

21 The legal burden of proof is on the applicant at stages (a) and (b). But it shifts to the respondent at stage (c): see *Moosa v Mavjee Bhawan (Pty) Ltd* (1966) (3) SA 131, 152 and *Asia Pacific Joint Mining Pty Ltd v Allways Resources Holdings Pty Ltd* [2018] ACSR 227, paras 32 and 43. Section 167(3) is in substantially the same terms as was section 225(2) of the UK Companies Act 1948. In *In re a Company (No 2567 of 1982)* [1983] 1 WLR 927, 933, Vinelott J held that "other remedy" in section 225(2) was not limited to a statutory remedy provided only by the court. For example, an unreasonable refusal to accept a fair offer for the applicant's shares might bar relief by way of winding up. The Board agrees with this analysis.

22 With this general introduction to the relevant law it is now possible to address directly each of the criticisms of the judge's legal analysis by the Court of Appeal, accepting as it did that it was not enough for it simply to

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take a different view from the judge about the evidence or about his exercise of discretion.

Looking at the Beibu Gulf Level in assessing deadlock

23 It is necessary to start with a little more analysis of the law. Leaving aside corporate quasi-partnership, when addressing the question of functional deadlock it is the management of the company sought to be wound up that must be addressed. Deadlock about other matters is neither here nor there, if the subject company is still capable of being effectively managed, and decisions made about important aspects of the direction of its business and assets. Nonetheless the breadth of the parties' falling-out over other business matters may be very relevant to the court's assessment of the question whether an apparent deadlock within the subject company has become irremediable.

24 In concluding that the judge had impermissibly taken account of disputes between Mr Lau and Mr Chu at the Beibu Gulf level the Court of Appeal placed reliance on its previous decision in *Wang Zhongyong v Union Zone Management Ltd* (Claim No BVIHCMAP 2013/0024) (unreported) 12 January 2015. It was there held that exclusion of the applicant from the management of a company, which was not a subsidiary of the subject company, could not be relied upon as unfairly prejudicial conduct of the affairs of the subject company, relying upon *Rackind v Gross* [2005] 1 WLR 3505. *Union Zone* was not a deadlock case, nor was the subject company a corporate quasi-partnership. At para 53 Farara JA said:

> "The breakdown in the relationship between shareholders is not, in of itself, justification for winding up a company. For such a state of affairs to rise to the level of a just and equitable winding up of the company, it must represent or lead to deadlock on the board or between the shareholders in general meeting, or a breach of some underlying agreement, express or implied, between the shareholders as to their rights inter se or the extent to which they are to participate in the management and decision-making of the company, or some unauthorized change in the type of business or activity for which the company was incorporated in the first place."

Dicta to similar effect are to be found in *Loch v John Blackwood Ltd* [1924] AC 783, where Lord Shaw of Dunfermline said, at p 788:

> "It is undoubtedly true that at the foundation of applications for winding up, on the 'just and equitable' rule, there must lie a justifiable lack of confidence in the conduct and management of the company's affairs. But this lack of confidence must be grounded on conduct of the directors, not in regard to their private life or affairs, but in regard to the company's business. Furthermore the lack of confidence must spring not from dissatisfaction at being outvoted on the business affairs or on what is called the domestic policy of the company. On the other hand, wherever the lack of confidence is rested on a lack of probity in the conduct of the company's affairs, then the former is justified by the latter, and it is under the statute just and equitable that the company be wound up."

That was neither a deadlock nor a quasi-partnership case. The winding up was sought (successfully) on the ground that the minority shareholder petitioner had lost confidence in the probity of the directors.

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25 Where the subject company is a corporate quasi-partnership the position is otherwise. What matters is the relationship between the quasi-partners, and the extent to which the necessary basis of trust and confidence has evaporated. For this purpose, no aspect of their business relationship is likely to be irrelevant. In the *Ebrahimi* case [1973] AC 360, 375 Lord Wilberforce said:

> "it has been suggested, and urged upon us, that (assuming the petitioner is a shareholder and not a creditor) the words ['just and equitable'] must be confined to such circumstances as affect him in his capacity as shareholder. I see no warrant for this either. No doubt, in order to present a petition, he must qualify as a shareholder, but I see no reason for preventing him from relying upon any circumstances of justice or equity which affect him in his relations with the company, or, in a case such as the present, with the other shareholders."

That was a quasi-partnership case.

26 Turning to the facts, the breakdown in trust and confidence which the judge found had occurred between Mr Lau and Mr Chu manifested itself to a substantial extent in their activities in connection with Beibu Gulf, of which they were both directors, on the nomination of PBM. A substantial part of the funding for the purchase of the Beibu Gulf fleet had been contributed by PBM, and an early and fundamental point of difference between Mr Lau and Mr Chu was whether this had taken the form of on-demand lending (which PBM could seek to recover summarily) or capital injection. This question directly affected the interests of both PBM and Beibu Gulf, and was an important matter of debate for the boards of both companies.

27 An early method by which Mr Lau and Mr Chu tried to disengage their business affairs was by a form of asset division in which Mr Chu would take Mr Lau's half interest in OSL while Mr Lau would take Mr Chu's half interest in another jointly owned enterprise, equality money being paid in respect of their differing values. The valuation of OSL critically depended upon financial information about the business of Beibu Gulf, of which Mr Chu was managing director. An important plank in Mr Lau's case about loss of trust and confidence in Mr Chu arose from Mr Chu's alleged failure to make that financial information available to Mr Lau and his advisers, an allegation which the judge upheld.

28 Another disengagement alternative consisted in negotiation with PRC Holdco for PRC Holdco to buy out Mr Lau. When this failed, due to PRC Holdco being unwilling to buy out Mr Lau alone, rather than both him and Mr Chu (who was not willing to sell), it was resolved at board level in Beibu Gulf in December 2015 that its four ships would be divided equally between PBM and PRC Holdco. Mr Chu then engineered what he called a re-financing of the two ships due to be transferred to PBM (called the Lohas Transaction) which, although taking place primarily at the Beibu Gulf level, involved what the judge held to be a commitment of valuable assets of PBM without authority and behind Mr Lau's back.

29 In January 2016 PRC Holdco sold its interest in Beibu Gulf to Bright Good (Asia) Ltd ("BGAL") which in February 2016 sub-sold a 6% stake in Beibu Gulf to Polyrise Team Ltd ("Polyrise"). Mr Lau claimed, and the judge found, that Mr Chu and associates beneficially owned both BGAL and

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Polyrise, which then combined at shareholder level in Beibu Gulf to remove Mr Lau as a director, and then to sell its ship chartering and commodity trading businesses to Cosmic Glory Ltd, a company beneficially owned by Mr Chu's son. The judge held that the acquisition of control of Beibu Gulf by BGAL and Polyrise, without disclosure of his interest, may arguably have amounted to a breach by Mr Chu of his fiduciary duty to PBM and OSL.

30 All of these matters were plainly relevant to the breakdown of trust and confidence between Mr Lau and Mr Chu. The judge held, applying Lord Wilberforce's test in the *Ebrahimi* case, that OSL was a quasi-partnership company, and (which is not challenged) that the management of OSL included the management of the affairs of its wholly owned subsidiary PBM. Neither of these findings were departed from by the Court of Appeal, but Mr Chu has put in issue on this appeal whether OSL was a corporate quasi-partnership. Mr Hacker relied on the undoubted fact that the third of Lord Wilberforce's indicia (restrictions on the transfer of a member's shares) (see para 18 above) is not part of the constitution of OSL.

31 In the Board's view, it is clear from the part of Lord Wilberforce's judgment quoted at para 18 above that none of the three indicia of quasi-partnership represent necessary elements, in the sense that the absence of one or more of them is fatal to such a finding. The judge found both the other indicia to be established (relationship of mutual confidence and an understanding that both shareholders would be involved in management) and there was, in the Board's view, ample evidence to support his conclusion that OSL was a company in which the superimposition of equitable considerations was fully justified.

32 It follows therefore that all the matters upon which the judge relied which may be said to have occurred between Mr Lau and Mr Chu at the Beibu Gulf level were relevant and admissible evidence on the question whether the former relationship of trust and confidence between them had so far evaporated as to justify the winding up of OSL on the just and equitable ground, regardless of functional deadlock.

33 But at least some of those matters were relevant also to the question whether the management of OSL and PBM was deadlocked. PBM's main asset was its 49% shareholding in Beibu Gulf, and the maximisation of its value was a matter about which its management needed to form a view, and present (albeit as a minority joint venture partner) to PRC Holdco, on a united basis. If Mr Lau and Mr Chu could not agree upon or (latterly) even discuss how that contribution to the direction of Beibu Gulf should be made, an important aspect of the management of PBM's affairs was paralysed.

34 More importantly, the other main asset of PBM was the chose in action represented by its large financial contribution to the amount needed by Beibu Gulf for the acquisition of its fleet. Mr Lau and Mr Chu could not even agree whether it was debt or capital or, therefore, whether PBM could demand immediate payment, let alone whether it should. The nature of that asset, and the question how it should be realised, was just as much a matter for the management of PBM as it was for the management of Beibu Gulf.

35 Mr Chu's refinancing in the form of the Lohas Transaction was or involved, on any view, a dealing with an important asset of PBM which ought to have involved both him and Mr Lau as PBM's directors. The fact that Mr Chu chose to implement the transaction behind Mr Lau's back, and not to disclose even its existence until April 2017, a month before the

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hearing, was powerful evidence of deadlock, in the sense that Mr Chu no doubt feared that, if he involved Mr Lau in the necessary decision-making, disagreement between them would have prevented the refinancing from happening.

36 Finally, the fact that Mr Chu may have acted in breach of fiduciary duty owed to OSL or PBM arising from the buy-out of PRC Holdco presented a major management challenge for those two companies, namely whether to sue Mr Chu for an account, about which the two men would be bound to be deadlocked.

37 It follows in the Board's view that the Court of Appeal was wrong, both in law and on a factual analysis, in its first main criticism of the judge.

Failure to assess deadlock and breakdown of trust and confidence as at the date of filing the application

38 The Court of Appeal held that the judge's analysis of whether the application for winding up was well founded should have been by reference to the factual position prevailing as at the date of filing the application, disregarding matters arising subsequently, at least to the extent relied upon by Mr Lau as demonstrating deadlock, or a breakdown in trust and confidence between him and Mr Chu. Further the Court of Appeal found that evidence after that date demonstrated that any deadlock or breakdown apparent at that date cannot have been irretrievable, having regard to the parties' ability to agree upon important matters thereafter. This criticism of the judge's analysis raises questions both of law and fact.

39 The Board considers that this criticism by the Court of Appeal is mistaken for three reasons:

(a) There is no rule that a just and equitable application for winding up must be justified solely by reference to the position as at the date of the filing of the application.

(b) In any event the judge found that there was both deadlock and an irretrievable breakdown of trust and confidence by May 2015, when the application was filed.

(c) There was ample evidence about matters which occurred thereafter from which the judge could conclude (as he did) that, rather than demonstrating continued co-operation between the two men, they just made matters worse.

40 The apparent origin of the supposed rule that a just and equitable winding up application in the BVI must be made good solely by reference to matters occurring by the date of the filing of the application lies in the decision of the English Divisional Court in *Eshelby v Federated European Bank* [1932] 1 KB 254. The defendants were guarantors of a series of instalments payable to the plaintiff for alterations and repairs to a club-house in Soho, London. The plaintiff sued the defendants for the first instalment after it became due. By permitted amendment they later added a claim for the second instalment after it became due, and recovered at first instance for both. The Divisional Court disallowed the recovery of the second instalment, in part on the ground that the amendment to plead its recovery asserted a cause of action which did not exist as at the date of the issue of the writ. In fact the plaintiff lost altogether because the Divisional Court also held that a condition precedent to the defendant's liability as guarantor had never been satisfied.

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41 The *Eshelby* rule has had a chequered career, and nowhere more so than in relation to winding up proceedings. It is no longer applicable at all in England and Wales, mainly due to changes in the procedure rules: see *Hendry v Chartsearch Ltd* [1998] CLC 1382 (CA) at paras 21–23 per Evans LJ and *Maridive & Oil Services (SAE) v CNA Insurance Co (Europe) Ltd* [2002] 1 All ER (Comm) 653, para 54 per Chadwick LJ. It was applied to an unfair prejudice application in Hong Kong in *Cheung Hon Wah v Cheung Kam Wah* [2005] 2 HKLRD 599 (also referred to as *In re Kammy Town Ltd*), but that first instance decision was doubted in both *Geoglobal Partners llc v Peaktop Technologies (USA) Hong Kong Ltd* [2007] HKCFI 1286 and *Lu Jun v Yu Qi* [2011] HKCFI 1516. In England and Wales the authorities are firmly against its application to members' winding up proceedings: see *In re Walter L Jacob & Co Ltd* [1989] BCLC 345 and *In re Fildes Bros Ltd* [1970] 1 WLR 592. In New Zealand the High Court has followed the English analysis: see *Jenkins v Supscaf Ltd* [2006] 3 NZLR 264 (a deadlock case). The Supreme Court of New South Wales followed New Zealand's lead in *Bessounian v Australian Wholesale Mortgages Pty Ltd* [2007] NSWSC 35, paras 6–7. There is some contrary authority in Australia but, as was pointed out in the *Jenkins* case, in those cases the winding up order took effect from the date of the application rather than, as in New Zealand and the BVI, upon the making of the order.

42 In the present case, the judge decided that the date of the hearing was the relevant date, following the *Jacob* case. The Court of Appeal had the *Kammy Town* case cited, but gave no reasons of its own for preferring the application date rule.

43 In the Board's view, even if it had any continuing effect in civil proceedings generally in the BVI, the *Eshelby* rule has no application to proceedings for a "just and equitable" winding up. The reasons are as follows. First, section 162(1)(b) of the 2003 Act is couched in the present tense. The court has to ask itself, at the time of the hearing, whether it *is* just and equitable that a liquidator should be appointed. In the absence of any requirement in the 2003 Act or in the Insolvency Rules 2005 to ignore relevant evidence (and there is none), it naturally follows that the court should consider all relevant matters as at the date of the hearing. Secondly this is entirely in accordance with the court's ordinary practice when considering whether to grant discretionary relief of an equitable nature. Thirdly, the *Eshelby* rule performs no concrete function. It can easily be evaded by the filing of a fresh application just prior to the hearing, relying on matters occurring since the filing of the original application, with a request that the two applications be heard together. Provided only that the respondent has sufficient notice of the new material relied on, the court would have no good case management reason to refuse. In the present case all the additional matters, except the Lohas Transaction (of which Mr Lau only learned shortly before the hearing) were the subject of an application to amend, which Wallbank J dealt with by directing written evidence rather than a proliferation of pleadings, as he was entitled to do under the Insolvency Rules. Mr Chu did not appeal his ruling.

44 The second reason why the Court of Appeal's criticism is mistaken is self-explanatory. After a detailed recitation of the facts prior to the making of the application the judge stated in the clearest terms, at para 57, that the litany of complaints, counter-complaints, suspicions, allegations and by

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A then existing proceedings between the two men were: "at the very least, entirely symptomatic of a complete and utter acrimonious breakdown of trust and confidence between Mr Lau and Mr Chu." He added that he was more than satisfied that the allegation of complete deadlock at both board and shareholder level in OSL pleaded in the application was made out, before even considering what he called the post-commencement events. There was no finding by the Court of Appeal that this conclusion was not B justified by the facts about the pre-commencement period. Mr Chu had himself by then been loudly asserting in written evidence (or in documents supported by a statement of truth) in other proceedings that the relationship of trust and confidence between him and Mr Lau had irretrievably broken down. The main basis for the Court of Appeal's ultimate conclusion that the judge had been wrong to find deadlock by May 2015 (when the application C was made) was because of its review of post-commencement events, and mainly at the Beibu Gulf level. To this the Board now turns.

45 On 15 and 16 December 2015 there was a board meeting of Beibu Gulf, attended by both Mr Lau and Mr Chu, at which the minutes record that it was agreed by all the directors that each of PBM and PRC Holdco would acquire two of Beibu Gulf's four ships, outstanding shareholder loans being used towards the acquisition price. The Court of Appeal treated this as D evidence of the continuing ability of Mr Lau and Mr Chu to agree a way out of their difficulties, and Mr Hacker made this apparent agreement the mainstay of Mr Chu's case on this appeal that there was neither a complete deadlock nor an irreversible loss of trust and confidence between them at this stage, more than six months after the filing of the application.

46 The Board does not accept this analysis, and nor did the judge. He E dealt with the December board meeting and its aftermath in detail at paras 67–72. On his analysis, the meeting left outstanding all the important aspects of the proposed demerger by ship transfers from PBM's perspective and that of the two men. How were the ships to be managed after the transfer? Were they to remain within the control of PBM, or distributed one each to Mr Lau and Mr Chu? How was their acquisition by PBM to be financed?

F 47 In the event, the two ships destined for PRC Holdco were duly transferred, but the two destined for PBM were not. They were refinanced by the Lohas Transaction behind Mr Lau's back by documents (which have never been disclosed but were apparently dated less than two weeks after the board meeting); and Mr Chu's buy-out of PRC Holdco, through BGAL and Polyrise, took place in January and February 2016. Looked at in context, the G December 2015 board meeting of Beibu Gulf looks more like the preparation for an ambush of Mr Lau than part of any process for the consensual resolution of their difficulties.

Mr Lau's freedom to sell his shares in OSL

48 As already noted, there was (perhaps unusually) no restriction in the articles of association of OSL against dealings by each member with his H shareholding. Mr Lau was, in theory at least, free to disengage from his association with Mr Chu in OSL simply by selling his shares. The Court of Appeal treated this as a self-sufficient reason on its own for a finding that there was no deadlock, and as a point to which the judge's attention had not been drawn. The same point arises in relation to the question whether OSL

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was a quasi-partnership, dealt with above, and again in relation to the question of alternative remedies, considered below. For present purposes the Board examines only the question whether it constitutes an answer to the allegation of deadlock.

49 It might in the Board's view be an answer to a case based purely on functional deadlock that a member could extract himself by a sale of his shares, but only if he could be expected to be able to do so upon fair terms. In the present case, an incoming third party purchaser of Mr Lau's shareholding would face the following disincentives to paying full value. First, he would be faced with Mr Chu as sole director, with no right to appoint himself or a nominee of his to the board. Incoming 50% shareholders of a private company do not usually pay full value with no concomitant share in management or control. Secondly, the incoming buyer would face the difficulties arising from Mr Chu's reluctance to provide financial information about Beibu Gulf, upon which any serious appraisal of the value of a 50% holding in OSL would have to be based. Thirdly, having regard to the notoriety of the dispute between Mr Lau and Mr Chu, an incoming purchaser would be likely to expect Mr Lau to be an involuntary seller, and reduce his offer price accordingly.

50 The only evidence before the judge about a possible buyer for Mr Lau's shareholding was that PRC Holdco might have been prepared to buy, but only if it could at the same time acquire Mr Chu's shareholding, which he was unwilling to sell. As for Mr Chu as a potential buyer, the judge found that he was unwilling to do so, and of doubtful financial ability in any event.

51 It does appear that little if anything was made at the trial about Mr Lau's theoretical ability to avoid deadlock by selling his shareholding in OSL to a third party. The Board thinks it most unlikely that this experienced judge was unaware of the lack of any restriction on sale. But the fact that it was not mentioned appears more consistent with the fact that Mr Lau's freedom to sell was purely theoretical, and properly ignored both by the parties and the judge. It does not, in the Board's view, provide any basis for the Court of Appeal to have departed from the judge's finding of functional deadlock.

Alternative remedies

52 As already explained, section 167(3) of the 2003 Act enables the respondent to a just and equitable winding up application to resist it by showing, the onus being on him, that the applicant has unreasonably failed to pursue an available alternative remedy, either in or out of court. Bearing in mind the onus of proof, a judge may reasonably expect the respondent (especially if represented by an experienced legal team) to put forward one or more remedies which it is alleged were both available and sufficiently attractive as an alternative to make it unreasonable to continue to seek a winding up. It was not for the judge to imagine every potential alternative remedy and deal with it, in the absence of a properly formulated invitation to do so.

53 The judge addressed alternative remedies at paras 96–97 and 101B of his judgment. He rejected any out of court settlement of their differences by the two men, in the light of their evident acrimony and inability to achieve such an outcome over several years. In particular he rejected a buy-

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A out of Mr Lau by Mr Chu because of Mr Chu's reluctance to do so, and his failure to demonstrate the financial means to do so. He noted that any valuation of Mr Lau's interest in OSL required Mr Chu to produce materials to enable the two ships to be allocated to PBM to be valued and that, despite promising to provide expert evidence for that purpose, Mr Chu had failed to do so.

B 54 The judge considered alternative shareholder remedies, such as relief from unfair prejudice, but regarded it as not unreasonable for Mr Lau to confine himself to seeking a winding up, mainly because of the risk that it would increase the range of litigation already on foot between the parties and would be both speculative and expensive, by comparison with a winding up application.

55 It does not appear that the judge considered a third party purchase as C a suitable alternative remedy. For reasons already given (in para 52) he should not be criticised for not dealing with it expressly if, which is not clear, it was even suggested to him.

56 The Court of Appeal took the view, at para 71, that it was for Mr Lau to demonstrate that there was no alternative remedy reasonably available to him. This was a misdirection in law. As explained above, the legal onus on this issue lies with the respondent to the application. The D Court of Appeal appears also to have concluded that, if a case for winding up had been established, the court could itself have ordered a buy-out of Mr Lau's shareholding: see para 75. This was also wrong in law. On a just and equitable winding up application the BVI court has no such jurisdiction. Only if Mr Lau had brought unfair prejudice proceedings would the court have had such a power and, incidentally, a power to wind up as well.

E 57 The Court of Appeal's view was that, if a case of deadlock had been proved, a buy-out by court order or by agreement under the threat of a suspended order would have been more appropriate than what it described as the "draconian" remedy of liquidation. Alternatively it contemplated a court order that Mr Lau's shares should be placed for sale to an interested third party.

F 58 Taking those in reverse order, there was no evidence to suggest that an interested third party might be likely to offer fair value to an involuntary seller like Mr Lau, selling pursuant to a court order, even if the court had power to make such an order. In fact an order for sale of Mr Lau's shareholding would have required proceedings based on, and proof of, unfair prejudice, and the judge gave a satisfactory reason why it was not unreasonable for Mr Lau to avoid such proceedings. The Board would add G that unfair prejudice in the management of a company is a different allegation from either deadlock or breakdown of trust and confidence. It is not lightly to be assumed that an applicant who can prove the latter will equally be able to prove the former: see *Hawkes v Cuddy (No 2)* [2009] 2 BCLC 427, para 108 and *Sim Yong Kim v Evenstar Investments Pte Ltd* [2006] 3 SLR 827, para 36.

H 59 The judge had found, rightly in the Board's view, that this was a paradigm case of breakdown in trust and confidence in a quasi-partnership company, and of functional deadlock, for either of which winding up is the typically appropriate remedy provided by statute.

60 The judge himself gave convincing reasons why the prospect of a sale to Mr Chu was not a realistic available remedy, and there is no convincing

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reason why a suspended order for winding up would have made all the difference. A buy-out order would have required unfair prejudice proceedings.

61 In conclusion on this issue, there was no basis for the Court of Appeal to set aside the judge's analysis on the issue of alternative remedy, and its own assessment was vitiated by errors of law.

Mr Chu's additional points

62 Mr Chu submits that the Court of Appeal's decision can be supported by the following additional grounds:

(a) That OSL was not in truth a quasi-partnership company to which equitable considerations should be applied.

(b) That Mr Lau should be refused relief because he did not come to court with clean hands.

(c) That the documents show that there was no deadlock between the two men, and that their relationship had not irretrievably broken down.

(d) That there were two further alternative remedies which Mr Lau unreasonably failed to pursue, namely derivative litigation in Hong Kong or a share split at the PBM or Beibu Gulf level.

63 Taking those in turn, the Board has already rejected the first. There is no basis for challenge to the judge's finding that OSL was a corporate quasi-partnership: see para 31 above.

64 Just and equitable winding up is a statutory remedy, albeit of an essentially equitable nature. The clean hands doctrine finds appropriate expression in this context by the requirement, expressed in the *Ebrahimi* case [1973] AC 360, that the applicant should not have been the sole cause of the breakdown in trust and confidence or of the deadlock: see para 19 above. The Board sees no reason to disturb that well-known, long standing analysis from the highest authority. Although the judge found that the two men must to some extent share the blame for the breakdown and the deadlock between them, he said, at para 101C, that Mr Chu was the more culpable of the two. Without having seen both of them being cross-examined, as the judge did, the Board cannot fault his assessment.

65 Mr Hacker attempted at length, both in writing and orally, to re-argue the deadlock and breakdown issues by reference to the documents. But the attempt does no more than raise an arguable case which the judge rejected with cogent reasons, after hearing cross-examination, which was no doubt of particular value on issues of that kind. It amounted to no more than what the English Court of Appeal rightly criticised as "island hopping" in *Fage UK Ltd v Chobani UK Ltd* [2014] FSR 29, para 114. It is not, in the Board's view, a proper use of the appellate procedure.

66 The judge dealt compendiously with litigation as an alternative remedy, as already described. His conclusion that it was not unreasonable for Mr Lau not to pursue it is as valid in relation to a Hong Kong derivative action as to any other type of alternative proceedings.

67 Finally, the notion of a share split at the PBM or Beibu Gulf level does not appear on its face to be as suitable as a winding up of OSL. It would not achieve a clean break between Mr Lau and Mr Chu, and it would not (if it operated at the Beibu Gulf level) do anything about those assets of PBM consisting of its claims in relation to its loan to Beibu Gulf, or its claims

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against Mr Chu for misfeasance and breach of fiduciary duty, which would better be investigated and (if thought fit) pursued by a liquidator.

68 It follows that, neither singly nor in the aggregate, do Mr Chu's additional points amount to a basis for upholding the order of the Court of Appeal.

Costs

69 Mr Lau's free-standing costs appeal arises only in the event that his appeal was otherwise unsuccessful. Accordingly the Board says nothing about it.

Disposition

70 This is an unusual case in which the Court of Appeal took it upon itself to overturn an essentially factual decision followed by the exercise of discretion. It depended upon the judge having made relevant errors of law, taken into account inadmissible matters, ignored relevant matters and exercised his discretion on a flawed basis. The argument before the Board has demonstrated that all the Court of Appeal's criticisms of the judge were ill-founded.

71 For the foregoing reasons the Board will humbly advise Her Majesty that this appeal should be allowed, the order of Wallbank J made on 28 July 2017 be restored, and the order of the Court of Appeal dated 17 January 2020 be set aside and the order of the judge restored.

LADY ARDEN JSC

72 I agree that this appeal should be allowed. Moreover, in my judgment, the judge was entitled to, and did find, that the originating application succeeded, not merely on the ground explained by Lord Briggs JSC—that there was deadlock between Mr Lau and Mr Chu—but also on the ground that Mr Lau had been wrongly excluded from participation in the management of OSL, its subsidiaries and affiliates.

73 There was nothing in the articles of OSL which gave Mr Lau the right to participate in management, but the judge found that OSL was a "quasi-partnership". It follows from this that the court must have regard not merely to the articles of association but also to the equitable obligations which Mr Lau and Mr Chu owed each other. I will amplify these points, starting with the judge's findings.

Summary of the factual allegations which the judge found proved

74 In this section of my judgment, I summarise the judge's core findings on exclusion. In a nutshell, he found that OSL had been set up by Mr Chu and Mr Lau on the basis that each of them would participate in their various ventures, whether carried on by it or indirectly through subsidiaries or affiliated companies, that Mr Lau was excluded in various ways from management participation in OSL's business, and that that exclusion was in breach of the equitable obligations which Mr Chu owed to Mr Lau and that accordingly it was just and equitable that OSL should be wound up.

75 OSL, a 50:50 company of which Mr Lau and Mr Chu were the sole directors and shareholders, had been established on the basis that they

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would both participate in the management of OSL's business ventures. OSL had a wholly owned subsidiary, PBM. This company made loans of approximately $36·34m (and a capital contribution of approximately $9·8m) to Beibu Gulf Ocean Shipping (Group) Ltd ("BGL") in which it held 49% of the shares, to buy ships but the orders for the ships were cancelled and the money was not used for this purpose. Mr Lau wanted the loans to be repaid, but Mr Chu wanted to leave the money in BGL. The parties tried to agree terms for separation of their interests, but the negotiations failed. Mr Chu refused to give Mr Lau financial information about BGL to evaluate any proposal for separation of his interest from that of Mr Chu. Mr Chu, without consulting Mr Lau, approved the making by BGL of loans to its parent company, Beibu Gulf Holding (Hong Kong) Co Ltd. Mr Chu claimed that he was in charge of PBM. He had also been appointed managing director of BGL. Mr Chu extracted monies from PBM without any explanation to Mr Lau. He procured the removal of Mr Lau as a director of subsidiaries of BGL. He appeared to be interested in businesses which competed with BGL or which should have been acquired for its benefit.

76 In May 2015, Mr Lau filed an originating application for the winding up of OSL on the just and equitable ground. There were further attempts to negotiate a division of Mr Lau's interests from those of Mr Chu. Under an agreement reached in December 2015, two of the vessels operated by BGL were to be transferred to PBM as a first stage in the separation of interests between Mr Lau and Mr Chu but the transfer did not happen in the way Mr Lau (whose evidence the judge preferred) intended. He understood that finance would be raised for PBM to complete this purchase if the PBM loans were insufficient. This did not occur. Instead Mr Chu arranged for the ships to be mortgaged to Lohas without consultation or explanation to Mr Lau. Kaye J found that Mr Lau had simply been presented with a fait accompli (para 71).

77 The majority shareholders in BGL transferred their interest in BGL to Bright Good (Asia) Ltd ("BGAL"), a company believed to be associated with Mr Chu. The judge considered that it was at least arguable that Mr Chu and BGL held the 51% interest so acquired on trust for PBM. BGAL transferred 6% of the shares in BGL to Polyrise Ltd. A meeting to remove Mr Lau would now be quorate, and he was removed as a director of BGL. BGL sold its ship chartering business to Cosmic Glory Ltd (subsequently known as Ausca Group Ltd) in which Mr Chu's son was interested. Mr Lau continued to complain about the lack of financial information and in September 2016 BGL resolved to opt out of its obligation to circulate financial reviews to its shareholders.

78 Kaye J held that:

> "The plain purpose of this (with all the other steps previously taken including Mr Lau's removal as director) was in my judgment to hi-jack the business of Beibu Gulf and to prevent PBM as shareholder (and more especially Mr Lau) from finding out any financial information about the business and its activities thus preventing any proper valuation of PBM's interest and thereby OSL for any buy-out purposes" (para 80).

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79 The judge went on to summarise his relevant findings on just and equitable winding up as follows:

"C. Mr Chu had managed to engineer, in my judgment, a situation whereby he, or associates of his, seized effective overall control of Beibu Gulf by BGAL and Polyrise in order to exclude Mr Lau from any participation in management (via OSL and PBM) of PBM's 49% interest in Beibu Gulf and, thereby in its subsidiaries. All this was done or engineered by Mr Chu (in breach, it might well be said, of his fiduciary obligations to his partner in OSL, Mr Lau) without properly or fully informing Mr Lau despite his personal interest via PBM's 49% share and his own 50% share in OSL. He removed, or secured the removal of Mr Lau as director of Beibu Gulf and its subsidiaries, and diverted the two operating subsidiaries (BBG Shipping and BBG Resources) to a company, Ausca, which he now accepts is owned by his son and of which he is a director and moreover without any cogent due diligence or any approach or explanation to Mr Lau. Mr Chu failed to explain or justify the commercial reasons for this (by which he had effectively engineered a situation whereby Beibu Gulf was stripped of its apparently potentially valuable operating assets, thereby reducing the value of PBM's interest), but I infer and find it was done directly or indirectly to exclude Mr Lau from any benefit;

"D. Moreover, he caused PBM, without PBM's and Mr Lau's true knowledge or consent, to participate in a re-financing transaction (the Lohas transaction), to its detriment;

"E. Mr Chu has consistently and repeatedly obstructed, frustrated and blocked, Mr Lau's repeated requests for full and proper financial information as to the financial affairs of Beibu Gulf via a series of excuses (such as it was confidential, he needed the permission of fellow directors to provide the requested information, or the issue was irrelevant, or contrary to some unspecified agreement) and cynically blamed Mr Lau for failing to implement the restructuring agreements. Indeed, although Mr Chu was plainly aware of the details of many transactions about which Mr Lau expressed concern, he consistently failed to produce the relevant supporting documentation in evidence and failed to give a full and proper explanation to many of his commercial and corporate machinations in Beibu Gulf" (para 81).

80 The word "hi-jack" is striking. The judge used it again at para 92 of his judgment.

"As to the allegation that Mr Lau was excluded from Beibu Gulf: the gravamen here of course is that whilst both initially contemplated they would, through PBM, share in the commercial venture of the Beibu Gulf Group, Mr Chu has effectively hi-jacked a business venture that was intended to benefit the two of them via OSL and PBM. I accept Mr Lau's case on this."

81 In my judgment, for the reasons contained in this judgment, the judge was entitled to analyse this case as one of exclusion from management participation. The starting point is the judge's finding that OSL was a "quasi-partnership" as Lord Briggs JSC has explained. I agree with Lord Briggs JSC that that conclusion had to be reached on an assessment of the

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facts of the case as a whole and that the fact that there was an unrestricted right for a shareholder to transfer his shares does not in this case prevent the conclusion that this company was a quasi-partnership company. I now come to the significance of that conclusion.

The significance of OSL being found to be a quasi-partnership

82 Prior to the decision of the House of Lords in *In re Westbourne Galleries Ltd; Ebrahimi v Westbourne Galleries Ltd* [1973] AC 360, the courts tended to hold that the rights of the shareholders were exclusively governed by the company's articles. The classic case is *In re Cuthbert Cooper & Sons Ltd* [1937] Ch 392, in which the directors and sole registered shareholders blocked the registration of the shares of their deceased father to his younger sons. Those sons petitioned for the company to be wound up on the just and equitable ground because they could not get the shares registered in their own name and the directors were paying themselves salaries, denying them financial information and not authorising any dividends. Simonds J refused relief. He held that, even though the company bore a resemblance to a partnership and the partnership analogy applied, the rights of the younger sons were only those set out in the articles of association of the company. This decision was criticised in *Ebrahimi* as having taken too narrow a view of equitable obligations. As I explained in *Strahan v Wilcock* [2006] 2 BCLC 555, it was clear to the House in *Ebrahimi* from several sources, including *In re Yenidje Tobacco Co Ltd* [1916] 2 Ch 426, Scottish cases such as *Symington v Symington's Quarries Ltd* (1905) 8 F 121 and Australian cases, such as *In re Wondoflex Textiles Pty Ltd* [1951] VLR 458, that the approach illustrated in *In re Cuthbert Cooper* did not meet the case of participants in private companies where an analogy with partnership applied.

83 On its facts, *Ebrahimi* [1973] AC 360 was a strong case for being a quasi-partnership because the company had previously been a partnership in which the partners had been involved in management and shared the profits, but a pre-existing partnership is not a universal requirement for a quasi-partnership. There were initially two, then three shareholders who were also directors. Two of the shareholders removed the third by resolution of the company in general meeting. He therefore ceased to be entitled to remuneration as a director and was at the mercy of the remaining directors as to his share in the profits. It was not suggested that he had been guilty of misconduct which would justify his expulsion if the company had been a partnership. As Lord Briggs JSC has explained, Lord Wilberforce laid down a description of a quasi-partnership company, but it was never intended to be read as a statute. Where there was a quasi-partnership, then it was possible to read obligations into the articles of association.

84 In *Ebrahimi* and many other cases, one of the fundamental understandings between the quasi-partners was that they would all be entitled to be involved in the management and share in the profits of the business. By analogy with the rights of partners, the power of expulsion was to be interpreted strictly (see *Blisset v Daniel* (1853) 10 Hare 493). In particular, in the case of the power to remove a director, that meant that, if the quasi-partners exercised their power to remove one of their number as a director against his will, without justification and giving him an opportunity to put his case, and paying him the full value of his share in the company, the

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court would make an order for the winding up of the company on the just and equitable basis: see per Lord Wilberforce at p 380. Exclusion from management might be justified if there was serious misconduct or where the quasi-partner in question came to the court without "clean hands" (per Lord Cross of Chelsea at pp 386–387).

85 In my judgment the facts found by the judge show that exclusion from participation in management occurred in substance in this case. There would be no basis for confining exclusion from management to the case where a quasi-partner is removed from office as a director as opposed to making it effectively impossible in some other way for him to take part in the management of the company's businesses, as such a distinction would be artificial and enable his rights of participation to be easily circumvented. It must include preventing him from participating in the management of the company's assets without removal as a director. In this case, Mr Chu ensured that the question of the recovery of the substantial PBM loans was shifted to BGL, where PBM has only a minority shareholding. Mr Chu by working with the other shareholders of BGL was able to procure the removal of Mr Lau as a director of BGL, Mr Chu ensured that the ship received from BGL for Mr Lau's share should not be available for Mr Lau, or even be under the control of PBM as it was transferred to Lohas without consultation with Mr Lau. So, as I see it, this case is additionally one of exclusion from management and not just deadlock. Put another way, deadlock is the symptom and consequence of a more fundamental malaise, namely that of exclusion by Mr Chu of Mr Lau from management participation.

86 There are, however, some points which I would like to make about deadlock, to which I now turn.

Different meanings attached to deadlock and the relationship of deadlock to the just and equitable jurisdiction

87 The judge described the principal issue as being whether the affairs of OSL were so deadlocked as to justify an order on the just and equitable ground for the liquidation of that company (para 25). By contrast, the Court of Appeal were using a different approach to deadlock. They treated deadlock as the absence of provisions of the memorandum and articles of OSL to provide a means of resolving the differences of opinion between Mr Chu and Mr Lau. They found that that test was not satisfied because there was a means of dealing with the differences between the parties. In particular Mr Lau could sell and transfer his shares to a third party.

88 The judgment of the Board in the present case does not seek to provide any definition of deadlock based on the authorities or to analyse the lower courts' difference of view. In its earlier decision in *Ng Eng Hiam v Ng Kee Wei* (1965) 31 MLJ 238, an appeal from the Supreme Court of the Federation of Malaya, the Board gave the term a narrow meaning, as the Court of Appeal did in this case, and held that "deadlock" meant that there had to be complete deadlock in the management of the company. This would cover the case where the constitution of the company did not provide any means for resolving the deadlock, as where there were only two directors who were also 50:50 shareholders, and there was disagreement between them and neither of them was entitled to a casting vote. This was the case in *Ng Eng Hiam*. So, if one of the directors has executive powers,

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for example as a managing director, and the acts complained of could be carried out by him under those powers, disagreement between him and his fellow director would not give rise to deadlock. In *Ng Eng Hiam* the trial judge had refused to make a winding up order on the basis that the company's business was profitable and could still be carried on. Lord Donovan, giving the advice of the Board, held that:

> "The question whether such a deadlock exists as makes it just and equitable to wind the company up is a question predominantly of fact in each case. The principle is clear that if the court is satisfied that complete deadlock exists in the management of a company the jurisdiction will be exercised. See *Buckley on the Companies Act*, 13th ed (1957), p 456. It may be that the jurisdiction will be more readily exercised where (as is alleged to be the case here) although the business is carried on by means of a private limited company, the case is one not unlike a partnership" (p 240).

89 Thus, in companies which are quasi-partnerships, deadlock may be one of the elements which show that the respondent director is acting in breach of some equitable obligation owed by him to his fellow shareholders. It is, therefore, important not to get carried away by the word "deadlock" itself: Lord Wilberforce made it clear that the words "just and equitable" are perfectly general and are not to be cut down by reference to previous cases in which a winding up order has been made. Deadlock today can more meaningfully be seen as illustrating the general principles established in *Ebrahimi* [1973] AC 360.

90 The appellants also rely on *Loch v John Blackwood Ltd* [1924] AC 783. There was no deadlock in this case, Lord Wilberforce cited it in *Ebrahimi* and it shows the breadth of the jurisdiction. In that case, the Board dismissed an appeal against the making of a winding up order on the just and equitable ground on the basis that there was a lack of probity and a justifiable lack of confidence. There was no finding that the company was a quasi-partnership company nor was there any deadlock in the sense given in *Ng Eng Hiam*.

91 In my judgment, in the interests of clarity, the use of the term "deadlock" to describe a category of case in which the court may decide to exercise its just and equitable jurisdiction should be reserved for cases in which there is complete deadlock at the level of management and that is the only matter on which the party is seeking a just and equitable order. Most cases involving quasi-partnership companies will be found to involve much more than that.

92 In short, in quasi-partnership companies, deadlock often covers some of the same territory as failure to observe the equitable obligations which are not written into the articles but which are owed by one quasi-partner to another. A quasi-partnership is not a commercial transaction in which, to borrow the words of Judge Learned Hand, "it does not in the end promote justice to seek strained interpretations in aid of those who do not protect themselves" (*James Baird & Co v Gimbel Bros Inc* (1933) 64 F 2d 344, 346). The implication of equitable obligations in a quasi-partnership is the way in which the courts secure that justice is done between quasi-partners who have not taken every contractual protection that they might have done to prevent the misuse of corporate powers. The contest between

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law and equity in this type of situation has been fought over many years and is graphically illustrated by the contest between Shylock and Portia in Shakespeare's *The Merchant of Venice*.

Position in relation to BGL

93 Needless to say, Mr Lau did not accept that he should be excluded from the management of the businesses. So, the situation developed in which the parties were unable to agree about OSL's business and in that sense, which is not the sense in which the Board used the term in *Ng Eng Hiam* 31 MLJ 238, there was deadlock. It is nothing to the point that the BGL group were not subsidiaries of OSL. The indirect minority holding which OSL held in that company was one of its assets. Therefore, the equitable obligations Mr Chu owed to his quasi-partner Mr Lau affected also his activities in the relation to BGL, again as the judge held. The position is different in relation to the unfair prejudice remedy which includes the words "the affairs of the company" and "any act or acts of the company" (see section 1841(1) of the Business Companies Act 2004). In those cases, attention has to be paid to whether those statutory words are fulfilled.

Miscellaneous points

94 As to the temporal issue, namely whether Mr Lau could rely on matters subsequent to the filing of the application, I agree with Lord Briggs JSC's judgment and specifically with his point that the wording of the section requires the court to be satisfied that it is just and equitable to appoint a liquidator at the date of the hearing. This provides powerful support for the proposition that the parties may file evidence about matters which occur after the date on which the originating application is issued. (In this case, by virtue of the interlocutory order of Wallbank J, the function of the pleadings was also performed by the parties' witness statements).

95 The Court of Appeal did not address the judge's findings on exclusion from participation in management. The judge relied on these as reasons why it was just and equitable to make an order on the just and equitable ground. The appellant has always complained about his exclusion from participation in management. If the Court of Appeal had not been misled into thinking that they could not rely on matters occurring after the commencement of the proceedings, they would in my judgment have had to deal with the impact of the judge's findings on exclusion. If they stood, it is difficult to see how the judge's order could have been set aside.

96 I also agree with what Lord Briggs JSC holds about alternative remedies.

97 Further, given the potential remedies arising from the management by Mr Chu of OSL's businesses and investments, it is not an objection to the appointment of a liquidator on the just and equitable ground that OSL or PBM may now be insolvent.

98 The respondent submits that there could be no deadlock in BGL because he and Mr Lau were only minority shareholders and could always be outvoted by the majority shareholders, but this too misses the point. There is still the question of exclusion from management.

99 The respondent relies on the first sentence of para 53 of the decision of the Eastern Caribbean Court of Appeal in *Wang Zhongyong v Union*

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Zone (Claim No BVIHCMAP 2013/0024) (unreported) 12 January 2015, where Farara JA held that a breakdown in the relationship between shareholders is not necessarily a ground for winding up (see para 24 above). It is clear from the whole paragraph that Farara JA was explaining that the applicant for just and equitable relief had to show deadlock or breach of some agreement about management participation or the failure of the object for which the company was formed. There are two points arising from that.

100 Firstly, Farara JA expressly contemplated the present type of case, namely exclusion from management. Exclusion from management can in an appropriate case be a ground for a just and equitable order in conjunction with or as an alternative to deadlock.

101 Secondly, in so far as Farara JA might be taken to mean that there is a closed list of grounds for just and equitable winding up, this is contrary to *Ebrahimi* [1973] AC 360. Lord Wilberforce clearly held the phrase "just and equitable" was general and should "not be reduced to the sum of particular instances" (pp 374–375). He also held that the courts may have been too timorous in the past in just and equitable winding up and that it was impossible or undesirable to define the circumstances in which equitable considerations could arise (p 379).

Conclusion

102 For these reasons, in addition to those given by Lord Briggs JSC in his judgment I would also humbly advise Her Majesty that this appeal should be allowed.

Advice given to allow appeal.

COLIN BERESFORD, Barrister

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ITEM NO. 163

JA-49

Re Sova Capital Ltd (in administration)

[2023] EWHC 452 (Ch)

CHANCERY DIVISION

MILES J

20, 21 FEBRUARY, 2 MARCH 2023

Company – Administration order – Administrator – Powers – Administrators seeking approval to sell assets to unsecured creditor in return for discharge of liabilities – Principles to be applied – Whether appropriate in principle for administrators to seek court's approval of the transactions – Whether administrators' decision to commit company to transactions within their statutory powers and/or complying with principles of insolvency law – Whether administrators' decision to enter transactions rational and honest – Whether real risk that transactions breaching applicable sanctions laws.

Prior to being put in special administration, S Ltd ('the company') was an authorised and regulated broker, providing investment brokerage services to institutional and corporate clients, mostly trading in the Russian market. It was placed in special administration following the market turmoil caused by Russia's invasion of Ukraine, and the subsequent imposition of sanctions on Russia, which caused a significant devaluation of Russian securities held by the company. One of the company's largest unsecured creditors was D, with an admitted claim of some £233m. By the instant applications, the joint special administrators ('JSAs') sought permission to perform, and to procure the company to perform, two transactions with D. In broad terms the transactions would result in D acquiring from the company a portfolio of Russian securities in return for D waiving all or a portion of its claims against the company. The Western sanctions and Russian countermeasures meant that the JSAs and the company were unable to realise the Russian securities by normal means for the benefit of the company's estate. The administrators believed that the deal was the best way of realising the company's Russian securities which were effectively trapped. The majority of creditors were in favour of the proposed transactions. However, the applications were opposed by BZ, who was also an unsecured creditor with an estimated claim of £19.9m. BZ was also part of a consortium that wished to acquire the same Russian securities. The consideration offered by the consortium was a combination of £125m of cash and the waiver of BZ's claims against the company. Four principal issues arose: (i) whether the administrators had surrendered their discretion to the court and whether it was otherwise appropriate in principle for the administrators to seek the court's approval of the transactions; (ii) whether the administrators' decision to commit the company to the transactions was within their statutory powers and/or whether it complied with the principles of insolvency law, including whether the transactions were to be regarded as distributions and in breach of the pari passu principle; (iii) whether the administrators' decision to enter the transactions was rational and honest; and (iv) whether there was a real risk that the transactions breached applicable sanctions laws.

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Held – The applications would be granted for the following reasons—

(1) Administrators were professionals who fulfilled a commercial role in conducting the business and affairs of the company in administration. They were generally required to make their own commercial decisions and could not expect to rely on the approval of the court in those respects. There could in that regard be differences between trustees of private trusts and office-holders appointed under the insolvency legislation. Office-holders were required routinely to take momentous commercial decisions and to weigh up the risks and rewards of competing courses. The question whether there were particular reasons for applying to the court could not depend on whether the commercial decision was more or less difficult. Even hard commercial decisions were for the administrators, not the court. Nor could the scale of the transaction be the touchstone. Administrators should not assume that the court would entertain an application for directions simply because the matter was hard or large. It might be appropriate to seek the court's approval, inter alia, where doubts had been expressed about the administrators' powers or there were potential conflicts of interest or where there might be potential issues as to the legality of a proposed transaction. The court was, however, unlikely to give directions in a case which was in truth seeking the blessing of a commercial decision. The court could in an appropriate case also be asked to consider the rationality of the proposed course of action (for the purposes of the proper purpose rule). Where it did so, it did not necessarily follow from a ruling on rationality that the court was satisfied that there were no possible claims against the office holder (for example in negligence) concerning the process that had led up to the relevant decision. The scope of any immunity would depend very much on the facts. The court was not a sanctuary or bomb shelter for office-holders. There was no blanket or automatic rule about the scope of any immunity for the office-holder. The scope of any immunity depended on what precisely the court decided. What mattered most for office-holders and others interested in the estate was that the transaction covered by the approval was secure against future challenge (absent some flaw in the approval process). On an application for directions, the court did not have the benefit of disclosure or cross-examination. The court depended on the administrators to make complete and candid disclosure of the necessary material but the court was not in the position of making a full investigation of the position. A directions hearing should be comparatively short and contained. It was not intended to be a trial, even a mini one. That was a further reason why the court would be cautious about reaching findings of fact going beyond those strictly required by the directions sought (see [184], below); *Public Trustee v Paul Cooper & Co* [2001] WTLR 901, *Re T&N Ltd* [2005] 2 BCLC 488, *Re MF Global UK Ltd* [2014] Bus LR 1156 and *Re Nortel Networks UK Ltd* [2017] 2 BCLC 572 applied.

(2) The entry by an office-holder into an agreement that was conditional on the court's consent did not mean that the office-holder had (without more) surrendered his or her discretion. On the contrary the office-holder had already exercised his or her discretion by deciding to execute the transaction but wished to obtain the approval of the court as a pre-condition to its being effective. That was no different in substance from the office-holder seeking the court's advance approval before entering the transaction. The relevant question in that respect was essentially whether the administrators were asking for approval of a course already decided upon or leaving the decision to the court. In the instant case it was clear that the administrators had already decided to

exercise their discretion in a specific way by entering the transactions. They had not thrown the decision onto the court on the footing that they could not decide how to act. They were sure that the transactions were the right course (but had structured it as dependent on obtaining approval). In principle, the instant case was an appropriate case for the administrators to seek the court's approval. The applications concerned the disposal of a substantial part of the company's estate; they arose in very unusual circumstances in which there was a sharp asymmetry in the value of the relevant property from the perspectives of the company and any Russian buyer, including D; the legal mechanism of the transactions (the transfer of the securities in return for the waiver of D's claim) was novel; and the decision to enter the transactions was challenged by BZ who said that the administrators were acting in excess of their powers and contrary to the principles of insolvency law. The transactions also raised the potential application of sanctions laws and the court would plainly not approve any action by its officer holder where there would be a realistic risk of breaching such laws. It followed that the applications were proper applications to bring before the court (see [188]–[194], below).

(3) In the circumstances, there was no real doubt about the administrators' powers to enter into the transaction. The administrators' power to sell or otherwise dispose of the company's property was broad enough to cover a transaction whereby a creditor waived its claim against the company. In exercising such power an administrator was required to act reasonably to obtain the best price in the circumstances as they reasonably appeared to the administrator. That placed an important constraint on the exercise of the power. It prevented an administrator from simply transferring assets to a particular creditor in return for the claim of the creditor where that might be at the expense of the estate. It was only if the administrator genuinely and rationally believed proper value was being obtained that the power was exercisable. Further, the transaction was properly characterised as a sale or other disposal rather than a distribution. D would be receiving the Russian securities as a buyer and would (to the appropriate agreed extent) cease to be a creditor. It would not be receiving anything qua creditor (for such part of its claim as was waived) and would therefore not receive a distribution. The pari passu principle did not have any relevant application; nor did it undermine the powers of the administrators to sell the Russian securities to D (see [248]–[261], below); *Guy v Churchill* (1888) 40 Ch D 481 considered.

(4) The decision of the administrators to enter the transactions was an honest one. They genuinely considered that the transactions were in the interests of the creditors. Further, that decision was rational in the sense of being one that could be reached by reasonable honest office-holders seeking to fulfil their functions, or putting it negatively, was not one that could be regarded as perverse or irrational. The decision was within their powers. The administrators were seeking to make the best of a challenging set of constraints, which had effectively strangled their ability to sell the Russian securities for anything approaching their nominal value. Their comparative assessment of the rival bids could not be seen as perverse or irrational. It was rational for them to conclude that they should enter the transactions now, rather than waiting to see whether they might at some uncertain future time be able to obtain a higher price for the Russian securities. Things could very well get worse. It was also relevant that the vast majority of creditors

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supported the administrators' position (see [271]–[279], below); *Re MF Global UK Ltd* [2014] Bus LR 1156 and *Re Nortel Networks UK Ltd* [2017] 2 BCLC 572 considered.

(5) Having regard to the relevant sanctions regimes, there was no realistic risk that the transactions would infringe UK sanctions. Nor, so far as material, would they infringe EU or US sanctions (see [282], [284], [285], [192], [293], [295], [297], below).

Notes

For the general powers and functions of the administrator, see *Halsbury's Laws* COMPANY AND PARTNERSHIP INSOLVENCY vol 16 (2017) para 224.

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T&N Ltd, Re [2004] EWHC 2361 (Ch), [2005] 2 BCLC 488, [2004] All ER (D) 283 (Oct).
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Applications

The joint special administrators, David Philip Soden, Ian Colin Wormleighton and Stephen Browne ('the JSAs'), applied under para 63 of Sch B1 to the Insolvency Act 1986 for a direction that they be at liberty to enter into two transactions concerning the assets and liabilities of Sova Capital Ltd (in special administration) ('Sova') with LCC Holding Company Dominanta ('Dominanta'), which was an unsecured creditor of Sova. The applications were opposed by Boris Zilbermints ('BZ'), who was also a creditor.

Mark Phillips KC, William Willson and *Dr Riz Mokal* (instructed by *Hogan Lovells International LLP* and *Shoosmiths LLP*) for the JSAs.
Stephen Robins KC and *Charlotte Cooke* (instructed by *DMH Stallard LLP*) for BZ.
William Buck and *Nicholas Wright* (instructed by *Quillon Law LLP*) for Dominanta.

Judgment was reserved.

2 March 2023. The following judgment was delivered.

MILES J.

INTRODUCTION

[**1**] The joint special administrators ('the JSAs') of Sova Capital Ltd ('Sova') apply, by two closely interrelated applications, for a direction that they be at liberty to enter into two transactions concerning the assets and liabilities of Sova.

[**2**] Sova is in special administration. It is an FCA authorised and regulated broker. Before the administration it provided investment brokerage services to institutional and corporate clients, mostly trading in the Russian market.

[**3**] The applications are made under para 63 of Sch B1 to the Insolvency Act 1986 ('Sch B1' and 'the 1986 Act'). These are applicable in Sova's special administration by reg 15(4)(a) of the Investment Bank Special Administration Regulations 2011, SI 2011/245 ('the IBSARs').

[**4**] The JSAs seek the permission of the Court to perform, and to procure Sova to perform, two transactions with LCC Holding Company Dominanta ('Dominanta').

[**5**] These are referred to in the evidence as **the Dominanta Transaction** and **the Further Dominanta Transaction** (together, 'the Transaction'). Dominanta is one of the largest unsecured creditors of Sova with an admitted claim of c £233m.

[**6**] In very broad terms the Transaction would result in Dominanta acquiring from Sova a portfolio of Russian securities in return for Dominanta waiving all or a portion of its claims against Sova. The JSAs say that they have agreed this deal because it is the best way of realising Sova's Russian securities which are effectively trapped.

[**7**] The applications are opposed by Boris Zilbermints ('BZ'), who is a creditor of Sova with an estimated claim of £19.9m. BZ is also part of a consortium which wishes to acquire the same Russian securities. The consideration offered by the consortium is a combination of £125m of cash and the waiver of BZ's claims against Sova of c.£20m.

[**8**] At the first hearing of the applications, which was on 13 January 2023, I adjourned the applications and gave directions for an expedited hearing. This included a timetable for the service of further evidence and consolidated skeleton arguments. I also considered that the adjournment would give a chance for the competing bids to be fully assessed and for any further competitive tension to be exploited.

[**9**] The evidence is extensive. The applications are supported by ten witness statements of Mr Soden, one of the JSAs. The exhibits include three memoranda prepared by the JSAs' UK and US solicitors concerning the possible application of UK, US and EU sanctions. BZ has served two statements. Mr Trakhtenberg has served a statement for Dominanta.

[**10**] I have carefully considered this evidence. I have also been assisted by the very full written submissions and oral submissions of the parties. Much of the factual background is not controversial and I have drawn on the parties' written submissions in preparing this judgment.

BACKGROUND TO THE APPLICATIONS

[**11**] In broad outline the background to the applications (as explained by Mr Soden in his statements) may be summarised as follows.

[**12**] A large part of Sova's estate consists of financial assets which are held in depositaries in Russia. Many of these Russian securities trade on the Moscow Stock Exchange ('MOEX') and are either: securities issued by entities incorporated in and under the laws of Russia; securities issued by entities within corporate groups with material operations in Russia; or securities issued by the Russian government (together 'Russian Securities'). As explained below Sova cannot trade on MOEX.

[**13**] Russia invaded Ukraine on 24 February 2022.

[**14**] This created turmoil in the markets on which the Russian Securities are traded. Assets issued by Russian entities and traded on Russian markets fell in value, counterparties holding them by way of collateral issued margin calls, and MOEX and related market infrastructure closed. This severely impaired Sova's liquidity and it was unable to leverage or finance its Russian Securities. This rendered Sova cashflow insolvent.

[**15**] On 3 March 2022, on the application of its directors, Sova was placed in special administration by order of Leech J.

[**16**] The UK, the EU and the US introduced sanctions in response to the invasion ('Western Sanctions'). The Russian government imposed countermeasures ('Russian Restrictions'). As a result of the Western Sanctions and the Russian Restrictions (together 'the Sanctions Regimes'), the JSAs and Sova are unable to realise the Russian Securities by normal means for the benefit of Sova's estate.

[**17**] Russian Securities amount to about 87% by value of the total securities Sova owns (valued as at 11 November 2022). These are illiquid or otherwise unrealisable other than for a much reduced price.

[**18**] Adding more detail, MOEX ceased trading in late February 2022. It has not reopened to securities trading for foreign residents in countries designated under the Russian Restrictions as 'hostile' (which include the UK, the US and the EU member states). So the JSAs cannot trade on MOEX and cannot sell the Russian Securities on-exchange on a line-by-line basis. The only option is an over-the-counter sale. Such an over-the-counter ('OTC') sale could be either to a Russian buyer (or potentially to a non-Russian buyer from a non-hostile jurisdiction) or to a non-Russian buyer from a 'hostile' jurisdiction.

[**19**] As for a sale to a Russian buyer (or a non-Russian buyer from a non-hostile jurisdiction), under the Russian Restrictions, as Sova is incorporated in a hostile jurisdiction, any transaction it enters with a Russian buyer in relation to the Russian Securities is subject to approvals ('Government Commission Consent') from the relevant Russian authority, the Government Commission for Control of Foreign Investment in the Russian Federation ('the Government Commission').

[**20**] Additionally Sova would need to find a buyer who is not subject to Western Sanctions. A material target population of buyers for the Russian Securities would have been Russian financial institutions. However, many Russian financial institutions are subject to Western Sanctions.

[**21**] The Russian Restrictions also make it difficult for Sova to repatriate cash from Russia to the UK. Generally, this would require the approval of the Central Bank of Russia ('the CBR'), and there is a lack of clarity in relation to this process and the operation of the different Russian laws which creates potential uncertainty when entering cash transactions with such buyers.

[**22**] On this last point, BZ has submitted evidence of Russian law and practice which concludes that Government Commission Consent to a transaction would satisfy the requirements concerning approvals of the transfers of cash. The JSAs' position is that there is a risk that further CBR approval would be needed. There was no cross-examination of witnesses and the court is not in a position to resolve this difference of view.

[**23**] A sale to a buyer in a 'hostile' jurisdiction (such as a Western buyer) would be extremely challenging. Though theoretically allowed under Russian law, there would have to be a buyer willing to invest in Russian assets at a time when most such parties are exiting Russian markets. The buyer would also

have to be willing to hold the assets for an extended period since it would not be able to trade on MOEX and would be subject to the same restrictions on selling as Sova faces.

[**24**] The JSAs say that these unusual conditions make it extremely hard for them to realise the value of the Russian Securities through a normal marketing process.

[**25**] It is against this background that they seek the court's approval for the JSAs to perform and procure Sova to perform the Dominanta Transaction and the Further Dominanta Transaction.

[**26**] The Dominanta Transaction relates to 71 of some of the highest value Russian Securities held by Sova ('the First Target Russian Securities'); the Further Dominanta Transaction relates to a further 18 such securities ('the Second Target Russian Securities'; together 'the Target Russian Securities').

[**27**] The terms of the Dominanta Transaction are set out in a portfolio transfer agreement dated 2 December 2022, as amended on 30 December 2022 and 10 February 2023 ('PTA1'). The terms of the Further Dominanta Transaction are set out in a portfolio transfer agreement dated 30 December 2022, as amended on 13 February 2023 ('PTA2').

[**28**] The parties to each of these PTAs are Sova and the JSAs on the one hand and Dominanta, a Russian entity, on the other.

[**29**] Dominanta is one of Sova's largest unsecured creditors by virtue of having taken assignments of certain claims against Sova. Dominanta is ultimately beneficially majority-owned by Mr Roman Avdeev ('Mr Avdeev'), a dual Russian and Cypriot national, who is also the ultimate beneficial owner of Sova. According to the JSAs' due diligence, Dominanta is not owned or controlled by persons subject to UK, EU, or US sanctions.

[**30**] By the two PTAs, the JSAs have caused Sova to agree to transfer a large bulk of its Russian Securities (i e the First and Second Target Russian Securities, respectively) to Dominanta, in return for Dominanta waiving its admitted claim of £233,261.442.85 against Sova. This amount has been admitted for proof by the JSAs ('the Dominanta Adjudicated Claim').

[**31**] The JSAs have calculated a cash equivalent value to Sova of the Transaction. The calculation works like this: (a) Start with the final dividend payable to creditors assuming that the Transaction does not take place. (This will be a positive number even if the relevant Russian Securities cannot be realised as there are other realised or realisable assets in the insolvent estate.) (b) Then assume that the Transaction happens (and that the full amount of the Dominanta Adjudicated Claim is waived) and determine the final dividend for the other creditors. (c) Then calculate the amount that would have to be contributed to the estate to pay the dividend that would be payable under (b) above, but on the assumption that the Dominanta Adjudicated Claim remains. This is the cash equivalent value ('CEV') of the Transaction to Sova.

[**32**] The CEV analysis can of course be applied to any offer which involves the waiver of the creditor's claim in the insolvent estate. As explained below it has been applied to the claim waiver element of BZ's offers for comparative purposes.

[**33**] Mr Soden explains that the CEV can also be understood by (notionally) assuming that a creditor such as Dominanta (and this example uses Dominanta as an illustration) (i) receives an initial dividend (from assets otherwise available to the estate) and (ii) successfully bids this dividend for a proportion of the Target Russian Securities. It then (iii) receives another dividend (being its pari passu share of the amount paid into the estate at (ii)), and (iv) bids that

dividend for another portion of the Target Russian Securities. It iteratively receives and bids subsequent dividends until it has acquired all the Target Russian Securities. The total amount of the dividends that would have been received and paid back to Sova in order to acquire Target Russian Securities is the same as the CEV. Mr Soden describes this as the **Dividend Bid Model**. This is best seen as a way of conceptualising how the amounts contributed by a bidder swell the estate; it is not a description of the way things will actually happen under the Transaction.

[**34**] It will be seen that an input into the CEV calculation is the final dividend rate payable to Sova's creditors. This cannot be known until the conclusion of the special administration. The JSAs have however calculated projected final dividends (assuming no Transaction and no other realisations from the Russian Securities) on the basis of assumptions about the overall admitted creditors of the estate, realisations of other assets, and expenses. They have calculated a **Low case** and a **High case**. They have also shown a **Mid case** as the median between the other two.

[**35**] There have been various iterations of these cases as the administration has progressed.

[**36**] In the latest (given in Mr Soden's eighth statement of 14 February 2023), in the Low case the total claims against Sova are estimated at £862.4m and net realisations are estimated at £316.4m. In the High case the total claims are the same and net realisations are £390.8m.

[**37**] On the JSAs' latest Low case the projected final dividend rate (assuming the Transaction does not happen and no other realisation of value from the Russian Securities) is 36.7% (ie 316.4/862.4).

[**38**] If the Dominanta Adjudicated Claim were waived the final dividends for Sova's other creditors would increase from 36.7% to 50.3% (ie 316.4/(862.4–233.3)). The CEV of the Dominanta claim is therefore £117.3m. Expressed in numbers, that is: 50.3% = 433.7/862.4; and £433.7m minus £316.4m = £117.3m.

[**39**] Using the Dividend Bid Model, on the Low case, Dominanta's estimated dividend (assuming no Transaction) would be c £85.6m (being 36.7% of £233.3m). If Dominanta was (notionally) treated as iteratively bidding these dividends for the assets the amount returned to the estate would be £117.3m.

[**40**] On the High case the projected final dividend rate (assuming the Transaction does not happen and no other realisation of value from the Russian Securities) is 45.3% (ie 390.8/862.4). Waiver of the Dominanta Adjudicated Claim increases projected dividends for Sova's other creditors to 62.1% and the CEV of the Transaction is £144.9m.

[**41**] In the Mid case (ie the median case) the projected dividend rate for other creditors (assuming the Transaction happens) would be 56.2% and the CEV of the Transaction would be £131.0m.

[**42**] The JSAs have estimated the value of the Target Russian Securities of c £274m to those able to trade in them unimpeded by the Sanctions Regimes.

[**43**] It was common ground before me however that Sova and the JSAs are seriously affected by the Sanctions Regimes and that they cannot realise the Target Russian Securities at or even close to £274m. The realisable value of the assets is far lower.

[**44**] The £274m figure is therefore merely a nominal value for the Target Russian Securities from the JSAs' and Sova's perspective (and I shall adopt the parties' coinage **the Nominal Value**).

[**45**] Russian securities are of course likely to have a much higher value for a Russian market participant than they have for a holder in the position of Sova. A Russian owner would be able to use MOEX to deal in the securities and would not need to obtain the consent of the Government Commission. This asymmetry in value for different holders has provoked much of the argument on these applications. Put simply, a Russian buyer of the Target Russian Securities (such as Dominanta) is likely to be able to sell them for far more than the JSAs are able to achieve and may even be able to realise the Nominal Value. I shall return to this issue when addressing the arguments below.

[**46**] Returning to the numbers, the CEV of the Transaction represents 42.8% of the Nominal Value of the Target Russian Securities in the Low case and 52.8% in the High case.

[**47**] The evidence of the JSAs, which was not challenged, is that it is completely uncertain when, if at all, Sova might be able to sell the Target Russian Securities unimpeded by the Sanctions Regimes. Nor is there any certainty as to how the value of the Target Russian Securities might change in the meantime.

[**48**] The JSAs are therefore of the view that the Transaction will realise the best price reasonably obtainable in the circumstances for the Target Russian Securities for the benefit of Sova and its (remaining) creditors.

[**49**] The parties' obligations in each PTA are subject to conditions precedent ('CPs'). As relevant these are for the JSAs to obtain the court's approval and for Dominanta to obtain Government Commission Consent.

[**50**] The Government Commission Consent was obtained on 11 January 2023. The only outstanding CP is therefore the approval of the court.

[**51**] I turn to the position of BZ. As already explained, he is an unsecured creditor. His claim is estimated by the JSAs at just under £20m.

[**52**] He is also a joint bidder for the Target Russian Securities in conjunction with Limited Liability Company TPM-PLUS ('TPM').

[**53**] There has been much correspondence between the JSAs and BZ and his solicitors. I was taken to the material parts. For present purposes, the position may be summarised as follows. In late October 2022, he made several offers to purchase some of the Russian Securities in consideration of the waiver of his claim against Sova. In December 2022 he made a further 'hybrid' bid via a mixture of claim waiver and cash funding. The JSAs told BZ they would not be progressing the initial offers on 18 November 2022; and on 5 December 2022 the JSAs confirmed that they would not be proceeding with his hybrid offer.

[**54**] On 10 January 2023 BZ and TPM ('the Joint Bidders') made another 'hybrid' bid involving waiver of BZ's claim together with £120m in cash. BZ also sought an adjournment of the JSAs' applications to enable the JSAs to consider the new offer and potentially exploit competitive tension for the benefit of creditors. BZ alternatively asked the court to dismiss the applications because the Transaction offends the pari passu principle and the statutory scheme; or because the JSA had surrendered their discretion; or because the Transaction may now not represent the best price reasonably obtainable.

[**55**] The JSAs opposed the adjournment.

[**56**] I decided that the time estimate for the hearing and pre-reading was inadequate. This has proved right in that the hearing lasted two very full days. I also expressed the view that the JSAs should use the additional time to explore whether either of Dominanta or the Joint Bidders were minded to improve their respective offers.

[**57**] The JSAs invited Dominanta and the Joint Bidders to state whether they were prepared to improve their offers. Dominanta stuck to its existing offer.

[**58**] On 24 January 2023 the Joint Bidders submitted **the Final BZ Offer**. The cash element of the offer was raised from £120m to £125m. Under the terms of the Final BZ Offer, if the Court held the claim waiver element of that offer (alongside the same element of the Transaction) to be contrary to the pari passu principle, then the Final BZ Offer would consist of the cash component of £125m alone.

[**59**] The JSAs have calculated the CEV of the Final BZ Offer using the same method as described above. The CEV is £134.9m (against £117.3m for the Transaction) in the Low case, £136.3m (against £131.0m) in the Mid case, and £137.2m (against £144.9m) in the High case.

[**60**] The JSAs have explained that because the amount of the waiver of debt under the Dominanta offer is much higher, there is an amplifying effect depending on the estimated final outcomes for the estate. The lower the expected dividends the less favourable is the comparative amplifying effect of the Dominanta offer and vice versa.

[**61**] Mr Soden says that the JSAs have concluded that in value terms the Final BZ Offer is reasonably comparable to the Transaction. The former is marginally better than the latter in the Low case and marginally worse in the High case. Mr Soden also says that these cases are not intended to be more probable than one another but are each prudent estimates.

[**62**] The JSAs say that they nonetheless have serious concerns about the deliverability of the Final BZ Offer. I shall return to this aspect below.

[**63**] Sova's creditors are institutional and professional parties. The creditors who have filed proofs of claim have indicated their approval of the Transaction. In an indicative vote which took place from 9 to 13 February 2023, in which the creditors were asked to express their preference for the Transaction or the Final BZ Offer (or for both or neither), some 97% by value of non-conflicted creditors who voted by the closing date for voting (constituting over 72% of all the creditors who have filed proofs of claim) supported the Transaction (and only a single creditor representing 0.6% of those voting, and being 0.4% of those who have filed proofs of claim, supported the Final BZ offer). After the closing date for voting four further indicative votes were received, of which three (1.3% by value) supported the Transaction and one (0.2% by value) supported neither.

[**64**] The JSAs have undertaken a detailed analysis of the compliance of the Transaction with Western Sanctions with the assistance of legal advice (privilege in which has been waived). They have concluded that the Transaction complies with Western Sanctions. I shall return to this below.

BROAD SUMMARY OF THE PARTIES' POSITIONS

[**65**] The JSAs seek the Court's permission to enter the Transaction. They say, first, that the Russian Securities that are likely to be transferred to Dominanta by the Transaction form a large proportion of Sova's estate, and Dominanta's claim against Sova, which will be waived (together with the dividend received in respect of it), constitutes a significant proportion of Sova's liabilities. They say that completion of the Transaction would therefore be 'particularly momentous' for Sova (in Robert Walker J's words, as cited by Hart J in *Public Trustee v Paul Cooper & Co* [2001] WTLR 901 at 922). Second, BZ has objected to the Transaction on the grounds that it infringes fundamental principles of insolvency law and public policy and the JSAs seek the court's guidance

concerning their powers. Third, at the hearing on 3 March 2022 when the administration order was made, Leech J indicated that in the event that any Sanctions-related issue arose in Sova's administration, the JSAs could and should return to the Court for directions. The completion of the Transaction potentially gives rise to such issues.

[**66**] The JSAs contend that the court should approve the Transaction for various reasons, which may be summarised broadly as follows.

[**67**] First, it will benefit Sova and its broader creditor population by increasing the dividend rate to the remaining creditors: the (current) projected final dividend will increase from 36.7% to at least 50.3% (in the Low case) and may increase to 62.1% or more (High case).

[**68**] Second, the value provided by the Transaction (on the JSAs' best estimates) equates to some 42.8% of the Nominal Value of the Target Russian Securities (Low case) and may amount to 52.8% or more (High case). On the evidence that is a good return.

[**69**] Third, by reducing the exposure of Sova to a large and otherwise illiquid Russian securities portfolio, the remainder of Sova's business may become more attractive to potential investors, who may in turn make an offer to rescue all or part of the same.

[**70**] Fourth, the JSAs consider that overall (taking into account value and deliverability together) the Transaction remains the best offer in relation to the Russian Securities currently available to the broader creditor population.

[**71**] Fifth, the completion of the Transaction may form the basis for similar transactions with other creditors, which may have further value to the estate in due course. There are hundreds of other Russian Securities which the JSAs still need to realise over and beyond the Target Russian Securities (as well as Russian related securities held in Western depositories).

[**72**] Sixth, while the Transaction and the Final BZ Offer are broadly comparable in value (see above) the JSAs have serious concerns about the deliverability of the latter.

[**73**] In his eighth statement Mr Soden says that it remains uncertain whether the Final BZ Offer will obtain Government Commission Consent; and that there is also a risk that the terms of any such Consent (if given) would seriously alter the commercial nature of the transaction.

[**74**] As to this, new criteria were introduced by the Russian Ministry of Finance on 30 December 2022 ('the MinFin Criteria') under which (a) the Government Commission may require the payment to the foreign seller to be deferred by 1–2 years and/or (b) the Commission may require the making of (what is described in translation as) a 'voluntary payment' of at least 10% of the transaction amount to the Russian federal budget and/or (c) Sova is prohibited from selling the Russian Securities at more than 50% of its market value. The JSAs say that the imposition of any or all of these conditions through a Government Commission Consent for the Final BZ Offer would make its value much worse than the Transaction and, if it involved a payment to the Russian government, would in any case be unacceptable to the JSAs.

[**75**] It was common ground that these criteria would not apply to existing Government Commission Consents, such as that obtained by Dominanta.

[**76**] BZ has served a report from Mr Murygin, a Russian lawyer. He notes that there is another condition in the MinFin Criteria – namely establishing key performance indicators for new shareholders. He says that there is therefore an argument that the decision of 12 December 2022 (ie the creation of the MinFin Criteria) was concerned with exit sales, ie sales of large equity stakes in Russian

businesses by exiting foreign companies, and that on this basis these additional conditions do not apply to sales of diversified portfolios such as the Target Russian Securities. He says that the risk that the conditions apply to such portfolios cannot be completely excluded. He accepts that there is uncertainty about the position. He also says that he has 'arranged through my contacts an unofficial discussion of this issue with the Ministry of Finance and it was confirmed that the additional conditions are intended to apply to corporate exits and not to the acquisition of a diversified securities portfolio'. There has been no cross examination and I cannot resolve this dispute. I can only proceed on the footing that it is uncertain whether the MinFin criteria will apply to the Final BZ Offer.

[**77**] The JSAs also say that the time required to obtain the Government Commission Consent is uncertain, and there is a risk that changes in the Sanctions Regimes in the meantime may render any transaction unviable.

[**78**] Seventh, the JSAs say that the views of the independent creditors, while not binding, are persuasive support for the rationality of the JSAs' view that Sova should enter the Transaction. The creditors are institutional or professional investors who are able to assess the commercial options. They are able in particular to assess the risks and rewards of the competing courses, which included entering either of the two live bids or rejecting both. The creditors are also aware that Dominanta may obtain a benefit by selling the securities on MOEX at a profit. The JSAs also provided the creditors with the correspondence from BZ's solicitors explaining the merits of the Final BZ Offer. 97% of the votes cast were for the Transaction, as compared to 0.6% for the Final BZ Offer.

[**79**] Eighth, the JSAs argue that the position they are in requires urgent action. It is impossible to predict the duration or course of the war in Ukraine. More sanctions or Russian countermeasures may be imposed at any time. The JSAs do not consider it to be in the interests of Sova's creditors as a whole to await (a) the end of the war and (b) the relaxation of the Sanctions Regimes before seeking to realise the Russian Securities. Further changes in the Sanctions Regimes may reduce the Russian Securities that the JSAs are able to use in the way currently envisaged pursuant to the Transaction to realise value for the benefit of Sova's creditors as a whole, and/or may make the process of doing so harder or practically impossible.

[**80**] Dominanta supports the applications.

[**81**] BZ opposes the approval of the Transaction.

[**82**] As already explained, he is an unsecured creditor for an estimated amount of just short of £20m. He is also a joint bidder for the Target Russian Securities in conjunction with TPM.

[**83**] I shall address BZ's legal objections to the Transaction in some detail below. In broad outline, he submits first that the Transaction was outside the powers of the JSAs or was contrary to public policy because it would infringe the pari passu principle. That requires equal treatment of creditors and the Transaction will result in one creditor, Dominanta, benefiting at the expense of the others.

[**84**] BZ submits second that the Final BZ Offer was preferable to the Transaction in some of the projected outcomes, including the Low Case. He says the Joint Bidders are confident that Government Commission Consent would be forthcoming and that the MinFin Criteria do not apply to the offer as

it is not an equity exit transaction of the kind covered by them. The cash element would be paid outside Russia and any requirement of CBR consent would be implicit in the consent of the Government Commission.

[**85**] BZ submits third that the JSAs could not show that they had reasonably achieved the best price for the Target Russian Securities. They had not taken the kinds of marketing steps to be expected of administrators and it was unclear whether they had achieved the best possible deal with Dominanta.

[**86**] BZ submits fourth that the JSAs have wholly surrendered their discretion to the court and that the court should not assume the task of exercising that discretion in their place.

FURTHER BACKGROUND

[**87**] Before turning to the issues raised by the parties' positions I should flesh out some further factual details. I shall do this under a number of heads.

Sova's business and assets

[**88**] Sova is incorporated in England and Wales and is authorised by the FCA to undertake regulated financial activities under Pt 4A of the Financial Services and Markets Act 2000. Sova provided a full range of investment brokerage services, included trading and execution services in all major asset classes and sectors, to institutional and professional clients.

[**89**] Sova's products included equities and derivatives, FX trading, commodities and fixed income. The primary focus of Sova's business was to provide international investors with access to the Russian market. It is not a deposit-taker. It is an investment bank for the purposes of the IBSARs and was placed into special administration on that basis: see Leech J's judgment at [2022] EWHC 814 (Ch) at [5].

[**90**] Sova's clients are sophisticated institutional or professional investors. Sova was not authorised to and did not provide services to retail clients.

[**91**] Before the special administration, Sova had 72 employees at its London office and 248 at its Moscow branch, which numbers were reduced to 27 and 103 as of 23 November 2022.

[**92**] It was managed by a team of four ('Management Team'), none of whom is a 'Designated Person' for the purposes of the UK Sanctions regime. The JSAs have continued to seek support from the Management Team during the special administration. It is by this means that they are able to conduct day to day business in Moscow.

[**93**] The JSAs' appointment in relation to Sova is not recognised in Russia, with the result that, but for the Management Team, the JSAs would be unable to operate Sova's Russian bank accounts, access its assets, or pay its employees in Moscow.

[**94**] Sova mainly operated under three sets of legal agreements with its clients. Since no point was taken on the calculation of the claims there is no need to recite the terms or the evidence concerning them.

[**95**] As at 11 November 2022 (following some realisations by the JSAs) Sova held (as its own property) 741 securities with an estimated value of approximately $US585.3m. Of these, 579 positions worth approximately $US506.6m (87% of the total value of the portfolio) consist of Russian Securities. (Where figures are given in currencies other than sterling, they have been converted using an appropriate exchange rate.)

[**96**] These Russian Securities are held in an account in Russia with the National Settlement Depository ('NSD'), Russia's central securities depository,

either directly or on Sova's behalf by a Russian custodian, Region Broker Company LLC ('Region'). 28 of the securities relevant to the Transaction are held by the NSD either at Euroclear or at Clearstream.

[**97**] The remaining 162 securities are held in non-Russian depositories and have an estimated value of $US78.7m.

The special administration

[**98**] By IBSAR 10, the special administration may pursue any of the three statutory objects, prioritising them as the JSAs see fit: (1) the return of client assets as soon as is reasonably practicable; (2) timely engagement with market infrastructure bodies and relevant authorities; and (3) either (a) rescue of the investment bank as a going concern or (b) its winding up in the best interests of its creditors.

[**99**] On 26 April 2022 the JSAs published their statement of proposals for achieving the purpose and the objectives of the special administration.

[**100**] Since their appointment, the JSAs have pursued all three objectives equally without prioritising one over others. In relation to objective (1) they have identified and returned client assets to clients. In relation to (2) they have continued to liaise with market infrastructure bodies and relevant authorities, including the FCA, the Office of Financial Sanctions Implementation (OFSI), securities exchanges, clearing houses and depositaries.

[**101**] As to objective 3, the JSAs considered that Sova's business could not be sold or recapitalised whilst there was significant uncertainty about its assets (including in an uncertain sanctions and restrictions environment). The JSAs have prepared for a winding-up in the event a rescue of the business is not possible.

Constraints on Sova's ability to deal with the Russian Securities

[**102**] As already explained Sova cannot easily realise the Russian Securities because of outright prohibitions pursuant to the Sanctions Regimes, or where transfer is subject to approval or authorisation.

[**103**] The first constraint arises because Sova cannot trade on MOEX. The Russian Securities generally trade on MOEX, which has since February 2022 been closed to foreign residents of countries designated as 'hostile' by the Russian authorities. The accounts of such investors, including Sova, were designated as 'C' or 'S' accounts and the holder of such an account cannot trade on MOEX.

[**104**] This is part of the reason that the trading prices of the Russian Securities published by MOEX are inaccessible to Sova and the JSAs.

[**105**] The JSAs have explained (and I accept) that they are forced to treat such prices as no more than Nominal Values of such Securities.

[**106**] The second constraint arises from the need for Sova to obtain Government Commission Consent to enter into an OTC trade with a Russian buyer.

[**107**] Such consent is discretionary, may be withheld, and may take an uncertain length of time to obtain even if eventually given. A prospective Russian buyer may be required to set aside funds to complete the purchase, in circumstances where it was uncertain whether and, if so, when it would obtain such Consent.

[**108**] There is a particular issue concerning the MinFin criteria, which were published on 30 December 2022. These apply prospectively. As already explained there is uncertainty (which I cannot resolve) about the application of

these criteria. If they were to apply to the Russian Securities they would impose serious restrictions because of the 50% value limit, the requirement of 1–2 year deferment and/or the requirement to pay at least 10% to the Russian federal budget.

[**109**] These potential costs and uncertainties also mean that a potential Russian buyer may prefer to trade with a Russian seller (on exchange).

[**110**] This is another reason why MOEX prices for the Russian Securities are no more than nominal for Sova.

[**111**] A third set of constraints concerns the ability of Sova to extract cash from a sale. Banks are subject to high capital charges for balances in currencies from 'hostile' jurisdictions. As a result, prospective Russian buyers of Russian Securities find it difficult to access foreign currencies in Russia. Further, the JSAs' Russian law evidence is that a Russian buyer seeking to make a payment outside Russia would generally require the consent of the CBR.

[**112**] Absent such consent, a Russian buyer would only be permitted to pay in roubles into Sova's 'C' account in Russia. Payment in Russia would be very unattractive to the JSAs as they are subject to significant constraints in repatriating cash from Russia to the UK.

[**113**] BZ's position is that in practice Government Commission Consent would carry with it the consent of the CBR. The JSAs' evidence is that this is not clear and that it is possible that separate consent is required. They say that CBR permission is separate from Government Commission Consent and that the CBR is not likely to approve a transfer of funds. I am unable to resolve this issue on these applications. Hence I proceed on the basis that this is another potential constraint.

[**114**] The fourth set of such constraints arise under Western Sanctions. Sova and the JSAs cannot deal with a Designated Person (or its equivalent). The most likely buyer of a significant portfolio of Russian Securities would be a Russian financial institution. However, as Mr Soden explains, most significant such institutions are subject to sanctions and/or asset freezes. This severely limits the universe of potential buyers.

[**115**] Sales to a Western buyer are unlikely for all the above reasons. Any such buyer would be subject to the same constraints. More generally most Western parties who were previously active in the Russian market have exited or are seeking to exit that market, which again limits the population of buyers.

[**116**] I raised with the JSAs during the hearing whether there might be a class of non-Russian buyers in jurisdictions which have not been branded as hostile by the Russian government. I was informed that such buyers have not been at all active in acquiring Russian securities and that the JSAs do not consider them to constitute a realistic population of buyers. This was confirmed in Mr Soden's tenth statement.

[**117**] A member of staff at Sova made some very rudimentary inquiries of a number of Western institutions, including Citibank and Goldman Sachs, which showed no interest in acquiring Russian securities.

[**118**] The JSAs have also invited all Sova's creditors to make bids for the Russian Securities. The creditors include BCS Global Markets, an independent (non-sanctioned) Russian broker, which was Sova's principal competitor. Though some indicative offers were made, no solid bid capable of acceptance has been made by any of the other creditors.

[**119**] The result is that the only serious offers the JSAs have received for the Russian Securities are the Transaction and the Final BZ Offer.

[**120**] The JSAs' contend that the position of parties able to trade in the Russian Securities without being significantly constrained by the issues explained above is analogous to that of special purchasers.

The JSAs' treatment of the Russian Securities in Estimated Outcome Statements

[**121**] The JSAs have produced an Original Estimated Outcome Statement and an Interim Estimated Outcome Statement for the administration. These assume no realisation in respect of the Russian Securities (with three limited exceptions).

[**122**] Mr Soden explains that this is because the JSAs considered these assets to be either difficult or practically impossible to realise, or that the quantum of any such realisation was so uncertain that any estimate would be a best guess based on little or no evidence.

[**123**] The EOSs represent a prudent assessment of the potential realisations, and the JSAs considered it appropriate to ascribe a nil or minimal value to the assets to avoid overstating the financial position.

[**124**] Mr Soden explains that the nil valuation of the Russian Securities in the Original EOS and the Interim EOS does not affect the assessment of the different bids that are now being advanced, nor the comparative fairness of those bids.

Dominanta

[**125**] Dominanta is a company incorporated in Russia, and with premises in Moscow. It is (indirectly) majority owned by Mr Avdeev. Mr Avdeev is not a sanctioned individual under the UK, EU, or US Sanctions Regimes. He is a sanctioned person under Ukrainian law. I shall return to this below.

[**126**] At the commencement of the special administration, Dominanta was not a creditor of Sova. It then took assignments of claims originally held by five Sova creditors and submitted a proof in Sova's estate of £233,261,442 and $US20,075,724.

[**127**] The first element of this proof has been admitted for dividend purposes. This is the Dominanta Adjudicated Claim. It consists of four claims assigned by four parties.

[**128**] The second element of the proof has not yet been adjudicated. This element represents the claim assigned to Dominanta by a party ('the ISDA Assignor') affected by Western Sanctions.

[**129**] Dominanta is a member of the creditors' committee (as constituted on 8 June 2022) and holds about 29% of the unsecured claims against Sova (including the unadjudicated part acquired from the ISDA Assignor).

The Dominanta offers

[**130**] Dominanta made an offer to the JSAs initially in draft on 18 August 2022, and then in final form on 22 August 2022.

[**131**] Dominanta offered to acquire a portfolio of Russian Assets (to be agreed between the parties) with a Nominal Value (by reference to a source and exchange rate to be agreed) equal to its debt divided by 85% in return for the full discharge and release of the debt owed to it by Sova. This was initially intended to apply to Dominanta's claim in full. However, due to sanctions constraints regarding the ISDA Assignor, this offer was subsequently limited to the Dominanta Adjudicated Claim. The transaction was expressed to be subject to approval by the Government Commission.

[**132**] The result of the Transaction, if successfully completed, would be the release by Sova of the entire £233,261,442 Dominanta Adjudicated Claim in return for the transfer by Sova to Dominanta of Russian Securities with a Nominal Value of £274,425,226.88.

[**133**] On 20 October 2022 Dominanta updated the terms of its offer. While the core commercial terms remained the same, Dominanta: (a) clarified that the target securities were certain of those securities held by Sova with the NSD either directly or indirectly; (b) provided an updated list of target securities in order of priority; and (c) introduced a condition that any Target Russian Securities and Other Russian Securities should not be disposed until after the Dominanta Adjudicated Claim had been satisfied in full.

[**134**] In relation to negotiations between the JSAs and Dominanta, Mr Soden explains that the initial communications were made to the JSAs via the Management Team, but subsequent engagement has been directly between the JSAs and Dominanta. He says that the terms of the Transaction (and without waiving privilege) have been negotiated directly between the JSAs and Dominanta (including the parties' respective legal representatives). The JSAs have had no direct contact with Mr Avdeev.

[**135**] There was no direct evidence about the course of the negotiations with Dominanta. In particular there was no evidence about the extent to which the JSAs pushed back on the 15% discount proposed by Dominanta. I was however informed by the JSAs during the hearing that the JSAs had sought to negotiate this and had not succeeded. It has not been the subject of evidence.

Market testing

[**136**] Mr Soden gives evidence of what he calls market testing following receipt of Dominanta's initial offer in August 2022. They concluded that there was limited market interest in acquiring these securities from Sova for cash.

[**137**] Mr Soden refers to Sova approaching Sova's traditional market counterparties (Citigroup Global Markets, Goldman Sachs, JP Morgan and BCS). BCS is the largest independent broker in Moscow and was (as mentioned above) Sova's primary competitor. 'Market testing' is to my mind a rather grand word for what happened. It appears that a very brief inquiry was made of these houses through an online chat function concerning their appetite for some lines of Russian Securities. Nonetheless it appears to me that the lack of appetite of the Western entities to invest in Russian securities was entirely predictable.

[**138**] BCS is Russian, but as already explained, it is a member of the creditors' committee and has been invited to make its own bid for the Russian Securities.

[**139**] The JSAs have also of course informed BCS (along with other creditors) about the Transaction and the BZ offers and BCS could, if it thought the securities were being seriously undervalued, have made its own offer. The JSAs indeed invited offers along the same lines as the Dominanta offer (see further below).

[**140**] Mr Soden also says that the JSAs approached seven distressed debt funds (which are used to transacting in illiquid assets in distressed situations) and that they showed no interest.

[**141**] None of the parties approached by the JSAs have made more than indicative quotes, which were between 20–50 cents in the US$. These were not real offers, in the sense that they were price indications only.

[**142**] The JSAs considered that many other relevant market participants would have been notified as part of the creditor bidding process in circumstances where Sova's creditors include parties who originally transacted with Sova in relation to these types of assets.

[**143**] These creditors included a number of brokers, asset managers and other market participants with operations in Russia and elsewhere (eg Cyprus and the UK) who would usually be the target for portfolio placement of line-by-line securities. These included ITI Invest, Region and SPB Bank. These parties were made aware of the opportunity to bid for the securities held by Sova.

[**144**] The JSAs also contacted (via the Management Team) Veles, Aton and Rencap to investigate their potential appetite for transacting in the Russian Securities.

[**145**] The JSAs contend that they made what, in the circumstances, were reasonable efforts to market the Russian Securities in the relevant markets to the proper audience.

[**146**] BZ criticises the JSAs for failing to appoint an independent Russian brokerage or investment adviser to assist them in seeking to market the Russian Securities. He says that there are grounds for concluding that the JSAs may not have taken the steps reasonably available to them to test the market. He also says that the initial negotiations appear to have come via staff at Sova who may have been conflicted. I shall revert to these complaints below.

[**147**] However I record at this stage that I am satisfied that there has been widespread knowledge of the JSA's wish to dispose of the Russian Securities through the JSA's communications with creditors, who are likely to include a broad cross-section of Russian market participants.

[**148**] In any event as things stand the position is that there are only two realistic offers for the Russian Securities – the Transaction and the BZ Final Offer. As already explained, these effectively place a value on the Target Securities (on different projected outcomes) of £117m to £144m, being 42.8% to 52.8% of the Nominal Value of the Target Russian Securities of c £274m.

[**149**] Moreover the court's decision in January 2023 to adjourn the hearing of the JSAs' applications created a further period of competition between Dominanta and the Joint Bidders. This led to an increase in the bid of the latter. I conclude that these bids (which are reasonably comparable in value) are good evidence of the current realisable value of the Target Russian Securities for Sova.

The securities: valuation and the consideration

[**150**] The Target Russian Securities which are the subject-matter of the Transaction comprise (a) bonds issued by the Russian government, (b) bonds issued by the Credit Bank of Moscow, (c) bonds issued by other legal entities incorporated in Russia, (d) equities issued by legal entities incorporated in Russia, and (e) bonds and equities issued by members of corporate groups with substantial operations in Russia.

[**151**] The First Target Russian Securities and the Second Target Russian Securities ostensibly have a respective estimated Nominal Value of approximately £188.2m (PTA1) and £104.5m (PTA2) (based on a combination of OTC prices agreed between the JSAs and Dominanta, and 13 January 2023 prices based on MOEX and FX rates).

[**152**] The JSAs have however concluded that (for the reasons already given above) this is not the value to Sova of the Target Russian Securities.

[**153**] In relation to 32 of the First Target Russian Securities and four of the Second Target Russian Securities, the relevant securities are fixed income positions and a single equity position, and ones where there has been minimal trading since the Appointment Date. On the basis that recent public market prices covering material trading volumes are not available, and the latest prices are not an accurate reflection of each security's value and/or may be inflated in any event, the JSAs have agreed an OTC fixed price with Dominanta which, together with accrued interest as at 13 January 2023, gives a Nominal Value of £84.0m and £6.4m respectively.

[**154**] In relation to the remaining 39 of the First Target Russian Securities and 14 of the Second Target Russian Securities, there is no fixed value set out in the relevant transfer agreement, and the final value will be determined by reference to an agreed pricing methodology. Clause 4.8 of the transfer agreements provides Sova with protection against trading prices being negatively impacted by any volume trading in the relevant securities by Dominanta and its affiliates.

[**155**] There are twelve First Target Russian Securities and three Second Target Russian Securities which it appears require the approval of the Russian President in order to be transferred on the basis they are of strategic interest ('Russian Strategic Securities'). These have been removed from the PTAs. The consequence of this is the removal of approximately £15.3m (8.1%) by Nominal Value of the First Target Russian Securities from Sch 1 of PTA1, the reduction of the Nominal Value of the First Target Russian Securities to £172.9m and the increase of the residual claim to be addressed by the Further Dominanta Transaction to £86.3m. In turn, the value of the Second Target Russian Securities would reduce by £5.4m to £99.1m. This gives a total value for the First Target Russian Securities and the Second Target Russian Securities, excluding Russian Strategic Securities, of c £274.0m (or £272.0m using revised FX rates as at 13 January).

PTA1 and PTA2

[**156**] The JSAs and Dominanta entered PTA1 on 2 December 2022.

[**157**] As already explained, a subset of 71 of some of the highest-value Russian Securities held by Sova will be offered to Dominanta as partial consideration for the extinguishment of the Dominanta Adjudicated Claim.

[**158**] PTA1 (which is in materially the same terms as PTA2) has the following features:

(a) It is subject to the CPs, including the confirmation of the making of the Court order on the First Application. The other CP, obtaining Government Commission Consent, has been satisfied.

(b) The agreement contains a mechanism for selection of securities, as (a) market prices on the MOEX will continue to fluctuate, (b) exchange rates will continue to fluctuate, and (c) certain of the Target Russian Securities may be redeemed or otherwise become incapable of transfer. These contingencies mean that it is not currently possible to determine the precise extent of the securities that Dominanta will receive. Clauses 4.4, 4.5 and 4.6 therefore create a process for the selection of the final list of Target Russian Securities. In short, at the Valuation Date (being the date upon which the Court's approval is obtained such that the remaining CP is satisfied), Sova will assign value to each of the Target Russian Securities that does not have already have a fixed value, such that every security on

Sch 1 is ascribed a value. This will allow Sova to determine the extent of the securities which need to be transferred to extinguish the Dominanta Adjudicated Claim. Sova will then select the securities to be transferred in descending order, starting with the first listed security and ending with the 'Cut-Off Security' at the point that the aggregate value of the securities transferred equals or exceeds the value of the Dominanta Adjudicated Claim. Any Target Russian Securities listed after the Cut-Off Security will not be transferred.

(c) In the event that the Nominal Value of the Final Target Russian Securities (x 85%) is less than the value of the Dominanta Adjudicated Claim, a Residual Creditor Claim will remain to be dealt with under PTA2.

[**159**] By an amendment agreement dated 30 December 2022, the JSAs and Dominanta agreed to some (limited) changes to the agreement. These are not material.

[**160**] PTA2 was executed on 30 December 2022. This was because, in late November 2022, it was realised that Hogan Lovells International LLP (which includes its UK offices) would be unable to act in relation to all the Target Russian Securities that were ultimately included within the scope of the Transaction because of US Sanctions.

[**161**] Sova instructed a second firm of solicitors, Shoosmiths LLP, to act in relation to these securities.

[**162**] Sova executed PTA2 on 30 December 2022. It is the same as PTA1 (as amended) other than in relation to the list of securities set out at Sch 1. PTA2 includes a subset of 18 Russian Securities held by Sova. If the 15 Russian Strategic Securities are unable to be transferred (because it is finally determined that they are such securities and the requisite presidential approval is not received), then based on 13 January 2023 Nominal Values, it is anticipated that these Russian Securities, in conjunction with those under PTA1, would not be sufficient to extinguish the Dominanta Adjudication Claim in full. As such, further transactions would be needed in order to extinguish the Dominanta Adjudicated Claim in full.

Further amendments to the PTAs

[**163**] PTA1 and PTA2 were further amended, respectively, on 10 February 2023 and 13 February 2023. These changes were proposed by the JSAs in order to address the argument advanced by BZ that the PTAs infringe the pari passu principle.

[**164**] The material changes were these:

(a) Three new terms were defined. The 'Final Dividend Percentage' was defined as a percentage value currently estimated to be between 50.3% and 62.1%, being the aggregate total dividend percentage ultimately paid by Sova to its unsecured creditors after completion of the Transaction. 'Value' was defined as the Nominal Value of that Security multiplied by 85% of the Final Dividend Percentage. 'Creditor Claim Value' was defined as the Dominanta Adjudicated Claim multiplied by the Final Dividend Percentage.

(b) Clause 4.1 was inserted which defined the consideration each party received. By transferring a Target Russian Security to Dominanta, Sova would give Dominanta consideration worth the Value of that Security (such that if sufficient Russian Securities were transferred, Dominanta would acquire securities with a value of £274.4m x 85% x the Final

Dividend Percentage). In return, Dominanta would waive that proportion of the Dominanta Adjudicated Claim which has the same Creditor Claim Value as the Value of the Security transferred to it by Sova (such that if sufficient Russian Securities were transferred, Dominanta provide consideration with a value of £233.3m x the Final Dividend Percentage).

(c) By multiplying the Dominanta Adjudicated Claim by the Final Dividend Percentage, the parties were therefore agreeing that the Dominanta Transactions would only result in Dominanta getting the same value as the other creditors.

[**165**] As already explained, these changes were designed to spell out the respective benefits to the parties. The overall substance of the Transaction has not however changed: the essential bargain is that Dominanta will receive the Russian Securities and Sova will receive a waiver of Dominanta's claims in exchange.

The Final BZ Offer

[**166**] The Final BZ Offer is an offer to buy the Russian Securities (including the Strategic Russian Securities but excluding the Excluded Russian Securities) for a consideration consisting of: (i) £125m in cash; and (ii) the discharge of Mr Zilbermints' claim in the sum of £19.9m (if this is legally permissible), on the basis that each £1.00 of Russian Securities will discharge £1.00 of his claim.

[**167**] In the event that the value of the Russian Securities to be transferred (excluding the Strategic Russian Securities) is ultimately lower than £274,425,226.88 on the transfer date, the cash component will be reduced proportionately.

[**168**] Further, if the court holds that it is not permissible for the JSAs to transfer assets to a creditor (see below), the consideration will consist solely of £125m in cash.

[**169**] The Final BZ Offer is set out in the letter dated 24 January 2023 from BZ's solicitors. This was accompanied by: KYC information in respect of TPM; a guarantee from AresBank dated 23 January 2023; a Loan Facility Agreement between AresBank and TPM dated 23 January 2023; and a statement of Chairman of the Board of AresBank in relation to Aresbank's asset position dated 23 January 2023.

[**170**] On 25 January 2023 the JSAs were provided with the opinion of Russian counsel, addressing the legal and regulatory requirements and deliverability. An updated Russian opinion (addressing the MinFin criteria) has also been provided. There has also been further correspondence between the solicitors for BZ and the JSAs concerning the Final BZ Offer.

PRINCIPLES CONCERNING THE APPROVAL BY THE COURT OF A TRANSACTION

[**171**] There was no real dispute about the relevant legal principles concerning the court's approval of a transaction to be undertaken by insolvency office holders.

[**172**] The starting point is the excerpt from Robert Walker J's judgment set out by Hart J in *Public Trustee v Paul Cooper & Co* [2001] WTLR 901 at 922:

> 'The second category is where the issue is whether the proposed course of action is a proper exercise of the trustees' powers where there is no real doubt as to the nature of the trustees' powers and the trustees have decided how they want to exercise them but, because the decision is

particularly momentous, the trustees wish to obtain the blessing of the court for the action on which they have resolved and which is within their powers. Obvious examples of that, which are very familiar in the Chancery Division, are a decision by trustees to sell a family estate or to sell a controlling holding in a family company. In such circumstances there is no doubt at all as to what the trustees want to do but they think it prudent, and the court will give them their costs of doing so, to obtain the court's blessing on a momentous decision. In a case like that, there is no question of surrender of discretion and indeed it is most unlikely that the court will be persuaded in the absence of special circumstances to accept the surrender of discretion on a question of that sort, where the trustees are prima facie in a much better position than the court to know what is in the best interests of the beneficiaries.'

[**173**] *Re MF Global UK Ltd* [2014] EWHC 2222 (Ch), [2014] Bus LR 1156 was a case concerning a compromise of claims by administrators. At [32] David Richards J explained the Court's function in Category 2 cases by approving the following statement from *Lewin on Trusts*:

'The court's function where there is no surrender of discretion is a limited one. It is concerned to see that the proposed exercise of the trustees' powers is lawful and within the power and that it does not infringe the trustees' duty to act as ordinary, reasonable and prudent trustees might act, ignoring irrelevant, improper or irrational factors; but it requires only to be satisfied that the trustees can properly form the view that the proposed transaction is for the benefit of beneficiaries or the trust estate and that they have in fact formed that view. In other words, once it appears that the proposed exercise is within the terms of the power, the court is concerned with limits of rationality and honesty; it does not withhold approval merely because it would not itself have exercised the power in the way proposed. The court, however, acts with caution, because the result of giving approval is that the beneficiaries will be unable thereafter to complain that the exercise is a breach of trust or even to set it aside as flawed; they are unlikely to have the same advantages of cross-examination or disclosure of the trustees' deliberations as they would have in such proceedings. If the court is left in doubt on the evidence as to the propriety of the trustees' proposal it will withhold its approval (though doing so will not be the same thing as prohibiting the exercise proposed). Hence it seems that, as is true when they surrender their discretion, they must put before the court all relevant considerations supported by evidence. In our view that will include a disclosure of their reasons, though otherwise they are not obliged to make such disclosure, since the reasons will necessarily be material to the court's assessment of the proposed exercise.'

[**174**] At [41] David Richards J said:

'In commercial matters, administrators are generally expected to exercise their own judgment rather than to rely on the approval or endorsement of the court to their proposed course of action: see *In re T & D Industries plc* [2000] 1 WLR 646. While the compromise of claims raising difficult legal issues may not be on all fours with a purely business decision, administrators commonly exercise the power of compromise without

recourse to the court and in general apply to the court for directions only if there are particular reasons for doing so: see *In re Lehman Bros International* Europe [2014] BCC 132.'

[**175**] In the *T&D Industries* case cited there, Neuberger J said ([2000] 1 All ER 333 at 344, [2000] 1 WLR 646 at 675) that—'a person appointed to act as an administrator may be called upon to make important and urgent decisions. He has a responsible and potentially demanding role. Commercial and administrative decisions are for him, and the court is not there to act as a sort of bomb shelter for him.'

[**176**] This finds echoes in another decision of David Richards J in *Re T&N Ltd* [2004] EWHC 2361 (Ch), [2005] 2 BCLC 488, [2004] All ER (D) 283 (Oct). At [76] he said:

'The administrators have wide powers to realise assets of the companies. The exercise of these powers, and other powers associated with the management of the company's business, are regarded by the court as matters for the commercial judgment of the administrators, rather than as appropriate matters for directions by the court … The court would not normally give directions to an administrator as to the means by which he should market assets, any more than as to which particular deal to make.'

[**177**] In *Re Nortel Networks UK Ltd* [2016] EWHC 2769 (Ch), [2017] 2 BCLC 572, [2017] Bus LR 590 (at [49]–[50]), having cited the same passage from *Lewin on Trusts*, Snowden J said:

'[49] For my part, whilst noting that the position of an administrator seeking directions under the Insolvency Act, and a trustee seeking directions under the Trustee Act are not identical, I see no obvious reason why most of the same considerations should not apply when the court considers giving directions to an administrator who wishes to enter into a compromise which is particularly momentous. In short, the court should be concerned to ensure that the proposed exercise is within the administrator's power, that the administrator genuinely holds the view that what he proposes will be for the benefit of the company and its creditors, and that he is acting rationally and without being affected by a conflict of interest in reaching that view. The court should, however, not withhold its approval merely because it would not itself have exercised the power in the way proposed.

[50] … But having regard to the fact that its approval will prevent subsequent challenge, the court will require the administrator to put all relevant material before it, including a statement of his reasons, and the court will not give its approval if it is left in any doubt as to the propriety of the proposed course of action.'

[**178**] In *Nortel* Snowden J was concerned with a case where there was a potential conflict of interest and there was no issue about the administrators' powers to compromise claims. Snowden J referred to the passage from *MF Global* [2014] Bus LR 1156 at [41] (see above). That highlights the limitations on the willingness of the court to approve the decisions of office-holders on commercial matters. Snowden J was satisfied that there were particular reasons for the administrators' application.

[**179**] In the context of Russian sanctions, in *Re Petropavlovsk plc* (*in administration*) [2022] EWHC 2097 (Ch), [2022] All ER (D) 27 (Aug) (at [73]),

Jonathan Hilliard QC, sitting as a Deputy Judge of the High Court, applied the same principles. To the extent that the judgment went further than the earlier cases I would not follow it.

[**180**] There was some discussion before me of the extent to which an order by which the court approves a transaction will immunise an office holder from subsequent proceedings. I was referred to *Denaxe Ltd v Cooper* [2022] EWHC 764 (Ch), [2022] 4 WLR 52 where the point directly arose. In that case receivers appointed by way of equitable execution (rather than office-holders under the Insolvency Act) applied for approval of a sale to their preferred bidder. Marcus Smith J approved the sale. The owner of the sold assets then sued the receivers for negligence for selling the assets as a package and for failing to obtain the best price reasonably obtainable. Fancourt J struck out the claims. He held that the receivers were immune from any challenge to the transaction and that it did not matter whether the claim was framed as one for breach of fiduciary duty or in negligence. It was the necessary consequence of Marcus Smith J's order that the receivers had acted properly in the sense of undertaking a proper decision making process. Fancourt J said at [84] that, to attract immunity, the wrong alleged against the office holder must relate to the decision making process or the aspects of the transaction that the court has sanctioned. If the breach alleged relates to an unconnected decision or other conduct of the office-holder there would be no immunity. He explained at [85] that if the court is asked to approve a sale what is approved is the decision to sell at the time. There is no endorsement of any decision taken previously not to sell the asset.

[**181**] This decision has been appealed. None of the parties before me suggested that it was wrongly decided or directed any real argument to it.

[**182**] It appears to me that the scope of any subsequent immunity where the court is asked for directions from an office-holder must be sensitive to the particular facts: it depends on the specific nature of the question(s) before the court on the application and of any answer(s) given by the court. I do not think there can be a blanket rule of law that the court's approval of a transaction automatically generates full immunity in all respects concerning the transaction. It depends on the issues raised and the court's answers.

[**183**] It is unnecessary to express any concluded views on this issue as the JSAs explained that the purpose of the applications was not to seek sanctuary or immunity from suit and, moreover, that it would be open to the court on giving its approval to spell out the nature of such approval.

[**184**] I add these observations (drawn from the caselaw and the court's practice):

(a) Administrators are professionals who fulfil a commercial role in conducting the business and affairs of the company in administration. They are generally required to make their own commercial decisions and cannot expect to rely on the approval of the court in those respects.

(b) There may in this regard be differences between trustees of private trusts and office-holders appointed under the insolvency legislation. Office-holders are required routinely to take momentous commercial decisions and to weigh up the risks and rewards of competing courses. As Snowden J observed in *Nortel* [2017] 2 BCLC 572, [2017] Bus LR 590 the principles may be similar, but they may not be identical in all respects.

(c) The question whether there are particular reasons for applying to the court cannot depend on whether the commercial decision is more or less

difficult. Even hard commercial decisions are for the administrators, not the court. Nor can the scale of the transaction be the touchstone. Administrators should not assume that the court will entertain an application for directions simply because the matter is hard or large.

(d) It may be appropriate to seek the court's approval where doubts have been expressed about the administrators' powers or there are potential conflicts of interest or where there may be potential issues as to the legality of a proposed transaction. This is not an exhaustive list but, putting it negatively, the court is unlikely to give directions in a case which is in truth seeking the blessing of a commercial decision.

(e) The court may in an appropriate case also be asked to consider the rationality of the proposed course of action (for the purposes of the proper purpose rule). Where it does so, it does not necessarily follow from a ruling on rationality that the court is satisfied that there are no possible claims against the office holder (for example in negligence) concerning the process which has led up to the relevant decision. The scope of any immunity will depend very much on the facts (see above).

(f) The court is not a sanctuary or bomb shelter for office-holders. There is no blanket or automatic rule about the scope of any immunity for the office-holder. The scope of any immunity depends on what precisely the court decides.

(g) What most matters for office-holders and others interested in the estate is that the transaction covered by the approval is secure against future challenge (absent some flaw in the approval process).

(h) On an application for directions, the court does not have the benefit of disclosure or cross examination. The court depends on the administrators to make complete and candid disclosure of the necessary material but the court is not in the position of making a full investigation of the position. A directions hearing should be comparatively short and contained. It is not intended to be a trial, even a mini one. This is a further reason why the court will be cautious about reaching findings of fact going beyond those strictly required by the directions sought.

THE PRINCIPAL ISSUES FOR DETERMINATION

[**185**] The principal issues may now be identified:

(a) Have the JSAs surrendered their discretion to the court and is it otherwise appropriate in principle for the JSAs to seek the court's approval of the Transaction?

(b) Is the JSAs' decision to commit Sova to the Transactions within their statutory powers and/or does it comply with the principles of insolvency law?

(c) Is the JSAs' decision to enter the Transaction rational and honest?

(d) Is there a real risk that the Transaction breaches applicable sanctions laws?

Issue (a): Have the JSAs surrendered their discretion to the court and is it otherwise appropriate in principle for the JSAs to seek the court's approval of the Transaction?

[**186**] BZ submitted that, because the JSAs will only proceed to completion of the Transaction if the court approves it, the JSAs have surrendered their discretion to the court.

[**187**] I am unable to accept this submission.

[**188**] To my mind the entry by the office-holder into an agreement which is conditional on the court's consent does not mean that the office-holder has (without more) surrendered his or her discretion. On the contrary the office-holder has already exercised his or her discretion by deciding to execute the transaction but wishes to obtain the approval of the court as a pre-condition to its being effective. This is no different in substance from the office-holder seeking the court's advance approval before entering the transaction.

[**189**] I agree with counsel for the JSAs that the relevant question in this respect is essentially whether the administrators are asking for approval of a course already decided on or leaving the decision to the court.

[**190**] The caselaw shows an office-holder may commit to a transaction on condition that the court gives its approval to the transaction and then apply to the court for such approval. In *Nortel* [2017] 2 BCLC 572, [2017] Bus LR 590 the administrators sought directions that they be at liberty to perform a global settlement agreement of disputes that had arisen concerning the affairs of the Nortel group. The agreement had already been executed but was subject to a condition that the administrators should obtain the approval of the court.

[**191**] On the present facts it is clear that the JSAs have already decided to exercise their discretion in a specific way by entering the Transaction. They have not thrown the decision onto the court on the footing that they cannot decide how to act. They are sure that the Transaction is the right course (but have structured it as dependent on obtaining approval). The JSAs have decided that they have the power to commit Sova to enter into the PTAs and in the circumstances, the Transaction is the appropriate way of discharging their duties and functions.

[**192**] They have therefore pursued the Transaction by negotiating its terms, seeking the views of creditors and the creditors' committee, causing Sova to enter it, agreeing to cause Sova to use its reasonable endeavours to obtain the court's approval, engaging in extensive due diligence to ensure compliance with sanctions law, and, when making these applications, positively advocating the Transactions.

[**193**] I also consider that in principle this was an appropriate case for the JSAs to seek the court's approval. The applications concern the disposal of a substantial part of Sova's estate. They also arise in very unusual circumstances in which there is a sharp asymmetry in the value of the relevant property from the perspectives of Sova and any Russian buyer, including Dominanta. The legal mechanism of the Transaction (the transfer of the securities in return for the waiver of Dominanta's claim) appears to raise novel issues which have not previously been decided by the courts. The decision to enter the Transaction has been challenged root and branch by BZ who says that the JSAs are acting in excess of their powers and contrary to the most basic principles of insolvency law. The Transaction also raises the potential application of sanctions laws and the court will plainly not approve any action by its officer holder where there would be a realistic risk of breaching such laws. I am also satisfied there is urgency in that there may be further changes in the Western and Russian legal regimes which may make it still more difficult for the JSAs to realise value from the Russian Securities.

[**194**] For these reasons I am satisfied that these were proper applications to bring before the court. I should add that I am not persuaded that the scale of the Transaction makes it a particularly momentous one which would, on its

own, justify an application. It is commonplace for administrators to sell or dispose of the assets of the company. They often indeed sell all of the assets at once. These are commercial decisions and they are for the administrators to make, not the court. To my mind this applies whether the sale is of all, most or only some of the assets.

Issue (b) Is the JSAs' decision to commit Sova to the Transactions within their statutory powers and/or does it comply with the principles of insolvency law?

[**195**] The parties' submissions under this head ranged broadly over some basic principles of insolvency law.

[**196**] I shall refer to the parties' submissions in more detail below. But before that I should identify the statutory provisions and general principles of insolvency law relied on by the parties. It helps to recite them here so that the parties' submissions are easier to follow. These principles were common ground. The real debate was about their application.

The statutory insolvency scheme

[**197**] The first general principle is that creditors are entitled to require the company's assets to be distributed in accordance with the statutory scheme. See *Mitchell v Carter; Re Buckingham International plc* [1997] 1 BCLC 673 at 684 in which Millett LJ explained:

> 'The making of a winding-up order divests the company of the beneficial ownership of its assets which cease to be applicable for its own benefit. They become instead subject to a statutory scheme for distribution among the creditors and members of the company. The responsibility for collecting the assets and implementing the statutory scheme is vested in the liquidator subject to the ultimate control of the court. The creditors do not themselves acquire a beneficial interest in any of the assets, but only a right to have them administered in accordance with the statutory scheme. These principles were established in *Ayerst (Inspector of Taxes) v C & K (Construction) Ltd* [1975] 2 All ER 537, [1976] AC 167. They apply to all the assets of the company, both in England and abroad, for the making of a winding-up order is regarded as having worldwide effect. The powers of the court are, of course, more limited. But it has power to take whatever steps are open to it within the territorial limits of its own jurisdiction to enable the liquidator (one of its own officers) to get in and realise for the benefit of the creditors all the assets of the company which are subject to the statutory scheme, wherever in the world they may be.'

[**198**] See also *Ayerst (Inspector of Taxes) v C & K (Construction) Ltd* [1975] 2 All ER 537 at 540–541, 543, [1976] AC 167 at 176–177 and 180 per Lord Diplock, *Roberts Petroleum Ltd v Bernard Kenny Ltd* [1983] 1 All ER 564 at 572, [1983] 2 AC 192 at 208 per Lord Brightman and *Re International Tin Council* [1987] 1 All ER 890 at 899, [1987] Ch 419 at 446 per Millett J.

[**199**] The rights of creditors are materially the same in administrations, as Stanley Burnton LJ explained in *Harms Offshore AHT 'Taurus' GmbH & Co KG v Bloom* [2009] EWCA Civ 632, [2009] 2 BCLC 473, [2010] Ch 187 (at [24]).

[**200**] The right of creditors to have the company and its assets dealt with in accordance with the statutory scheme is an enforceable statutory right, as David Richards J explained in *Re HIH Casualty & General Insurance Ltd, McMahon v McGrath* [2005] EWHC 2125 (Ch), [2006] 2 All ER 671 (at [115]):

> 'The statutory scheme of insolvency is not only seen as binding on liquidators and the courts but also as conferring enforceable rights on creditors. Creditors do not have a proprietary interest in the assets of the company in liquidation, but they do have a personal right to the administration and distribution of the assets in accordance with the statutory scheme.'

The pari passu rule or principle

[**201**] The pari passu principle requires that the distribution among unsecured creditors of assets available in an insolvent estate should be equal: see *Revenue and Customs Comrs v Football League Ltd* [2012] EWHC 1372 (Ch), [2013] 1 BCLC 285, [2012] Bus LR 1539 (at [63]).

[**202**] The principle is reflected for present purposes in r 149 of the Investment Bank Special Administration (England and Wales) Rules 2011, SI 2011/1301 ('the 2011 Rules') (which is materially the same as r 14.12(2) of the Insolvency (England and Wales) Rules 2016, SI 2016/1024). This provides:

> 'Debts, other than preferential debts, rank equally between themselves in the special administration and, after the preferential debts, shall be paid in full unless the assets are insufficient for meeting them, in which case they abate in equal proportions between themselves.'

[**203**] The Supreme Court has recently confirmed that the pari passu rule 'embodies the fundamental principle of equality': *Re Lehman Bros International (Europe) (in admin)* [2017] UKSC 38, [2018] 1 All ER (Comm) 629, [2018] AC 465 (at [20]) per Lord Neuberger; see also *Rubin v Eurofinance SA, New Cap Reinsurance Corp Ltd (in liq) v Grant (as members of Lloyd's syndicate 991 for the 1997 year of account)* [2012] UKSC 46, [2013] 1 All ER (Comm) 513, [2013] 1 AC 236 (at [94]) per Lord Collins.

[**204**] Arden LJ explained in *Re Lehman Bros International (Europe) (in admin)* [2010] EWCA Civ 917, [2011] 2 BCLC 184, [2011] 1 CMLR 783 (at [76]) that the—

> 'basic principle … [is] that creditors who rank on the same footing should be entitled to distributions pari passu and rateably … " … 'The maxim that equality is equity … expresses in a general way the object both of law and equity, namely to effect a distribution of property and losses proportionate to the several claims or to the several liabilities of the persons concerned …"'

[**205**] There are a number of exceptions to the pari passu rule, such as insolvency set-off under rr 14.24 and 14.25 of the Insolvency (England and Wales) Rules 2016 and r 164 of the 2011 Rules. See, generally, Goode *Principles of Corporate Insolvency* (5th edn, 2020) [8-16] and [8-18] to [8-34].

Variation of creditors' rights under the statutory scheme

[**206**] The rights of creditors under the statutory scheme may be varied by way of the unanimous agreement of the creditors, provided that the variation does not prejudice the interests of shareholders: see, eg, *Longley v ACN 090 609 868 Pty Ltd* (in liq) (formerly Solar Systems Pty Ltd) [2010] FCA 1468, (2010) 81 ACSR 517.

[**207**] Where the creditors do not agree unanimously to a variation of their rights under the statutory scheme, the variation must take place by way of a

binding statutory arrangement, such as a scheme of arrangement under Pt 26 of the Companies Act 2006, in order for the variation to be binding on the non-agreeing creditors. See, eg, *Re Trix Ltd, Re Ewart Holdings Ltd* [1970] 3 All ER 397, [1970] 1 WLR 1421; *Re Calgary and Edmonton Land Co Ltd* [1975] 1 All ER 1046, [1975] 1 WLR 355; *Equity Trust (Jersey) Ltd v Halabi (executor of Nouri (decd))*; *ITG Ltd v Fort Trustees Ltd* [2022] UKPC 36, (2022) 25 ITELR 533, [2023] 2 WLR 133 (at [311]); and *Re Stanford International Bank Ltd (in liq)* [2019] UKPC 45, [2020] 2 LRC 280, [2020] 1 BCLC 446 (at [109]).

[**208**] A variation of creditors' rights may now also be achieved by way of a restructuring plan under Pt 26A of the Companies Act 2006 or a company voluntary arrangement under Pt I of the Insolvency Act 1986.

[**209**] As stated in Goode *Principles of Corporate Insolvency* (5th edn, 2018) [8–31], these statutory arrangements, which are capable of binding dissentients, provide a recognised exception to the pari passu rule. At [8-31], footnote 180, the same text states that 'the position unsecured creditors would be in were the company to be liquidated is relevant to determining the fairness of the scheme'.

Pre-insolvency contracts which infringe the pari passu principle

[**210**] The pari passu principle applies to any distribution whether or not it is expressly triggered by the relevant insolvency procedure. It is enough if the relevant contractual or other provision would lead to an asset being distributed or applied to an unsecured creditor at or following the commencement of the insolvency procedure in a non-pari passu way.

[**211**] This is shown by *Ex p Mackay, Ex p Brown, Re Jeavons* (1873) LR 8 Ch App 643, (1873) 42 LJ Bkcy 68; *British Eagle International Airlines Ltd v Cie Nationale Air France* [1975] 2 All ER 390, [1975] 1 WLR 758; *Carreras Rothmans Ltd v Freeman Mathews Treasure Ltd (in liq)* [1985] 1 All ER 155 at 168, [1985] Ch 207 at 226 per Peter Gibson J ('where the effect of a contract is that an asset which is actually owned by a company at the commencement of its liquidation would be dealt with in a way other than in accordance with [the statutory pari passu rule] … then to that extent the contract as a matter of public policy is avoided'); *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2011] UKSC 38, [2012] 1 All ER 505, [2012] 1 AC 383 (at [7]–[12]) per Lord Collins; and the *Football League* case per David Richards J at [65]:

> 'It is enough that the effect of the relevant contractual or other provision is to apply an asset belonging to the debtor at or following the commencement of the insolvency procedure in a non-pari passu way, as was the case in *British Eagle*. Contracts conflicting with the pari passu principle are void without any need to show that their purpose was to avoid a pari passu distribution. The purpose of the parties is irrelevant and, as in *British Eagle*, a contract may be void once an insolvency proceeding commences even though it is a bona fide commercial arrangement made for reasons unconnected with insolvency.'

Distributions in specie

[**212**] Rule 151(1) of the 2011 Rules provides:

> 'The administrator may, with the permission of the creditors' committee, or if there is no creditors' committee, the creditors, divide in

its existing form amongst the investment bank's creditors, according to its estimated value, any property which from its peculiar nature or other special circumstances cannot be readily or advantageously sold.'

[**213**] Rule 151(1) of the 2011 Rules is the equivalent of r 14.13 of the Insolvency (England and Wales) Rules 2016 (which applies to liquidations and administrations) and s 326 of the Insolvency Act 1986 (which applies to bankruptcy). A provision in materially the same form has existed since s 27 of the Bankruptcy Act 1869.

[**214**] Three things may be noted at this stage about r 151(1):

(a) The power to distribute assets to creditors in specie applies only in respect of any property which from its peculiar nature or other special circumstances cannot be readily or advantageously sold.

(b) Where the power to distribute assets to creditors in specie arises, the administrator is entitled to divide such property in its existing form amongst the investment bank's creditors. Any distribution in specie must take place rateably, on a pari passu basis.

(c) Where the power to distribute assets to creditors in specie arises, the property in question must be distributed according to its estimated value. Rule 151(2) requires the administrator to 'state the estimated value of the property' and 'provide details of the basis of the valuation'. On this basis, r 151 provides protection for (i) any creditors with claims ranking below the ordinary unsecured claims (such as claims for statutory interest) and (ii) shareholders.

The powers to sell or otherwise dispose and do other things

[**215**] Paragraph 60 of Sch B1 to the 1986 Act, read with IBSAR 15(4) and Table 1, confers on the JSAs the powers in Sch 1 to the 1986 Act.

[**216**] Paragraph 2 of Sch 1 confers on the JSAs the power to sell or otherwise dispose of the property of the company by public auction or private contract.

[**217**] Section 167(1) of the 1986 Act, read with IBSAR 15(4) and Table 2, confers on the JSAs the powers in Sch 4 to the Act.

[**218**] Paragraph 13 of Sch 4 to the Act, read with Table 2 of the IBSARs, confers on the JSAs the power to do all such things as may be necessary for pursuing the special administration objectives.

The proper purpose rule

[**219**] In exercising their powers to cause Sova to commit to and perform the Transaction, the JSAs must use their powers for proper purposes. This is explained in Lightman and Moss *The Law of Administrators and Receivers of Companies* (6th edn, 2017), at para 12-037 (footnotes omitted):

> 'The "proper purposes" control on the exercise of office-holder powers derives from the "fraud on a power" doctrine in trusts law and its variant in corporate law, the duty of a company director to exercise powers for the purpose for which they are conferred, now codified in the Companies Act 2006 s.171(b). Its effect is to prohibit the administrator from exercising his powers for a purpose, or with an intention, beyond their scope. It follows that the administrator must not act perversely or irrationally or for irrelevant or extraneous reasons as, properly understood, in doing so he would be abusing his powers by acting beyond their scope. As an office-holder, he must also take reasonable steps to acquire information

relevant to his decisions, including, if appropriate, taking relevant professional advice. If the administrator seeks advice (in general or specific terms) from apparently competent advisers as to the implications of the course he is considering taking, and follows the advice so obtained, then it would appear that the administrator would not be in breach of his fiduciary duty for failure to have regard to relevant matters if the failure occurs because it turns out that the advice given to him was materially wrong.'

[**220**] The concept of reasonableness in this context was explained by the Court of Appeal in *Re Edennote Ltd, Tottenham Hotspur plc v Ryman* [1996] 2 BCLC 389 at 394, [1996] BCC 718 at 722:

'(fraud and bad faith apart) … the court will only interfere with the act of [an officeholder] if he has done something so utterly unreasonable and absurd that no reasonable man would have done it.'

***The parties' submissions on issue* (*b*)**

[**221**] The JSAs submitted in outline as follows.

[**222**] First, the Transaction is a sale or other disposal of the company's property within the JSAs' powers under para 2 of Sch 1. (I shall use 'sale' below as shorthand for 'sale or other disposal'.) As a matter of general law the waiver of a claim by a creditor may constitute the consideration for the sale or disposal by the debtor of its property. There is nothing in the insolvency legislation to prevent a transfer of assets in return for a waiver of claims, or to require such a transaction being characterised otherwise than as a sale. BZ is wrong to contend that the Transaction amounts to a distribution to Dominanta.

[**223**] Second, such a sale of the company's property does not infringe the pari passu principle. The principle is concerned with distributions to creditors and the Transaction is not properly to be characterised as a distribution.

[**224**] The JSAs submitted that in characterising the Transaction the court must consider its substance by looking at the terms used in the PTAs. There is no such thing as the substance divorced from the words used. Generally when the law is looking at the substance of a matter it is normally concerned with its legal substance, not its economic substance (if different). They relied on *McEntire v Crossley Bros Ltd* [1895] AC 457 at 462, [1895–9] All ER Rep 829 at 831; *Lloyds and Scottish Finance Ltd v Cyril Lord Carpets Sales Ltd* [1992] BCLC 609 at 614–615 and *Re Polly Peck International plc* (*in administration*) [1996] 2 All ER 433 at 443–444.

[**225**] Third, the matter may be tested by considering analogous situations. Suppose that the JSAs were to declare an interim distribution. The pari passu rule would not prevent a creditor from using the distribution to buy property of the company. The creditor is acting in two capacities, as creditor in receiving the distribution and as buyer in buying the assets. The pari passu rule applies to the first aspect but not the second.

[**226**] The analogy may be taken through further steps: suppose that there was an interim distribution and the creditor used it to buy property; that would generate further property available for distribution and, one may assume, a further distribution, which the relevant creditor uses to buy more property from the company; and so on, iteratively, until the amount being paid to the

creditor in the relevant round shrinks to a negligible one. This is what the JSAs have called the Dividend Bid Model. The amounts that would have been paid into the estate are the equivalent of the CEV calculated by the JSAs.

[**227**] The JSAs accept of course that there has been and will be no actual iterative series of interim distributions and purchases by Dominanta, but they say that the fact that such dividend bids would not infringe the pari passu principle strongly demonstrates that a sale of the company's property in return for a waiver of claims (which necessarily involves a waiver of the right to distributions) is permissible.

[**228**] Fourth, there is always a constraint on the exercise of the power of sale, namely, the requirement that the sale be for a proper price. An office-holder is under a duty to take reasonable care to obtain the best price that the circumstances permit (see *Re Charnley Davies Ltd (No 2)* [1990] BCLC 760 at 775, [1990] BCC 605 at 618).

[**229**] It follows from this that it would not be open to the JSAs to sell Sova's property to a creditor without regard to the value of the assets or the size of the claim. This is the relevant constraint on the exercise of the power, rather than the pari passu rule (as submitted by BZ).

[**230**] Fifth, office-holders may sell claims (thus, property) belonging to an insolvent estate and there is nothing to stop a sale to a creditor. It is also common for such claims to be sold in return for a share of the proceeds of the claim. This amount may not be known at the time of the sale. While there have been cases concerning the question whether the office-holder has obtained the best price for the claim there has never been a suggestion that the pari passu principle applies to the sale.

[**231**] *Guy v Churchill* (1888) 40 Ch D 481 illustrates this. By a deed of sale a trustee in bankruptcy transferred a right of action vested in him to one of the creditors, F. The deed recited that the trustee was not disposed to take on the risk of the action, and provided that F would carry on the action at his own expense and would share any proceeds of the litigation with three-quarters going to F and one-quarter to the trustee. F would be entitled to a dividend from the estate and would therefore share in the one-quarter going to the trustee. The defendants to the action contended that the arrangement was champertous. This failed on the principle that the bankruptcy laws permitted such arrangements. The JSAs observed that there was no suggestion that the arrangement was contrary to the pari passu principle.

[**232**] Sixth, the other creditors will benefit from the Transaction. The Transaction will lead to a waiver of Dominanta's claims (in part or in full). To the extent that the claims are waived the available assets will be divided among a smaller class of unsecured creditors, and this may be regarded as having a CEV for the insolvent estate. The numbers have been given above.

[**233**] Seventh, it may be the case that the Russian Securities acquired by Dominanta are worth more to Dominanta than their realisable value for Sova. The JSAs accept that Dominanta may be able to make a profit from the transaction. But that arises from the unusual circumstances in which Dominanta (like other Russian purchasers) are in the position of special purchasers. It does not mean that there is an impermissible distribution of assets to Dominanta or any other infringement of the statutory scheme.

[**234**] Eighth, the fact that Dominanta is connected with Sova by way of Mr Avdeev's interest in both companies does not impair the JSAs' power to commit Sova to the two PTAs. Such a connection is relevant to the exercise of the JSAs' powers but they have assessed the commercial value of the

Dominanta Offer with the benefit of legal advice and negotiated the commercial terms of the deal with Dominanta at arm's length. They have also explained that Mr Avdeev's involvement was disclosed to creditors and is now explained to the Court.

[**235**] BZ submitted in outline as follows.

[**236**] First, under the statutory scheme, BZ has a right to receive his pari passu share of realisations of Sova's assets. He is also entitled to insist that no other unsecured creditor is treated differently or receives a better return.

[**237**] Second BZ is also entitled to insist that Sova's assets are distributed in specie only in accordance with r 151 and not otherwise.

[**238**] Third, there has been nothing to vary Mr Zilbermints' rights.

[**239**] Fourth, the Transaction is contrary to r 149. In summary, if the Transaction is implemented, Dominanta will receive 117% of its claim in specie, whereas the other unsecured creditors (including BZ) will receive between 50% and 62% in cash. This is a major departure from the principle of equal treatment of creditors which is embodied by the pari passu rule.

[**240**] Fifth, what is proposed is some sort of novel and unprecedented contravention of creditors' rights to equal treatment in circumstances which do not fall within any of the well-established and limited number of exceptions to the pari passu rule.

[**241**] Sixth, by contrast, if the Transaction does not proceed, the JSAs will be able to sell the Russian Securities for a cash consideration (to the Joint Bidders), which will be distributed pari passu amongst the unsecured creditors, pursuant to r 149.

[**242**] Seventh, the proposition that the Transaction is an impermissible contravention of the pari passu principle and the statutory insolvency scheme may be tested by reference to the hypothetical scenario in which (prior to the commencement of Sova's administration) Sova had entered into a transaction with a creditor in materially the same terms as the Transaction, providing that, in Sova's administration, the creditor would receive Sova's assets in specie in discharge of the creditor's claim.

[**243**] Such a transaction would obviously be void on the principles in *Ex p Mackay* (1873) LR 8 Ch App 643, (1873) 42 LJ Bkcy 68, and *British Eagle* [1975] 2 All ER 390, [1975] 1 WLR 758 (see above). If a transaction in the terms of the Transaction would be void if entered into by Sova before the commencement of its administration on the basis that it is contrary to the pari passu principle, it is difficult to see how such a contract could properly be entered into by Sova after the commencement of its administration. It would still contravene the pari passu principle in the same way and would be void.

[**244**] Eighth, the Transaction is contrary to r 151 in that, first, the Russian Securities are not property which from its peculiar nature or other special circumstances cannot be readily or advantageously sold (as demonstrated by the Final BZ Offer itself). Secondly, the Transaction does not provide for the Russian Securities to be divided in their existing form amongst the investment bank's creditors. Instead, the Transaction provides for the Russian Securities to be transferred to a single creditor, Dominanta. Thirdly, the Transaction does not provide for the Russian Securities to be distributed in specie 'according to [their] estimated value' with £1.00 of assets discharging £1.00 of claims. Rather, as explained above, Dominanta will receive £1.00 of assets for every £0.85 of claim discharged, resulting in the substantial overpayment of Dominanta, which will receive 117% of its claim.

[**245**] Ninth, it follows that the Transaction falls outside the scope of the JSAs' powers and/or is contrary to the pari passu principle and/or the statutory scheme of insolvency law. Accordingly, it should not be approved.

[**246**] Tenth, at the very least, the Court cannot be satisfied in these circumstances that there is 'no real doubt' that the Transaction is within the JSAs' powers (see *Nortel* [2017] 2 BCLC 572, [2017] Bus LR 590 (at [48]); *MF Global* [2014] Bus LR 1156 at [32]).

[**247**] Dominanta supported the position of the JSAs essentially for the reasons given by them.

***Conclusions on issue* (*b*)**

[**248**] I prefer the submissions of the JSAs.

[**249**] First, I consider that the administrators' power to sell or otherwise dispose of the company's property is broad enough to cover a transaction whereby a creditor waives its claim against the company. I see no reason to read the power down to exclude such a transaction.

[**250**] Second, as the JSAs submit, in exercising such power an administrator is required to act reasonably to obtain the best price in the circumstances as they reasonably appear to the administrator. This places an important constraint on the exercise of the power. It prevents an administrator from simply transferring assets to a particular creditor in return for the claim of the creditor where this may be at the expense of the estate. It is only if the administrator genuinely and rationally believes proper value is being obtained that the power is exercisable.

[**251**] It also seems to me that *Guy v Churchill* (1888) 40 Ch D 481 provides at least some support for the view that the pari passu principle has no application to a sale by an office-holder. The agreement in that case would have infringed the pari passu principle if the sale were to be seen as a distribution. The buyer of the right of action stood to keep three-quarters of the proceeds and also share in a distribution in respect of the other quarter. It is fair to observe that nobody argued the pari passu point, but it seems to me that is probably because the principle simply has no application to sales (as opposed to distributions). The case does not amount to binding authority as the point was not argued but I think it illustrates the way the court has generally approached sales.

[**252**] Third, in my judgment the Transaction is properly characterised as a sale or other disposal rather than a distribution. I agree that the proper approach to characterisation is found in the cases cited by the JSAs (*McEntire*, *Lloyds and Scottish* [1992] BCLC 609 and *Polly Peck* [1996] 2 All ER 433, [1996] 1 BCLC 428). The court must determine the substance of the transactions and not their mere form. But this connotes legal and not economic substance and the court must assess the terms of the Transaction to determine the proper description of what is happening. I am unable to accept BZ's submissions that the substance of the Transaction is a distribution. To my mind it is clearly a sale of certain assets in return for the waiver of Dominanta's claims (in full or part).

[**253**] BZ submits that the result of the Transaction is that Dominanta will end up with the Russian Securities and these are potentially worth more to it (perhaps as much as or more than its claims) than the projected final dividend payable to other creditors. It appears to me that BZ's argument amounts to the assertion that you look at the overall outcome and ignore the legal steps or route by which it has come about. It appears to me that this is not merely an appeal to economic substance, it is a one sided one. One can equally well say that as a matter of economic substance Dominanta has paid for the Russian

Securities by giving up its rights to participate in any further dividends. This is an equally valid economic description. But it has the merit of corresponding with the legal form of the Transaction. As was said in *Polly Peck* we are concerned not with economic substance but with the law.

[**254**] Fourth, in my judgment the JSAs are right to say that BZ's argument collapses the distinction between Dominanta's position as creditor and its position as buyer. It will receive the Russian Securities as a buyer and will (to the appropriate agreed extent) cease to be a creditor. It will not be receiving anything qua creditor (for such part of its claim as is waived) and will therefore not receive a distribution.

[**255**] Fifth, for these reasons I do not consider that the pari passu principle has any relevant application or more specifically that it undermines the powers of the JSAs to sell the Russian Securities to Dominanta. The principle is concerned with equality of distribution and does not apply to sales of assets. Of course if a distribution is dressed up as a sale and in reality is a distribution the rule would apply. But for the reasons just given I do not think there is any basis for saying that the Transaction is a disguised distribution.

[**256**] Sixth, I agree with the JSAs' submission that BZ's argument also ignores the difference in the value of the assets to a Russian entity such as Dominanta and their value to Sova. As administrators they are and can only be interested in the realisable value of the Russian Securities by Sova. Of course the fact that a Russian bidder may stand to make a profit is a factor the JSAs have to take into account when seeking to negotiate a sale and when assessing the commercial appeal of any given bid. There are starkly asymmetrical values for non-Russian and Russian owners of Russian securities. But these arise from the various legal restrictions (Western and Russian) and not from any action or choice of the JSAs. They are a feature of the world in which the JSAs are having to operate. I agree with the JSAs that it is simply unreal to suggest that Sova would be able to realise anything like the Nominal Value of the Russian Securities.

[**257**] In short I agree with the JSAs that if it should turn out that Dominanta (as a special purchaser) should do better economically than the other creditors, that is not because of the distribution of the assets of the estate; it is because of the various legal restrictions which have strangled Sova's ability to obtain full value for its assets (in the sense of the value that a Russian could obtain). It is in this sense a collateral consequence.

[**258**] Seventh, I accept the JSAs' submission that the fact that Dominanta is connected with Sova by way of Mr Avdeev's interest in both companies does not impair the JSAs' power to commit Sova to the two PTAs. Such a connection may be relevant to the exercise of the JSAs' powers (for instance, in requiring them to take steps to ensure that a proper price and terms have been negotiated), but not to the existence of those powers. They have explained that Mr Avdeev's involvement was disclosed to creditors and is now explained to the Court.

[**259**] Eighth, I do not think that the question is properly to be tested by reference to a hypothetical pre-insolvency contract under which Dominanta would have been allowed to buy in the event of the insolvency of Sova. This argument simply takes you back to the question of whether the Transaction is a sale or other disposal rather than a distribution. If it is a sale the question is whether it is for proper consideration (in the sense described above), not whether it would result in a non-pari passu outcome.

[**260**] For these reasons in my view the Transaction does not infringe the statutory scheme. The Transaction will not operate contrary to r 149 and r 151 is not engaged.

[**261**] Having had the benefit of full argument on the point, I have reached a clear conclusion on this issue and do not think there is a real doubt about the powers of the JSAs to enter the Transaction.

Issue (c): Is the JSAs' decision to enter the Transaction rational and honest?

[**262**] The JSAs have invited the court to approach the applications by asking whether their decision to enter the Transaction is rational and honest. This approach is derived from the statements of principle in *MF Global* [2014] Bus LR 1156 and *Nortel*.

[**263**] As explained in [219] above, the administrator must not act perversely or irrationally or for irrelevant or extraneous reasons as, properly understood, in doing so he would be abusing his powers by acting beyond their scope.

[**264**] I have set out the JSAs' approach to the Transaction in some detail above. The JSAs say in summary that they were in a difficult predicament and that the various restrictions constrained their ability to obtain anything like the Nominal Value of the Russian Securities. They sought other quotes which were unfavourable. They then negotiated with Dominanta to obtain the best terms they could. They sought offers from the other creditors, who included key Russian market participants. They obtained a number of offers from BZ. The Final BZ Offer is broadly comparable in value to the Transaction (with the outcome being marginally better in some possible cases and marginally worse in others) but is subject to execution risks.

[**265**] It is also subject to the risk that the MinFin criteria may apply, which would materially affect the economics of any such sale and might indeed make it unworkable (if for instance it required the payment of part of the purchase price to the Russian government). The adjournment of the hearing in January allowed a period of competitive tension and nothing more was produced from Dominanta. The JSAs also said that the bird in the hand should not be allowed to fly away. They also referred to the overwhelmingly supportive vote of the non-conflicted voting creditors as evidence of the rationality of their decision.

[**266**] The JSAs also submitted that it is not unreasonable for the officeholder to prefer a transaction which settles a greater part of the company's affairs than another even if the latter may, on its own more limited terms, bring greater value into the company's estate.

[**267**] BZ said that the court should not permit the JSAs' to enter the Transaction. He submitted in summary, that the JSAs' did not take reasonable care to achieve the best price that circumstances permit. For example, they did not appoint an independent Russian unsanctioned broker (such as Renaissance Capital, Aton and BCS) to market the portfolio among unsanctioned family offices in Russia or larger Russian banks with sufficient capital (such as Bank Saint Petersburg, Zenit Bank and Ak Bars Bank). Instead, they relied on Sova's management to propose the Dominanta Transactions and to conduct very limited market testing to justify the Dominanta Transactions.

[**268**] BZ also raised concern about the lack of independence between management of Sova (who were involved in the early stages of the negotiations and the market testing) and Dominanta, particularly given Mr Avdeev's role in relation to both companies.

[**269**] BZ also submitted that there was no evidence about the course of the negotiations between Dominanta and the JSAs. For instance Dominanta asked for a 15% discount to the market value of the Russian Securities and this was reflected in the PTAs.

[**270**] He submitted that the court cannot properly be satisfied that the Dominanta Transaction represents the best price that circumstances permit. He also submitted that the Court should be cautious about expressing views about the merits of the decision, particularly given the absence of disclosure or cross-examination.

[**271**] I have concluded that the decision of the JSAs to enter the Transaction is an honest one. I accept that they genuinely consider that the Transaction is in the interests of the creditors of Sova.

[**272**] I have also concluded that the JSAs' decision is rational in the sense of being one that could be reached by reasonable honest office-holders seeking to fulfil their functions – or putting it negatively, is not one that can be regarded as perverse or irrational.

[**273**] First, I consider that the JSAs are seeking to make the best of a challenging set of constraints, which have effectively strangled their ability to sell the Russian Securities for anything approaching their Nominal Value. They have sought to find a way of realising value for the creditors, who might otherwise have had to wait for many years, which is obviously unpalatable given the time value of money and the radical uncertainty about what may happen.

[**274**] Second, it also appears to me that looking strictly at the position they are in now, the JSAs' comparative assessment of the rival bids cannot be seen as perverse or irrational. They have explained the economics of the bids by assessing their CEVs, and no issue has been taken with this methodology (though of course the use of a waiver of claims has been attacked on the legal grounds already addressed). There is uncertainty about the timing of any government consents for the BZ Final Offer. There is also uncertainty about the applicability of the MinFin Criteria. If the criteria do apply, there would be a material impact on the economics of the sale.

[**275**] I also consider it is rational, in the light of these uncertainties – and the possibility of more severe legal constraints on a sale process – for the JSAs to conclude that they should enter the Transactions now, rather than waiting to see whether they might at some uncertain future time be able to obtain a higher price for the Russian Securities. Things could very well get worse.

[**276**] Third, I consider it rational for the JSAs to put to one side any concerns that might be thought to arise from the fact that Dominanta and its beneficial owner may (in a sense) profit as a special purchaser of the Russian Securities. The ability to make a turn would accrue to any Russian purchaser of the Russian Securities, including the Joint Bidders. It is built into the asymmetry of value which arises from the various legal constraints on an owner in a state branded 'hostile' by the Russian government. The fact that a Russian buyer is able to make a turn might be unpalatable, but it is collateral to the decision the JSAs now face.

[**277**] Fourth, I also consider the landslide indicative vote of the creditors supports the JSAs' position. The non-aligned creditors are institutions and professionals. They are likely to be the best judges of their commercial interests. They are able to assess the competing deals and are also likely to be able to assess the benefits of doing nothing. They are also of course aware of the involvement of Dominanta and its beneficial owner. A vote of this kind is

not of course binding in the way that it would be in a scheme of arrangement. However the JSAs have sought to give the creditors the type and quality of information they would get in the case of a scheme. This has included, in relation to the latest vote, BZ's solicitors' own letter setting out the reasons why the BZ Final Offer is to be preferred.

[**278**] Fifth, I accept the submission of the JSAs that it is not unreasonable for the officeholder to prefer a transaction which settles a greater part of the company's affairs than another even if the latter may, on its own more limited terms, bring greater value into the company's estate.

[**279**] Overall I have concluded that the decision of the JSAs to enter the Transaction is an honest and rational one, within the scope of their powers.

[**280**] However I am not expressing a more general view as to the conduct of the JSAs. I do not eg express any view as to whether a different outcome could have been achieved had the JSAs taken the steps now suggested by BZ to market the assets. Nor do I express any view about the negotiations of the Transaction or whether better terms could have been reached. Nor do I express any overall view as to whether the JSAs have achieved the best price reasonably achievable. In setting out these reservations, I do not wish it to be understood either that I am suggesting that the JSAs have failed to act reasonably or have failed to achieve the best price. I am simply making no ruling either way. I return to something I explained earlier: the commercial decision to enter the Transaction is one the JSAs have already taken and by giving them permission to carry it out I am not seeking to remake or second guess the decision.

Issue (d): Is there a real risk that the Transaction breaches applicable sanctions laws?

[**281**] As already explained the JSAs, with the help of their UK and US solicitors (and leading counsel with expertise in UK and EU sanctions law), have undertaken a detailed review of the possible application of Western sanctions. The JSAs relied on three memoranda of advice. They also made written and oral submissions about them. There was no suggestion by BZ that the Western sanctions would be breached.

[**282**] In my judgment, there is no realistic risk that the Transaction will infringe UK sanctions. I also conclude (to the extent it is material) that the Transaction does not infringe US or EU sanctions. I shall set out a summary of my conclusions by reference to UK, US and EU sanctions in turn.

UK Sanctions

[**283**] The relevant sanctions regime in the UK is found in Russia (Sanctions) (EU Exit) Regulations 2019, SI 2019/855 ('2019 UK-Russia Regulations'). It applies to conduct inside and outside the UK but, in the case of the latter, only where it is committed by a 'United Kingdom person' (regs 3(1) and (2)). Since Sova is incorporated in the UK, the 2019 UK-Russia Regulations apply to it (reg 2 and s 21 of the Sanctions and Anti-Money Laundering Act 2018). Broadly speaking, they restrict Sova's dealings with specific persons and assets. Taking these in turn:

(a) 'Designated Persons'. Regulation 5 gives the Secretary of State the power to 'designate persons' based on the criteria in reg 6. Designated Persons are inter alia subject to asset-freezing restrictions (reg 10). This means that entities subject to the 2019 UK-Russia Regulations (ie Sova and the JSAs) must not (i) deal with funds or economic resources owned, held

or controlled by Designated Persons (reg 11), or (ii) make funds or economic resources directly or indirectly available to them or for their benefit (regs 12–15).

(b) The asset-freezing restrictions also apply against legal entities that are 'owned or controlled directly or indirectly by' Designated Persons. The definition of 'owned or controlled' is set out at reg 7. There are two criteria. Either (a) the Designated Person holds directly or indirectly more than 50% of the shares or voting rights, or the right to appoint or remove the majority of the board of directors, of the relevant entity, or (b) it is reasonable, having regard to the circumstances of the case, to expect that the Designated Person would be able to, in most cases or in significant respects, by whatever means and whether directly or indirectly, to achieve the result that the affairs of the relevant entity are conducted in accordance with the Designated Person's wishes.

(c) The 2019 UK-Russia Regulations also enact sanctions on specific assets. First, regs 16(1) to 16(4H) deal with transferable securities (including shares, bonds, and any form of negotiable securitised debt) issued by certain named entities, or entities owned by such named entities, on or after 1 March 2022. Secondly, reg 18B prohibits UK Persons from acquiring (but not alienating) any of a wide range of ownership interests or control over corporate persons connected with Russia. However, by reg 60ZZA(2)(b) and (c), this does not apply to company shares, bonds, or other forms of securitised debt which were (a) admitted to trading on a regulated market prior to 19 July 2022 or (b) not issued for a prohibited purpose.

[**284**] Having examined the JSAs' due diligence about the various parties and assets involved and heard submissions from the JSAs' counsel I am satisfied that there is no real risk that the Transaction breaches these Regulations.

(a) The relevant Russian Securities are owned, held, or controlled by Sova which is neither a Designated Person nor controlled by one.

(b) Neither Dominanta nor the person who controls Dominanta – Mr Avdeev, who indirectly holds 82.9% of its share capital and voting rights – are Designated Persons.

(c) Neither the parties who assigned the relevant claims to Dominanta nor their apparent owners are Designated Persons.

(d) Region and its apparent owners are not Designated Persons.

(e) Although the NSD (not itself a Designated Person) was initially thought to be controlled by Bella Ilyinichna Zlatkis, who is a Designated Person, it was ultimately concluded that she no longer has any influence over NSD. NSD's ultimate beneficial owner is MOEX, a publicly listed Russian company mainly owned by individual investors. Thus, no one person is in control of NSD.

(f) Such of the Russian Securities which were issued by a sectorally sanctioned entity (or by an entity owned by the same or acting on behalf or at the direction of the same) were issued prior to 1 August 2014 and none of the Russian Securities was issued after 1 March 2022.

(g) The Russian Securities were admitted to trading on a regulated market prior to 19 July 2022 and were not issued for a prohibited purpose.

[**285**] Accordingly, neither the parties nor the assets involved in the Dominanta Transactions trigger the 2019 UK-Russia Regulations.

US Sanctions

[**286**] The US sanctions regime has two relevant categories: (i) primary sanctions, which apply when a 'US nexus' is present; and (ii) secondary sanctions, which apply extraterritorially even when there is no US nexus.

[**287**] In relation to primary sanctions, there may be a US nexus where (a) the activity is taking place in the US, (b) US persons are involved directly or indirectly or (c) there is any other US nexus (e g US origin goods or services).

[**288**] Secondary sanctions are imposed at the discretion of the US Department of the Treasury's Office of Foreign Assets Control ('OFAC'). This typically involves a determination whether a particular activity involves provision of material support.

[**289**] Non-US persons can also be targeted by US secondary sanctions where such persons are determined to have operated in designated sectors in the Russian economy.

[**290**] In general, US persons are restricted from dealing with persons on the Specially Designated Nationals and Blocked Persons ('SDN') List.

[**291**] As Dominanta has confirmed that it will not perform the Transaction in the US, and nor is there any other US nexus, the only issue is whether there are US Persons and/or SDNs involved in the transaction.

[**292**] None of Dominanta, Mr Avdeev, the TTCA Assignors, Region and Mr Sudarikov and NSD are SDNs or appear on any other list of sanctioned entities maintained by OFAC. Second, some of the Russian Securities were issued by SDNs ('SDN Securities'). As such, no US Persons may be directly or indirectly involved with transactions involving them. However, although Hogan Lovells counts as a US Person, it was not involved in the Portfolio Transfer Agreement containing the SDN Securities (which were covered by PTA2 and the second application).

[**293**] I am accordingly satisfied that there is no realistic risk of a breach of US primary sanctions law.

EU Sanctions

[**294**] The EU sanctions regime is contained in EU Council Regulations 833/2014 and 269/2014 ('EU-Russia Regulations'). They apply (a) within the territory of the EU, including its airspace, (b) to any person inside or outside the territory of the EU who is a national of a Member State, (c) to any legal person, entity or body, inside or outside the territory of the EU, which is incorporated or constituted under the law of a Member States and (d) to any legal person, entity, or body in respect of any business done in whole or in part within the EU.

[**295**] Sova is not incorporated within an EU Member State and will not perform any activity in connection with the Transaction in any EU Member State. While 28 of the relevant Russian Securities are ultimately held within the EU, the transfer of ownership interests entailed by the Transaction only needs to be registered at NSD in Russia. No action (or omission) is required within the EU. Sova and the Transaction are therefore not subject to the EU regime.

Ukrainian Sanctions Law

[**296**] Though the point was not raised in advance, at the hearing BZ observed that Mr Avdeev, who controls both Sova and Dominanta, is a sanctioned person under Ukrainian sanctions law.

[**297**] However I do not consider that this has any bearing on the decision for the court. First, Ukrainian law is not the governing law nor is Ukraine the place

of performance of the Transaction. Second, there was no suggestion that there would be any material connection or nexus between the Transaction or its performance and Ukraine. Third, and in any event, counsel for BZ did not identify any respect in which the Transaction or its performance would breach Ukrainian law.

DISPOSITION

[**298**] I shall make an order permitting the JSAs to enter the Transaction.

Applications granted.

Aaron Turpin Barrister.

ITEM NO. 164

JA-50

Supreme Court

Mitchell and another (Joint Liquidators of MBI International & Partners Inc (in liquidation)) *v* Al Jaber and another

[2025] UKSC 43

2025 May 13, 14, 15; Nov 24

Lord Hodge DPSC, Lord Briggs, Lord Sales, Lord Stephens, Lord Richards JJSC

Equity — Fiduciary duty — Breach — Defendant's powers as director of BVI company ending on commencement of liquidation — Whether defendant assuming fiduciary duty by effecting transfer of shares owned by company

Vendor and purchaser — Vendor's lien — Exclusion — Sale of shares — Whether parties to sale transaction intending to exclude vendor's lien — Whether court's consideration limited to documents executed by parties

Equity — Equitable compensation — Quantum — Defendant in breach of fiduciary duty by misappropriating company's shares — Proper assessment of equitable compensation to be paid — Whether shares to be valued as at date of trial — Whether company suffering no loss where shares worthless at date of trial — Whether burden on defendant to establish supervening event breaking chain of causation of loss

The defendant was a director of a BVI company ("the Company") and owned the global corporate group of which it was a part. When the Company went into liquidation in 2011 the defendant's powers as a director of the Company came to an end under BVI law. Nevertheless in 2016 the defendant caused some 891,000 shares which the Company owned in another company in the same corporate group ("JJW Inc") to be transferred to an associated company by signing two share transfer forms as "director" and backdating the forms to a time prior to the liquidation. Those shares were rendered worthless in 2017 as a result of the transfer of all of JJW Inc's assets and liabilities to another company within the corporate group. The Company's liquidators brought a claim against the defendant in England and Wales, alleging that in bringing about the 2016 share transfers the defendant had acted in breach of fiduciary duty. The judge allowed the claim and awarded equitable compensation of €67,123,403, representing her assessment of the value of the 891,000 shares. The defendant appealed, contending that (i) he had not owed any fiduciary duty to the Company and that, in any event, the Company had suffered no financial loss because (ii) the 891,000 shares had been subject to unpaid vendor's liens in favour of the entities which sold them to the Company, which exceeded the sum ordered as equitable compensation, and (iii) the shares were worthless at the date of trial, which was when equitable compensation was measured. The Court of Appeal dismissed the defendant's appeal on issues (i) and (ii) but allowed his appeal on issue (iii).

On appeal by the defendant on issues (i) and (ii) and the liquidators on issue (iii)—

Held, dismissing the defendant's appeal and allowing the liquidators' appeal, (1) that fiduciary duties were not confined to well established categories of relationship such as trustee and beneficiary or company director and company but could arise ad hoc where, looking at the matter objectively, someone undertook not to pursue his own interests and to act in the interests of another; that, thus, fiduciary duties could arise where a person arrogated to himself, or purported to exercise, a fiduciary power, such as a company director's powers of administration over the property of the company; that it was not necessary that a person who had arrogated to himself a fiduciary power to deal with property had title to or possession of the property before he could come under a fiduciary duty, nor was there any reason why

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the arrogation of a fiduciary power might not itself involve a breach of fiduciary duty at one and the same time; and that, accordingly, by pretending to be a director of the Company who had the power to transfer the 891,000 shares the defendant had both assumed fiduciary duties to the Company and breached those duties, it being irrelevant to the defendant's liability that the recipient of the shares was a company under his control rather than the defendant (post, paras 37–39, 42–47, 50–51, 54–56, 129).

Dicta of Blackburn J in *Gibson v Barton* (1875) LR 10 QB 329, 338, DC, of Lord Esher MR and Bowen LJ in *Soar v Ashwell* [1893] 2 QB 390, 394, 396, CA, of Viscount Cave in *Taylor v Davies* [1920] AC 636, 651, PC, of Millett LJ in *Bristol and West Building Society v Mothew* [1998] Ch 1, 18, CA, of Lord Millett in *Dubai Aluminium Co Ltd v Salaam* [2003] 2 AC 366, para 138, HL(E), of Lord Neuberger of Abbotsbury PSC in *Williams v Central Bank of Nigeria* [2014] AC 1189, para 54, SC(E) and of Lord Briggs and Lord Burrows JJSC in *Byers v Saudi National Bank* [2024] AC 1191, paras 56–61, 175–188, SC(E) applied.

(2) That the unpaid vendor's lien arose by operation of law according to equitable principles where it was just and fair that the vendor should have a lien over his property until the price for it had been paid, but would be excluded where the joint intention of the parties to the sale transaction, on an objective assessment, was that there should be no lien, having regard to the the true nature of that transaction; that since the existence or otherwise of the unpaid vendor's lien took place by reference to equitable principles, the test for implication of a contractual term did not have to be satisfied in order for the lien to arise or, conversely, for the lien to be excluded; that, when determining whether a joint intention to exclude the unpaid vendor's lien could be made out, the court was not limited to an examination of the documents executed by the parties to the sale transaction but would also take account of other sources of evidence as might be appropriate to determine the issue in accordance with fairness and the justice of the case, which evidence would need to be closely related to the sale transaction; and that the judge had been entitled to find, in the light of relevant evidence about the nature of the relevant transactions, that the unpaid vendor's liens contended for by the defendant had been excluded (post, paras 69–73, 78–80, 85, 129).

Dicta of Millett LJ in *Barclays Bank plc v Estates & Commercial Ltd* [1997] 1 WLR 415, 420–421, CA applied.

(3) That where a fiduciary misappropriated company property under their management and control, the general objective of a court of equity in awarding compensation if the misappropriated property could not be returned in specie was to restore to the company the value of the property misappropriated; that there was no fixed rule that the date as at which the misappropriated property was valued had to be the date of trial, the appropriate date being an open question which required consideration of what was just and equitable as between the company and the fiduciary; that, if the misappropriated property had value when misappropriated, the company suffered an immediate loss of value at that time; that, in such circumstances, if the defaulting fiduciary wished to rely upon a supervening actual or counterfactual event as breaking the chain of causation between the breach and the company's loss, the burden lay squarely upon the fiduciary to prove that supervening event and to show that it should be treated as having broken the chain of causation; that, generally speaking, supervening events were unlikely to qualify if the fiduciary had a hand in them, in the absence of a clear and convincing innocent explanation provided by the fiduciary; that since the defendant had been an active participant in, and stood to benefit from, the 2017 transfer of JJW Inc's assets and liabilities which had rendered the 891,000 shares worthless and had made no attempt to prove otherwise, there had been no grounds for the Court of Appeal to reduce the equitable compensation payable by the defendant to zero; and that, accordingly, the order of the judge that the defendant pay equitable compensation of €67,123,403 would be restored (post, paras 93–96, 101, 106–115, 122–123, 128–129).

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In re Brogden; Billing v Brogden (1888) 38 Ch D 546, CA, *Carruthers v Carruthers* [1896] AC 659, HL(Sc) and *Libertarian Investments Ltd v Hall* (2013) 17 ITELR 1 applied.

Target Holdings Ltd v Redferns [1996] AC 421, HL(E) and *AIB Group (UK) plc v Mark Redler & Co Solicitors* [2015] AC 1503, SC(E) considered.

Decision of the Court of Appeal [2024] EWCA Civ 423; [2024] BCC 934 reversed.

The following cases are referred to in the judgment of Lord Hodge DPSC, Lord Briggs and Lord Sales JJSC:

AIB Group (UK) plc v Mark Redler & Co Solicitors [2014] UKSC 58; [2015] AC 1503; [2014] 3 WLR 1367; [2015] 1 All ER 747; [2015] 2 All ER (Comm) 189, SC(E)

Aberdeen Railway Co v Blaikie Bros (1854) 1 Macq 461, HL(Sc)

Ahmed, In re [2018] EWCA Civ 519; [2018] BPIR 535, CA

Albert Life Assurance Co, In re (1870) LR 11 Eq 164

Attorney General v Blake [1998] Ch 439; [1998] 2 WLR 805; [1998] 1 All ER 833, CA

Attorney General v New York Breweries Co Ltd [1899] AC 62, HL(E)

BTI 2014 LLC v Sequana SA [2022] UKSC 25; [2024] AC 211; [2022] 3 WLR 709; [2022] Bus LR 920; [2023] 2 All ER 303; [2023] 1 BCLC 1, SC(E)

Barclays Bank plc v Estates & Commercial Ltd [1997] 1 WLR 415, CA

Barnett v Creggy [2016] EWCA Civ 1004; [2017] Ch 273; [2017] 2 WLR 1054, CA

Belmont Finance Corpn v Williams Furniture Ltd (No 2) [1980] 1 All ER 393, CA

Brentwood Brick and Coal Co, In re (1876) 4 Ch D 562, CA

Bristol and West Building Society v Mothew [1998] Ch 1; [1997] 2 WLR 436; [1996] 4 All ER 698, CA

Brogden, In re; Billing v Brogden (1888) 38 Ch D 546, CA

Byers v Saudi National Bank [2023] UKSC 51; [2024] AC 1191; [2024] 2 WLR 237; [2024] 3 All ER 877, SC(E)

Canadian Land Reclaiming and Colonizing Co, In re (1880) 14 Ch D 660, CA

Carruthers v Carruthers [1896] AC 659, HL(Sc)

Cassegrain v Gerard Cassegrain & Co Pty Ltd [2015] NSWSC 851

County Personnel (Employment Agency) Ltd v Alan R Pulver & Co [1987] 1 WLR 916; [1987] 1 All ER 289, CA

Dawson, decd, In re; Union Fidelity Trustee Co Ltd v Perpetual Trustee Co Ltd [1966] 2 NSWR 211

Dubai Aluminium Co Ltd v Salaam [2002] UKHL 48; [2003] 2 AC 366; [2002] 3 WLR 1913; [2003] 1 All ER 97; [2003] 2 All ER (Comm) 451; [2003] 1 Lloyd's Rep 65, HL(E)

English v Dedham Vale Properties Ltd [1978] 1 WLR 93; [1978] 1 All ER 382

Fraser v Whalley (1864) 2 H & M 10

Galambos v Perez 2009 SCC 48; [2009] 3 SCR 247

Gawton and the Lord Dacres case (1589) 1 Leo 219

George Wimpey Manchester Ltd v Valley and Vale Properties Ltd [2012] EWCA Civ 233; [2012] 2 EGLR 113, CA

Gibson v Barton (1875) LR 10 QB 329, DC

Golden Strait Corpn v Nippon Yusen Kubishika Kaisha [2007] UKHL 12; [2007] 2 AC 353; [2007] 2 WLR 691; [2007] Bus LR 997; [2007] 3 All ER 1; [2007] 2 All ER (Comm) 97; [2007] 2 Lloyd's Rep 164, HL(E)

Hopcraft v Close Bros Ltd [2025] UKSC 33; [2025] 3 WLR 423, SC(E)

Hospital Products Ltd v United States Surgical Corpn (1984) 156 CLR 41

Inland Revenue Comrs v Stype Investments (Jersey) Ltd [1982] Ch 456; [1982] 3 WLR 228; [1982] 3 All ER 419, CA

Kettlewell v Watson (1884) 26 Ch D 501, CA

Lands Allotment Co, In re [1894] 1 Ch 616, CA

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Libertarian Investments Ltd v Hall [2013] HKFCA 93; (2013) 17 ITELR 1
Lyell v Kennedy (1889) 14 App Cas 437, HL(E)
Mara v Browne [1896] 1 Ch 199, CA
Marks and Spencer plc v BNP Paribas Securities Services Trust Co (Jersey) Ltd [2015] UKSC 72; [2016] AC 742; [2015] 3 WLR 1843; [2016] 4 All ER 441, SC(E)
Nolan v Nolan [2004] VSCA 109
Phipps v Boardman [1965] Ch 992; [1965] 2 WLR 839; [1965] 1 All ER 849, CA; [1967] 2 AC 46; [1966] 3 WLR 1009; [1966] 3 All ER 721, HL(E)
Recovery Partners GP Ltd v Rukhadze [2025] UKSC 10; [2025] 2 WLR 529; [2025] Bus LR 610; [2025] 1 Lloyd's Rep 329, SC(E)
Satyam Enterprises Ltd v Burton [2021] EWCA Civ 287; [2021] 2 BCLC 724; [2021] BCC 640, CA
Soar v Ashwell [1893] 2 QB 390, CA
Target Holdings Ltd v Redferns [1996] AC 421; [1995] 3 WLR 352; [1995] 3 All ER 785, HL(E)
Taylor v Davies [1920] AC 636, PC
Thanakharn Kasikorn Thai Chamkat (Mahachon) v Akai Holdings Ltd [2010] HKCFA 63; (2010) 13 HKCFAR 479
Tyne and Wear Passenger Transport Executive (trading as Nexus) v National Union of Rail, Maritime and Transport Workers [2024] UKSC 37; [2025] AC 1222; [2024] 3 WLR 909; [2025] ICR 153; [2025] 2 All ER 205, SC(E)
Vickers v Bell (1864) 4 De G J & S 274
Williams v Central Bank of Nigeria [2014] UKSC 10; [2014] AC 1189; [2014] 2 WLR 355; [2014] 2 All ER 489, SC(E)
Winter v Lord Anson (1827) 3 Russ 488

The following additional cases were cited in argument:

Auden McKenzie (Pharma Division) Ltd v Patel [2019] EWCA Civ 2291; [2020] BCC 316, CA
Caffrey v Darby (1801) 6 Ves 488
Davies v Ford [2021] EWHC 2550 (Ch)
Kuwait Airways Corpn v Iraqi Airways Co (Nos 4 and 5) [2002] UKHL 19; [2002] 2 AC 883; [2002] 2 WLR 1353; [2002] 3 All ER 209; [2002] 1 All ER (Comm) 843, HL(E)
Tulip Trading Ltd v Bitcoin Association for BSV [2023] EWCA Civ 83; [2023] 4 WLR 16; [2023] 2 All ER (Comm) 479, CA
Younger v Saner [2002] EWCA Civ 1077, CA

APPEAL from the Court of Appeal

In May 2019 the liquidator of MBI International & Partners Inc, a company incorporated in the British Virgin Islands ("the company"), who was subsequently replaced as the company's liquidator by Greig William Alexander Mitchell and Kenneth Melvin Krys ("the liquidators"), commenced proceedings against the defendants, Sheikh Mohamed Al Jaber and JJW Ltd, alleging: (1) that the first defendant, as one of the company's two directors, had been in breach of fiduciary duty in respect of the transfer of company property, namely 891,761 shares in JJW Hotels & Resorts Holdings Inc to the second defendant; and (2) that the second defendant was liable for knowing receipt of that property. On 24 February 2023 Joanna Smith J [2023] EWHC 364 (Ch) gave judgment in favour of the liquidators and ordered that the defendants pay equitable compensation of €67,123,403.36.

By appellant's notices filed on 29 and 31 March 2023 the defendants appealed. On 26 April 2024 the Court of Appeal (Newey, Arnold and

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Snowden LJJ) [2024] EWCA Civ 423; [2024] BCC 934 allowed the appeal in part, upholding the judge's findings that the first defendant had acted in breach of fiduciary duty and that the second defendant had knowingly received the shares, but quashing the award of equitable compensation on the basis that the liquidators had failed to establish any loss.

Pursuant to leave granted by the Supreme Court (Lord Briggs, Lord Burrows and Lord Richards JJSC) on 8 October 2024 the first defendant and the liquidators each appealed.

The issues for the court, as stated in the parties' agreed statement of facts and issues, were: (1) whether someone who intermeddled with company property was liable only to the extent of their receipt of the said property, and whether a person could otherwise assume fiduciary duties by purporting to exercise a power which they did not, as a matter of law, have; (2) whether the shares were subject to an unpaid vendor's lien; and (3) what was the proper approach to equitable compensation in cases where the value of the misapplied asset had declined after the date of breach, and the burden of proof as regards the cause of the diminution in value.

The second defendant, having been placed into compulsory liquidation on 31 July 2020 by an order of the Guernsey Royal Court, appeared as a respondent to the liquidators' appeal to the Supreme Court to ensure that the order made on the appeal recorded the appropriate position as against it, but did not make any substantive submissions of its own on the appeal.

The facts are stated in the judgment of Lord Hodge DPSC, Lord Briggs and Lord Sales JJSC, post, paras 1–3, 6–18.

Philip Rainey KC, *Marc Glover*, *Andrew Martin* and *Sami Allan* (instructed by *Spencer West LLP*) for the first defendant.

Tom Smith KC, *Joseph Curl KC* and *Jon Colclough* (instructed by *Clyde & Co LLP*) for the liquidators.

James Fennemore (instructed by *Troutman Pepper Locke UK LLP*) for the second defendant.

The court took time for consideration.

24 November 2025. **LORD HODGE DPSC, LORD BRIGGS** and **LORD SALES JJSC** (with whom **LORD STEPHENS** and **LORD RICHARDS JJSC** agreed) handed down the following judgment.

1 This appeal concerns a dispute between the liquidators of a company incorporated in 1990 in the British Virgin Islands, MBI International & Partners Inc ("the Company"), and Sheikh Mohamed Bin Issa Al Jaber ("the Sheikh") arising out of the dishonest transfer by the Sheikh of 891,761 shares ("the 891K shares") which the Company owned in another BVI company, JJW Hotels & Resorts Holding Inc ("JJW Inc"), after the Company had entered into liquidation. Those shares were transferred for no consideration to JJW Ltd, a company registered in Guernsey ("JJW Guernsey"), of which the Sheikh was a director at all relevant times and which is also now in liquidation. The liquidators of the Company ("the Liquidators") have sued the Sheikh and JJW Guernsey for equitable compensation, for breach of fiduciary duty in the case of the Sheikh and as a knowing recipient of the Company's property in the case of JJW Guernsey.

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Since 8 June 2019 the Joint Liquidators have been Greig Mitchell and Kenneth Krys.

2 The Sheikh is an international businessman and the founder and chairman of many companies which operate in various areas of business including commercial property, finance, hospitality and the food industry. Some of those companies incorporate the letters "MBI" in their names, which, as the Sheikh explained in his written evidence, is derived from "Mohamed Bin Issa" in his own name. The relevant transactions occurred between companies which are associated with him in the MBI group and of which he or members of his family appear to have ultimate beneficial ownership and control.

3 In summary, after the dishonest transfer of the 891K shares in JJW Inc which the Company owned, the Sheikh was involved in the transfer of all the assets and liabilities of JJW Inc to JJW Hotels & Resorts UK Holdings Ltd ("JJW UK"). In the courts below the parties argued their cases on the basis that that transfer of assets and liabilities denuded the shares in JJW Inc of any value and the Sheikh submitted that the Company had as a result suffered no loss from the earlier transfer of the Company's shares in JJW Inc to JJW Guernsey.

4 The appeals by the Liquidators and by the Sheikh against the orders of the Court of Appeal, which we discuss below, give rise to two principal questions, which break down into three principal issues. They are:

(1) Did the Sheikh in making the dishonest transfer of the Company's 891K shares in JJW Inc act in breach of a fiduciary duty owed to the Company when, under BVI company law, the winding up had removed his powers as a director of the Company? (Issue 1)

(2) If so, does the Company have a remedy against the Sheikh in equitable compensation for loss suffered as a result of the transfer of those shares? This question involves two separate matters.

(3) The first matter relating to the calculation of loss is whether the Company suffered no financial loss from the transfer of the 891K shares in JJW Inc because, as the Sheikh argues, the Company acquired those shares subject to unpaid vendor's liens. (Issue 2)

(4) If Issue 2 is answered in the negative, the second matter is how to calculate the loss of the value of the Company's 891K shares in JJW Inc when (as the parties argued in the courts below), after their transfer, the value of those shares was destroyed by the subsequent transfer of all JJW Inc's assets and liabilities to JJW UK. (Issue 3)

(1) The background facts

5 To understand the context of the challenged transactions we set out some of the corporate history of the relevant companies.

6 The Company was incorporated on 24 July 1990. At all material times the Sheikh has been one of the Company's directors and its sole shareholder. In 2004 the Company became a "business company" under the provisions of the BVI Business Companies Act 2004 ("BCA 2004"). In around 2008 the Sheikh was considering a restructuring of the companies associated with him. The restructuring was to involve an initial public offering of shares ("the IPO") in JJW Inc, which was incorporated in September 2008. The Sheikh was the only director of JJW Inc until 23 December 2016.

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7 From 23 December 2016, the sole directorship of JJW Inc was held in succession by BVI companies. Initially, MBI International Holdings Inc ("MBI International Holdings") was the director and after February 2018 MBI International Holding Group Inc took on that role.

8 In January 2009, in the context of the proposed IPO, the following shares in JJW Inc were issued:

(1) 129,100 shares ("the 129K shares") in favour of the Company;

(2) 8,038,120 shares ("the 8M shares") in favour of the Sheikh, who was until December 2011 the majority shareholder in JJW Inc;

(3) 567,556 shares ("the 567K shares") in favour of JJW Guernsey; and

(4) 324,205 shares ("the 324K shares") in favour of JJA Beteiligungsverwaltungs GmbH ("JJAB").

As explained below, the 891K shares, which were later the subject of the dishonest transfer from the Company, comprised the 567K shares and the 324K shares which were initially issued to JJW Guernsey and JJAB.

9 The Company acquired the 567K shares and the 324K shares from JJW Guernsey and JJAB under two share purchase agreements ("the SPAs"), which were in materially identical terms, on 18 March 2009 ("the March 2009 transfers"). The 567K shares were transferred from JJW Guernsey in consideration of €56,755,600 "to be paid on demand by [the Company] to [JJW Guernsey] in such way that is mutually agreed by [the Company] and [JJW Guernsey]". The SPA involving JJAB was in the same terms, while referring to JJAB rather than JJW Guernsey. The March 2009 transfers were intended to enable the Company to generate returns from the IPO, and to use those returns to pay JJW Guernsey and JJAB the consideration due for the 891K shares transferred under the SPAs. The IPO did not proceed. JJW Guernsey and JJAB never demanded payment under the SPAs nor was any agreement reached as to how such payment would be made. The consideration due under the SPAs was never paid.

10 As a result of the March 2009 transfers the Company held 1,020,861 shares in JJW Inc, comprising items (1), (3) and (4) in para 8 above, which was 11.27 percent of JJW Inc's total share capital.

11 On 23 December 2011 the Sheikh transferred his 8M shares in JJW Inc to MBI International Holdings.

12 The Company was wound up by order of the Eastern Caribbean Supreme Court on a creditor's application on 10 October 2011 at a time when it was the registered owner of the shares in JJW Inc referred to in para 10 above. In October 2013 the Sheikh applied unsuccessfully for the BVI court to terminate the winding up and on 14 January 2015 the Eastern Caribbean Court of Appeal dismissed his appeal against that refusal.

13 Section 175(1) of the BVI Insolvency Act 2003 ("the IA 2003") provides that, on the commencement of a company's winding up:

> "(a) the liquidator has custody and control of the assets of the company; (b) the directors and other officers of the company remain in office, but they cease to have any powers, functions or duties other than those required or permitted under this Part . . ."

As a result of the winding up therefore, the Sheikh's powers as a director of the Company came to an end.

14 That notwithstanding, on or around 29 February 2016, without the knowledge of Ms Charlotte Caulfield who was the liquidator of the

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Company at that time, the Sheikh signed two undated share transfer forms for the transfer of the 567K shares and the 324K shares from the Company to JJW Guernsey. He purported to sign the share transfer forms "for and on behalf of [the Company]" as its "Director". The Sheikh's case at trial was that the transfer forms had been signed in 2010 before the commencement of the winding up of the Company. The trial judge did not accept that and found that the Sheikh had signed the share transfer forms in 2016 and that in so doing he did not act honestly or in good faith. The Sheikh effected the registration of JJW Guernsey as the shareholder of the 891K shares in JJW Inc by his written resolution dated 29 February 2016 as the sole director of JJW Inc ("the 29 February 2016 resolution"). JJW Guernsey was registered as the holder of the 891K shares in JJW Inc's share register on 8 March 2016. The 29 February 2016 resolution, which appears to be a document prepared by lawyers, states that the director (i e the Sheikh) had reviewed the share transfer instruments and had "ascertained that the Instruments of Transfer were signed for and on behalf of the transferor on the 6th day of July 2010 (the 'Signing Date')" so that "beneficial ownership of the Transferring Shares transferred to [JJW Guernsey] on the Signing Date". The trial judge found that the Sheikh in taking these steps had acted dishonestly and in bad faith and that he did not act in the best interests of the Company. The Sheikh and JJW Guernsey did not appeal those findings. We refer to these transactions as "the 2016 Share Transfers".

15 On 8 May 2017 Ms Caulfield applied for recognition in the United Kingdom of the BVI liquidation as a foreign main proceeding under the Cross-Border Insolvency Regulations 2006 (SI 2006/1030). Ms Caulfield's BVI lawyers informed the Sheikh of the application by letter dated 22 May 2017. On 9 June 2017, Registrar Derrett granted the application recognising the Company's liquidation in the BVI as a foreign main proceeding and thereby enabling Ms Caulfield to obtain relief from the courts of Great Britain to protect the Company's assets and the interests of its creditors. On 23 June 2017 JJW Guernsey transferred the 891K shares to MBI International Holdings, another company which is part of the MBI group.

16 In July 2017 all JJW Inc's assets and liabilities were transferred to JJW UK which was at all relevant times owned by MBI International Group Holdings UK Ltd ("MBI IGH"), another MBI group company. We refer to this transaction as "the 2017 Asset and Liability Transfer". The transaction took place in the following way.

17 Minutes of a meeting of JJW Inc dated 17 July 2017 record that JJW Inc owed €600m to MBI International Holdings evidenced by the 2016 accounts of JJW Inc. A letter dated 30 June 2017 from MBI International Holdings, signed by the Sheikh, to JJW Inc demanded settlement of the debt within 21 days. The minutes recorded that JJW Inc was not able to pay that debt. On 27 July 2017 the Board of Directors of JJW Inc met. The Preamble to the minutes of that meeting record that MBI International Holdings had assigned that debt to JJW UK. The minutes also record that, on the advice of its auditors, it was in the best interest of JJW Inc to "proceed with the offer to acquire 100% of [JJW Inc], taking over all the assets and liabilities by [JJW UK]". At this time the Sheikh was neither a director nor shareholder of JJW UK or of its parent company. He was nevertheless registered as a "person with significant control" of the parent company, MBI IGH, until 29 April

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2022. The Sheikh in his fourth witness statement acknowledged that he had attended the meetings of 17 and 27 July of MBI International Holdings' parent company. It is common ground that at this time JJW UK took over all JJW Inc's assets and liabilities. As Newey LJ records in his judgment in the Court of Appeal, the Sheikh provided no satisfactory explanation for this transaction because, according to JJW Inc's accounts for the year ending 31 December 2016, its assets exceeded its liabilities by a considerable margin, having net assets of nearly €682m. It was also common ground and was recorded in the statement of facts and issues in this court that because of the 2017 Asset and Liability Transfer the 891K shares became worthless.

18 Thus, in summary, the appeal is concerned with three transactions and their legal effects. First, the Company acquired the 891K shares in *the March 2009 Transfers* in the context of a planned IPO. This is the context of Issue 2 concerning the assertion that there were unpaid vendor's liens. Secondly, after the Company went into liquidation in 2011 on a creditor's application, *the 2016 Share Transfers*, which purported to give effect to a transaction which predated the winding up of the Company, transferred the 891K shares from the Company to JJW Guernsey. This is the context of Issue 1: whether the Sheikh was in breach of his fiduciary duty to the Company in effecting the 2016 Share Transfers. Thereafter, following the recognition in the United Kingdom of the BVI liquidation of the Company, the 891K shares were transferred to MBI International Holdings in June 2017. Thirdly, in July 2017 JJW Inc's assets and liabilities were transferred to JJW UK by *the 2017 Asset and Liability Transfer*. This is the context of Issue 3: whether the 2017 Asset and Liability Transfer meant that the Company suffered no financial loss from the Sheikh's alleged breach of fiduciary duty.

(2) The legal proceedings

19 Ms Caulfield, as liquidator, commenced proceedings in May 2019 pursuant to section 212 of the Insolvency Act 1986. So far as relevant to this appeal she advanced three claims: (i) that the 2016 Share Transfers were void, (ii) that the Sheikh in bringing about the 2016 Share Transfers acted in breach of a post-liquidation fiduciary duty or in breach of trust, and (iii) that JJW Guernsey was the knowing recipient of the 891K shares.

20 The Liquidators took the place of Ms Caulfield and continued the action. The trial commenced on 3 February 2021 before Joanna Smith J and lasted 19 days, but because of repeated adjournments did not end until 14 October 2022.

21 In her detailed and thorough judgment [2023] EWHC 364 (Ch) the trial judge found on the question of liability (i) that the 2016 Share Transfers were void, (ii) that the Sheikh owed a duty of fiduciary stewardship during the winding up and had acted in breach of that duty by signing the share transfer forms and putting the 2016 Share Transfers into effect, and (iii) that JJW Guernsey was a knowing recipient of the 891K shares.

22 On the question of remedy, the trial judge held that the Liquidators were entitled to equitable compensation on a substitutive basis and that the loss to the Company was the value of the 891K shares which had been transferred from its ownership by the 2016 Share Transfers, that value being assessed using hindsight and common-sense. In assessing that value Joanna Smith J looked to JJW Inc's accounts for the year ended 31 December 2016

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which showed that it had net assets of €681.9m. Using that figure as an approximation of the value of JJW Inc when the 2016 Share Transfers took place, she calculated the pro rata proportion of JJW Inc's value to be attributed to the 891K shares in the amount of €67,123,403.36. She found that the Sheikh and JJW Guernsey were jointly and severally liable to pay equitable compensation in that sum.

23 The trial judge held that it was not necessary to determine whether Ms Caulfield would have sold the 891K shares before the 2017 Asset and Liability Transfer. To the extent that it was necessary so to determine, she held that Ms Caulfield was "doing what she could to progress the Liquidation in the face of stonewalling from the Sheikh" and that "had she been provided with accurate information she would have taken appropriate steps 'to take control' of the 891K shares and to realise them for the benefit of the creditors".

24 The Sheikh and JJW Guernsey appealed against Joanna Smith J's order. The Sheikh argued that she had erred (i) in finding that he had been in breach of fiduciary duty by effecting the 2016 Share Transfers and (ii) in making the order for equitable compensation. He argued against the order for equitable compensation on two grounds: (a) that the 2017 Asset and Liability Transfer had denuded the 891K shares of any value and (b) that the Company had suffered no loss as the 891K shares were subject to an unpaid vendor's lien which exceeded the sum ordered as equitable compensation. JJW Guernsey appealed against the order for equitable compensation on the two grounds which the Sheikh advanced.

25 The Court of Appeal (Newey, Arnold and Snowden LJJ) in a judgment dated 26 April 2024 [2024] EWCA Civ 423; [2024] BCC 934 allowed the appeals only on the ground that the Liquidators had failed to establish any loss. Newey LJ gave the sole substantive judgment, with which the other members of the court agreed.

26 The Court of Appeal rejected the Sheikh's first ground of appeal. It held that the Sheikh, by claiming that the share transfer forms were executed in 2010, had purported to exercise a power to effect the 2016 Share Transfers which a director would have had in 2010. He had thereby intermeddled with the property of the Company and was liable as a fiduciary. The fact that the Sheikh did not himself receive the 891K shares was not an objection to the Liquidators' claim. Causing the title of company property to be transferred elsewhere can amount to intermeddling regardless of whether the intermeddler receives the property.

27 The Sheikh succeeded on his second ground of appeal. The Court of Appeal held that the substitutive approach to equitable compensation required the court to assess the existence of loss at the time of the trial. By then, the 891K shares had become worthless because of the 2017 Asset and Liability Transfer. The question then was whether the Liquidators could sustain the trial judge's decision on the basis that, but for the misappropriation of the 891K shares, Ms Caulfield as liquidator would have sold them at a time when they were still valuable. The trial judge had not found that the 891K shares would have been sold before the 2017 Asset and Liability Transfer and the evidence would not have entitled her to do so. As a result, the Company would not have been better off if the 2016 Share Transfers had not taken place. It had therefore not suffered any loss from the Sheikh's breach of fiduciary duty.

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28 The Court of Appeal rejected the Sheikh's other ground of challenge to the order for payment of equitable compensation. It upheld the trial judge's finding that the March 2009 Transfers (para 9 above) did not give rise to an unpaid vendor's lien. The Court of Appeal considered that the trial judge was wrong in holding that the written terms of the March 2009 Transfers had excluded the existence of such a lien but held that she had been correct that the existence of an unpaid vendor's lien would have been inconsistent with the object of the transaction which was to facilitate the IPO and thereby obtain the funds to pay the vendors.

(3) The appeal to this court

29 The Liquidators and the Sheikh now appeal to this court. JJW Guernsey, acting through its liquidators since 31 July 2020, also formally joins issue in respect of the Liquidators' appeal. JJW Guernsey accepts that the knowledge of the Sheikh, as a director, was attributable to it and that, if the Sheikh is held to be in breach of fiduciary duty and is liable to pay equitable compensation, it will be liable in knowing receipt for the same sum. It also accepts liability as a knowing recipient of the 891K shares on another basis. The finding of the trial judge that the 2016 Share Transfers were void because the share transfer forms were signed after the Company had been put into liquidation was not challenged and the Court of Appeal's order declared its knowing receipt in taking registered title to the 891K shares. JJW Guernsey is only concerned to establish whether the Company is a creditor in its liquidation and makes no substantive submissions in this appeal.

30 We recorded in para 4 above the three issues which are raised on this appeal. We address each in turn.

(i) Issue 1: Whether the Sheikh was in breach of fiduciary duty in effecting the 2016 Share Transfers?

31 The first issue is one of the two matters on which the Sheikh appeals the order of the Court of Appeal. Philip Rainey KC for the Sheikh acknowledges the trial judge's finding of dishonesty and its unattractiveness. The Sheikh's case, however, is that he did not owe any fiduciary duty to the Company. In his grounds of appeal when seeking permission to appeal to this court, the Sheikh focussed his challenge on the argument that he could not be liable as an intermeddler in the Company's affairs unless he had received and held title to the Company's property. In the Sheikh's written case in this court and in Mr Rainey's oral submissions that argument was presented only as an answer to a case which based his liability on an analogy with a trustee de son tort (i e a trustee in his own wrong). It was submitted that the Court of Appeal, in imposing liability because the Sheikh had intermeddled by pretending to be a fiduciary, had adopted "an entirely novel approach" by imposing liability on the Sheikh as if he were a trustee de son tort and treating as irrelevant that he had never received the Company's property.

32 The principal focus of the appeal has moved to an argument that liability as an intermeddler or de facto fiduciary would arise only if a person voluntarily assumed the office of a fiduciary. A person could only become accountable for the functions and duties of a fiduciary if those functions and

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duties were legally capable of being discharged. It was asserted that a person cannot owe fiduciary duties if he does not have fiduciary powers. The Sheikh had no such powers because his powers as a director of the Company had ceased to have effect on the commencement of the winding up pursuant to section 175 of the IA 2003.

33 The Sheikh also argues that a single indivisible act (i e signing the share transfer forms for the 2016 Share Transfers) cannot both create a fiduciary duty and be a breach of that duty.

34 Further, the Sheikh challenges the idea that he had caused the 2016 Share Transfers. It is argued, first, that while the Sheikh had signed the share transfer forms on behalf of the Company and it was only that act which could conceivably be characterised as a breach of fiduciary duty, that act had no legal effect as he had no power to act and the share transfer forms were void. Secondly, article 4 of JJW Inc's articles of association and section 54 of the BCA 2004 provided that a share transfer was effected only when JJW Inc entered the transferee's name in its register of members. It was that act of JJW Inc through its company registration agents which required it to treat JJW Guernsey as the owner of the 891K shares. It was the act of the Sheikh in his capacity as a director not of the Company but of JJW Inc in signing the 29 February 2016 resolution that caused the company registration agents to update JJW Inc's register.

35 We are satisfied that there is no substance in those challenges to the judgment of the Court of Appeal on this issue. Before discussing the circumstances in which the Sheikh came under a fiduciary duty to the Company we deal very briefly with the argument in para 34 above which suggests that the Sheikh had not caused the 2016 Share Transfers and could not be in breach of fiduciary duty for anything done in his capacity as a director of JJW Inc. That suggestion is wrong. The purpose of the Shiekh's signing of the share transfer forms to JJW Inc in his purported capacity as a director of the Company and his signing of the 29 February 2016 resolution in his capacity as a director of JJW Inc was clearly to protect the 891K shares from the claims of the Company's creditors. Both steps were part and parcel of the same dishonest transaction and cannot be separated as the Sheikh seeks to do. As we explain below, the Sheikh owed a fiduciary duty to the Company in his purported exercise of a fiduciary power in transacting with its property. That fiduciary duty to the Company extended to having regard to the interests of its creditors in the context of its insolvency: *BTI 2014 LLC v Sequana SA* [2024] AC 211.

36 The challenge based on the absence of a power to transact on behalf of the Company is also without substance.

37 The paradigm of a fiduciary is the trustee acting under an express trust, who holds legal title to property in which the cestui que trust or trust beneficiary has the beneficial interest. But fiduciary duties have been extended by analogy with such a trustee to several offices and roles, including directors of companies: *Fraser v Whalley* (1864) 2 H & M 10; *Aberdeen Railway Co v Blaikie Bros* (1854) 1 Macq 461; *In re Lands Allotment Co* [1894] 1 Ch 616.

38 Fiduciary duties are however not confined to well established categories of relationship such as trustee and beneficiary, company director and company, principal and agent, and solicitor and client. Fiduciary duties can arise ad hoc. Millett LJ helpfully summarised the position of a fiduciary

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in *Bristol and West Building Society v Mothew* [1998] Ch 1, 18, in a passage which this court has quoted with approval in both *Recovery Partners GP Ltd v Rukhadze* [2025] 2 WLR 529 ("*Rukhadze*"), para 17 and *Hopcraft v Close Bros Ltd* [2025] 3 WLR 423 ("*Hopcraft*"), para 89:

> "A fiduciary is someone who has undertaken to act for or on behalf of another in a particular matter in circumstances which give rise to a relationship of trust and confidence. The distinguishing obligation of a fiduciary is the obligation of loyalty. The principal is entitled to the single-minded loyalty of his fiduciary. This core liability has several facets. A fiduciary must act in good faith; he must not make a profit out of his trust; he must not place himself in a position where his duty and his interest may conflict; he may not act for his own benefit or the benefit of a third person without the informed consent of his principal. This is not intended to be an exhaustive list, but it is sufficient to indicate the nature of fiduciary obligations. They are the defining characteristics of the fiduciary."

Millett LJ went on to endorse the statement in Dr Paul Finn's classic work, *Fiduciary Obligations* (1977), p 2, that the fiduciary is not subject to fiduciary obligations because he is a fiduciary; it is because he is subject to those duties that he is a fiduciary.

39 As this court has recently explained in *Hopcraft* para 82ff, equity recognises the existence of fiduciary duties by analysing objectively the relationship between the parties to ascertain whether it involves a relationship of trust and confidence because a party has, or is treated as having, undertaken to act with the loyalty of which Millett LJ spoke in *Mothew*. The relationship of trust and confidence is the consequence, and not the cause, of a fiduciary duty. The fiduciary duty exists because, looking at the matter objectively, the fiduciary has undertaken not to pursue his own interests. As Lord Woolf MR said in *Attorney General v Blake* [1998] Ch 439, 454, "the relationship of trust and confidence . . . arises whenever one party undertakes to act in the interests of another".

40 There is support for this view of the law in other common law jurisdictions. The High Court of Australia in *Hospital Products Ltd v United States Surgical Corpn* (1984) 156 CLR 41 recognised that a fiduciary duty can arise where a person agrees to act on behalf of another person and exercises a discretion which can affect the interests of that other person. In an influential statement of the law Mason J stated (at pp 96–97):

> "The critical feature of these relationships is that the fiduciary undertakes or agrees to act for or on behalf of or in the interests of another person in the exercise of a power or discretion which will affect the interests of that other person in a legal or practical sense. The relationship between the parties is therefore one which gives the fiduciary a special opportunity to exercise the power or discretion to the detriment of that other person who is accordingly vulnerable to abuse by the fiduciary of his position. The expressions 'for', 'on behalf of', and 'in the interests of' signify that the fiduciary acts in a 'representative' character in the exercise of his responsibility, to adopt an expression used by the Court of Appeal."

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41 In *Galambos v Perez* [2009] 3 SCR 247, a judgment of the Supreme Court of Canada, there is a similar emphasis on the undertaking of the fiduciary to act in a disinterested manner. Cromwell J stated (para 75) that "what is required in all cases is an undertaking by the fiduciary, express or implied, to act in accordance with the duty of loyalty reposed on him or her." He continued (para 76):

> "Thus, what is required in all cases of ad hoc fiduciary obligations is that there be an undertaking on the part of the fiduciary to exercise a discretionary power in the interests of that other party. To repeat what was said by McLachlin J in *Norberg* [*Norberg v Wynrib* [1992] 2 SCR 226], 'fiduciary relationships . . . are always dependent on the fiduciary's undertaking to act in the beneficiary's interests' (p 273). As Dickson J put it in *Guerin* [*Guerin v The Queen* [1984] 2 SCR 335], fiduciary duties may arise where 'by statute, agreement, or perhaps by unilateral undertaking, one party has an obligation to act for the benefit of another' (p 384)."

An undertaking to act only in the interests of the other need not be express but could be implied in the particular circumstances of the parties' relationship (paras 79 and 80).

42 Equity, however, does not require an express or implied undertaking to act in a disinterested manner in all circumstances. As the case law which we now discuss shows, equity will recognise in the objective circumstances of a case the undertaking of a fiduciary duty by the putative fiduciary in circumstances where he or she has not made any conscious undertaking or considered the interests of the person to whom that duty is owed and indeed has acted contrary to that person's interests. This can arise where a stranger to a trust or an agency relationship arrogates to himself a power or purports to exercise a power which carries with it fiduciary obligations and may properly be described as a fiduciary power.

43 In *Soar v Ashwell* [1893] 2 QB 390, a case about whether a claim was barred by limitation or was preserved because the defendant was a trustee, the Court of Appeal recognised that where a person takes on a role or exercises a power which, if exercised by a trustee or agent, would carry with it fiduciary obligations, the person's so acting causes him or her to undertake fiduciary duties. In that case trustees, acting under a will settlement in favour of two life tenants and their respective families, employed a solicitor to invest the trust estate. The solicitor invested the trust fund in an equitable mortgage in his own name and, when the mortgage was paid off, paid one half of the proceeds to the family of one life tenant who had by then deceased, and did not pay the other half to the trustees but kept it for himself. The surviving trustee later sought an account from the estate of the by then deceased solicitor. The solicitor's estate was held liable to account as he had been a fiduciary agent of the trustees. The court stated the principle broadly. Lord Esher MR said (p 394):

> "The cases seem to me to decide that, where a person has *assumed, either with or without consent*, to act as a trustee of money or other property, i e, to act in a fiduciary relation with regard to it, and has in consequence been in possession of or has exercised command or control over such money or property, a Court of Equity will impose upon him all

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A the liabilities of an express trustee, and will class him with and will call him an express trustee of an express trust." (Emphasis added.)

Bowen LJ (p 396) stated:

> "The doctrine that time is no bar in the case of express trusts has been extended to cases where a person who is not a direct trustee nevertheless assumes to act as a trustee under the trust: *Life Association of Scotland v Siddal* [(1861) 3 De G F & J 58]. This extension of the doctrine is based on the obvious view that *a man who assumes without excuse to be a trustee ought not to be in a better position than if he were what he pretends.*" (Emphasis added.)

44 There is long standing authority for this approach in the older case law concerning liability arising when a person acts as an executor de son tort or a trustee de son tort. In *Gawton and the Lord Dacres case* (1589) 1 Leo 219 which concerned the question whether bailiffs acting for Lord Dacre in relation to his estate were liable to account to his auditors, Anderson CJ stated: "if one become my bailiff of his own wrong, without my appointment, he is accomptable to me." By intermeddling without authority in the assets of a deceased or the affairs of a trust or a company a person can incur liability as if he were an executor, trustee or director. See *Vickers v Bell* (1864) 4 De G J & S 274, a case concerning an alleged executor de son tort, per Turner LJ at p 283; *Gibson v Barton* (1875) LR 10 QB 329, a case concerning a defectively appointed director; *Mara v Browne* [1896] 1 Ch 199, a case about a trustee de son tort; and *Lyell v Kennedy* (1889) 14 App Cas 437, a case of an agent de son tort (or "self-constituted agent") who had by his acts made himself a trustee in relation to the rents which he had collected. See also *Phipps v Boardman* [1965] Ch 992 in which Lord Denning MR, at pp 1017–1018, treated the defendants as self-appointed agents for the trustees and thereby liable to account to the trustees on the basis of agency. Although the House of Lords [1967] 2 AC 46 decided the case on a broader basis, their Lordships did not criticise Lord Denning MR's approach.

45 In summary, if persons, although not appointed as trustees, take upon themselves the custody and administration of property on behalf of others, they are actual trustees and are fully subject to fiduciary obligations: *Taylor v Davies* [1920] AC 636, 651 per Viscount Cave; *Dubai Aluminium Co Ltd v Salaam* [2003] 2 AC 366, para 138 per Lord Millett, who described such persons as de facto trustees. In *Williams v Central Bank of Nigeria* [2014] AC 1189, para 54 Lord Neuberger of Abbotsbury PSC cited with approval a passage from the 18th edition (2008) of *Lewin on Trusts* (now para 42-101 of the 20th edition (2020)):

> "A trustee de son tort closely resembles an express trustee . . . The principle is that a person who assumes an office ought not to be in any better position than if he were what he pretends."

46 In relation to a person purporting to be a director of a company, it is relevant to consider what Blackburn J stated in *Gibson v Barton*, above (p 338):

> "There are many instances in which a person who de facto exercises an office cannot defend himself by saying, when he is called upon to bear liability in consequence of his wrong, 'I am not rightfully in the office,

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there is another man who may turn me out'. An executor de son tort is an instance in which a man incurs all the liabilities of an executor as to third persons, and he is not permitted to say, 'I am not executor; there is another man who may take out probate.' The answer is, 'Your liability as to a third person rests upon your being executor de son tort; you have usurped the office and must bear the liabilities.' . . . So, if a director were to set up in answer to a penalty under section 27 [a statutory penalty on directors of a company for failure to compile and send to the registrar of companies an annual list of the company's shareholders], that he was not a director, that he was illegally elected, the answer would be, 'You have acted as director, and were a director in your own wrong'."

47 One can be a director in his own wrong. Thus, self-appointed directors, such as those who do not qualify as directors under the articles of association of a company but have acted as such, are treated as taking on the obligations, including fiduciary obligations, of de jure directors: *In re Canadian Land Reclaiming and Colonizing Co* (1880) 14 Ch D 660, 670 per James LJ.

48 The doctrines of executor de son tort and trustee de son tort are common law doctrines in their origin: see Charles Harpum, "The Stranger as Constructive Trustee (Part 1)" (1986) 102 LQR 114. The common law principle from which the doctrine of trustee de son tort derived was that a person who wrongfully intermeddled with the assets of the deceased and thereby usurped the functions and assumed the authority of an executor was liable as an executor de son tort to the extent of the property that came into his hands.

49 Nonetheless, the common law has developed. As Newey LJ records in paras 44–46 of his judgment, there is case law which holds that an intermeddler does not need to have title to or possess property to incur liability as an executor de son tort. In *Attorney General v New York Breweries Co Ltd* [1899] AC 62 the House of Lords addressed a test case on liability to probate duty where an English company had transferred title to some of its shares and debentures to the American executors of a deceased shareholder domiciled in New York at their request when it should have transferred them to an English executor if one had been appointed. The case was concerned principally with the interpretation of provisions in the Stamp Act 1797 (37 Geo 3 c 90), the Crown Suits Act 1865 (28 & 29 Vict c 104) and the Customs and Inland Revenue Act 1881 (44 Vict c 12), but the Earl of Halsbury LC at pp 68–69 and 71 and Lord Shand at p 76 treated the company as an executor de son tort which had intermeddled with the shares and debentures by registering them in the names of the American executors. Similarly, in *Inland Revenue Comrs v Stype Investments (Jersey) Ltd* [1982] Ch 456, which concerned a claim by the Revenue for payment of capital transfer tax, the transfer by the Jersey-based nominee of the late Sir Charles Clore of the proceeds of sale of land in England to his personal representatives in Jersey and not to his personal representative in England amounted to intermeddling, making the defendant liable to the tax as an executor de son tort. See Templeman LJ giving the judgment of the Court of Appeal at p 474.

50 It is not necessary that a person who has arrogated to himself a fiduciary power to deal with property has title to or possession of the

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property before he can come under a fiduciary duty. As Lord Esher MR stated in *Soar v Ashwell* it is sufficient that he has "exercised command or control" over it. In *English v Dedham Vale Properties Ltd* [1978] 1 WLR 93 a proposed purchaser of land during the negotiation of its purchase applied in the name of the vendor and without the vendor's knowledge or consent for a planning permission which would enhance the value of the property. He obtained that permission but did not disclose it to the vendor, who learned of it only after the sale had been completed. Slade J held that the purchaser by acting as a self-appointed agent in making the planning application had created a fiduciary relationship between himself and the vendor which imposed on him a duty of disclosure before the sale was completed, and, because of his non-disclosure, a duty to account for the profits received from obtaining the planning permission. The purchaser's liability as a fiduciary predated the purchaser's acquisition of the property.

51 In any event, directors of a company do not have title to or possess the property of the company but have only powers of administration over that property, yet they are treated nonetheless as if they were trustees of the funds of the company under their control: *In re Lands Allotment Co* [1894] 1 Ch 616, 631 per Lindley LJ; *Belmont Finance Corpn v Williams Furniture Ltd (No 2)* [1980] 1 All ER 393, 405 per Buckley LJ; *Byers v Saudi National Bank* [2024] AC 1191, para 56 per Lord Briggs JSC. They are subject to fiduciary duties and, as discussed in *Byers* (Lord Briggs JSC, paras 56–61, and Lord Burrows JSC, paras 175–188), are treated as trustees of the company's property. The Sheikh pretended to be a director with authority to transfer the 891K shares. The fact that the recipient of the misappropriated 891K shares was a company under the Sheikh's control rather than the Sheikh is irrelevant to his liability as a fiduciary in respect of that transaction.

52 The Sheikh also prays in aid a judgment of the Supreme Court of Victoria, *Nolan v Nolan* [2004] VSCA 109. But that does not assist him. The case concerned a family dispute over three paintings by Sir Sidney Nolan. The claimant asserted that they formed part of the estate of Lady Nolan, Sir Sidney's first wife and the claimant's mother, and that Sir Sidney had converted them shortly after her death and not delivered them to her executors. The case concerned the application of limitation statutes as the claim was made about 30 years after Lady Nolan's death. The court rejected the assertion that Sir Sidney was an executor de son tort or a trustee de son tort at common law, because he never purported to act as executor or trustee in relation to the paintings but had acted in his own right. Ormiston JA (para 18) characterised as the main vice of the claimant's reply to the limitation defence the assumption that Sir Sidney could be an executor de son tort or a trustee de son tort without having performed acts which could be construed as asserting a right to act as either executor or trustee. By contrast, in this case the Sheikh purported to sign the share transfer forms as a director of the Company and facilitated the registration of JJW Guernsey's ownership of the 891K shares by the dishonest assertion that the share transfers had conferred a beneficial interest on JJW Guernsey at a time when he could exercise power as a director of the Company. In signing the share transfer forms he purported to exercise the power of a director of the Company to transfer part of its assets.

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53 Mr Rainey also submits that before a person can be treated as a fiduciary there needs to be in existence something like a trust. In this case in 2016 the Company held both the legal title and beneficial interest in the 891K shares. The Sheikh, while remaining a director de jure, had ceased to have any discretionary powers in relation to the Company's property through the operation of section 175 of the IA 2003. Absent such powers, he submitted, there could be no trust. He referred to the Canadian case of *Galambos v Perez* (above) which concerned a claim by the bookkeeper of a firm of solicitors, who had paid about $200,000 of her own money into the firm without the firm being aware of her investment, when the firm was in financial difficulty. When the firm went into receivership she claimed that she was entitled to be repaid the sums on the basis that the partners were her fiduciaries. The Canadian Supreme Court rejected her claim both because there had been no undertaking by the relevant partner, Mr Galambos, to act only in her interests as regards the advances (see para 41 above) and because he had no discretionary power over Ms Perez's interests that he could exercise unilaterally or otherwise and that was fatal to the claim that he owed an ad hoc fiduciary duty to act solely in her interests (see the judgment of Cromwell J at paras 83–87).

54 This second ground of defence in the *Galambos* case does not assist the Sheikh because that case is far removed from the line of authority which we have discussed above in which a person has arrogated to himself a power which is fiduciary in nature. It is inherent in this line of authority that the person is *not* an executor, trustee or director and so does not, as a matter of law, possess the power which he or she purports to exercise. But the principle is as stated by Bowen LJ in *Soar v Ashwell* (para 43 above) and by *Lewin on Trusts* (para 45 above), that a person who assumes an office ought not to be in a better position than if he were what he pretends. That principle when applied to this case means that the Sheikh falls to be treated as if he were a director of the Company whose powers had not been removed by section 175 of the IA 2003. The pretence by the Sheikh in signing the share transfer forms in the 2016 Share Transfers was that he had power as a director to transfer the 891K shares. He cannot hide behind the statutory provision which removed his power as director (section 175(1)(b) of the IA 2003, quoted in para 13 above) as that is contrary to his pretence and, indeed, it was the effect of that provision which he was seeking to avoid by using his pretence.

55 Finally, in his written case the Sheikh argues that the same act cannot be both an assumption of duty and a breach of that duty. He submits that the court must first identify whether a person has assumed fiduciary duties before inquiring whether there are any acts of breach. The Court of Appeal erred, he submits, in conflating accountability and liability by treating his signature of the share transfer forms in the 2016 Share Transfer as both rendering him a fiduciary and amounting to a breach of that duty. We do not agree. The arrogation to oneself of a fiduciary power may render a person accountable as a fiduciary without involving any breach of fiduciary duty. But there is no reason why that arrogation of a fiduciary power may not itself involve a breach of fiduciary duty at one and the same time.

56 We conclude, essentially for the reasons set out by the Court of Appeal, that the Sheikh fails on issue 1.

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57 We turn then to the issues concerning the quantification of the Company's claim.

(ii) Issue 2: Whether the Company suffered no loss because it acquired the 891K shares subject to unpaid vendor's liens?

58 As a defence to the Liquidators' claim, the Sheikh contends that the 891K shares are subject to unpaid vendor's liens arising in equity in favour of the entities which sold them to the Company pursuant to the two SPAs dated 18 March 2009, as to €56,755,600 in respect of the agreed price for the 567K shares sold by JJW Guernsey to the Company and as to €32,420,500 in respect of the agreed price for the 324K shares sold by JJAB to the Company. The price was never paid by the Company for the shares under those respective transactions. On the basis that at the date of the 2017 Transaction the 891K shares were charged with unpaid vendor's liens for sums totalling 89,176,160, the Sheikh submits that the Company suffered no loss as a result of that transaction.

59 We leave to one side any evaluation of the Liquidators' riposte to this that, even if such liens existed over the 891K shares, the Company suffered loss as a result of the 2017 Transaction because it remained liable for the contract price under each respective Share Purchase Transaction and, by that transaction, lost the value of assets which would otherwise have been available to generate the funds to pay those agreed sums. We focus on the reasons given by the courts below for rejecting this defence.

60 The judge rejected this defence of the Sheikh for two reasons, the first based on her construction of the SPAs and the second based on her more general assessment that the parties intended to exclude an unpaid vendor's lien in respect of both transactions. The Court of Appeal disagreed with the first reason but endorsed the second.

61 As is recorded in the agreed statement of facts and issues, JJW Inc was incorporated in September 2008 and it was intended that there would be an IPO of its shares. It was in the context of the proposed IPO that the 567K shares were issued and allotted to JJW Guernsey and the 324K shares were issued and allotted to JJAB. Then on 18 March 2009 both lots of shares were transferred to the Company pursuant to the Share Purchase Agreements ("the March 2009 Transfers"). As recorded in the statement of facts and issues, the March 2009 Transfers were intended to enable the Company to generate returns from the IPO and to use those returns to pay JJW Guernsey and JJAB the consideration for the 891K shares under the SPAs. This part of the statement of facts and issues reflects findings made by the judge which in turn reflect uncontested evidence given by the Sheikh.

62 The Share Purchase Agreements were in materially identical terms. In the JJAB agreement, clause 2 provided:

> "2. TRANSFER OF SHARES
>
> "2.1 The Seller [i e JJAB] hereby irrevocably transfers its legal and beneficial interests in the Company Shares [i e the 324,205 shares in JJW Inc] to the Buyer [i e the Company] free from Encumbrance in consideration for €32,420,500.00 (the 'Consideration') to be paid on demand by the Buyer to the Seller in such way that is mutually agreed by the Buyer and the Seller.

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"2.2 Upon receipt of the Consideration by the Seller, completion of the transfer of the Company Shares pursuant to this Agreement shall take place immediately, when

"2.2.1 the Seller shall deliver to the Buyer a share transfer [form] duly executed by the Seller in respect of the Company Shares in favour of the Buyer and procure that the Company shall register such transfers and issue and deliver to the Buyer a certificate representing the Company Shares in the name of the Buyer; and

"2.2.2 the Seller shall, at the request of the Buyer, do and execute or procure to be done and executed all such acts, deeds, documents and things as may be reasonably necessary to give effect to this Agreement."

63 Clause 3.2 of each agreement provided for it to be governed by Guernsey law, which in relevant part has been taken to be the same as the law of England and Wales. Clause 1.1 of each agreement stated that "Encumbrance" includes "any mortgage, charge, pledge, lien, hypothecation, security interest, trust arrangement, option or other third party interest whatsoever". The Court of Appeal, differing from the judge on this point, construed this as limited to encumbrances in favour of third parties, so that on its proper construction clause 2.1 did not include an express promise to negative the existence of an unpaid vendor's lien. There is no appeal in relation to this part of the Court of Appeal's judgment.

64 The judge also found (para 479) that the evidence before her, in particular in the form of explanations for the share purchase transactions given by the Sheikh in his witness statements, showed that the intention behind the transfer of the shares in those transactions was to enable the IPO to take place and that the Company would use the returns from the sale of the 891K shares in the IPO to pay the consideration for the transfers. This finding was also supported by the Sheikh's pleaded case and his written closing submissions. The Sheikh pleaded in his re-amended points of defence that the "entire rationale and purpose of the [March 2009 transfers] was to enable the Company to generate returns in the BVI from the IPO and to use those returns to pay the [consideration for the shares] to JJW Guernsey and [JJAB]".

65 The judge had evidence about the IPO and the way it was intended to be carried into effect. At para 488 she made a specific finding in relation to the Sheikh's contention that there were unpaid vendor's liens in equity which affected the 891K shares: "The existence of the lien would have prevented a sale of the 891K shares by the Company in the IPO and use of the proceeds of sale to pay the consideration, thereby thwarting the purpose and rationale for [the March 2009 Transfers]".

66 That finding was not challenged by the Sheikh on his appeal to the Court of Appeal. We can see no proper basis on which it can be disputed at this stage.

67 Newey LJ, at para 100, did not dispute that finding or suggest that it was in issue. He said that the clear inference from the circumstances of the March 2009 Transfers was that the parties intended to exclude a lien "which would at best complicate the intended sale of the shares through the IPO". It might have been possible, by careful drafting, to fashion a form of unpaid vendor's lien which did not impede the transfer of the shares to purchasers in an IPO free of any encumbrance in the form of a lien in favour of others, but

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so that the lien would at the stage of onward transmission of the shares to such purchasers attach instead to the proceeds of sale arising from the IPO. Be that as it may, there was nothing in the evidence or the case presented by the Sheikh that this was contemplated; nor did the evidence in the case show that it was thought that the purchasers in an IPO would regard this as acceptable or as sufficient to eliminate any risk to themselves from having a lien attached to the shares in the first place. On the contrary, as mentioned above, the judge found that the existence of the lien would have had the effect of making the IPO impossible. Newey LJ endorsed the judge's finding that the inference from the circumstances surrounding the March 2009 Transfers was that the parties intended to exclude any unpaid vendor's lien. He considered that the peculiar drafting of clause 2.1 (namely that the price for the shares in question should be "paid on demand by the Buyer to the Seller" but "in such way that is mutually agreed by the Buyer and the Seller") supported this inference, in that it showed that the Company as purchaser was intended to have a degree of control over when the consideration should be paid, which married up with the Sheikh's account that this was only to happen once the IPO had taken place.

68 In our view, the findings and conclusion of the judge and the Court of Appeal on this issue cannot be faulted.

69 Newey LJ said (para 100) that the judgment of Millett LJ in *Barclays Bank plc v Estates & Commercial Ltd* [1997] 1 WLR 415 ("*Barclays*") (the leading modern authority), "shows that the key question is whether there is 'a clear and manifest inference that it was the parties' intention to exclude [the unpaid vendor's lien]'" (at p 421).

70 In *Barclays* Millett LJ explained (p 420):

> "The lien arises by operation of law and independently of the agreement between the parties. It does not depend in any way upon the parties' subjective intentions. It is excluded where its retention would be inconsistent with the provisions of the contract for sale *or with the true nature of the transaction as disclosed by the documents*. It is also excluded where, on completion, the vendor receives all that he bargained for . . ." (Our emphasis.)

71 The lien arises by operation of law according to equitable principles, in that it is usually just and fair that the vendor should have a lien over his property until the price for it has been paid. This means that the test to be applied is more flexible and responsive to the equities of the case than the strict test governing the implication of terms in an agreement (as explained in *Marks and Spencer plc v BNP Paribas Securities Services Trust Co (Jersey) Ltd* [2016] AC 742); hence Millett LJ's comment that the lien arises independently of the agreement between the parties. Just as the test for implication of a term does not have to be satisfied for the lien to arise, so also it does not have to be satisfied in order to find that the lien does not arise but is in fact excluded. The whole debate regarding the existence or otherwise of such a lien takes place by reference to the equitable principles which govern this aspect of the law.

72 The focus in the present case is on the words we have highlighted above. Millett LJ says that the true nature of the transaction has to be "disclosed by the documents"; and later (at p 421, in the same sentence in the quotation by Newey LJ referred to in para 67 above) he said that *Winter v*

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Lord Anson (1827) 3 Russ 488 was authority that "the intention of the parties is to be objectively ascertained from the documents they have executed". However, the comments in that case were directed to its particular facts. In our view, since equitable principles govern here, it is not necessary that the relevant contrary intention should be made out only from documents executed by the parties to the sale transaction. It is possible that there may be other evidence from the circumstances surrounding the transaction which is sufficient to demonstrate clearly that the joint intention of the parties, on an objective assessment, was that there should be no lien, having regard to the "the true nature of the transaction" (which includes its purpose). As a matter of general approach, equity has never confined itself just to looking at documents, or documents executed by the parties to a transaction, but will also take account of other sources of evidence as may be appropriate to determine the relevant issue in accordance with fairness and the justice of the case. The equitable doctrine of rectification of written instruments is but one example of this: see *Tyne and Wear Passenger Transport Executive (trading as Nexus) v National Union of Rail, Maritime and Transport Workers* [2025] AC 1222.

73 Later in his judgment (p 422), Millett LJ's formulation was slightly different: "The lien arises by operation of law unless its exclusion can be objectively inferred from the terms of the documents and the nature of the transaction". At p 420 he cited with approval a passage from *Williams on Vendor and Purchaser*, 4th ed (1936), vol 2, p 984, dealing with implied waiver or abandonment of an unpaid vendor's lien, which stated that "the question is one of the parties' intention, to be determined by the documents they have executed *and the circumstances of the case* . . ." (our emphasis); and he said, "the authorities demonstrate the test is an objective one. The question is: what intention is to be attributed to the parties from the transaction into which they have entered?". Turning to the facts of the case before him he said (p 424) that the unpaid vendor "retained the lien by operation of law unless there was something in the transaction itself which would lead to the necessary inference that the parties must objectively be taken to have excluded the lien". All these formulations are consistent with the wider application of equitable principles which is appropriate in this area and are not tied to what appears from the documents themselves (although obviously the documents executed by the parties and exchanged by them will be an important source of relevant evidence about the joint intention in relation to the transaction in issue). The way in which Newey LJ formulated the question at para 100 (see para 67 above) reflects this interpretation of the law, and rightly so in our view.

74 At pp 422–424 Millett LJ considered *Kettlewell v Watson* (1884) 26 Ch D 501. In that case vendors sold land (with part of the purchase price remaining unpaid) to estate agent purchasers who intended to sell it on in lots to sub-purchasers on the footing that they were able to do so free from any charge or lien. The vendors, through their agent, were aware that this was the proposed scheme and could have intervened to stop the purchasers from selling on in this way, but did not do so. Later, the vendors sought to assert an unpaid vendor's lien against the sub-purchasers. Their claim was dismissed by the Court of Appeal. Lindley LJ explained (pp 509–510) that the conduct of the vendors' agent induced the sub-purchasers reasonably to believe that the estate agent purchasers had power to deal with the land as

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absolute owners free from any lien, which meant that the vendors were not entitled to enforce their lien against the sub-purchasers. Millett LJ pointed out that this was not a case where the unpaid vendor's lien was excluded, but rather was one where it was postponed to the equitable interest of the sub-purchasers of the lots because of the way the vendors, through their agent, had conducted themselves: p 424. However, it shows that the operation of an unpaid vendor's lien is subject to ordinary equitable principles applicable in light of the general circumstances of a case, and in our view there is no good reason why the position should be any different in relation to the question whether such a lien arises in equity in the first place. Indeed, one could say that the reason that an unpaid vendor's lien does not arise in equity is closely related to that identified in *Kettlewell v Watson*, namely because the circumstances of the transaction are such as ought to lead both vendor and purchaser reasonably to understand that no such lien would be given effect.

75 Millett LJ also reviewed (pp 421–422) *In re Brentwood Brick and Coal Co* (1876) 4 Ch D 562 ("*Brentwood Brick*"). In that case, pursuant to an agreement for sale of the leasehold of a brick-works made by the owner and a trustee for a company in the process of formation, and later adopted by the company, the vendor executed a conveyance of the leasehold to the company which was stated to be in consideration of a sum of £6000 in cash to be paid later in accordance with the payment terms set out in the conveyance and £2000 in fully paid up shares. The conveyance stated that 50% of all sums received by the company on the sale of its shares and 50% of all sums borrowed by it as capital should be paid to the vendor until the £6000 cash amount had been paid off. The company was not successful and failed to raise any money on the sale of shares or by borrowing, so the £6000 remained unpaid. The company was wound up and the brick-works were sold, with the proceeds of sale paid into court. The vendor claimed a lien on those proceeds for the unpaid purchase money, but the claim was dismissed. James LJ (with whom Brett JA agreed) said (p 565) that this was not a simple agreement to sell for £6000 and that "the nature of the transaction excludes [a] vendor's lien", continuing as follows:

> "No doubt the vendor got a higher price by agreeing to accept payment in the way he did, and taking his chance of capital being subscribed or capital being borrowed to an amount sufficient to pay him. He says in fact, 'Half of the first capital moneys that come in to the extent of £6000 is to be my purchase-money.' No day for payment was named: he agreed to receive his purchase-money if and when capital should come in. He got for his property a charge upon and a right to the capital of the company to the extent of £6000 when it came in. To my mind it is clear that he intended to rely on that fund for payment, and intended that the company should have the means of borrowing. This is quite inconsistent with a lien which would probably make the company unable to pledge their property."

76 There are two strands in the reasoning of James LJ: (i) the parties intended that the purchase price would be paid from a particular source, and from that source alone, namely the funds to be raised by share sales and borrowing of capital (and see p 565 per Baggallay JA: "it is evident that the party selling did not intend to rely on the security of the estate but on the

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funds of the company"); and (ii) the parties intended that the company should be able to borrow the funds needed to pay the cash amount, and a lien would have constituted a serious impediment to this as it would likely have made it impossible for the company to use the brick-works it was buying as security to borrow the funds required (the company was a new venture without an established business or cashflow which could not have supported borrowing in any other way). In combination, they were fatal to the vendor's claim for a lien. We consider that each of them by itself would have been fatal.

77 Millett LJ pointed out (p 422) that there would have been a vendor's lien if the consideration had been £6000 simpliciter, even if it had been obvious to both parties that the company would have no means of paying this unless it was able to borrow money or issue shares to that amount. Something more was required than that they contemplated that the purchase price was to be paid in that way. He said that what was determinative was that "the consideration expressed in the conveyance was not £6000 simpliciter but £6000 to be paid if and when the company borrowed or issued shares to that amount".

78 We consider, in agreement with Millett LJ, that it is clear that something more was required to prevent a vendor's lien from arising than the mere contemplation that the purchaser would be using certain sources of finance to pay the price. It had to be found that the parties had a positive joint intention either that the price was to be paid from a certain source or sources, with no obligation to have recourse to or right to call for recourse to be had to any other source (including by way of lien in relation to the property being sold) and/or that they had a positive joint intention that there should be no vendor's lien because it would constitute an unwarranted and excessive impediment for the raising of funds to constitute the agreed source for payment. In our view, it was not critical to the reasoning in *Brentwood Brick* that these inferences as to joint intention were based on what was written in the conveyance. In fact, the second point made by James LJ was not set out in the conveyance and in any event the conveyance was a document executed by only one of the parties (some time after the agreement, which was the document executed by them jointly but which was not drafted in such specific terms as the conveyance). A focus in the cases on documentary materials is justified by the fact that documents executed by the parties (in particular, if executed jointly) are a particularly significant form of evidence from which the relevant inference as to their joint intention may be drawn. But other forms of evidence are not excluded. Otherwise, this category of case would tend to collapse back into the narrower question of an examination of whether the existence of an unpaid vendor's lien is inconsistent with the terms of the contract, whether express or implied; but, as we have said and as the authorities indicate, the nature of the inquiry in equity is wider than that.

79 We would make three comments. First, given the very specific inference as to joint intention which has to be drawn (see para 78 above), the evidence which is relevant will need to be closely related to the transaction in question. Mere evidence of the background to the transaction, in abstract terms remote from the specific detail of what was agreed or jointly intended by the parties, is very unlikely to be sufficient to negative an unpaid vendor's lien.

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80 Secondly, the evidence regarding joint intention in this case was particularly strong and compelling. The SPAs were entered into as part of a general restructuring exercise within the corporate group owned by the Sheikh. The Sheikh stood on both sides of each of the agreements and could speak to the joint intention of the parties which underlay the transactions in each case. His evidence about that intention was very specific. The judge was entitled to make the finding she did in the light of that evidence and other evidence before her about the nature of the transactions.

81 Thirdly, as Newey LJ pointed out (para 100), there is a close analogy between the present case and *Brentwood Brick*. On the evidence of the Sheikh and the finding of the judge, both elements identified by James LJ in *Brentwood Brick* (para 75 above) were present. The inference that, in light of the nature of the March 2009 Transfers, the joint intention of JJW Inc and JJW Guernsey in the one case and JJW Inc and JJAB in the other was that there should be no unpaid vendor's lien which attached to the 891K shares was a strong one. Newey LJ drew attention to the fact that there was some trace of the underlying joint intention in the odd drafting of clause 2.1, which certainly was a relevant factor. However, the critical feature of the case was the evidence given by the Sheikh and his pleaded case regarding the background circumstances, rather than this aspect of the drafting of clause 2.1.

82 There is nothing in the other cases cited on this aspect of the appeal which affects the analysis we have set out. Mr Marc Glover, who presented this part of the submissions for the Sheikh, relied in particular on *George Wimpey Manchester Ltd v Valley and Vale Properties Ltd* [2012] 2 EGLR 113. In that case, in giving the lead judgment in the Court of Appeal, Arden LJ found that there was no unpaid vendor's lien by focusing on an inconsistency between the alleged lien and the terms of the contract of sale: paras 34–40. At para 38 she stated, "on a true interpretation of the sale agreement, the unpaid vendor's lien is excluded in this case". That is one of the types of cases identified by Millett LJ in *Barclays* in which such a lien will be excluded (see para 70 above), but it is not the only one and Arden LJ did not say that it was. At para 35 Arden LJ also said that an unpaid vendor's lien was excluded by the nature of the transaction, and that (referring to Millett LJ's judgment in *Barclays*) this was "to be determined by an objective assessment of the parties' intentions as expressed in their agreement". But as we have explained above, neither *Barclays* nor the other authorities support such a narrow approach.

83 In *In re Albert Life Assurance Co* (1870) LR 11 Eq 164 an unpaid vendor's lien was found to be excluded because it "would frustrate the very object of the arrangement", so it was "impossible to infer that, consistently with that intention, any such lien as [that contended for] could have been contemplated" (p 179). Bacon V-C said (p 178): "the rule of law upon which the doctrine of an unpaid vendor's lien depends must be very frequently influenced by the particular circumstances of each case in which it is said to arise". This supports our analysis of the nature of the doctrine and of the evidence which is relevant in applying it, as does this further passage (at pp 178–179):

> "there is one plain principle which guides and governs [the doctrine's] application in all cases. If it be expressed, *or can be safely and properly*

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inferred from documentary or other evidence, or from the nature of the contract, that it was the intention of the parties that the sale or transfer, however absolute in its terms, was subject to the condition that the purchase-money should be paid, or that the thing contracted to be done by the vendee should be performed, the lien will prevail. If, on the other hand, no such inference can be properly drawn—if the performance of the thing contracted to be done by the vendee was not the condition upon which the transfer was made, but the engagement to do the thing was the consideration for the transfer, the vendor, having accepted that engagement, has the very thing he bargained for, and cannot say that the consideration has not passed to him. In such cases the lien cannot prevail." (Our emphasis.)

84 We would add that, since reference to evidence about the circumstances of a transaction is permitted and may often be necessary for the purposes of assessing whether the narrow test for implication of terms in a contract is met, it could not sensibly be thought that this is not permissible when applying the wider equitable principles in issue here.

85 The Sheikh's appeal on Issue 2 therefore fails.

(iii) Issue 3: How to calculate the loss of the value of the Company's 891K shares in JJW Inc when (as the parties argued in the courts below), after their transfer, the value of those shares was destroyed by the subsequent transfer of all JJW Inc's assets and liabilities to JJW UK?

86 The trial judge quantified the Company's loss, attributable to the Sheikh's misappropriation of the 891K shares in the 2016 Share Transfers at €67,123,403.36. She did so by reference to what she regarded as the best evidence of value made available to her, namely the statement of shareholder value in JJW Inc's 2016 Accounts, as at 31 December 2016. This date was, as she noted, only a few months after the 2016 Share Transfers, and the Sheikh did not challenge the calculation of the amount derived from those accounts, as a matter of mathematics, or because no minority discount was applied to what was of course a small minority holding in JJW Inc.

87 The Court of Appeal reduced that quantification to zero, on the basis that, by the time of trial, the value of the 891K shares had been reduced to nil by the 2017 Asset and Liability Transfer. Relying upon an inference (not challenged on appeal to this court) that but for the 2016 Share Transfers the Liquidators would not have sold any of the Company's shares in JJW Inc before July 2017, they concluded that, valuing them at the trial date, as part of a trial date assessment of loss, they were worthless. Therefore, the Company suffered no loss by reason of their misappropriation by the Sheikh in 2016. In so doing they treated the 2017 Asset and Liability Transfer as a key element in the counterfactual scenario required to be erected by assessing what would the shares have been worth to the Company by the time of trial if the breach of duty constituted by the 2016 Share Transfers had not occurred. They were much encouraged in reaching that conclusion by the fact that the Liquidators had not sold the Company's 129K shares in JJW Inc which had not been misappropriated in 2016, and those shares had (as was common ground at least by the time of the hearing in the Court of Appeal) been rendered worthless to the Company by the 2017 Asset and Liability Transfer.

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88 These radically different outcomes, based on relatively straightforward and largely uncontested facts, appear to have resulted from a different application of the legal principles relating to the construction of counterfactuals, in deciding what would have happened but for the breach of fiduciary duty by the Sheikh in bringing about the 2016 Share Transfers. The general importance of those legal principles was a main reason why the Liquidators were given permission to appeal to this court. It is therefore necessary to consider those principles (or at least those which are decisive of this appeal) in some detail. But first it needs to be borne in mind how the Sheikh's case about the counterfactuals changed between trial and the hearing in the Court of Appeal.

89 The judge carefully set out the elements of the counterfactuals relied upon by the Sheikh before her, before rejecting all of them. At paragraph 559 of her judgment she identified four (one of which she classified as an alleged intervening act). They were:

(i) That JJW Guernsey always had a right to enforce its lien;

(ii) That the Liquidators never tried or wished to realise the shares;

(iii) That the Liquidators never wanted to investigate title to the Company's shares in JJW Inc; and

(iv) That the loss was caused (as an intervening act, breaking the chain of causation) by the Liquidators' failure to "take control" of the Company's shares in JJW Inc.

90 Striking by its absence from the judge's list of counterfactuals or intervening events was any allegation by the Sheikh that the 2017 Asset and Liability Transfer was itself an intervening event which broke the chain of causation by reducing the value of the shares to zero. This was all the more striking because, as the judge noted at para 557(iii) it was clear, and asserted by the Liquidators, that that transaction reduced the value of the shares in JJW Inc to zero. This omission was not a mistake by the judge. No such case was pleaded, proved or relied upon in submissions by the Sheikh. It was only before the Court of Appeal that the 2017 Asset and Liability Transfer itself became a plank (indeed the main plank) in the Sheikh's case that the shares were to be regarded as worthless, so that the Company suffered no loss by their misappropriation.

91 There appears to have been no opposition to this late introduction of a new point in the Court of Appeal, without it having been pleaded, proved or subjected to forensic examination at trial. Furthermore, Newey LJ was by no means satisfied that the Sheikh had made a clean breast (by full disclosure) as to how the 2017 Asset and Liability Transfer had come about, what was its purpose or his role in it, or whether it really did reduce the value of the shares in JJW Inc to zero. He said (at para 57):

> "I have to say that I would not myself regard it as obvious that the transfer of JJW Inc's assets and liabilities to JJW UK made shares in JJW Inc worthless. The 2016 Accounts reported that, as at 31 December 2016, JJW Inc had liabilities totalling €775m, including €595m owing on 'Owners' current account', but also that the company had assets amounting to €1,457m and, hence, net assets of nearly €682 million. It is far from clear how, in the circumstances, all JJW Inc's assets could properly have been transferred away in return for no more than JJW UK assuming responsibility for JJW Inc's (much smaller) liabilities. Even

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assuming that such a transaction could have been sanctioned with the unanimous consent of JJW Inc's members, it cannot have received it since the Company held 129,000 shares and had no knowledge of the transfer. *Nor has the Sheikh provided any satisfactory explanation (or, really, any explanation at all) for what was done.* The judge noted in the judgment that Ernst & Young, Cairo, had said in a letter dated 30 June 2017 that by the end of 2016 they had been so concerned about JJW Inc's status that they had been unable to continue as the company's auditors in the absence of a restructuring, that minutes of a meeting of JJW Inc dated 17 July 2017 mention a person at the meeting declaring that JJW Inc was not in a position to pay its debt to MBI International Holdings and that 'all possible avenues would need to be explored': see paras 114 and 117. The judge also referred to 'contemporaneous evidence as to the commercial considerations which caused various inter-connected companies to restructure their affairs at this time': para 541. To my mind, however, there remain unanswered questions as to the propriety of the transfer of JJW Inc's assets, whether JJW Inc might have a valuable claim in respect of it and whether a shareholder could bring a derivative claim or seek relief on an unfair prejudice basis. It is not inconceivable that the Company could even now put itself in a position to mount a valuable claim by having JJW Inc's register of members rectified in its favour." (Our italics.)

92 Nonetheless the Court of Appeal felt compelled to treat the 2017 Asset and Liability Transfer as an event which reduced the value of the misappropriated shares to zero because (a) that was the Liquidators' case before the judge and (b) they did not challenge that approach in the Court of Appeal. We will return to this question after examining the relevant law.

93 Where a trustee misappropriates trust property or (as here) a fiduciary misappropriates property under his management and control, then there is little doubt as to the general objective of a court of equity in awarding compensation to the beneficiary (or the principal: here, a company) if the misappropriated property cannot be returned in specie (and at a fair reflection of its value to the beneficiary or the company, according to the principles discussed below). It is to restore to the trust fund at the expense of the defaulting trustee or fiduciary (or to the company where its property is misappropriated by a director) the value of the property misappropriated. Looking backward from the time of trial, and with the full benefit of hindsight, the court asks what would have been the value of that property to the beneficiary (or company) if it had not been misappropriated. There are numerous well-known judicial statements to that effect both in cases of misappropriation and, by analogy, other cases of breach of trust. They include *In re Dawson, decd; Union Fidelity Trustee Co Ltd v Perpetual Trustee Co Ltd* [1966] 2 NSWR 211, and *Libertarian Investments Ltd v Hall* (2013) 17 ITELR 1 ("*Libertarian*"), which were about misappropriation, and *Target Holdings Ltd v Redferns* [1996] AC 421 ("*Target*") and *AIB Group (UK) plc v Mark Redler & Co Solicitors* [2015] AC 1503 ("*AIB*"), which were not, although they did involve the unauthorised payment of trust money.

94 The principle that the court looks back from the date of trial is a concept regarding the information to be taken into account by the court when it makes its evaluation of the value of what the trust fund or the

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company has lost. This does not in itself answer the question of what is the relevant date at which the value of the property to the trust fund or the company should be assessed. That gives rise to a distinct issue of principle, namely what is the date of valuation of the property which appropriately reflects the justice or equity of the case?

95 In many cases where there is an issue as to the value to be attributed to the property misappropriated, the court has regarded it as just and equitable to value the property as at the date of trial. Thus if it has appreciated since misappropriation (or would have if retained in the trust fund) the defaulting trustee will justly be chargeable with that increase. Similarly if it has (or would have) declined in value by reason of matters having nothing to do with the conduct of the defaulting fiduciary (including custodianship of the property) following misappropriation, such as a fall in the property market or, in the case of shares, a fall in the value of the company in which those shares are held due to general market conditions (*Thanakharn Kasikorn Thai Chamkat (Mahachon) v Akai Holdings Ltd* (2010) 13 HKCFAR 479 ("*Akai Holdings*") is an example), then the defaulting fiduciary will not be chargeable for that diminution in value, unless the beneficiary can show that the property would have been sold in the meantime, at a price reflecting a higher value than if retained until trial (the position in *In re Ahmed* [2018] BPIR 535). If events occur diminishing the value of the property which are extraneous to the relationship between beneficiary and trustee (or between company and director) and which would have had the same effect if the property had remained in the hands of the trust fund or the company, there is no sound justification for holding the trustee or director responsible for that loss of value. On the other hand, where the fall in value of the property is caused by misconduct by the trustee or director there may be justification for holding the trustee or fiduciary responsible for it.

96 In this respect this general tendency of equity to assess quantum (including value) at the date of trial departs from the common law, which traditionally quantified loss as at the date of breach. But neither is a fixed or invariable rule. *Golden Strait Corpn v Nippon Yusen Kubishika Kaisha* [2007] 2 AC 353 and *County Personnel (Employment Agency) Ltd v Alan R Pulver & Co* [1987] 1 WLR 916, CA show how the supposed breach date rule at common law may be departed from to meet the justice of the case, in contract and tort respectively. Cases about equitable compensation which demonstrate that there is no fixed or inflexible trial date rule include *Satyam Enterprises Ltd v Burton* [2021] BCC 640 and *Cassegrain v Gerard Cassegrain & Co Pty Ltd* [2015] NSWSC 851. Counsel on both sides of this appeal were agreed that there is no inflexible rule as to the date for assessment of value lost, either at common law or in equity. The fact that there is no fixed rule means that the question which date is appropriate to use to assess the value of what has been misappropriated is an open one, which requires consideration of what is just and equitable as between the beneficiary and the trustee (or the principal, such as a company, and the fiduciary).

97 It is unnecessary to decide why the common law and equity appear to start from opposite ends of a possible spectrum of time for assessing loss or value (between breach and trial dates), when both are pursuing broadly the same compensatory objective. It may be that the explanation given by

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Street J in *In re Dawson*, adopted in *Libertarian* by Ribeiro PJ, namely that unlike the common law, equity is not concerned with issues of remoteness, foreseeability and mitigation, comes nearest to a satisfying explanation. But a firm conclusion about the reasons for that divergence of approach between common law and equity is for another day.

98 It is fair to say that in both *Target* and *AIB* there are dicta which, read out of context, appear to treat a trial-date assessment of loss as a given when awarding equitable compensation. They are quoted by the Court of Appeal in the present case. But neither case was in substance about misappropriation of trust property for the trustee's benefit, and in neither case was it necessary to defer the assessment until trial, even if it was (at least in *Target*) necessary to escape from a slavish breach date assessment.

99 *Target* was a case in which the defendant solicitors' client account was used to hold the claimant's money on trust until exchanged by way of loan against the taking of specific security. It was paid out in June 1989, a month before the specified security was provided and hence in breach of duty. The summary judgment hearing took place over three years later. By then it was clear that the client lender's loss was attributable either to a general fall in the property market which affected the value of the security, to the overvaluation of the security or to the borrowers' fraud, and had nothing whatever to do with the defendant solicitors' default in paying out the loan money a month before receiving the security. The fact that the security was in fact received shortly after the money was paid out and at a time when it had the same value that it would have had if it had been taken at the time of the loan, as was supposed to happen, meant that the commercial object of the trust arrangement was fulfilled. The assessment of no loss implicitly depended on the fact that the property had not diminished in value between the date of payment of the money and the date of getting the security.

100 *AIB* was another case of an essentially negligent failure by solicitors acting for a lender to do their job properly. The breach of duty consisted of paying out the loan money held on a client trust account against a mortgage of property while failing to ensure that a prior security over the same property in favour of a third party was simultaneously discharged. The client's loss was assessed as at the date when the new security was realised and was quantified at the amount due to a third party on the earlier security which had not been discharged. It was another case in which the wisdom of hindsight available by the time of trial enabled the client's loss (assessed on a just and equitable basis) to be quantified, but not one in which there needed to be any trial-date valuation of property misappropriated, or indeed any valuation at all (since the amount due to the third party and covered by the prior security was determined by other circumstances).

101 Where a trustee or fiduciary has misappropriated trust property (or property under his fiduciary control) and the beneficiary (or principal) can prove that the property had value when misappropriated, the beneficiary suffers an immediate loss of value. In such a circumstance, if the defaulting fiduciary wishes to rely upon a supervening actual or counterfactual event breaking the chain of causation between the breach and the beneficiary's loss, on an assessment looking at all the information available to the court at trial, the burden lies squarely upon the fiduciary to prove that supervening event and to show that it should be treated as having that impact on the

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analysis of the causative link between the breach of duty and the loss suffered by the beneficiary. This is firmly laid down in the following three authorities and has never been doubted.

102 The first is *In re Brogden; Billing v Brogden* (1888) 38 Ch D 546. Trustees of a marriage settlement failed, in breach of trust, to pursue executors for payment of a legacy, but rather took security for payment which later proved valueless because of the failure of the business over which the security had been taken. But the surviving trustee, a Mr Budgett, alleged that taking proceedings against the executors would have left the beneficiaries no better off and the question arose as to who bore the burden of proof. Affirming the trial judge, the Court of Appeal held the trustee liable. Both Cotton and Fry LJJ said that the burden of showing that the breach of trust caused no loss to the beneficiaries lay squarely on the trustee. At pp 572–573 Fry LJ put it this way:

> "But then it is said by Mr Budgett that no loss has accrued to the cestuis que trust by reason of his want of diligence: he says that if he had been diligent, no greater good would have come to the Billing family than has come to them. In my judgment, the burden of sustaining any such argument as that rests distinctly upon the trustee who sets it up. When the cestui que trust has shewn that the trustee has made default in the performance of his duty, and when the money which was the subject of the trust is not forthcoming, the cestui que trust has made out, in my judgment, a prima facie case of liability upon the trustee, and if the trustee desire to repel that by saying that if he had done his duty no good would have flowed from it, the burden of sustaining that argument is plainly upon the trustee."

103 The second case is *Carruthers v Carruthers* [1896] AC 659, a Scottish appeal. One of the trustees of a deceased's estate was allowed by his co-trustees to act as a factor in collecting rents due to the estate and absconded with sums he had collected. The beneficiary sued the co-trustees for failing to require the factor to deliver regular accounts for audit, as required by the trust deed as a condition of the appointment of one of their number as factor. This was held to be a culpa lata, a severity of default equivalent to gross negligence, not covered by the trustees' indemnity in the trust deed. The defendants asserted that the obtaining of accounts from the factor and their auditing would not have prevented the loss of the moneys misappropriated by the factor. Rejecting that defence as unproven, Lord Herschell said, at p 665:

> "Then what is the extent of their liability? They are liable, as it seems to me, for all the results naturally flowing from the breach of duty on their part; and I think where this culpa lata is shewn, and it might be reasonably concluded that the trust would not have suffered as it did if the duty had been observed, it lies with the trustees to shew, if they seek to absolve themselves on that ground, that no benefit would have accrued to the trust if they had discharged their duty, and that the loss would have been precisely the same, and must have been precisely the same whether they did so or not. I do not think they are entitled to insist upon the court speculating as to whether it is or is not possible that, even if the trustees had done their duty, the loss would equally have resulted."

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In re Brogden was one of the authorities relied upon by the successful beneficiary.

104 The same conclusion about the burden of proof was reached by the Hong Kong Court of Final Appeal in *Libertarian* (2013) 17 ITELR 1. The claimant Mr Woods had entrusted his business partner Mr Hall with money to be used to buy shares in a company (TSE), but Mr Hall misappropriated the money for his own purposes in breach of fiduciary duty. Having followed *In re Dawson* in explaining that by assessing loss as at the date of trial the court is enabled to use the full benefit of hindsight, and to take account of changes in value of the trust property following breach, Ribeiro PJ continued, at para 93:

> "Where the plaintiff provides evidence of loss flowing from the relevant breach of duty, the onus lies on a defaulting fiduciary to disprove the apparent causal connection between the breach of duty and the loss (or particular aspects of the loss) apparently flowing therefrom."

Later, at para 117, he described the consequences of that burden as requiring the defence to be pleaded, proved by evidence and put in cross-examination to any opposing witness who might be supposed to have relevant knowledge about it.

105 Neither *In re Brogden* nor *Carruthers* were cases about a misappropriation of trust money by the defendant trustee. Rather, they were about breaches of trust consisting of failure to take steps to prevent foreseeable loss to the trust fund. But they both imposed a burden on the defendant, in effect to disprove an apparent connection between breach and loss, in the context of a "but for" and therefore counterfactual analysis. In short, they required the defendant to prove that, even if there had been no breach of trust, the same loss would have been incurred. It is noteworthy that the courts in both those cases acknowledged that a "but for" counterfactual analysis was an appropriate way of assessing loss, a century before *Target* and *AIB*. Thus it cannot be said that the principle as to the burden of proof which they laid down was overtaken by the requirement to carry out a counterfactual analysis in either of those much more recent cases.

106 By contrast *Libertarian* followed *Target* in time and as an authority. It was a relatively straightforward case of misapplication of trust money by the trustee, where the loss caused was, at least at first sight, the value of that property at the time of the misappropriation. We see no reason why the burden of proof set out in *In re Brogden*, *Carruthers* and *Libertarian* should not continue to be regarded as a firmly established principle in the law of equitable compensation for breach of trust or fiduciary duty.

107 So, for example, in *Barnett v Creggy* [2017] Ch 273 Sales LJ referred to the guidance in *Target* and summarised its effect at paras 44–45: "where a beneficiary has a claim against his trustee to require the trustee to restore trust property improperly disposed of by him, 'the basic rule is that a trustee in breach of trust must restore or pay to the trust estate either the assets which have been lost to the estate by reason of the breach or compensation for such loss' (*Target* [1996] AC 421, 434C, per Lord Browne-Wilkinson, and also see p 437C), but subject to the compensation payable being referable to loss actually suffered by the trust estate: pp 432E–433A, 437C–E . . ."; the claim "is restitutionary in nature (in the sense of being

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designed to restore the trust fund), albeit capable of being defeated if the defendant trustee can show that no loss was caused".

108 Applied to the present case, this means that, following his misappropriation of the 891K shares by the 2016 Share Transfers and by procuring the registration of JJW Guernsey as their owner in the books of JJW Inc, the Sheikh caused what is on the face of it an immediate loss to the Company of the whole of the then value of those shares, which the judge valued, as at a slightly later date, at about €67.1m. It was for the Sheikh to prove that the 2017 Asset and Liability Transfer was a subsequent event which defeated the prima facie causative relevance of the 2016 Share Transfers by reducing the value of those shares to zero in a manner which allowed the Sheikh to take the benefit of it. This required proof not merely that the 2017 Asset and Liability Transfer actually had that effect upon the value of the shares, (something which was not in issue, because for very different reasons the Liquidators positively asserted it), but also that it was a legitimate intervening event for the Sheikh to insert into the "but for" causation analysis.

109 It is not every supervening event which a defendant may pray in aid, either as breaking the chain of causation or as fit for inclusion in a counterfactual "but for" analysis. For example, it is no good for the trustee to say: "if I had not misappropriated the property, someone else would have done so later": see per Lord Toulson JSC in *AIB* at para 58. This is because the actual loss was caused by the trustee's misappropriation, and the hypothetical later loss would have had a different cause, for which someone else might have been liable. The law has always been careful not to permit a wrongdoer to seek to reduce the extent of a loss for which he is responsible by pointing to the possibility or likelihood of wrongdoing by another person as a relevant extraneous event for the purposes of analysis of causation. The claimant should not be deprived of the full benefit of its claim against the original wrongdoer by virtue of the fact that the claimant might have acquired a different right of action in respect of the same loss against someone whom it might be impossible or difficult to find or to sue and who might prove not to be in funds to meet the claim. To do so would allow the original wrongdoer to take the benefit of a putative obligation owed to the claimant, whereas the right to rely on obligations owed to the claimant is that of the claimant itself and the existence of such an obligation should not be capable of being used to undermine the claimant's interests in this way.

110 Generally speaking, looking at the decided cases, supervening events also appear to be unlikely to qualify if the defendant fiduciary had a hand in them, in the absence of a clear and convincing innocent explanation provided by the fiduciary. In line with the principle referred to by Lord Toulson in *AIB*, a wrongdoing fiduciary could not rely on any later wrongdoing by himself to reduce the loss regarded as flowing from his initial wrongdoing; and, if the fiduciary has not discharged the burden of proof on him, one cannot be sure that his later actions are not affected by wrongdoing. Counsel could think of no case in which a supervening event had qualified for inclusion in the legal causation analysis, in diminution of the loss, in which the defendant fiduciary had been (or may have been) actively involved.

111 A fiduciary, as steward of his principal's property or affairs, to whom he owes a duty of loyalty, has the responsibility to account for and

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explain what has happened in relation to them (and, if necessary, the principal is entitled to ask for a formal account without the need to show any breach of duty, as Lord Millett NPJ explained in *Libertarian* at para 167). The decision of the majority of this court in *Rukhadze* (above) that the equitable obligation to account for profits is a duty and not just a remedy is consistent with this responsibility. The principle in *In re Brogden*, *Carruthers* and *Libertarian* that the fiduciary has the onus of explaining what has happened and establishing that no loss has in fact occurred has developed in recognition of this fundamental aspect of the fiduciary relationship. It also recognises that there is typically information asymmetry as between fiduciary and principal, with the fiduciary being in possession of all the relevant facts.

112 It is easy by contrast to think of cases where a supervening event in which the defaulting fiduciary played no part at all was identified as the real cause of the loss. Thus in *Target*, the real cause of the loss, which would have occurred in the same way even if there had been no breach of trust by the solicitor trustees, was the fall in the market value of the security property due to a general decline in the property market. The same is true of the additional loss suffered by the claimant lender in *AIB*, over and above that attributable to the outstanding prior security. And in *Akai Holdings*, a decision much relied upon by the Court of Appeal in the present case, the loss in value of the misappropriated shares (until they were realised by the defendant) was caused by a decline in the fortunes of the business of the company in which the shares were held (which was a subsidiary of the claimant), again not attributable to anything done or omitted to be done by the defendant bank, which was assumed to be liable to make equitable compensation for knowing receipt.

113 It is easy enough to see why a supervening event in which the defaulting fiduciary had no hand at all, and to the risk of which the principal would have been equally exposed even if there had been no breach of trust, should be taken into account in diminution or even extinction of the loss attributable to the breach, on a "but for" counterfactual analysis, for example on the basis that the beneficiary had retained the trust property which was in fact misappropriated. It is because the risk of that harm happening to the relevant trust property is properly and fairly to be allocated to the principal, not to the fiduciary.

114 By contrast, if the fiduciary plays some part in the happening of the supervening event, either by participating in it or causing or increasing the exposure of the trust property to the risk of harm being caused by it, then it is by no means clear (absent some good explanation being given by the fiduciary) that the risk of the harm caused by the event should fairly be allocated to the principal. The example was examined during argument of a valuable painting held on trust and hung in a public gallery. If the trustee misappropriated it (in the sense of claiming it as his own beneficially), but left it hanging in the gallery, which was later burned down, no one would doubt that (leaving aside insurance) the trustee's arrogation of ownership of the painting caused the beneficiary no loss, at least if the beneficiary would not have sold it in the meantime and taken the proceeds. But for the breach of duty the painting would still have remained in the gallery and would still have been destroyed in the fire. But if the trustee had removed the painting to his own home, which had later been burned down, equally plainly the

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trustee could not have prayed in aid the fire. The fair allocation of the risk of destruction by fire would have fallen upon the trustee, because his action in moving the painting had created its exposure to the risk of the fire which later occurred, even though he had no part at all in the fire itself.

115 It might be thought even more difficult to treat loss caused by a subsequent event as for the principal's account if the defaulting fiduciary played a significant part in the bringing of that event to pass. The court would be naturally concerned to examine that subsequent event with particular care, and to require the defendant fiduciary to prove that he played no sufficient part in it to disqualify him from relying upon it in diminution of the principal's loss, the burden of proof being upon him in accordance with the authorities analysed above. In a typical case where the fiduciary rather than the principal held the requisite knowledge (or relevant documents) about the subsequent event, the court would expect the fiduciary to make full disclosure, if seeking to rely upon it.

116 The Sheikh has not given full disclosure. Nonetheless, in order to demonstrate the sort of problem to which this absence of explanation gives rise, we consider that it is at this point helpful to look more closely at such evidence as there is about the 2017 Asset and Liability Transfer and the Sheikh's role in it. It consisted of what was described as a "restructuring" of the Sheikh's MBI Group of companies in which all the assets and liabilities of JJW Inc were transferred to JJW UK, wholly owned by another MBI Group company, MBIIGH. It took place shortly after the Company's then liquidator Ms Caulfield obtained recognition of the Company's BVI liquidation as a foreign main proceeding under the Cross-Border Insolvency Regulations 2006, by application made on 8 May 2017, notified to the Sheikh on 22 May and granted by Registrar Derrett on 9 June. Shortly thereafter the 891K shares were transferred from JJW Guernsey to MBI International Holdings, another MBI Group company. It is a reasonably safe inference that, save where interfered with by a liquidation, all the MBI group companies shared the Sheikh as their ultimate beneficial owner, as did JJW Guernsey.

117 As we have explained above, the 2017 Asset and Liability Transfer was triggered by a letter dated 30 June 2017 and signed by the Sheikh on behalf of "our company MBI International Holdings Inc" and addressed to JJW Inc, demanding payment within 21 days of an outstanding loan of €600m, with an invitation either to pay up or enter into discussions about alternative arrangements. On 17 July the Board of JJW Inc noted the existence of the debt of €600m to MBI International Holdings. On 27 July the Board of JJW Inc resolved to accept an offer from JJW UK to take on all JJW Inc's assets and liabilities. The judge said that the Sheikh had not been present at that meeting but the Sheikh had already acknowledged his presence in an affidavit. He was not cross-examined because he was too ill to attend trial, but there was no evidence to the contrary. We conclude that the judge's finding that he was not in attendance was an inadvertent error. Nonetheless the Sheikh does not appear to have been a de jure director of JJW Inc.

118 As at 27 July 2017 Ms Caulfield did not know that any of the Company's shares in JJW Inc had been purportedly transferred to JJW Guernsey, or that the 891K shares had been transferred by JJW Guernsey to MBI International Holdings. By the beginning of the trial on 1 February

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2021 the Liquidators had been untruthfully informed (and the Sheikh had purported to verify in evidence) that all the Company's shares in JJW Inc had been transferred to MBI Group companies, and that in July 2017 all the shares in JJW Inc—as opposed to JJW Inc's assets and liabilities—had been transferred to JJW UK.

119 On the fourth day of the trial the Sheikh revealed for the first time that the 2017 transaction had involved a transfer of all JJW Inc's assets and liabilities, rather than its shares, and that the 129K shares in JJW Inc remained owned by the Company. But, as already noted, at no time during the trial did the Sheikh rely upon the 2017 Asset and Liability Transfer as an event relevant to quantification of the loss caused by the 2016 Share Transfers. Such evidence about the 2017 transaction as was available to the judge had to be dragged out of the Sheikh, and his attempts to explain it underwent fundamental changes over time.

120 For their part the Liquidators did pursue a case at trial that the 2017 Asset and Liability Transfer had been part of a dishonest conspiracy including the Sheikh against the Company, and that it had reduced the value of all the Company's shares in JJW Inc to zero. But the Liquidators failed to discharge the burden of proof upon them in relation to the conspiracy claim, or the Sheikh's part in the 2017 Asset and Liability Transfer, and the conspiracy claim was rejected by the judge.

121 When the matter reached the Court of Appeal the Sheikh simply relied upon the fact (effectively admitted by the Liquidators although doubted by the Court of Appeal) that the 2017 Asset and Liability Transfer had reduced the value of the 891K shares to zero, asserted that there was a rule that the value of misappropriated trust property had to be assessed as at trial in a claim for equitable compensation, and thereby succeeded in reversing the judge's award of €67m compensation. We agree with the observation of Newey LJ (quoted above) that the Sheikh had not provided any satisfactory explanation (or, really, any explanation at all) for what was done. The Court of Appeal did not think that mattered, but we respectfully disagree.

122 If the Sheikh had been a prime mover in the 2017 Asset and Liability Transfer, he could not in our view have prayed it in aid as a subsequent event in diminution or extinction of the loss which he had caused to the Company by the 2016 Share Transfers. It would have amounted to saying that if he had not destroyed the value to the Company of the 891K shares in 2016 he would in any event have succeeded in destroying that value a year later by the 2017 Asset and Liability Transfer, or at least have reaped the same benefit to himself, as the ultimate beneficial owner of the MBI Group. Using the analogy of the painting held on trust, he would actually have lit the fire which destroyed it. On any view the Sheikh appears to have been the prime beneficiary of the 2017 Asset and Liability Transfer, since it transferred the apparent net surplus of assets over liabilities of JJW Inc, in which the Company had a minority shareholding, to another MBI Group company of which he appears to have been the sole ultimate beneficial owner. And in the counterfactual world in which he had not already misappropriated the 891K shares the Sheikh would thereby have destroyed the value of the whole of the Company's original minority stake, in a zero-sum game where every Euro lost to the Company was a Euro gained by him.

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123 That being so, it was incumbent upon the Sheikh, if he wished to rely upon the 2017 Asset and Liability Transfer in diminution of the loss apparently caused to the Company by his misappropriation of the 891K shares, to prove that he played no significant part in, and derived no significant benefit—at the expense of the Company—from that transfer. This he made no attempt to do, either at trial or in the Court of Appeal. There is amply sufficient evidence to disclose a case to answer that the Sheikh was more than just a bystander in relation to the 2017 Asset and Liability Transfer. He triggered the process which led to the transaction by signing the letter of demand. He attended the key board meeting of JJW Inc. He stood to benefit from it as already explained and, as the ultimate owner of the MBI Group, there must be more than just a faint suspicion that he effectively controlled it.

124 An additional reason why the Court of Appeal thought that the assessment of a zero loss could be reached without any in-depth consideration of the appropriate counterfactuals is that the 891K shares were in fact rendered worthless by the 2017 Asset and Liability Transfer. Having considered in general terms whether a defendant can escape liability by invoking a counterfactual, Newey LJ continued, at para 66:

> "No such issue arises in the present case, however. The appellants are not seeking to lessen their liability by reference to what would have happened if the 891,761 shares had not been misappropriated. They emphasise that the shares have in fact become worthless."

125 Again, we respectfully disagree, for two reasons. First, the fact that a subsequent event happened in fact does not mean that its role in a particular loss assessment is to be regarded as not forming part of the relevant counterfactual picture which is the basis of that assessment. Generally, a counterfactual structure contains most of what did in fact happen after the relevant breach. A relevant normative question, and the vital one in this case, is whether a defendant can invoke to reduce or exclude his liability a particular factual event, as happens, for example, at common law where some event is treated as a novus actus interveniens (new intervening cause) in a counterfactual assessment for the purposes of assessing damages.

126 Secondly, and more fundamentally, the Sheikh *was* seeking to reduce his liability by reference to what would have happened if the 891K shares had not been misappropriated. The relevant assessment is not the value of the shares in the abstract, but the loss of their value to the Company. Their value to the Company was in the real world reduced to zero by the Sheikh's misappropriation of them in 2016. They may have retained the same value as shares, but thereafter it was a value to JJW Guernsey, and ultimately to the Sheikh as that company's ultimate beneficial owner. If A steals a car from B (and it cannot be found or reclaimed), then the value of the car to B is reduced to zero, but the car retains its value as a car, now enjoyed by A. So it was with these shares.

127 But the Sheikh wished to prove to the Court of Appeal that, if he had not destroyed the value of the shares to the Company in 2016, and they had remained vested in the Company, then in that counterfactual world they would have been reduced in value to the Company to zero by the 2017 Asset and Liability Transfer. In the real world, the Company lost all the value

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arising from ownership of the 891K shares when the Sheikh misappropriated them in 2016. By July 2017 the 891K shares were in the ownership of MBI International Holdings, and it was their value to that company that was actually reduced to zero by the 2017 Asset and Liability Transfer. The point may be illustrated by a contrast with the smaller block of shares in JJW Inc which the Company still retained in July 2017. Their value to the Company really was reduced to zero by the 2017 Asset and Liability Transfer, because they had not by then already been misappropriated.

128 For those reasons we would allow the Liquidators' appeal against the reduction by the Court of Appeal of the amount of compensation payable by the Sheikh to zero, and restore the judge's order in that respect.

(4) Conclusion

129 We would dismiss the Sheikh's appeal on Issues 1 and 2 (the existence of a breach of fiduciary duty and the unpaid vendor's liens) and allow the Liquidators' appeal on Issue 3 (the calculation of the loss which the Company suffered as a result of the 2016 Share Transfers). The result is that the Order made by the judge, that the Sheikh pay compensation to the Company of €67,123,403.36, is to be reinstated.

Appeal of first defendant dismissed.
Appeal of liquidators allowed.

COLIN BERESFORD, Barrister

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ITEM NO. 165

JA-51

Supreme Court

Hopcraft and another *v* Close Brothers Ltd

Johnson *v* FirstRand Bank Ltd (London Branch) trading as MotoNovo Finance

Wrench *v* FirstRand Bank Ltd (London Branch) trading as MotoNovo Finance

[2025] UKSC 33

2025 April 1, 2, 3; Aug 1

Lord Reed PSC, Lord Hodge DPSC, Lord Lloyd-Jones, Lord Briggs, Lord Hamblen JJSC

Equity — Fiduciary duty — Existence of duty — Customer buying car from dealer with credit provided by lender — Lender paying dealer commission for acting as intermediary with customer — Whether dealer owing customer fiduciary duty in relation to arranging of credit

Tort — Cause of action — Bribery — Whether common law tort of bribery to be abolished — Whether necessary that recipient of payment owing fiduciary duty — Whether partial disclosure of payment sufficient to avoid liability

Consumer protection — Consumer credit — Agreement — Customer buying car from dealer with credit provided by lender — Lender paying dealer undisclosed commission for acting as intermediary with customer — Whether relationship between lender and customer "unfair" — Consumer Credit Act 1974 (c 39), s 140A

In each of three cases the claimant customer approached a car dealer, wishing to obtain a car on credit for their own personal use, and the dealer arranged for the customer to obtain credit from the defendant lender on hire purchase terms. In each case the dealer received a commission from the lender, but there was either no disclosure to the customer of the existence of the commission or the only disclosure was that a commission of unidentifiable amount might be paid. The customers brought claims against the lenders, claiming: (a) (in the first and second cases) equitable compensation for dishonestly assisting in the dealers' receipt, in breach of fiduciary duty, of secret profits; (b) payment of amounts equivalent to the commissions under the tort of bribery; and (c) to re-open their hire purchase agreements under section 140A of the Consumer Credit Act 1974[1] on the basis that they gave rise to unfair relationships between the lender and the customer. The customers had limited success at first instance and on appeal, but the Court of Appeal allowed their appeals so as to uphold the dishonest assistance claims in the first and second cases, the bribery claims in the first and third cases and the 1974 Act claim in the second case. On the lenders' appeals to the Supreme Court, the issues included: (i) what would be necessary for a fiduciary relationship between a customer and a dealer to have arisen; (ii) whether the common law tort of bribery should be abolished; (iii) whether liability in the tort of bribery could arise if the dealer had owed the customer anything less than a fiduciary duty of single-minded loyalty; (iv) whether the dealer had owed the customer a fiduciary duty; and (v) whether the relationship between the lender and the customer in the second case was "unfair" to the customer for the purposes of section 140A of the 1974 Act.

On the appeals—

[1] Consumer Credit Act 1974, s 140A: see post, para 294.

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Held, allowing the appeals, (1) that fiduciary duties arose where a person consciously assumed (or undertook) responsibility to act exclusively on behalf of another in relation to the management of the property or affairs of the other, in circumstances where he or she knew or ought to appreciate that this carried with it the expectation that he or she would act with single-minded loyalty (meaning an attitude of altruism) to that other in that regard; that such an undertaking or assumption of responsibility could arise where the fiduciary had expressly undertaken to exclude his or her own interests and those of third parties in the conduct of the other's affairs, or where the objectively assessed circumstances (particularly arising out of the acts of the fiduciary) made it appropriate for equity to treat the parties as if such an undertaking had been given; that neither the existence of a relationship of trust and confidence, nor the existence of a relationship in which one party was in a position of power over another who was dependent on him, was sufficient to give rise to a fiduciary duty, each being the consequence rather than the cause of a fiduciary relationship; and that, when considering whether a party to a commercial relationship had undertaken to act exclusively on behalf of the other party, it was necessary to consider with care the terms of any contract between the parties or unilateral undertaking, the wider transaction, and the commercial context of the relationship between the parties (post, paras 90–91, 96–101, 104, 106, 108–110).

Bristol and West Building Society v Mothew [1998] Ch 1, CA, *FHR European Ventures LLP v Cedar Capital Partners LLC* [2015] AC 250, SC(E), *Recovery Partners GP Ltd v Rukhadze* [2025] 2 WLR 529, SC(E) and *Hotel Portfolio II UK Ltd v Stevens* [2025] 3 WLR 293, SC(E) applied.

Hospital Products Ltd v United States Surgical Corpn (1984) 156 CLR 41, *Galambos v Perez* [2009] 3 SCR 247 and dicta of Leggatt LJ in *Al Nehayan v Kent* [2018] 1 CLC 216, paras 163–165, considered.

(2) That the contention that the common law tort of bribery should be abolished was to be rejected, having regard to the facts that (i) although the common law tort of bribery had only recently been described as a tort, common law liability and remedies for the civil wrong of bribery dated back to the end of the 19th century and since the second half of the 20th century had become even more established by the passage of time and the large number of cases in which it had been recognised and applied, including by the House of Lords and the Supreme Court, (ii) the circumstances in which it would be appropriate for the Supreme Court to depart from such long-established law, which were the same as those in which it would depart from a previous decision of the House of Lords or Supreme Court, did not exist and (iii) the reasons for the law's strict approach to bribery, which was reinforced by the stricter remedies available at law, were as relevant today as they had been at the end of the 19th century, if not more so (post, paras 140–156).

Reading v Attorney General [1949] 2 KB 232, HL(E), *Mahesan s/o Thambiah v Malaysia Government Officers' Co-operative Housing Society Ltd* [1979] AC 374, PC and *Republic of Mozambique v Privinvest Shipbuilding SAL (Holding)* [2023] Bus LR 1359, SC(E) applied.

(3) That in order for liability in the common law tort of bribery to arise it was necessary that the defendant had made a payment to a person who owed a fiduciary duty of loyalty to the claimant, resulting in that person breaching the no conflict rule that a fiduciary should not put himself into a position where his interest and that of the beneficiary might conflict; that, therefore, a purely contractual duty (or, it might be, a duty in tort, or in public law) to give disinterested advice or information was not sufficient in itself to engage the tort of bribery, as distinct from other torts such as fraud, conspiracy, causing loss by unlawful means or inducing a breach of contract; that, further, the only defence to the tort of bribery was that the beneficiary had given fully informed consent to the fiduciary keeping the payment for himself, which required there to have been full disclosure of all material facts; and that, therefore,

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where the claimant had received partial disclosure of the payment this would be insufficient to negative the breach of the no conflict rule and insufficient to avoid liability in the tort of bribery (post, paras 164, 184, 187, 188, 199, 201–207, 288).

Hovenden & Sons v Millhoff [1900–03] All ER Rep 848, CA, *Industries & General Mortgage Co Ltd v Lewis* [1949] 2 All ER 573, *Reading v Attorney General* [1949] 2 KB 232, HL(E) and *Mahesan s/o Thambiah v Malaysia Government Officers' Co-operative Housing Society Ltd* [1979] AC 374, PC applied.

Hurstanger Ltd v Wilson [2007] 1 WLR 2351, CA and dicta of Christopher Clarke J in *Novoship (UK) Ltd v Mikhaylyuk* [2012] EWHC 3586 (Comm) at [108] explained.

Attorney General for Hong Kong v Reid [1994] 1 AC 324, PC and *Conway v Eze* [2019] EWCA Civ 88, CA considered.

Wood v Commercial First Business Ltd [2022] Ch 123, CA overruled.

(4) That the typical features of a tripartite transaction where a customer bought a car on credit from a dealer who acted as intermediary between the customer and the lender who provided the credit did not give rise to a fiduciary duty of loyalty on the part of the dealer such as to impose on the dealer a no conflict duty towards the customer in relation to the arranging of the credit, since they were incompatible with the recognition of any obligation of undivided and selfless loyalty by the dealer to the customer; that the transactions in the present cases all shared the typical features of such transactions, namely (i) each of the three participants in the transaction was separately engaged at arm's length from the other participants in the pursuit of a separate commercial objective of their own, (ii) the dealer's activity as intermediary between the customer and the lender was not a service that was distinct from the sale of the car but was ancillary to it, (iii) the dealer did not give any kind of express undertaking or assurance to the customer that in finding a suitable credit deal for the customer it was putting aside its own commercial interest in the transaction as seller, (iv) the dealer did not act as the customer's agent, (v) there was an element of the customer being dependent upon or vulnerable to the dealer in relation to the credit package, although these were not indicia of a fiduciary relationship in the absence of an undertaking of loyalty, and (vi) the way in which the dealer proffered the service of finding a suitable credit package may have engendered an element of trust and confidence on the part of the customer, although this did not go beyond that which frequently arose between commercial parties negotiating at arm's length; and that, accordingly, since the dealers did not owe the claimant customers any fiduciary duty, the defendant lenders were not liable as the dishonest assistants in any breach of fiduciary duty by the dealers and were not liable in the tort of bribery (post, paras 242, 263–266, 268–277, 280–286, 339).

(5) That the fact that there had been no disclosure, or only partial disclosure, of commission paid by a lender to a car dealer who acted as an intermediary between the customer and the lender in the arranging of a credit agreement would not necessarily suffice of itself to make the relationship between the lender and the customer arising out of that credit agreement "unfair" to the customer for the purposes of section 140A of the Consumer Credit Act 1974, although it would be a factor to be taken into account in the overall balancing exercise required under section 140A; that the relevant factors when conducting that exercise would normally include (i) the size of the commission relative to the charge for credit, (ii) the nature of the commission, (iii) the characteristics of the customer, (iv) the extent and manner of the disclosure and (v) compliance with the regulatory rules; that, in the second of the present cases, the decision of the Court of Appeal on this issue would be set aside as it was vitiated by mistake; that, however, remaking the decision, the relationship between the claimant customer and the defendant lender was unfair for the purposes of section 140A by reason in particular of the size of the commission, the failure to disclose the commission, the existence of and failure to disclose a commercial tie between the dealer and the lender, and the fact that the lender had

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breached provisions of the Financial Conduct Authority's Consumer Credit Sourcebook as in force at the relevant time, namely CONC 3.3.1R, CONC 3.7.3R, CONC 3.7.4G and CONC 4.5.3R; and that, accordingly, the lender would be ordered to pay the claimant a sum equivalent to the size of the commission (post, paras 316, 319–320, 325–327, 329–338, 340).

Plevin v Paragon Personal Finance Ltd [2014] 1 WLR 4222, SC(E) distinguished.

Per curiam. Where the common law tort of bribery is established, the claimant is automatically entitled to recover the amount of the bribe from the defendant without proof of loss or gain. The automatic entitlement to this remedy should not be abolished. There is a clear deterrent effect if any would-be briber knows that he or she is to be automatically liable for the amount of any bribe paid (post, paras 232–236).

Hovenden & Sons v Millhoff [1900–03] All ER Rep 848, CA, *Mahesan s/o Thambiah v Malaysia Government Officers' Co-operative Housing Society Ltd* [1979] AC 374, PC and *Republic of Mozambique v Privinvest Shipbuilding SAL (Holding)* [2023] Bus LR 1359, SC(E) considered.

Decision of the Court of Appeal sub nom *Johnson v FirstRand Bank Ltd (London Branch) trading as Motonovo Finance* [2024] EWCA Civ 1282 reversed.

The following cases are referred to in the judgment of the court:

Aas v Benham [1891] 2 Ch 244, CA
Aberdeen Railway Co v Blaikie Brothers (1854) 1 Macq 461, HL(Sc)
Alati v Kruger (1955) 94 CLR 216
Al Nehayan v Kent [2018] EWHC 333 (Comm); [2018] 1 CLC 216
Anangel Atlas Cia Naviera SA v Ishikawajima-Harima Heavy Industries Co Ltd [1990] 1 Lloyd's Rep 167
Arab Monetary Fund v Hashim [1993] 1 Lloyd's Rep 543
Arklow Investments Ltd v Maclean [2000] 1 WLR 594, PC
Armagas Ltd v Mundogas SA (Ocean Frost, The) [1986] AC 717; [1985] 3 WLR 640; [1985] 3 All ER 795; [1985] 1 Lloyd's Rep 1, CA; [1986] AC 717; [1986] 2 WLR 1063; [1986] 2 All ER 385, HL(E)
Attorney General v Blake [1998] Ch 439; [1998] 2 WLR 805; [1998] 1 All ER 833, CA
Attorney General v Goddard (1929) 98 LJ (KB) 743
Attorney General for Hong Kong v Reid [1994] 1 AC 324; [1993] 3 WLR 1143; [1994] 1 All ER 1, PC
Barlow Clowes International Ltd v Eurotrust International Ltd [2005] UKPC 37; [2006] 1 WLR 1476; [2006] 1 All ER 333, PC
Barry v Stoney Point Canning Co (1917) 55 SCR 51; 36 DLR 326
Birtchnell v Equity Trustees, Executors and Agency Co Ltd (1929) 42 CLR 384
Boardman v Phipps [1967] 2 AC 46; [1966] 3 WLR 1009; [1966] 3 All ER 721, HL(E)
Boston Deep Sea Fishing and Ice Co v Ansell (1888) 39 Ch D 339, CA
Breen v Williams (1996) 186 CLR 71
Bristol and West Building Society v Mothew [1998] Ch 1; [1997] 2 WLR 436; [1996] 4 All ER 698, CA
Canadian Land Reclaiming and Colonizing Co, In re; Coventry and Dixon's Case (1880) 14 Ch D 660, CA
Carter v Palmer (1842) 8 Cl & Fin 657, HL(E)
Children's Investment Fund Foundation (UK) v Attorney General [2020] UKSC 33; [2022] AC 155; [2020] 3 WLR 461; [2021] 1 All ER 809, SC(E)
Conway v Eze [2018] EWHC 29 (Ch); [2019] EWCA Civ 88, CA
Coomber, In re [1911] 1 Ch 723, CA
Daraydan Holdings Ltd v Solland International Ltd [2004] EWHC 622 (Ch); [2005] Ch 119; [2004] 3 WLR 1106; [2005] 4 All ER 73
Debtor (No 229 of 1927), In re A [1927] 2 Ch 367, CA

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Dubai Aluminium Co Ltd v Salaam [2002] UKHL 48; [2003] 2 AC 366; [2002] 3 WLR 1913; [2003] 1 All ER 97, HL(E)
Dunne v English (1874) LR 18 Eq 524
Edge v Pensions Ombudsman [1998] Ch 512; [1998] 3 WLR 466; [1998] 2 All ER 547; [2000] Ch 602; [2000] 3 WLR 79; [2000] ICR 748; [1999] 4 All ER 546, CA
English v Dedham Vale Properties Ltd [1978] 1 WLR 93; [1978] 1 All ER 382
F & C Alternative Investments (Holdings) Ltd v Barthelemy (No 2) [2011] EWHC 1731 (Ch); [2012] Ch 613; [2012] 3 WLR 10; [2012] Bus LR 891
FHR European Ventures LLP v Cedar Capital Partners LLC [2014] UKSC 45; [2015] AC 250; [2014] 3 WLR 535; [2014] 4 All ER 79, SC(E)
FM Capital Partners Ltd v Marino [2020] EWCA Civ 245; [2021] QB 1; [2020] 3 WLR 109, CA
Fiona Trust & Holding Corpn v Privalov [2010] EWHC 3199 (Comm)
Fraser v Whalley (1864) 2 Hem & M 10
Fyffes Group Ltd v Templeman [2000] 2 Lloyd's Rep 643
Galambos v Perez 2009 SCC 48; [2009] 3 SCR 247
Goldcorp Exchange Ltd, In re [1995] 1 AC 74; [1994] 3 WLR 199; [1994] 2 All ER 806, PC
Grant v Gold Exploration and Development Syndicate Ltd [1900] 1 QB 233, CA
Grimaldi v Chameleon Mining NL (No 2) [2012] FCAFC 6; 200 FCR 296
Hallett's Estate, In re; Knatchbull v Hallett (1880) 13 Ch D 696, CA
Harrington v Victoria Graving Dock Co (1878) 3 QBD 549, DC
Henderson v Merrett Syndicates Ltd [1995] 2 AC 145; [1994] 3 WLR 761; [1994] 3 All ER 506, HL(E)
Hilton v Barker Booth & Eastwood [2005] UKHL 8; [2005] 1 WLR 567; [2005] 1 All ER 651, HL(E)
Hospital Products Ltd v United States Surgical Corpn (1984) 156 CLR 41
Hotel Portfolio II UK Ltd v Stevens [2025] UKSC 28; [2025] 3 WLR 293, SC(E)
Hovenden & Sons v Millhoff [1900–03] All ER Rep 848; (1900) 83 LT 41, CA
Hurstanger Ltd v Wilson [2007] EWCA Civ 299; [2007] 1 WLR 2351; [2008] Bus LR 216; [2007] 4 All ER 1118, CA
Imperial Mercantile Credit Association (Liquidators of) v Coleman (1873) LR 6 HL 189, HL(E)
Industries & General Mortgage Co Ltd v Lewis [1949] 2 All ER 573
Johnson v Unisys Ltd [2001] UKHL 13; [2003] 1 AC 518; [2001] 2 WLR 1076; [2001] ICR 480; [2001] 2 All ER 801, HL(E)
Keech v Sandford (1726) Sel Cas Ch 61
Kelly v Cooper [1993] AC 205; [1992] 3 WLR 936, PC
Lands Allotment Co, In re [1894] 1 Ch 616, CA
Lister & Co v Stubbs (1890) 45 Ch D 1, CA
Lloyds Bank Ltd v Bundy [1975] QB 326; [1974] 3 WLR 501; [1974] 3 All ER 757, CA
Logicrose Ltd v Southend United Football Club Ltd [1988] 1 WLR 1256
Lyell v Kennedy (1889) 14 App Cas 437, HL(E)
Mahesan s/o Thambiah v Malaysia Government Officers' Co-operative Housing Society Ltd [1979] AC 374; [1978] 2 WLR 444; [1978] 2 All ER 405, PC
Morison v Thompson (1874) LR 9 QB 480
Naaman v Jaken Properties Australia Pty Ltd [2025] HCA 1; 99 ALJR 295; 421 ALR 227
New Zealand Netherlands Society "Oranje" Inc v Kuys [1973] 1 WLR 1126; [1973] 2 All ER 1222, PC
Nocton v Lord Ashburton [1914] AC 932, HL(E)
Novoship (UK) Ltd v Mikhaylyuk [2012] EWHC 3586 (Comm); [2014] EWCA Civ 908; [2015] QB 499; [2015] 2 WLR 526, CA
O'Sullivan v Management Agency and Music Ltd [1985] QB 428; [1984] 3 WLR 448; [1985] 3 All ER 351, CA

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Otkritie International Investment Management Ltd v Urumov [2014] EWHC 191 (Comm)
Panama and South Pacific Telegraph Co v India Rubber, Gutta Percha and Telegraph Works Co (1875) LR 10 Ch App 515
Parker v McKenna (1874) LR 10 Ch App 96
Petrotrade Inc v Smith [2000] 1 Lloyd's Rep 486; [2000] CLC 916
Philipp v Barclays Bank UK plc [2023] UKSC 25; [2024] AC 346; [2023] 3 WLR 284; [2023] Bus LR 1269; [2023] 4 All ER 847, SC(E)
Plevin v Paragon Personal Finance Ltd [2014] UKSC 61; [2014] 1 WLR 4222; [2014] Bus LR 1257; [2015] 1 All ER 625, SC(E)
R (Clydesdale Financial Services Ltd) v Financial Ombudsman Service Ltd [2024] EWHC 3237 (Admin); [2025] Bus LR 1323
Reading v Attorney General [1949] 2 KB 232; [1949] 2 All ER 68, CA; [1951] AC 507; [1951] 1 All ER 617, HL(E)
Recovery Partners GP Ltd v Rukhadze [2025] UKSC 10; [2025] 2 WLR 529; [2025] Bus LR 610, SC(E)
Regal (Hastings) Ltd v Gulliver [1967] 2 AC 134; [1942] 1 All ER 378, HL(E)
Republic of Mozambique v Privinvest Shipbuilding SAL (Holding) [2023] UKSC 32; [2023] Bus LR 1359; [2024] 1 All ER 763, SC(E)
Ross River Ltd v Cambridge City Football Club Ltd [2007] EWHC 2115 (Ch); [2008] 1 All ER 1004
Salford Corpn v Lever (1890) 25 QBD 363, DC; [1891] 1 QB 168, CA
Shipway v Broadwood [1899] 1 QB 369, CA
Smith v Royal Bank of Scotland plc [2023] UKSC 34; [2024] AC 955; [2023] 3 WLR 551; [2024] 1 All ER 97, SC(E)
Smith v Sorby (Note) (1875) 3 QBD 552
Soar v Ashwell [1893] 2 QB 390, CA
Target Holdings Ltd v Redferns [1996] AC 421; [1995] 3 WLR 352; [1995] 3 All ER 785, HL(E)
Thompson v Havelock (1808) 1 Camp 527
Thornton v Shoe Lane Parking Ltd [1971] 2 QB 163; [1971] 2 WLR 585; [1971] 1 All ER 686, CA
UBS AG v Kommunale Wasserwerke Leipzig GmbH [2017] EWCA Civ 1567; [2017] 2 Lloyd's Rep 621, CA
Ultraframe (UK) Ltd v Fielding [2005] EWHC 1638 (Ch); [2006] FSR 17
United Australia Ltd v Barclays Bank Ltd [1941] AC 1; [1940] 4 All ER 20, HL(E)
United Utilities Water Ltd v Manchester Ship Canal Co Ltd [2024] UKSC 22; [2025] AC 761; [2024] 3 WLR 356; [2024] 4 All ER 825, SC(E)
Walker v Corboy (1990) 19 NSWLR 382
Whaley Bridge Calico Printing Co v Green (1879) 5 QBD 109
Wood v Commercial First Business Ltd [2021] EWCA Civ 471; [2022] Ch 123; [2021] 3 WLR 395, CA

The following additional cases were cited in argument:

Branwhite v Worcester Works Finance Ltd [1969] 1 AC 552; [1968] 3 WLR 760; [1968] 3 All ER 104, HL(E)
Diplock, Executors, &c of Henderson v Blackburn (1811) 3 Camp 43
Expert Tooling and Automation Ltd v Engie Power Ltd [2025] EWCA Civ 292, CA
Halifax Building Society v Thomas [1996] Ch 217; [1996] 2 WLR 63; [1995] 4 All ER 673, CA
Hichens v Congreve (1828) 4 Russ 562
Ivey v Genting Casinos (UK) Ltd [2017] UKSC 67; [2018] AC 391; [2017] 3 WLR 1212; [2018] 2 All ER 406, SC(E)
Lachaux v Independent Print Ltd [2019] UKSC 27; [2020] AC 612; [2019] 3 WLR 18; [2019] 4 All ER 485, SC(E)

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A *McWilliam v Norton Finance (UK) Ltd* [2015] EWCA Civ 186; [2015] 1 All ER (Comm) 1026, CA
Medsted Associates Ltd v Canaccord Genuity Wealth (International) Ltd [2017] EWHC 1815 (Comm); [2018] 1 WLR 314; [2019] EWCA Civ 83; [2019] 1 WLR 4481; [2019] 2 All ER 959, CA
Pengelly v Business Mortgage Finance 4 plc [2020] EWHC 2002 (Ch); [2021] 1 All ER (Comm) 1191
B *Peskin v Anderson* [2001] 1 BCLC 372, CA
Royal Brunei Airlines Sdn Bhd v Tan [1995] 2 AC 378; [1995] 3 WLR 64; [1995] 3 All ER 97, PC
Rowland v Chapman (1901) 17 TLR 669
Roxborough v Rothmans of Pall Mall Australia Ltd [2001] HCA 68; 208 CLR 516
Suppipat v Narongdej [2023] EWHC 1988 (Comm)
Trafalgar Multi Asset Trading Co Ltd v Hadley [2022] EWCA Civ 1639, CA
C *Twinsectra Ltd v Yardley* [2002] UKHL 12; [2002] 2 AC 164; [2002] 2 WLR 802; [2002] 2 All ER 377, HL(E)
University of Nottingham v Fishel [2000] ICR 1462
White v Jones [1995] 2 AC 207; [1995] 2 WLR 187; [1995] 1 All ER 691, HL(E)

APPEALS from the Court of Appeal

By a claim form issued in March 2023 in the County Court at Kingston
D upon Hull, the claimant in the first case, Amy Louise Hopcraft, brought a claim against the defendant lender, Close Brothers Ltd, in connection with a hire purchase agreement which she had entered into with the lender on 10 January 2014, when purchasing a car from the car dealership, Jordan & Co (Hull) Ltd. The claimant claimed: (1) that a commission paid by the lender to the car dealer was a bribe; (2) that the commission was a secret
E profit received by the dealer in breach of fiduciary duty for which the lender was liable as an accessory; (3) that her relationship with the lender was unfair under the Consumer Credit Act 1974; and (4) relief in the form of damages and/or rescission. The claimant's father, Carl Hopcraft, was subsequently joined as a party to the proceedings. By a decision dated 4 September 2023 and by order dated 14 September 2023 Deputy District Judge Morris dismissed the claim, holding that the car dealer was not a fiduciary or agent
F for the claimant, nor did it owe her a disinterested duty, and that the transaction was not unfair for the purposes of her claim under the 1974 Act. By an appellant's notice filed in October 2023 the claimants appealed.

By a claim form issued in January 2022 in the County Court Money Claims Centre, the claimant in the second case, Marcus Gervase Johnson, brought a claim against the defendant lender, FirstRand Bank Ltd, in
G connection with a combined hire purchase and personal loan package he had entered into with the lender on 29 July 2017 when purchasing a car from the car dealership, The Trade Centre Wales Group Ltd. His claim was based upon (1) bribery, (2) dishonest assistance in the dealer's breach of fiduciary duty and (3) an unfair relationship with the lender under the 1974 Act. By a decision and order dated 18 January 2023 Deputy District Judge Sandercock dismissed the claim, holding that (1) there was no secrecy or even "half-
H secrecy" about the commission paid by the lender to the dealer, (2) the car dealership owed the claimant no fiduciary duty, and (3) the relationship between the claimant and the lender was not unfair for the purposes of the 1974 Act. The claimant appealed against the deputy district judge's decision, in which he abandoned his bribery claim. By a decision dated

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6 July 2023 and by order dated 20 July 2023 Judge Jarman sitting in the County Court at Cardiff (i) confirmed the district judge's conclusion that there was no fiduciary duty owed by the dealer to the claimant, so that his dishonest assistance claim against the lender failed; but (ii) allowed the appeal on the 1974 Act claim, directing that it be reheard by Deputy District Judge Sandercock. By an appellant's notice filed on 26 July 2023 and amended by order dated 3 January 2024 the claimant appealed.

By a claim form issued in July 2022 in the County Court Money Claims Centre, the claimant in the third case, Andrew Wrench, brought a single claim against the defendant lender, FirstRand Bank Ltd, in connection with credit agreements made with the lender when purchasing (i) a car from the car dealership, Fast Lane Motor Cars of Stoke-on-Trent, in May 2015, and (ii) a car from the car dealership, TT Sports and Prestige Ltd of Derby, in March 2017. He claimed that commissions paid by the lender to the car dealerships were bribes, so that he was at liberty to rescind both his credit agreements with the lender. He also made claims to re-open both credit agreements under the 1974 Act on the ground of an unfair relationship. By a decision and order dated 17 July 2023 Deputy District Judge Harrop held that both dealers owed the claimant a disinterested duty, sufficient to engage the tort of bribery, and that both commissions had been secret because a commissions clause in the credit agreements had not been expressly drawn to the claimant's attention, nor had the commissions been otherwise disclosed. He therefore held that the claimant succeeded in relation to both credit agreements, although he left remedies to be determined after any appeal on liability, and did not determine the 1974 Act claim. The lender appealed. By a decision and order dated 31 January 2024 Judge Worster sitting in the County Court at Birmingham held that neither dealer had owed the claimant a fiduciary or disinterested duty sufficient to engage the tort of bribery, and that the commissions clause was sufficient in both cases to disclose the possibility of a commission to the claimant, with the consequence that there was not the element of secrecy required for bribery. He remitted the 1974 Act claim to the district judge for reconsideration. By an appellant's notice filed on 21 February 2024 the claimant appealed.

The appeals of all three claimants were conjoined to be heard together. By the time of the hearing in the Court of Appeal there remained live: (1) bribery claims by the Hopcrafts and Mr Wrench; (2) equitable claims in dishonest assistance (in the dealers' breach of fiduciary duty) by the Hopcrafts and Mr Johnson; and (3) an unfair relationship claim under the 1974 Act by Mr Johnson.

By a decision dated 25 October 2024 the Court of Appeal (Andrews, Birss and Edis LJJ) [2024] EWCA Civ 1282 allowed all three appeals, holding: (1) that in providing a credit brokerage service to each claimant, the dealers had incurred both a disinterested duty and a fiduciary duty to their customers; (2) that in neither the Hopcrafts' nor Mr Wrench's transactions was there any (in the former case) or any sufficient (in the latter case) disclosure of the commissions, sufficient to avoid them being secret for the purposes of the tort of bribery; (3) that based upon his concession in the court below, there was sufficient partial disclosure of the commission in Mr Johnson's case to avoid the commission being a bribe, but insufficient disclosure to obtain his informed consent to the commission, which was

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A therefore an unauthorised profit made by the dealer in breach of its fiduciary duty, in which the lender dishonestly assisted; and (4) that Mr Johnson's relationship with the lender was so clearly unfair for the purposes of the 1974 Act that, in the interests of proportionality, that aspect of his claim should be upheld rather than remitted, as had been ordered by Judge Jarman.

By appellant's notices dated 22 November 2024 and with permission of
B the Supreme Court (Lord Reed PSC, Lord Hodge DPSC and Lord Lloyd-Jones) granted on 10 December 2024 the lenders appealed. The main issue for the Supreme Court was whether the continuing status of the dealer as seller of the car in the three-cornered transaction between dealer, lender and customer was fatal to the recognition of any fiduciary duty owed by dealer to customer in connection with providing a finance package as credit broker sufficient to ground a claim in dishonest assistance by the lender, or any
C lesser "disinterested" duty (whether as agent or otherwise) to avoid being affected by personal interest, sufficient to found a claim against the lender in bribery.

In particular, the appeal raised the following issue in relation to the claim in equity: whether a "disinterested" duty was sufficient to give rise to the equitable claim or whether only a full fiduciary duty would do. The appeal
D also raised the following issues relating to the tort of bribery: (i) Did the common law recognise a distinct tort of bribery at all and should it continue to? (ii) If a tort of bribery was to be recognised, what duty relationship engaged the tort of bribery and in particular whether any duty relationship (here between dealer and customer) less than a full fiduciary duty of single-minded loyalty was sufficient to engage the tort. In particular, was a
E "disinterested" duty, although falling short of a fiduciary duty, sufficient for that purpose? (iii) What was the meaning of the requirement for secrecy? (iv) If bribery be established, did the customers have an automatic remedy against the payer of the bribe for the full amount of the bribe and, if so, on what conceptual basis and with what, if any, requirements as to proof? Further, did the customer have both a common law and an equitable right to rescind in cases of bribery? The appeal raised the following issue in relation
F to the claim under the 1974 Act: was the relationship between the customer and the lender arising out the credit agreement unfair to the customer because of one or more of the matters set out in section 140A(1) of the 1974 Act? If the relationship was found to be unfair, there would arise the issue of remedies under section 140B of the 1974 Act.

The Supreme Court granted the Financial Conduct Authority and the
G National Franchised Dealers Association permission to intervene to make brief written and oral submissions.

The facts are stated in the judgment of the court, post, paras 13–49.

Laurence Rabinowitz KC, Andrew Scott KC, Niranjan Venkatesan KC, Ajay Ratan, George Molyneaux and *Dame Sarah Worthington KC (Hon)* (instructed by *Slaughter and May Ltd (London)*) for the defendant lender,
H Close Brothers Ltd.

Mark Howard KC, Matthew Hardwick KC, Simon Popplewell and *Frederick Wilmot-Smith* (instructed by *Eversheds Sutherland (International) LLP (Birmingham)*) for the defendant lender, FirstRand Bank Ltd.

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Robert Weir KC, *Jonathan Butters* and *Thomas Westwell* (instructed by *Consumer Rights Solicitors Ltd (Manchester)* and *HD Law Ltd (Bradford)*) for the claimant customers.

Jemima Stratford KC, *Aarushi Sahore*, *Jagoda Klimowicz* and *Jaamae Hafeez Baig* (instructed by *Financial Conduct Authority Legal Department*) for the Financial Conduct Authority, intervening.

Jonathan Kirk KC, *Richard Roberts*, *Jack Brady* and *Lee Finch* (instructed by *Caytons Law LLP*) for the National Franchised Dealers Association Ltd, intervening.

The court took time for consideration.

1 August 2025. **LORD REED PSC, LORD HODGE DPSC, LORD LLOYD-JONES, LORD BRIGGS** and **LORD HAMBLEN JJSC** handed down the following judgment of the court.

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1. Introduction

1 This judgment determines three conjoined appeals, all of which raise common issues about the lawfulness or otherwise of the payment of commission by finance lenders to motor dealers in connection with the provision of finance for the hire purchase of cars, where that commission is either not disclosed, or only partly disclosed, to the hirers of the cars. Although the individual sums at stake in each of the appeals are modest, the fact that the transactions in issue are of an extremely widely used type, and that non-disclosure, or partial disclosure, of such commission is very widespread, means that the outcome of these appeals is of major financial significance to finance lenders, to motor dealers and to the very large number of members of the public who typically obtain cars in this way, for whom the sums at stake may well be material.

2 Central to each of the appeals is a very well-known type of three-cornered transaction which comes about (broadly speaking) in the following way. Motor dealers offer cars for sale, typically on their forecourts or in showrooms, to the public. A person who wishes to obtain a car for their personal use visits the dealer, chooses a car and agrees a price with the dealer. The price may be reduced for a buyer on credit, below that payable by a cash buyer. If (as in all these appeals and in the majority of car sales) the customer wishes to obtain the car on credit rather than by paying cash, the dealer obtains an offer of finance from a finance company on hire purchase terms. The offer will come from one of a number of lenders on a panel maintained by the dealer, to whom the dealer has disclosed information about the customer's financial resources previously obtained from the customer. If the offer is acceptable to the customer then (1) the dealer sells the car to the lender, (2) the customer enters into a back to back hire purchase agreement with the lender for a specified term, usually with an option to return or purchase the car at the end of the term, (3) the customer drives away the car, and (4) the lender pays the dealer a commission for the introduction of the hire purchase business. No direct contract is made between the dealer and the customer. Nor does the customer generally meet or speak to any member of the staff of the lender. The offer of the hire purchase agreement is made to the customer in documents presented to the customer by the dealer, acting for that purpose on behalf of the lender.

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3 The provision of motor finance on terms exemplified by the transactions under appeal has been widespread for at least 75 years. It is a regulated credit activity under the Consumer Credit Act 1974 ("the CCA"). The regulator has since 2014 been the Financial Conduct Authority ("the FCA"), acting under powers conferred by the Financial Services and Markets Act 2000 ("FSMA"). Previously it was the Office of Fair Trading ("the OFT"). Both lenders, and dealers when acting as credit brokers in the sourcing of finance, fall within that regulatory framework. Nothing in that regulatory regime detracts from customers' rights at common law or in equity. Although rules made by the FCA in its Consumer Credit Sourcebook ("CONC") require the dealer to disclose commission receivable if it could either affect the dealer's impartiality or have a material impact on the customer's transactional decision, nothing in the regulatory regime requires lenders or dealers generally to disclose the existence or amount of any commission paid by lender to dealer, or to obtain the customer's consent to the payment.

4 These appeals arise from proceedings brought by three customers who obtained used cars (in the case of one customer two cars) from four different dealers under hire purchase arrangements involving two different lenders. It will be necessary to describe each of the transactions in more detail in due course but, in summary, in each case commission was paid by the lender to the dealer. There was either no disclosure of the existence of the commission or the only disclosure was that a commission (of unidentifiable amount) might be paid. The customers claimed that the commissions amounted to bribes, or to secret profits received by the dealers as fiduciaries. They each claimed payment of an amount equivalent to the commissions from the lenders under the tort of bribery. Two of them claimed in the alternative compensation from the lenders for dishonest assistance in the dealers' receipt of secret profits. Each of the customers claimed to re-open their hire purchase agreements under section 140A of the CCA on the basis that they gave rise to an unfair relationship. Only one of those CCA claims has survived for determination on these appeals. There were also claims to rescind the hire purchase agreements at common law or in equity but, for reasons which will appear, they were unlikely to succeed and have not been made the subject of much argument in this court.

5 The claimant customers had limited success at first instance and on first appeal. So they became the appellants in the Court of Appeal. There they each succeeded against their respective lenders, either on the basis of the tort of bribery or on the basis of the lenders' dishonest assistance in the dealers' breach of fiduciary duty. It will be necessary to review the judgment of the Court of Appeal in more detail in due course but, in summary, it was held that:

(1) All four dealers undertook a fiduciary duty to their customers when acting as credit brokers in obtaining offers of hire purchase finance from the lenders.

(2) They all also undertook a duty to act in a disinterested manner in obtaining offers of hire purchase finance sufficient to engage the tort of bribery (something labelled a "disinterested" duty).

(3) In three of the four transactions the commissions were secret, so that they were bribes.

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A (4) In the fourth transaction there was sufficient disclosure to prevent the commission being secret, but not a sufficiently informed consent by the customer to prevent it being an unauthorised profit received by the dealer in breach of fiduciary duty, in respect of which the lender was liable as a dishonest assistant.

(5) In the same case there was an unfair relationship between the lender B and the customer sufficient for the hire purchase agreement to be re-opened under the CCA.

6 The lenders, who are the appellants in this court, challenge every element in the Court of Appeal's analysis. They go so far as to submit that there either is not, or should no longer be recognised to be, a distinct tort of bribery at all. A fuller description of the lenders' submissions, and the issues C raised, will follow a summary of the key features of each of the four transactions. But it is worthwhile first to identify what the court considers to be the central issue in all three appeals, which is decisive of all of them.

7 Both the tort of bribery and the equitable claim based upon dishonest assistance in a breach of fiduciary duty treat the payment and its receipt as objectionable because it tends to corrupt, undermine or at least conflict with some duty or obligation arising out of a relationship between the recipient of D the payment and a third party (typically the claimant), to whom the duty or obligation is owed. The obligation may be a fiduciary duty, which is a feature of the relationship between a trustee and his beneficiary or between a director and her company or between many kinds of agent and their principals. That is often called a duty of single-minded (or undivided) loyalty. Or, according to some authorities, it may be a duty to perform a E service in a manner independent from any personal interest (falling short of a full fiduciary duty), sometimes called a "disinterested" duty, such as may be owed by a professional valuer to a client. Or, according to some authorities, it may be a duty of fidelity, generally owed by an employee to her employer.

8 Common to all those types of duty or obligation is a requirement to avoid having the performance of the duty, or of the service to which it F relates, affected by any personal interest of the obligor. Generally it requires the obligor to avoid any conflict between his duty and his interest or, at the very least, to declare it. As between fiduciaries and their principals it is usually called the no conflict duty. In several types of well-recognised relationship, such as between trustee and beneficiary, the duty is treated as always arising, so that it may be described as being implied by law. In others G the existence of such a duty may be expressly stated, where the relationship is contractual, or governed by statute, such as that between director and company.

9 In other types of relationship a duty to avoid any conflict of interest may be implied as a necessary incident of the service to be performed. Or the particular context in which the relationship arises may be inimical to the existence of such a duty, or at least of such a duty in an unqualified form. Or H there may simply be nothing (or nothing sufficient) about the service to be performed which makes the implication of a no conflict duty necessary. In such cases the question whether a payment made to the obligor under that relationship by a third party is objectionable will depend, as a threshold question, upon whether the factual context requires or permits the

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implication of a no conflict duty which would be breached by the making and receipt of the payment.

10 Common to these appeals is the relationship between the motor dealer and the customer, during the course of which the dealer selects for the customer a suitable hire purchase (or other) finance package from among a panel of lenders. Viewed separately from the marketing and sale of the car, the service of selecting a finance package for the customer may be labelled "credit brokerage". Viewed in isolation, the provision of a credit brokerage service, or the relationship between the broker and the client, is not one which automatically attracts a no conflict duty as a matter of implication by law, but it may on particular facts be sufficient to import a necessarily implied no conflict duty, such that a secret payment by lender to broker would be objectionable from the perspective of the client. That is what the Court of Appeal concluded was to be implied as between dealer and customer in each of the four transactions, a conclusion which the respondent customers maintain was correct.

11 But the lenders submit that the credit brokerage service provided by the dealers in these typical hire purchase cases cannot be viewed in isolation from the general relationship between dealer, customer and lender in the three-cornered transaction of which the finance package is only a part. Viewed in that way, the lender appellants say that the dealer never loses its status as seller, and acts, and is expected and entitled to act, in its own interests as an arm's length seller throughout. A no conflict duty, or any other duty which would make undisclosed commission payments by the lender to the dealer objectionable in law or in equity, would be incompatible with that continuing arm's length relationship, which persists until the transaction is completed, so that no such duty is to be implied.

12 We have summarised this question at the outset of this judgment for three reasons. The first is that it is the question which we consider necessarily arises from the analysis of the law which follows. The second is that the answer to it will be determinative of this appeal, save for the single surviving CCA claim. The third is that it is a question which needs to be answered by reference to the detail about the facts of the four transactions, and from what may be gathered from them as the typical features of transactions of this type, to which we now turn.

2. The agreed or assumed facts and the litigation history

13 As already noted, there are three customer claimants, with claims arising from four transactions, involving four dealers and two lenders. All of the claims went to trial in either the Fast Track or the Small Claims Track. It is therefore no criticism of the judgments that the findings of fact are sometimes brief. In any event the agreed statement of facts and issues before this court, which is largely based on those judgments and on uncontentious documents, provides a sufficient non-contentious basis for the resolution of the issues arising on the three appeals.

(1) Hopcraft

14 Ms Hopcraft was, in January 2014, a 22-year-old student nurse, looking for a replacement car. She found a second-hand Fiat 500 at Jordan & Co (Hull) Ltd ("Jordans"), motor dealers in Hull, priced at £8,530, for which

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she needed finance. Jordans proffered a finance package from Close Brothers Ltd, licenced to provide motor finance by the OFT, and one of the finance providers on Jordans' panel. For that purpose Jordans obtained financial information from Ms Hopcraft. That may have included three years' address and employment history and three months' income and outgoings, supported by bank statements. Jordans uploaded that information onto a platform together with a finance proposal, available for inspection by its panel of lenders, including Close Brothers, who responded with a hire purchase package for Ms Hopcraft's acquisition of the car.

15 On 10 January 2014, together with her father as co-borrower, Ms Hopcraft signed a hire purchase agreement with Close Brothers, under which:

(1) Credit of £8,280 would be given to the Hopcrafts to purchase the second-hand Fiat 500 which she had selected. She had previously paid a deposit of £250.

(2) Interest charges would be £2,452.42, calculated at the rate of 5.5% per annum, fixed for the term of the agreement.

(3) The annual percentage rate of charge ("APR") was 12.3%.

(4) The term of the agreement would be 45 months and would involve 43 monthly payments of £144.43, a first payment of £313.43 and a final ("balloon") payment of £4,576.50. This would be payable only if Ms Hopcraft decided to purchase rather than return the car.

(5) Jordans was named as the credit intermediary.

16 Close Brothers paid Jordans a commission of £183.26, pursuant to a formula contained in its standard terms of business with brokers, the details of which were not available at trial. The commission was not disclosed to Ms Hopcraft in any way.

17 The Hopcrafts terminated the hire purchase agreement 13 months early, by paying everything then due, less an early settlement rebate of interest charges.

18 Close Brothers' then standard terms of business with brokers included an undertaking by the dealer that it had made all disclosures to the customer required by law, including as to commission. Its then dealer guide advised dealers to exercise high levels of conduct and integrity, to select finance products from any available range based upon what was best for the customer, to make customers aware of alternative sources of finance and to outline any finance package to the customer in a fair and transparent way so as to enable the customer to make an informed decision.

19 Ms Hopcraft issued a claim against Close Brothers in March 2023 in the County Court at Kingston upon Hull. She claimed:

(1) That the commission paid by Close Brothers to Jordans was a bribe.

(2) That the commission was a secret profit received by Jordans in breach of fiduciary duty for which Close Brothers was liable as an accessory.

(3) That her relationship with Close Brothers was unfair under the CCA.

(4) Relief in the form of damages and/or rescission.

20 In dismissing her claim in September 2023, DDJ Morris found that:

(1) Ms Hopcraft had only been offered one finance package (i e that from Close Brothers) on a take it or leave it basis, and without advice or recommendation.

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(2) That she was perhaps a little naïve and vulnerable in some respects, although her father, who took part in considering the finance package on offer, was not.

(3) That Ms Hopcraft's main concern was that the monthly payments were about right.

(4) That she was not told about the commission but that she doubted whether, if she had been told, it would have made any difference to her decision to obtain that car.

(5) That the commission was "very low" and the interest rate neither excessive nor unusual for the time.

21 DDJ Morris's conclusions were that Jordans were not fiduciaries or agents for Ms Hopcraft, nor owed her a disinterested duty, and that the transaction was not unfair for the purposes of her claim under the CCA.

22 Ms Hopcraft, and her father who had been joined as a party by the trial judge, appealed in October 2023. Their appeal challenged the findings that Jordans owed her no relevant fiduciary or disinterested duty, but not the trial judge's adverse conclusion about her CCA claim. Their appeal was transferred to the Court of Appeal to be heard with the Wrench and Johnson appeals described below.

(2) Wrench (1)

23 Mr Wrench was a postman who liked used sports cars. In May 2015 his eye fell on a second-hand Audi TT, offered for sale by Fast Lane Motor Cars Ltd of Stoke-on-Trent ("Fast Lane") for £8,995 cash. Mr Wrench had £3,000 available, but needed to finance the balance.

24 As to the dealer's role in arranging that financing, Mr Wrench's evidence at trial was that the sales representative at Fast Lane told him that the dealership would find him the best rate from their panel of lenders, and he was not directly challenged on this in cross-examination.

25 Fast Lane offered Mr Wrench a finance package from FirstRand Bank Ltd ("FirstRand") on the following terms, reflected in a credit agreement ("the 2015 Wrench Credit Agreement") made on 23 May 2015:

(1) Credit of £5,995 was provided for the purchase, on top of the deposit paid by Mr Wrench of £3,000.

(2) Interest charges amounted to £2,213.20 at a fixed rate of 8.75%.

(3) The APR was 19.3%.

(4) The term was 49 months, with monthly payments of £175.15, and a final payment of £374.15.

(5) Fast Lane was named as the credit intermediary.

26 The 2015 Wrench Credit Agreement was accompanied by FirstRand's then standard terms and conditions ("the 2015 Wrench Terms and Conditions"). These included, at clause 12.6, the following: "A commission may be payable by us to the broker who introduced this transaction to us. The amount is available from the Broker on request." We will call this "the Commissions Clause". The only reference made to the 2015 Wrench Terms and Conditions in the 2015 Wrench Credit Agreement appears on its declarations and signature page, where it is stated: "The customer has had his/her attention drawn to the provisions of clause 10 overleaf." The 2015 Wrench Terms and Conditions are not "overleaf" but in a separate

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A accompanying document not signed by Mr Wrench. Clause 10 has nothing to do with commission.

27 FirstRand paid Fast Lane a commission of £179.85, which was not disclosed to Mr Wrench, other than in the Commissions Clause. This was calculated as 3% of the amount of the credit.

B *(3) Wrench (2)*

28 In March 2017 Mr Wrench decided to buy another car, a second-hand BMW 3 series, which he found offered by TT Sports and Prestige Ltd of Derby ("TT Sports") for £9,750. Mr Wrench had £1,000 cash available but required finance for the rest of the price. Once again (according to Mr Wrench's evidence, unchallenged in this regard) he was told that the C dealership (this time TT Sports) would get him the best terms.

29 TT Sports offered him a finance package, again from FirstRand, on the following terms, contained in the hire purchase agreement which he signed on 11 March 2017 ("the 2017 Wrench Credit Agreement"):

(1) Credit of £8,750 was provided on top of Mr Wrench's deposit of £1,000.

(2) Interest charges were £1,578.84 at a fixed rate of 4.32%. This was D chosen from a discretionary range within which TT Sports had authority to set the rate, of between 3.25% and 8.25%.

(3) The APR was 10.2%.

(4) The term was 49 months, with 47 payments of £219.33 and a final payment of £418.33.

(5) TT Sports was named as the credit intermediary.

E 30 The 2017 Wrench Credit Agreement was accompanied by a terms and conditions document ("the 2017 Wrench Terms and Conditions") in substantially the same form as the 2015 Wrench Terms and Conditions, with the same cross-referencing to the Credit Agreement, and the same Commissions Clause, save that it was numbered 13.6. Mr Wrench did not sign the 2017 Wrench Terms and Conditions.

F 31 FirstRand paid TT Sports commission of £408.98. Apart from the Commissions Clause, that commission was not disclosed. The amount was made up from a two-element formula in FirstRand's then standard dealer terms. The first part, of £299.60, was derived in part from the difference between the minimum interest rate in the range referred to above, and the rate actually set by TT Sports. The second part, of £109.38, was described as a "revenue share of advance" and calculated as 1.25% of the total amount G of credit. Commission based upon differences in interest rates set by the dealer were banned by the FCA from use in motor finance from 2021.

32 Mr Wrench repaid both the 2015 and 2017 agreements early, in 2017 and 2019 respectively, receiving an interest rebate in each case.

33 FirstRand's standard terms and conditions issued to dealers (including Fast Lane and TT Sports) contained exhortations to dealers to H treat customers fairly and to pay due regard to their interests similar to those of Close Brothers, described above. In addition, Clause 1.15 of the General Terms issued to dealers provided that:

> "You agree to disclose to the customer early in the sales process in relation to each regulated finance agreement that commission may be

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payable to you for acting as a credit broker and/or credit intermediary. If requested to do so by the customer you will inform the customer of the amount of any commission and or other benefits payable by us to you in relation to the prospective or actual regulated finance agreement."

We will call that "the Wrench Disclosure Requirement".

34 Mr Wrench issued a single claim in the County Court Money Claims Centre in July 2022, claiming that both commissions were bribes, so that he was at liberty to rescind both his credit agreements. He also made claims to re-open both credit agreements under the CCA on the ground of unfair relationship.

35 The claim was tried by DDJ Harrop in July 2023. He found that:

(1) Mr Wrench received no oral information about the credit package proffered by either dealer, and had no direct contact with FirstRand.

(2) That although the Commissions Clause featured in the documents provided to Mr Wrench on both occasions, on neither was it drawn to his attention.

(3) That Mr Wrench had not been told the amount of either commission.

36 DDJ Harrop concluded that both dealers owed Mr Wrench a disinterested duty, sufficient to engage the tort of bribery, and that both commissions had been secret because neither Commissions Clause had been expressly drawn to his attention, or the commissions otherwise disclosed. He therefore held that Mr Wrench succeeded in relation to both credit agreements, although he left remedies to be determined after any appeal on liability, and did not determine the CCA claim.

37 FirstRand's appeal was heard in the County Court at Birmingham on 15 November 2023 and allowed by Judge Worster in a reserved judgment given on 31 January 2024. He held that neither dealer had owed Mr Wrench a fiduciary or disinterested duty sufficient to engage the tort of bribery, and that the Commissions Clause was sufficient in both cases to disclose the possibility of a commission to Mr Wrench, with the consequence that there was not the element of secrecy required for bribery. He remitted the CCA claim to the district judge for reconsideration.

38 Mr Wrench appealed Judge Worster's order to the Court of Appeal, where it was conjoined with those of the Hopcrafts and Mr Johnson.

(4) Johnson

39 Mr Johnson was a factory supervisor, looking for his first car in mid-2017. He had already obtained a credit package before he visited the premises of a dealer in Cardiff called The Trade Centre Wales Group Ltd ("The Trade Centre Wales") in late July. Having looked at various cars, he identified a second-hand Suzuki Swift, on offer for £6,499, to secure which he paid a three day holding deposit of £100. The transaction was completed on 29 July.

40 Mr Johnson was told that his finance package would not be sufficient to enable him to buy the Suzuki. Instead he was offered a combined hire purchase and personal loan package from FirstRand, for the purposes of which he completed and signed a Finance Proposal Form in which he included basic personal, employment and financial details. The combined package was required because FirstRand only provided hire purchase

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finance up to 100% of the Glass's Guide valuation of a car, and the Glass's Guide valuation of the Suzuki was less than the purchase price by just under £1,600. Accordingly Mr Johnson borrowed £4,803.69 on hire purchase terms and £1,595.31 by way of personal loan ("the Johnson Credit Agreement"). These, together with his cash deposit, made up the purchase price of £6,499.

41 The standard terms of the hire purchase part of the package were similar to those obtained by Mr Wrench from FirstRand, and therefore included the Commissions Clause.

The particular terms were as follows:

(1) As noted, the hire purchase credit was £4,803.69 and the personal loan credit was £1,595.31.

(2) The combined interest charge was £2,635.20 and the fixed interest rate was 8%.

(3) The APR for the hire purchase was 18.1% and for the personal loan 15.1%.

(4) The term for both parts of the package was 60 months, requiring aggregate monthly payments of £153.72 and a final payment of £352.72.

(5) The Trade Centre Wales was named as the credit intermediary.

42 Also on 29 July Mr Johnson signed, but did not read, a Suitability Document prepared by The Trade Centre Wales. This stated that The Trade Centre Wales was authorised and regulated by the FCA and permitted to advise on and arrange consumer credit contracts. Under the heading "Credit Brokerage" it stated:

> "We will undertake an assessment of your Demands and Needs for Consumer Finance and provide an illustration of the Consumer finance product that best meets your individual requirements based upon the answers you provide.
>
> "We do not charge a fee for handling your application for Consumer Credit, but we may receive a commission from the product provider.
>
> "We do not offer a whole market option for Consumer Credit we offer products from a select panel of lenders, details of which can be seen below: Panel of lenders: . . ."

There followed a heavily redacted list of 22 potential lenders, including FirstRand. The Suitability Document further stated that:

> "Within our organisation [i e The Trade Centre Wales] there are a number of finance options we are able to provide. Based on our discussions and your responses to our questions we will have narrowed down this selection to the one that may be most appropriate given your personal circumstances and requirements."

43 The Trade Centre Wales and FirstRand had at the material time a Rates and Terms Agreement in force between them, included in a letter dated 18 July 2017, under which the dealer had discretion as to the interest rate between 8% and 13%. Commission was payable in two elements. First, commission of 80% of the difference between the minimum discretionary interest rate and the rate actually charged. Secondly, a revenue share of advance commission at 25.8% of the total amount of credit. Since the interest rate chosen for Mr Johnson was the minimum 8%, the first commission

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element was nil. But the second element amounted to £1,650.95, and this was the commission actually paid by FirstRand to The Trade Centre Wales.

44 The Rates and Terms Agreement between FirstRand and The Trade Centre Wales included a commercial tie under which The Trade Centre Wales was required to offer all its business to FirstRand, which had first refusal. That tie was not disclosed to Mr Johnson.

45 Mr Johnson repaid all his borrowings from FirstRand 21 months early, receiving the usual rebate of interest charges for early settlement.

46 Mr Johnson issued his claim against FirstRand in the County Court Money Claims Centre in January 2022. His claim was based upon (1) bribery, (2) dishonest assistance in the dealer's breach of fiduciary duty and (3) an unfair relationship under the CCA.

47 The claim was tried remotely by DDJ Sandercock on 29–30 November 2022. On 18 January 2023 he gave judgment dismissing the claim. He found that:

(1) There was no pleading or evidence that the price of the Suzuki was affected by the amount of the commission paid.

(2) Mr Johnson's evidence that, had he known of the amount of the commission he would have looked for a car elsewhere, was based upon his mistaken assumption that the commission affected the price of the car.

(3) Mr Johnson did not rely upon the dealer for information, nor was he interested in the detailed terms of the transaction, beyond the headline figures.

(4) Mr Johnson displayed an almost wilful disregard of the pre-contract information supplied to him. He deliberately chose not to read the documents placed before him. Had he done so he would have seen the Commissions Clause.

(5) There was no evidence that Mr Johnson agreed to pay more money than he needed in order to secure the car.

48 The district judge concluded that (1) there was no secrecy or even "half-secrecy" about the commission, (2) The Trade Centre Wales owed Mr Johnson no fiduciary duty, and (3) the relationship between Mr Johnson and FirstRand was not unfair for the purposes of the CCA. Therefore he dismissed the claim. It does not appear that any reference was made to the Suitability Document in evidence, in submissions or in the judgment, although it was included in the trial bundle.

49 Mr Johnson's appeal was heard by Judge Jarman KC in June 2023. During the appeal Mr Johnson abandoned his bribery claim. In his judgment given on 6 July 2023 Judge Jarman confirmed the district judge's conclusion that there was no fiduciary duty owed by the dealer to Mr Johnson, so that his dishonest assistance claim against FirstRand failed. But he allowed the appeal on the CCA claim, directing that it be re-heard by DDJ Sandercock. That re-hearing was overtaken by Mr Johnson's appeal to the Court of Appeal and remains undetermined.

(5) The Court of Appeal

50 The Court of Appeal (Andrews, Birss and Edis LJJ) heard the three appeals together over three days from 2 to 4 July 2024. They delivered a reserved judgment of the court on 25 October 2024. It will be necessary to

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consider in more detail aspects of the reasoning of the court in due course, but the following summary will suffice for the purpose of explaining the issues before this court.

51 By the time of the hearing in the Court of Appeal there remained live:

(1) Bribery claims by the Hopcrafts and Mr Wrench.

(2) Equitable claims in dishonest assistance (in the dealers' breach of fiduciary duty) by the Hopcrafts and Mr Johnson.

(3) An unfair relationship claim under the CCA by Mr Johnson.

The Court of Appeal provided, at paras 18–20, a helpful summary of their decision. By way of even more compressed summary, they concluded:

(4) That in providing a credit brokerage service to each appellant, the dealers incurred both a disinterested duty and a fiduciary duty to their customers because, even though they were selling the cars, they undertook to search for and provide to their customers a finance package from among their panel of lenders which was both competitive and suitable for their customers' needs.

(5) That in neither the Hopcrafts' nor Mr Wrench's transactions was there any (in the former case) or any sufficient (in the latter case) disclosure of the commissions, sufficient to avoid them being secret for the purposes of the tort of bribery.

(6) Based upon his concession in the court below, there was sufficient partial disclosure of the commission in Mr Johnson's case to avoid the commission being a bribe, but insufficient disclosure to obtain his informed consent to the commission, which was therefore an unauthorised profit made by the dealer in breach of its fiduciary duty, in which FirstRand dishonestly assisted.

(7) Mr Johnson's relationship with FirstRand was so clearly unfair for the purposes of the CCA that, in the interests of proportionality, that aspect of his claim should be upheld rather than remitted, as had been ordered by Judge Jarman.

52 On their way to those conclusions the Court of Appeal declined the appellants' invitation to treat the existence of a disinterested duty (rather than a full fiduciary duty) as sufficient to trigger a liability in equity of the dealer for breach of fiduciary duty, with a corresponding accessory liability of the lender in dishonest assistance, where a bribery claim was defeated by partial disclosure of the commission. That was the only point on which the appellants failed before the Court of Appeal, who regarded themselves as bound in that regard by *Hurstanger Ltd v Wilson* [2007] 1 WLR 2351 ("*Hurstanger*") and *Wood v Commercial First Business Ltd* [2022] Ch 123 ("*Wood*").

53 The result was that the three customers were all successful in their appeals to the Court of Appeal, leaving the lenders Close Brothers and FirstRand to appeal to this court. Their grounds of appeal, together with the points raised by the customers in their respondents' notice, sufficiently appear from the summary of the issues before this court which follows.

54 The decision of the Court of Appeal came as a shock to the car finance industry. The decision was based not on very specific or unusual facts about the four transactions under review, but upon common features very likely to be widely replicated across the industry as a whole, and with potentially wider implications for credit brokerage provided by sellers in

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other fields. Furthermore it conflicted with what had until then been the contrary assumption made by the FCA as regulator, namely that those common features did not, without more, give rise either to a disinterested or fiduciary duty sufficient to enable either a bribery claim or an equitable claim in dishonest assistance.

55 For those reasons we permitted the FCA to intervene to make brief written and oral submissions, directed to the regulatory context of the issues for decision. Although no dealer had been joined as party to the cases under appeal, the profound consequences for car dealers generally led us to permit the National Franchised Dealers Association also to intervene to make brief written and oral submissions. The court is grateful for the assistance which both interveners provided.

56 The court also received, but rejected, a request to intervene from HM Treasury. Although the draft submissions clearly expressed the apprehension within Government as to the national economic consequences of the Court of Appeal's decision, it provided nothing of substance either as to the relevant law or context.

3. The issues before this court

57 We have already described the main issue which we regard as decisive of these appeals (save for Mr Johnson's CCA claim). That is whether the continuing status of the dealer as seller of the car in the three-cornered transaction between dealer, lender and customer is fatal to the recognition of any fiduciary duty owed by dealer to customer in connection with providing a finance package as credit broker sufficient to ground a claim in dishonest assistance by the lender, or any lesser "disinterested" duty (whether as agent or otherwise) to avoid being affected by personal interest, sufficient to found a claim against the lender in bribery.

58 But the issues potentially for decision (depending upon the outcome of the main issue) go much wider than that, and wider in some respects than those canvassed before the Court of Appeal. This is in part because most of the relevant authorities come from the Court of Appeal or below, by none of which is this court bound. We were not invited to depart from the fully argued ratio of any prior decision of this court, or of the House of Lords or the Judicial Committee of the Privy Council, for which an enlarged panel might have been appropriate.

(1) Bribery

59 Perhaps the most potentially wide-ranging of the additional issues raised by the appellant lenders is whether the common law does, or should continue to, recognise a distinct tort of bribery at all. The submission, advanced primarily by Mr Laurence Rabinowitz KC for Close Brothers, was that for most purposes the older equitable claim based upon breach of fiduciary duty was sufficient to deal with the evils of bribery, with such assistance from established common law claims such as deceit, misrepresentation and money had and received (or restitution) as might be required to fill any gaps.

60 The next issue, if a tort of bribery is to be recognised, is what duty relationship engages the tort of bribery and in particular whether any duty relationship (here between dealer and customer) less than a full fiduciary

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duty of single-minded loyalty is sufficient to engage the tort. In particular, is what has come to be known as a "disinterested" duty, although falling short of a fiduciary duty, sufficient for that purpose? The submission that it is sufficient comes from the Court of Appeal authorities of *Wood* and *Hurstanger*, supported by the customer respondents. In the lenders' submission, nothing short of a full fiduciary duty will do.

61 Next, still within the context of bribery, there is an issue as to the meaning of the requirement for secrecy. The lenders submit, following the decision in *Hurstanger*, that if the customer is told that a commission *may* be paid by lender to dealer or broker, then if it is subsequently paid, without further disclosure, that payment cannot be secret. The customers say that nothing short of the full disclosure necessary to obtain a beneficiary's informed consent in a trust or fiduciary context will do.

62 There follow issues about remedies, if bribery be established. The first is whether the customer has an automatic remedy against the payer of the bribe (here the lender) for the full amount of the bribe and, if so, on what conceptual basis, and with what, if any, requirements as to proof? Is it a form of damages, in which loss at least equivalent to the bribe is to be presumed, irrebuttably or otherwise? Or is it a claim in unjust enrichment, or a claim for restitution for a wrong? The second is whether the customer has both a common law and an equitable right to rescind in cases of bribery.

(2) The claim in equity

63 There are a reduced number of issues under this heading. The first, rejected by the Court of Appeal but renewed by the respondents, is whether a disinterested duty is sufficient to give rise to the equitable claim or whether, as the appellants maintain, only a full fiduciary duty will do. This issue was somewhat obscured during submissions by the apparent agreement of counsel that the two duties are really the same, the "disinterested" duty just being the common law analogue of the fiduciary duty, with no separate characteristics. As will appear, the parties proposed this supposed common ground for their own separate and opposed purposes, but we reject it.

64 The second issue is about the now well-established requirement for accessory liability of a person who assists in a breach of fiduciary duty, namely that the assistance be dishonest. As will appear, our resolution of the logically anterior issues about fiduciary duty make that an unprofitable issue to address on these appeals, other than at a very high level of generality.

(3) The CCA claim

65 All three customers initially claimed to re-open their hire purchase agreements under section 140A of the CCA on the basis that they gave rise to an unfair relationship between customer and lender. The only one of those CCA claims which has survived for determination on these appeals is that brought by Mr Johnson.

66 The issues arising in relation to Mr Johnson's CCA claim are discrete from the other issues on these appeals and may be summarised as follows.

(1) The central issue is whether the relationship between the customer and the lender arising out of the Johnson Credit Agreement (which comprised a hire purchase agreement and a personal loan agreement) was unfair to the

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customer because of one or more of the matters set out in section 140A(1) of the CCA.

(2) It is conceded that antecedent negotiations with the customer were deemed by section 56(2) of the CCA to be conducted by the dealer as agent of the lender as well as in its actual capacity.

(3) It is alleged that the existence and amount of a commission paid by the lender to the dealer were not disclosed to the customer and made the customer/lender relationship unfair.

(4) It is alleged that the existence of a commercial tie between the dealer and the lender under which the dealer was required to offer all its business to the lender which had first refusal, which tie was not disclosed to the customer, made the customer/lender relationship unfair. It is alleged that the dealer/lender relationship was falsified and actively concealed by the dealer acting as agent for the lender.

(5) It is alleged that breaches by the lender and the dealer of their regulatory obligations contained in CONC made the customer/lender relationship unfair and were actionable under section 138D of FSMA.

(6) A further issue in relation to unfairness of the customer/lender relationship is the failure of the customer to read the documents provided to him by the dealer.

(7) Finally in this regard, if the customer/lender relationship is held to be unfair, there arises the issue of remedies under section 140B of the CCA.

4. The law

67 In this section we will describe in more detail the two non-statutory means whereby the law provides a response to the matters complained of, namely the claim in equity and the common law tort of bribery, and then conclude with an analysis of the limited effect upon those principles of the statutory intervention wrought by the CCA, and the regulatory framework now administered by the FCA. We will begin with the equitable claim because of its greater antiquity, and because aspects of the claim in tort at least arguably owe their origin to pre-existing equitable principles.

(1) The claim in equity

(i) The no profit and no conflict rules

68 At the heart of equity's response to objectionable payments to fiduciaries lies what is usually called the no profit rule (or, by some, the profit rule). It amounts to a general and strictly enforced prohibition on fiduciaries making any profit for themselves out of their fiduciary position without the fully informed consent of their principals. The no profit rule is imposed upon all those who undertake fiduciary duties of single-minded loyalty in order to protect them from succumbing to the temptation to allow their personal interest to undermine the performance of their duty. It is the twin sister of the conflict (or no conflict) rule which, equally strictly and for the same purpose, prohibits a fiduciary from getting into a position where his personal interest may conflict with his duty to his principal.

69 The no profit rule has been settled in its scope and effect since at least the early 18th century, the best-known leading authority for it being *Keech v Sandford* (1726) Sel Cas Ch 61. It is the subject of numerous decisions of the

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House of Lords, including *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134 ("*Regal v Gulliver*") and *Boardman v Phipps* [1967] 2 AC 46, and was very recently reviewed and affirmed by this court in *Recovery Partners GP Ltd v Rukhadze* [2025] 2 WLR 529 ("*Rukhadze*") and again in *Hotel Portfolio II UK Ltd v Stevens* [2025] 3 WLR 293 ("*Hotel Portfolio*").

70 The no profit rule originated in the relationship between trustees and beneficiaries, but it has long since been extended to all those who are in a fiduciary relationship, such as directors and their companies, solicitors and clients, and many types of agents and their principals. The consequences of breach are, deliberately, draconian. Any unauthorised profit (i e a profit to the making of which the principal has not given their fully informed consent) is held upon receipt by the fiduciary upon an immediate institutional constructive trust for the principal, so that it becomes from the moment of receipt beneficially owned by the principal as the beneficiary of that constructive trust. The principal therefore has all the proprietary rights and remedies against the property constituted by the profit arising from that beneficial ownership. The fiduciary is personally liable to account to the principal for the profit and is also personally liable to the principal for any loss caused to it by the breach of duty consisting of its having been made and received: see generally *Hotel Portfolio*.

71 There was until recently a long-standing uncertainty in English law as to how far the receipt of a bribe or secret commission by a fiduciary was to be assimilated with the law about unauthorised profits. The question was whether the recipient of the bribe held it upon constructive trust for the principal. In *Lister & Co v Stubbs* (1890) 45 Ch D 1 the English Court of Appeal held that it was not, but in *Attorney General for Hong Kong v Reid* [1994] 1 AC 324, the Privy Council, applying the equivalent law of New Zealand, held that it was. This uncertainty was finally resolved by this court in *FHR European Ventures LLP v Cedar Capital Partners LLC* [2015] AC 250 ("*FHR*"), which held that it was. Since then it has become appropriate to regard bribes and secret commissions paid to fiduciaries as a subset of unauthorised profits: see *Hotel Portfolio*.

72 That classification is made all the easier when unauthorised profits are, as they frequently are by trust lawyers, labelled "secret profits", but it is not (and never has been) a condition of the fiduciary's liability that a profit made from his fiduciary position be concealed from his principal. The fiduciary's only defence is that the principal gave its fully informed consent to the fiduciary keeping it for himself: see *Boardman v Phipps* per Lord Guest at p 117, affirmed in *Rukhadze* at para 40.

73 The no profit rule is, as already noted, primarily intended and therefore designed to act as a support for the conscientious discharge of the duty of single-minded loyalty undertaken by a trustee or other fiduciary to his beneficiary or principal. It treats the primary liabilities arising from any breach as those of the fiduciary. Anyone involved in assisting the fiduciary in that breach is treated as incurring only a secondary or accessory liability. In this respect the relevant equitable principles differ significantly from those which affect the payer of a bribe under the common law tort of bribery. As will appear, the payer of a bribe is treated as a primary wrongdoer, and the remedies against him are very different.

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74 The only basis which equity recognises for the imposition of accessory liability for a breach of fiduciary duty, including the breach of the no profit rule occasioned by the receipt of a bribe, is that which is now labelled "dishonest assistance". It used to be called "knowing assistance in a dishonest breach of trust", but the more recent label better summarises the essential conditions for accessory liability. This means that the claimant beneficiary or principal must show that the defendant materially assisted the fiduciary in his breach of duty, and that the defendant's conduct was dishonest, applying the two-stage semi-objective test now generally regarded as finally settled (after acute controversy) by the Privy Council in *Barlow Clowes International Ltd v Eurotrust International Ltd* [2006] 1 WLR 1476. The requirement to prove dishonesty is no mean forensic task. There are many hard-fought reported cases where the failure to prove dishonesty was fatal to the claim, and there will no doubt be very many others where the perceived difficulty in surmounting that hurdle meant that the claim was never brought against the assistant at all.

75 The remedies available against the dishonest assistant are limited. The assistant will generally have no vulnerability to any proprietary claim by the principal, unless he has received some part of the profit or its traceable proceeds. Critically, the dishonest assistant is not liable jointly (or at all) to account for the fiduciary's unauthorised profit, but only for his own, if any: see *Novoship (UK) Ltd v Mikhaylyuk* [2015] QB 499, affirmed by this court in *Hotel Portfolio* at para 37. Thus in stark contrast with the position at common law under the tort of bribery, the dishonest assistant who pays a bribe to a fiduciary is not liable in equity to pay an amount equivalent to the bribe to the principal.

76 The dishonest assistant is jointly liable with the fiduciary to compensate the principal for any loss occasioned by the breach of duty. But as against both of them, equity requires that loss to be proved. No presumptions, rebuttable or irrebuttable, come to the principal's rescue in what may be a difficult and expensive forensic task. And in many cases of secret commissions or bribes, the principal may have suffered no loss.

77 Finally in relation to remedies, equitable rescission is, in sharp contrast to the parallel remedy at common law, neither automatic, nor available by way of self-help. It is a discretionary form of relief available only at trial. Nonetheless the much more flexible and pragmatic approach taken by equity to the need for restitutio in integrum makes it generally more useful than its common law sister.

78 This general description of the claim in equity may fairly be said thus far to have skirted round the main question raised by this appeal, namely to what relationships does it apply, under the general label "fiduciary"? Most of the relationships to which the main authorities on the no profit rule relate are those to which the fiduciary label has become attached beyond question. They include trustee and beneficiary (*Keech v Sandford*), director and company (*Regal v Gulliver*, *Rukhadze* and *Hotel Portfolio*), solicitor and client (*Boardman v Phipps* and *Target Holdings Ltd v Redferns* [1996] AC 421), and fiduciary agent and principal (*FHR*). In none of them was there any dispute that a fiduciary relationship existed. In all of them there was present what has come to be regarded as the hallmark of a fiduciary relationship, namely a duty of single-minded or undivided loyalty, in the

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A performance of which the fiduciary's personal interest is not allowed to play any part.

79 It was common ground between counsel that a de facto fiduciary relationship may arise outside the settled categories mentioned above, where the particular facts about the relationship justify that conclusion. For the respondents Mr Robert Weir KC submitted that equity imposes a fiduciary duty wherever the dealer provides the customer with a product or service (here the finance package) from a lender on the basis of a judgmental choice as to its suitability for the customer, or its competitiveness, and the customer relies upon that choice. The dealer has offered or agreed to play a role in the customer's decision-making about the relevant transaction and is therefore required by equity to act with single-minded loyalty to the customer, to the exclusion of the dealer's own interests.

C 80 The appellants submitted that this approach was wrong. First, equity does not impose a duty of undivided loyalty. That duty is recognised only where it is undertaken, expressly or impliedly, by the alleged fiduciary. Then equity imposes the no profit and no conflict rules as a means of ensuring that the duty of single-minded loyalty is adhered to. Secondly, there are numerous instances in ordinary business and commerce where a D seller or trader makes choices as to what to recommend to a customer by way of products or services without anyone thinking that the seller is undertaking any duty of loyalty, let alone single-minded loyalty, to the customer. Examples were given of the shopkeeper who tells the customer; "I've got just the right item for you. It's the best your money can buy", or the wine waiter in a restaurant who recommends a particular wine from his stock as "a perfect accompaniment" to the food chosen by the customer. E They each play a role in the customer's decision-making process without undertaking a duty of single-minded loyalty to the customer, and without undertaking, or being required, to put their own interests on one side.

81 Dicta may be extracted from well-known authorities which, read in isolation and out of context, might be said to support either of these very different approaches. We consider that the question needs to be addressed F from first principles, which we do in the next section of this judgment.

(ii) What brings a fiduciary duty into being?

82 In discussing the law of fiduciary duties in this part of the judgment we use the term "fiduciary duty" in the sense adopted by Millett LJ in *Bristol and West Building Society v Mothew* [1998] Ch 1, 16 ("*Mothew*") and G approved by Lord Walker of Gestingthorpe in *Hilton v Barker Booth & Eastwood* [2005] 1 WLR 567, para 29, to refer to the duties which are peculiar to a fiduciary, and the breach of which attracts legal consequences differing from those consequent upon the breach of other duties. Thus, as Millett LJ stated in *Mothew* at p 18 the duties which are special to fiduciaries "attract those remedies which are peculiar to the equitable jurisdiction and are primarily restitutionary or restorative rather than compensatory".

H 83 The law has not created a precise definition of when a person undertakes, or is treated as having undertaken, fiduciary duties in relation to another: see, for example, *Lloyds Bank Ltd v Bundy* [1975] QB 326, 341 per Sir Eric Sachs; *Hospital Products Ltd v United States Surgical Corpn* (1984) 156 CLR 41 ("*Hospital Products*"), 68 per Gibbs CJ, 96 per Mason J,

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141–142 per Dawson J; *Breen v Williams* (1996) 186 CLR 71, 92 per Dawson and Toohey JJ. The categories of fiduciary relationships are not closed. This should not surprise as fiduciary duties in English law are the creation of equity and judges have developed the rules of equity over time: *In re Hallett's Estate; Knatchbull v Hallett* (1880) 13 Ch D 696, 710 per Sir George Jessel MR. In a commercial setting the task is to find in a particular context the boundary between normal (self-interested) arm's length activity and the circumstances in which equity recognises fiduciary duties of one of the commercial parties requiring that party to put aside his or her own interests and act altruistically in the interests of another.

84 The paradigm of a fiduciary is a trustee acting under an express trust. In its simplest form an owner of property, A, empowers and directs the trustee, B, to hold and administer property for the benefit of the cestui que trust, or trust beneficiary, C, in accordance with the terms of the trust which A sets out in the trust deed. B holds and administers the property only for those purposes and for the benefit of C. B has no beneficial interest in the trust property. The no conflict rule and the no profit rule, which we have described, apply to regulate B's behaviour. Thus, for example, it has long been established that a trustee is not entitled to remuneration for his or her service without authorisation: *Lewin on Trusts*, 20th ed (2020), para 20.001.

85 Judges have not developed an all-embracing conceptual basis for the recognition of fiduciary duties. Instead, they have often identified the incidence of fiduciary duties in the commercial sphere by drawing analogies with the obligations of a trustee under an express trust. Thus, by analogy, company directors have been treated as fiduciaries of their company: *Fraser v Whalley* (1864) 2 Hem & M 10; *Aberdeen Railway Co v Blaikie Brothers* (1854) 1 Macq 461; *In re Lands Allotment Co* [1894] 1 Ch 616. Partners are treated as fiduciaries of their partners in relation to partnership property: *Aas v Benham* [1891] 2 Ch 244 (see also the Partnership Act 1890, section 20). The fiduciary duties arise out of roles which a person undertakes in the office of director or as a partner in a partnership. Similarly, a solicitor is the fiduciary of his or her client to the extent of the solicitor's retainer and in relation to the client's funds or property which the solicitor handles: *Nocton v Lord Ashburton* [1914] AC 932, 956–957 per Viscount Haldane LC. The obligations attached to those roles are well known, at least in general terms. Thus a person who voluntarily assumes a well-known type of role which is generally assumed to be fiduciary will have undertaken a fiduciary obligation.

86 The relationship between principal and agent is another well-known example of a relationship which may give rise to fiduciary obligations where the agent has undertaken to act on behalf of a principal in circumstances which bring into being a relationship of trust and confidence: *Mothew*, p 18; *FHR*, para 5. But, as explained in paras 101–104 below, the scope of any fiduciary obligations will be ascertained by having regard to the nature of the parties' contract or the fiduciary's undertaking and the context of the particular relationship of agency.

87 Fiduciary duties may also arise outside such established relationships on an ad hoc basis where a person so acts as to bring himself or herself under such obligations. In *Soar v Ashwell* [1893] 2 QB 390 the Court of Appeal

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A recognised that where a person takes on a role or exercises a power which, if exercised by a trustee or agent, would carry with it fiduciary obligations, the person's so acting causes him or her to undertake ad hoc fiduciary duties. Lord Esher MR stated at p 394:

> "where a person has assumed, either with or without consent, to act as a trustee of money or other property, i e, to act in a fiduciary relation with B regard to it, and has in consequence been in possession of or has exercised command or control over such money or property, a Court of Equity will impose upon him all the liabilities of an express trustee, and will class him with and will call him an express trustee of an express trust."

Bowen LJ in the same case put the matter pithily: "a man who assumes without excuse to be a trustee ought not to be in a better position than if he C were what he pretends" (p 396). We consider that, where Lord Esher spoke of equity "imposing" a duty, he was saying no more than that the defendant had deliberately chosen to exercise a trust power and equity recognised the nature of that power as fiduciary. If persons, although not appointed as trustees, take upon themselves the custody and administration of property on behalf of others, they are de facto trustees and are subject to fiduciary D obligations: *Dubai Aluminium Co Ltd v Salaam* [2003] 2 AC 366, para 138 per Lord Millett.

88 Equity has adopted a similar approach to self-appointed agents. Thus, where a person purported to act as the agent of the unascertained heirs of a landowner in the management of land, he fell to be treated as having undertaken fiduciary duties: *Lyell v Kennedy* (1889) 14 App Cas 437, 463 per Lord MacNaghten. See also *English v Dedham Vale Properties Ltd* E [1978] 1 WLR 93 in which Slade J held that a prospective purchaser of land who applied for planning permission in respect of that land in the name of the vendors and without their knowledge or consent owed fiduciary obligations to the vendors which required the disclosure to them of the application before the contract of sale was concluded. Again, the defendant had chosen to exercise and exercised a power which was that of an agent of F the vendors and which equity recognised as fiduciary. Self-appointed corporate directors are treated as taking on the fiduciary obligations of de jure directors: *In re Canadian Land Reclaiming and Colonizing Co; Coventry and Dixon's Case* (1880) 14 Ch D 660, 670 per James LJ; and *Ultraframe (UK) Ltd v Fielding* [2005] EWHC 1638 (Ch) at [1254]–[1257] per Lewison J.

89 Millett LJ in *Mothew*, p 18 gave a classic description of a fiduciary in G his often-quoted dictum in which he stated:

> "A fiduciary is someone who has undertaken to act for or on behalf of another in a particular matter in circumstances which give rise to a relationship of trust and confidence. The distinguishing obligation of a fiduciary is the obligation of loyalty. The principal is entitled to the single-minded loyalty of his fiduciary."

H

He then gave a non-exhaustive list of the facets of this "core liability", by stating:

> "A fiduciary must act in good faith; he must not make a profit out of his trust; he must not place himself in a position where his duty and his

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> interest may conflict; he may not act for his own benefit or the benefit of a third person without the informed consent of his principal."

He described these duties as the defining characteristics of the fiduciary and endorsed the statement in Dr Paul Finn's classic work, *Fiduciary Obligations* (1977), p 2 that the fiduciary is not subject to fiduciary obligations because he is a fiduciary; it is because he is subject to those duties that he is a fiduciary.

90 The key principle is therefore that a fiduciary acts for and only for another. He owes a duty of single-minded loyalty to his principal, meaning that he cannot exercise any power in relation to matters covered by his fiduciary duty so as to benefit himself. Accordingly, if a person is a fiduciary then he must not put himself into a position where his interest and that of the beneficiary might conflict (the no conflict rule), subject to the principal's informed consent. In addition, or perhaps in consequence, he must not receive a personal benefit from his fiduciary position (the no profit rule), subject again to the principal's informed consent.

91 The description of the duty of loyalty as single-minded should not be misunderstood. It is possible that a fiduciary's principals may have competing interests among themselves, and that the fiduciary may have to exercise a power or discretion in a way which will benefit some of them over others. The fiduciary will nevertheless fulfil his duty of loyalty if he exercises the power or discretion disinterestedly. By doing so, he fulfils the trust and confidence placed in him. A familiar example of such a situation is where the fiduciary is the trustee of a discretionary trust, and has to decide which of the beneficiaries should benefit from the trust fund. The trustee is undoubtedly a fiduciary, notwithstanding that the beneficiaries have competing interests. He fulfils his duty of loyalty to each of them if he exercises his powers with complete impartiality as between them, and without any interest of his own.

92 What then are the indicators which the court relies upon when addressing whether fiduciary duties arise in circumstances which fall outside the relationships in which it is well-established that fiduciary duties arise?

93 Fiduciary duties are recognised by equity. An objective test is applied, and a person may be treated as having undertaken fiduciary duties when that person has never applied his or her mind to such an undertaking. Thus, in *F & C Alternative Investments (Holdings) Ltd v Barthelemy (No 2)* [2012] Ch 613, 652 ("*F & C*") Sales J stated:

> "Fiduciary duties are obligations imposed by law as a reaction to particular circumstances of responsibility assumed by one person in respect of the conduct of the affairs of another."

Because the courts have not delimited the circumstances in which fiduciary duties may arise, judges have used different formulae, which have in common a high level of abstraction, to describe such circumstances.

94 Thus, it is said that an undertaking to act in the interest of, or for, another person can create fiduciary obligations where the undertaking gives rise to a relationship of trust and confidence: see, for example, *Mothew* at p 18; *FHR* at para 5. This can occur where a person agrees to act on behalf of another person and exercises a discretion which can affect the interests of

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A that other person: *Hospital Products* at pp 96–97 per Mason J. It is worth setting out Mason J's influential statement more fully:

> "The critical feature of these relationships is that the fiduciary undertakes or agrees to act for or on behalf of or in the interests of another person in the exercise of a power or discretion which will affect the interests of that other person in a legal or practical sense. The
B relationship between the parties is therefore one which gives the fiduciary a special opportunity to exercise the power or discretion to the detriment of that other person who is accordingly vulnerable to abuse by the fiduciary of his position. The expressions 'for', 'on behalf of', and 'in the interests of' signify that the fiduciary acts in a 'representative' character in the exercise of his responsibility, to adopt an expression used by the Court
C of Appeal."

95 In *Arklow Investments Ltd v Maclean* [2000] 1 WLR 594, 600 the Judicial Committee of the Privy Council in an appeal from New Zealand treated a relationship of trust and confidence as something that would arise out of an undertaking by the supposed fiduciary of an obligation of loyalty. In that case Arklow had turned down the offer of the defendant merchant
D bankers to act on its behalf and the bankers undertook no obligation, either expressly or impliedly, to act on Arklow's behalf. The claim for breach of fiduciary duty therefore failed.

96 It is consistent with the court's practice of recognising fiduciary duties by analogy to well-established categories of fiduciary that fiduciary duties arise where a person consciously assumes (or undertakes) responsibility in relation to the management of the property or affairs of another, in
E circumstances where he or she knows or ought to appreciate that this carries with it the expectation that he or she will act with loyalty to that other in that regard. The person undertaking that task does not have to have a subjective awareness of the duty of loyalty and the specific legal duties that that entails. "Loyalty" here is used in the strong sense of requiring an attitude of altruism as referred to in para 83 above.

F 97 The existence, in a commercial context, of trust and confidence between parties to a transaction is not of itself sufficient for equity to impose fiduciary duties on one of the parties towards the other. As Leggatt LJ pointed out in *Al Nehayan v Kent* [2018] 1 CLC 216 ("*Al Nehayan*"), paras 163–165, trust and confidence arise in arm's length commercial relationships in which there is no suggestion of one party owing the other
G any fiduciary obligations. By contrast, the trust and confidence characteristic of a fiduciary relationship is (para 165):

> "founded on the acceptance by one party of a role which requires exercising judgment and making discretionary decisions on behalf of another and constitutes *trust and confidence in the loyalty of the decision-maker to put aside his or her own interests and act solely in the interests of*
H *the principal*." (Emphasis added.)

It is the acceptance of the role which gives rise to the objectively assessed undertaking.

98 In *Mothew* Millett LJ emphasised the role of the undertaking by the fiduciary to act in the interests of another person (and therefore not in his

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own interest) as the source of the duties. So did Mason J in the passage from *Hospital Products* which we have quoted in para 94 above. The approach of focusing on the undertaking by the fiduciary readily fits the circumstance of a trustee under an express trust, as the trustee in accepting office as trustee undertakes to hold and administer the property for the beneficiaries which the settlor has established. Similarly, if a person takes on the office of director of a company or enters into partnership with another or others, that person takes on well-known or at least readily ascertainable legal responsibilities, which, through the operation of equity, carry with them those fiduciary obligations.

99 In other circumstances, such as those in *Soar v Ashwell*, in which the exercise of a power, which would require a properly appointed trustee or agent to act in a fiduciary capacity, brings with it the obligations of a fiduciary, one can perhaps speak about equity imposing the obligations, as Sales J did in *F & C*.

100 There must be the assumption of responsibility by the fiduciary to act exclusively on behalf of the other in the conduct of the other's affairs. This can arise where the fiduciary has expressly undertaken to exclude his or her own interest and those of third parties when so acting. That is what loyalty means and requires in this context. It can also arise where the objectively assessed circumstances enable equity to identify such an undertaking in the acts of the fiduciary.

101 Fiduciary duties can arise in the context of commercial relations in many different circumstances. One must consider with care the terms of any contract between the parties or unilateral undertaking, the wider transaction, and the commercial context of the relationship between the parties in order to ascertain whether and to what extent a person is to be taken to have undertaken such obligations. Thus in *New Zealand Netherlands Society "Oranje" Inc v Kuys* [1973] 1 WLR 1126 Lord Wilberforce spoke of the need to mould the precise scope of a fiduciary duty such as the no profit rule according to the nature of the relationship between the principal and its alleged fiduciary. In discussing the position of an employee of an incorporated non-profit society he stated (p 1130): "A person in his position may be in a fiduciary position quoad a part of his activities and not quoad other parts: each transaction, or group of transactions, must be looked at." He quoted as a principle of general application the dicta of Dixon J in an appeal concerning partnership, *Birtchnell v Equity Trustees, Executors and Agency Co Ltd* (1929) 42 CLR 384, 408:

> "The subject matter over which the fiduciary obligations extend is determined by the character of the venture or undertaking for which the partnership exists, and this is to be ascertained, not merely from the express agreement of the parties . . . but also from the course of dealing actually pursued by the firm."

102 It is important not to distort the commercial bargain between the parties to a contract by too readily implying fiduciary obligations into the commercial relationship. As Sales J stated in *F & C*, at p 650:

> "The touchstone is to ask what obligations of a fiduciary character may reasonably be expected to apply in the particular context, where the

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A contract between the parties will usually provide the major part of the contextual framework in which that question arises."

103 Similarly, in *Hospital Products*, at p 97, in a statement which the Privy Council adopted in *Kelly v Cooper* [1993] AC 205, 215, Mason J stated that where a contractual relationship provides the foundation for the erection of a fiduciary relationship:

B "The fiduciary relationship, if it is to exist at all, must accommodate itself to the terms of the contract so that it is consistent with, and conforms to, them. The fiduciary relationship cannot be superimposed upon the contract in such a way as to alter the operation which the contract was intended to have according to its true construction."

C See also *Henderson v Merrett Syndicates Ltd* [1995] 2 AC 145, 206 per Lord Browne-Wilkinson. It is hard to think of circumstances in which a fiduciary would not be subject to the no profit rule or no conflict rule and any such instances will be very rare (see e g *Edge v Pensions Ombudsman* [1998] Ch 512, 538–541, per Sir Richard Scott VC, and [2000] Ch 602 on appeal). Nonetheless, a contractual provision may be so precise in its regulation of what a party may do so as to remove any scope for the creation of a fiduciary D duty: *Breen v Williams* 186 CLR 71, per Gummow J at pp 132–133.

104 Furthermore, as Sales J recognised in *F & C*, and as Viscount Haldane LC made clear in *Nocton v Lord Ashburton* [1914] AC 932, 956–957, the contract between the parties is not the totality of the context. The wider commercial context of the transaction must be borne in mind. Thus, in the Privy Council case of *Kelly v Cooper*, it was held that an estate E agent, whose business it was to act for several principals at the same time, was entitled to act for competing principals in selling competing properties and to keep confidential the information obtained from each of his principals. Similarly, in the Australian case of *Walker v Corboy* (1990) 19 NSWLR 382 the Court of Appeal of New South Wales addressed the question whether a farm produce agent, licensed under statute, who sold F farm produce at market for a number of principals, held the proceeds of the sales as trustee specifically for each principal. The court concluded that he did not and that the relationship between the agent and the principals was one of debtor and creditor. In reaching that conclusion each of the Justices of Appeal (Priestley, Clarke and Meagher JJA) attached weight to the terms of the statute and the practicalities of operating an agency for sale business selling the produce of many producers.

G 105 Attempts have been made to argue that the existence of a relationship, in which one party, A, is in a position of power over another, B, and B is dependent on A, is sufficient to give rise to fiduciary obligations. In *Galambos v Perez* [2009] 3 SCR 247, the Supreme Court of Canada rejected the contention that such a power-dependency relationship was sufficient on its own to do so. Cromwell J stated (para 75) that "what is required in all H cases is an undertaking by the fiduciary, express or implied, to act in accordance with the duty of loyalty reposed on him or her". He continued (para 76):

"Thus, what is required in all cases of ad hoc fiduciary obligations is that there be an undertaking on the part of the fiduciary to exercise a

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> discretionary power in the interests of that other party. To repeat what was said by McLachlin J in *Norberg* [*Norberg v Wynrib* [1992] 2 SCR 226], 'fiduciary relationships . . . are always dependent on the fiduciary's undertaking to act in the beneficiary's interests' (p 273). As Dickson J put it in *Guerin* [*Guerin v The Queen* [1984] 2 SCR 335], fiduciary duties may arise where 'by statute, agreement, or perhaps by unilateral undertaking, one party has an obligation to act for the benefit of another' (p 384)."

He clarified this statement in the following paragraph (para 77) and stated: "The critical point is that in both per se and ad hoc fiduciary relationships, there will be *some undertaking on the part of the fiduciary to act with loyalty.*" (Emphasis added.) Such an undertaking (to act only in the interests of the other) need not be express but could be implied in the particular circumstances of the parties' relationship (paras 79 and 80). More recently the High Court of Australia in *Naaman v Jaken Properties Australia Pty Ltd* (2025) 99 ALJR 295 in the judgment of Gageler CJ and Gleeson, Jagot and Beech-Jones JJ stated that vulnerability is not the touchstone of a fiduciary relationship (para 43):

> "Vulnerability is relevant to the existence of a fiduciary relationship only to the extent that the vulnerability in question is suggestive of a responsibility on the part of the putative fiduciary to act in the interests of the vulnerable party to the exclusion of the interests of the putative fiduciary."

106 Mr Weir for the respondents argues that the reasoning in *Galambos* is not consistent with English law. We disagree. In *Nocton v Lord Ashburton*, for example, at pp 956–957, Viscount Haldane LC explained that the fact that a person has assumed responsibilities giving rise to duties in contract or tort to act to protect the interests of another is not sufficient in itself to give rise to a fiduciary duty. More is needed.

107 Dr Paul Finn and Professor Matthew Conaglen have suggested that equity will recognise the existence of fiduciary obligations where it is reasonable to expect that the person who is said to be a fiduciary will act in the other's interest and to the exclusion of his or her own interest. See Dr Finn in T G Youdan (ed) *Equity, Fiduciaries and Trusts* (Carswell, 1989), Ch 1, p 54 and Professor Conaglen in *Fiduciary Loyalty* (Hart Publishing) 2010, Ch 9. That may be so, but such an expectation arises because the putative fiduciary has, or is treated as having, undertaken to act with the loyalty of which Millett LJ spoke in *Mothew*. See Paul Finn in his capacity as Finn J in a joint judgment with Stone and Perram JJ in *Grimaldi v Chameleon Mining NL (No 2)* (2012) 200 FCR 296, para 177; and *Children's Investment Fund Foundation (UK) v Attorney General* [2022] AC 155, paras 47 and 48 per Lady Arden JSC.

108 As we have said, fiduciary obligations are the creation of equity. That does not mean that the existence and scope of equitable obligations are not influenced by the common law: see paras 101–104 above. Nonetheless, equity rather than the common law recognises the fiduciary duty. Equity analyses objectively the relationship between the parties to ascertain whether it involves a relationship of trust and confidence *because* a party has, or is treated as having, undertaken to act with the loyalty of which

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Millett LJ spoke in *Mothew*. The relationship of trust and confidence is the consequence, and not the cause, of a fiduciary duty. The fiduciary duty exists because the fiduciary has undertaken not to pursue his own interests. As Lord Woolf MR said in *Attorney General v Blake* [1998] Ch 439, 454, "the relationship of trust and confidence . . . arises whenever one party undertakes to act in the interests of another or places himself in a position where he is obliged to act in the interests of another". Similarly, the vulnerability which is the typical characteristic of a person to whom a fiduciary duty is owed, is a consequence and not a cause of a fiduciary relationship. It is because the fiduciary has undertaken to act solely in the best interests of the principal, and the latter trusts the fiduciary to do so, in a situation where it is usually possible for the fiduciary to act in a self-interested way, that the vulnerability typically arises.

109 As the courts have for good reasons eschewed any attempt to give a precise definition of when a person is to be treated as having undertaken fiduciary duties towards another, there are no bright lines when addressing whether ad hoc fiduciary duties arise. But there are clear indicators. The courts have extended the application of fiduciary duties by analogy with established fiduciary relationships. A fiduciary may expressly or impliedly undertake to act solely in the interests of another, which is the norm that Cromwell J wrote about in *Galambos*; or equity, in an objective assessment of the parties' arrangements or a party's unilateral acts (viz *Soar v Ashwell* and the other cases in paras 87 and 88 above), may treat a party as if he or she had so undertaken and for that reason recognise a fiduciary duty of loyalty and impose the no profit and no conflict rules which protect it. In the latter case, there must be circumstances in the relationship between the parties, and in particular arising out of the conduct of the supposed fiduciary, which make it appropriate for equity to treat the parties as if such an undertaking had been given.

110 As a general rule, outside well-established fiduciary relationships, such as company director, partner, or agent, in a commercial context "it is normally inappropriate to expect a commercial party to subordinate its own interests to those of another commercial party": *Snell's Equity*, 35th ed (2025), para 7-007. We are not concerned here with one person's subjective trust and confidence in another in the other's performance of a contractual obligation; one may trust a plumber to do a job properly without the plumber becoming a fiduciary. The sales assistant in advising a customer on the attractiveness of a garment, or the wine waiter in advising the diner on the suitability of a wine with a meal, addresses the interests of the customer or diner without taking on a duty to act exclusively in the other's interests. He or she provides a commercial service in the interests of his or her employer, who may thereby come under contractual obligations and may incur vicarious liability for its employee's tortious acts. No obligation of loyalty, of which Millett LJ spoke in *Mothew*, arises. Such a commercial transaction or arrangement, in which one party has a personal financial interest, known or apparent to the other party, in bringing the transaction into fruition, is not one in which an undertaking of undivided loyalty and altruism can readily be implied into a contract or such a duty recognised by equity. It is against this background that we will assess the contention that the dealers owed fiduciary duties to their customers.

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(2) The tort of bribery

(i) Introduction

111 A generally accepted definition of a bribe is that stated by Slade J in *Industries & General Mortgage Co Ltd v Lewis* [1949] 2 All ER 573 ("*Industries & General*") at p 575:

> "For the purposes of the civil law a bribe means the payment of a secret commission, which only means (i) that the person making the payment makes it to the agent of the other person with whom he is dealing; (ii) that he makes it to that person knowing that that person is acting as the agent of the other person with whom he is dealing; and (iii) that he fails to disclose to the other person with whom he is dealing that he has made that payment to the person whom he knows to be the other person's agent."

112 This definition has been frequently cited and applied—see, for example, *Armagas Ltd v Mundogas SA (The Ocean Frost)* [1985] 1 Lloyd's Rep 1, 18 per Staughton J; *Petrotrade Inc v Smith* [2000] 1 Lloyd's Rep 486, para 16; *Fiona Trust & Holding Corpn v Privalov* [2010] EWHC 3199 (Comm) ("*Fiona Trust*"), para 70; *Novoship (UK) Ltd v Mikhaylyuk* [2012] EWHC 3586 (Comm) ("*Novoship*"), para 104 and *Conway v Eze* [2018] EWHC 29 (Ch), para 127.

(ii) The historical development of the tort

113 Bribery has been recognised as giving rise to a liability at common law and to common law rights and remedies since a trilogy of cases at the end of the 19th century: *Salford Corpn v Lever* [1891] 1 QB 168 ("*Salford*"); *Grant v Gold Exploration and Development Syndicate Ltd* [1900] 1 QB 233 ("*Grant*"); and *Hovenden & Sons v Millhoff* [1900–03] All ER Rep 848 ("*Hovenden*"). There are in addition two significant cases from the early and later parts of the 20th century: *In re A Debtor (No 229 of 1927)* [1927] 2 Ch 367 ("*In re A Debtor*") and *Mahesan s/o Thambiah v Malaysia Government Officers' Co-operative Housing Society Ltd* [1979] AC 374 ("*Mahesan*").

114 In *Salford*, the plaintiffs (Salford) were proprietors of gasworks. It was the duty of their manager (Hunter) to examine and advise on tenders for the supply of coal. The defendant coal merchant (Lever) agreed to pay Hunter one shilling per ton in respect of tenders recommended by him to and accepted by Salford. The tender prices were increased by that amount from the prices which would otherwise have been asked. Hunter advised Salford to accept the tenders, which they did. On discovery of the secret commission or bribe paid to Hunter, Salford brought claims against him which were settled in return for his assistance in relation to actions brought against suppliers, including Lever.

115 Salford then brought a claim against Lever, put alternatively on the basis of (1) damages for fraud or (2) payment of the amount of the bribes as money had and received by Lever to Salford's use. Lord Esher MR accepted that there had been fraud, which he described as follows (p 175):

> "The fraud was this, that the defendant allowed and assisted the agent of the corporation to put down a false figure as the price of the coals in

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A order to cheat the corporation out of a shilling a ton, which was to be paid to their own agent . . . The damage to the corporation is clearly the 1s per ton out of which they have been cheated, neither more nor less . . . they are entitled to sue the defendant for the 1s a ton in one form of action or another, although he has parted with the money, and has handed it over to his confederate Hunter, because it was once in his hands, and he is
B liable for the fraud to which he was thus a party."

In those circumstances, Lord Esher MR considered that the form of the action was immaterial: Salford was "entitled to sue the defendant for the 1s a ton in one form of action or another" (p 175). Lindley LJ considered it "obvious that in some form of action the corporation have a right to recover this shilling a ton from the coal merchants. Under the old practice I think
C they could have recovered it by an action for money had and received; probably they could have recovered it in more ways than one" (p 179). He went on to refer to Lever's "liability to account to the corporation for the money received by him", and described the claim as being "an action by the defrauded principals against the man who has defrauded them, and bribed their agent, to recover for themselves what they can of the money of which
D they have been defrauded" (p 180). Lopes LJ described the claim against the briber as being "to recover the excess of price which he obtained through his fraud" (p 181). He expressed his agreement with the judgment below of Charles and Denman JJ, who held that the plaintiffs were entitled to recover the excess price which the defendant had received over the market price, "either as damages for the fraud he had committed . . . or . . . as money received for the plaintiffs' use": (1890) 25 QBD 363, 372.

E **116** The Court of Appeal also expressed the opinion that Salford's claim against Lever would not be reduced by the recovery of the bribe from Hunter. As it was summarised in the headnote:

> "Where an agent, who has been bribed so to do, induces his principal to enter into a contract with the person who has paid the bribe, and the contract is disadvantageous to the principal, the principal has two distinct
F and cumulative remedies: he may recover from the agent the amount of the bribe which he has received, and he may also recover from the agent and the person who has paid the bribe, jointly or severally, damages for any loss which he has sustained by reason of his having entered into the contract, *without allowing any deduction in respect of what he has recovered from the agent under the former head*, and it is immaterial
G whether the principal sues the agent or the third person first." (Emphasis added.)

117 In *Grant*, the plaintiff (Grant) was the owner of a mine and agreed to pay a 10% commission to Govan if he could find a purchaser for the mine. Govan found a purchaser ("the Syndicate"). He was the managing director of the Syndicate, a fact known to Grant before the purchase was concluded.
H The court held that the Syndicate was entitled to recover the amount of the commission from Grant. A L Smith LJ held that this could be recovered as "damages for deceit" but added that he was "by no means prepared to hold that an action for money had and received would not lie" (p 245). Collins LJ held that Grant was liable "for money had and received" and said that

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"possibly he could not be made liable in an action of deceit" (p 249). He stated:

> "The facts are, then, that the vendor and the buyers' agent, known to the vendor to be such, agree upon a price to be paid by the purchaser, one-tenth of which is to go into the pocket of the buyers' agent. To put it in plain language, it is a bribe, and the purchase-money is made large enough to include it . . .
>
> ". . .
>
> ". . . where the buyer . . . can . . . point to a specific sum over and above what must be taken as between the parties to be the real price, which has found its way into the vendor's pocket as a result of a sale so effected, he is entitled to recover it back. When the sum is thus liquidated, and in the hands of the vendor, I think it would be clearly contra aequum et bonum that he should retain it . . . he is in possession of a sum which, whether the bargain stands or is rescinded, never ought to have been paid by the buyer, or found its way into the pocket of the seller. He is responsible as for money had and received to the use of the buyer . . . ." (pp 247, 249)

Vaughan Williams LJ held that the commission could be recovered in an action for damages and doubted that an action for money had and received would lie (p 256).

118 In *Hovenden*, the plaintiff ("Hovenden") had for many years purchased cigars and cigarettes from the defendant (Millhoff). These purchases, totalling £28,000, had been made on the recommendation of the plaintiff's buyers. It was discovered that the defendant had been paying 2.5% of the invoice price to the buyers in respect of the purchases, totalling £700. The plaintiff brought a claim for payment of the amount of all fraudulent overcharges, and for damages. At trial, the jury found that the prices paid for the purchases were not excessive, and damages were assessed at one farthing. On appeal, it was held that this secret commission or bribe could be recovered from the defendant as money had and received.

119 A L Smith LJ held that:

> "It seems to me clear from the judgments in *Salford Corpn v Lever* and in *Grant v Gold Exploration and Development Syndicate, Ltd* that, inasmuch as the amount of the bribes has been quantified, it can be recovered as money had and received . . . If a vendor bribes a purchaser's agent, of course the purchase money is loaded by the amount of the bribe. It cannot be denied. In this case the purchase money was 28,000 pounds, in which was included the 700 pounds given to the purchasers' agents. Of course the vendor would have sold the goods for 28,000 pounds less 700 pounds; therefore, he has in his pocket 700 pounds, money of the purchasers. That 700 pounds he must disgorge. That is the cause of action here . . . When it was proved at the trial that the bribes had been paid, the direction to the jury ought to have been that the amount which could be recovered as money had and received was the amount of the bribes." (p 850)

120 Vaughan Williams LJ agreed, and observed that he "used to think that the action against the briber was an action of fraud sounding in

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damages", but that the judges in *Salford* "did not hold out much encouragement to me in that view" and that Collins LJ in *Grant* had taken the other view (p 850). He held that the amount in issue was quantified and concluded that "the same amount is recoverable whether the action is on an indebitatus count or in damages" (p 851): that is to say, whether the action was based on an obligation to make restitution of the amount which the briber had received as a result of his wrongful act, or was based on an obligation to compensate the principal for the loss he had suffered as a result of the briber's wrongful act.

121 Romer LJ did not address the nature of the cause of action, although he contemplated that an action for damages could be brought against the briber and stated that if it is alleged that there is loss and damage beyond the bribe, it must be proved. He stated that the following constitutes a bribe (at p 851):

> "If a gift be made to a confidential agent with the view of inducing the agent to act in favour of the donor in relation to transactions between the donor and the agent's principal and that gift is secret as between the donor and the agent—that is to say, without the knowledge and consent of the principal—then the gift is a bribe in the view of the law."

122 Romer LJ went on to say that if a bribe is proved then the following rules applied "in the interests of morality with the view of discouraging the practice of bribery" (p 851):

> "First, the court will not inquire into the donor's motive in giving the bribe, nor allow evidence to be gone into as to the motive. Secondly, the court will presume in favour of the principal and as against the briber and the agent bribed, that the agent was influenced by the bribe; and this presumption is irrebuttable. Thirdly, if the agent be a confidential buyer of goods for his principal from the briber, the court will assume as against the briber that the true price of the goods as between him and the purchaser must be taken to be less than the price paid to, or charged by, the vendor by, at any rate, the amount or value of the bribe. If the purchaser alleges loss or damage beyond this, he must prove it. As to the above assumption, we need not determine now whether it could in any case be rebutted. As at present advised, I think that, in the interests of morality, the assumption should be held an irrebuttable one; but we need not finally decide this, because in the present case there is nothing to rebut the presumption."

123 Although Romer LJ cited no authority for these rules, each of them was supported by earlier decisions. Several earlier authorities made clear that the court was unwilling to inquire into the briber's motives, and that secret payments to the agent of the other party to a transaction are in any event objectionable not because of the motive with which they are given but because of their objective effect on the agent. In *Panama and South Pacific Telegraph Co v India Rubber, Gutta Percha and Telegraph Works Co* (1875) LR 10 Ch App 515 ("*Panama*") James LJ said at p 527 that "in this court a surreptitious sub-contract with the agent is regarded as a bribe to him for violating or neglecting his duty". He added that this was "a plain principle of equity which is to be enforced without regard to the particular

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circumstances of the case . . . you must act on general principles, without regard to the particular facts or the particular conduct or misconduct of the parties in a particular case. You must act upon the general principle from the impossibility which the court finds itself in of ever ascertaining the real truth of the circumstances". In *Barry v Stoney Point Canning Co* (1917) 36 DLR 326, 343, Anglin J observed: "Moreover, by whatever sophistry the person who promises the secret benefit may endeavour to persuade himself to the contrary, the instances are rare indeed in which in his inmost heart he does not hope to derive some advantage from it, direct or indirect, which from the nature of the case must involve a dereliction of duty by the agent to his own principal."

124 As to the irrelevance of an inquiry into the actual effect of the bribe upon the agent's behaviour, the courts have long proceeded on the basis that the agreement between the briber and the agent "is a corrupt one, and is not enforcible at law, whatever the actual effect produced on the mind of the person bribed may be. The tendency of such an agreement as this must be to bias the mind of the agent or other person employed, and to lead him to act disloyally to his principal": *Harrington v Victoria Graving Dock Co* (1878) 3 QBD 549, 551 per Cockburn CJ. Mellor J observed in the same case at pp 551–552 that "It would be most fatal if it were open to a person, who had entered into an agreement that he knew was designed to induce him to act unfaithfully to his employers, to allege that it had not in fact had that effect". The same reasoning was applied in relation to the briber in *Shipway v Broadwood* [1899] 1 QB 369, where the Court of Appeal rejected an argument that it was necessary to inquire whether the agent's mind had been influenced by the bribe. Chitty LJ stated at p 373:

> "Directly it is established that money was paid or promised to the agent of the other party, it is quite unnecessary to go further and see what effect that had on the mind of the person to whom it was paid or to be paid . . . I wish to state again emphatically that in such a case as this it is an immaterial inquiry to what extent the bribe or the offer of it influenced the person to whom it was given or offered. A contrary doctrine would be most dangerous, for it would be almost impossible to ascertain what had been the effect of the bribe."

125 In relation to the third rule, namely the assumption that the price paid by the principal was inflated by the value of the bribe, Romer LJ's approach was consistent with *Salford* and *Grant*.

126 As was noted in *Industries & General* at pp 576–577, the implication of the first of Romer LJ's rules is that motive does not have to be established in order for a payment to be regarded as a bribe, contrary to the impression which might otherwise have been conveyed by Romer LJ's definition of a bribe: "a gift . . . made to a confidential agent with the view of inducing the agent to act in favour of the donor in relation to transactions between the donor and the agent's principal . . . without the knowledge and consent of the principal". The essential elements of a bribe, as laid down in Romer LJ's judgment, are accordingly that it is a payment made by a person to the agent of the other party to a transaction, without that party's knowledge and consent. Although not mentioned by Romer LJ, it is also necessary that the briber should know that the recipient of the payment is

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A acting on behalf of that other party, as appears from the judgments of A L Smith and Collins LJJ in *Grant* at pp 240–241 and 246–247 respectively, and, more recently, the judgment of Slade J in *Industries & General* at p 575 (cited at para 111 above), and that of Millett J in *Logicrose Ltd v Southend United Football Club Ltd* [1988] 1 WLR 1256 ("*Logicrose*"), at p 1261.

127 We should add that, although both Romer LJ in *Hovenden* and
B Slade J in *Industries & General* couched their definitions of bribery in the language of agency, some of the leading cases in this area of the law were not concerned with agents, as will appear, but with other kinds of fiduciary. Accordingly, it should not be thought that a relationship of agent and principal is an essential element.

128 The case of *In re A Debtor* is also of some importance. The debtor employed an agent to negotiate a loan with a moneylender. The
C moneylender agreed to lend money to the debtor, and paid the agent a commission which was not revealed to the debtor. The moneylender subsequently obtained judgment against the debtor for the amount of the loan, and presented a petition for his bankruptcy. On the hearing of the petition the debtor learned about the commission. The Court of Appeal held that the debtor "had a right to set aside the contract as voidable" (per Lord
D Hanworth MR at p 374), with the consequence that the moneylender could not prove the debt on which his petition was founded. Lord Hanworth MR rejected a submission based on the absence of evidence as to the motive with which the commission was paid, or the effect which it had on the agent's behaviour, stating (p 373) that "it seems to me, following *Shipway v Broadwood*, that if a sum is offered by the money-lender to the borrower's
E agent, it can only be accepted with the knowledge and assent of the borrower".

129 In the leading Privy Council case of *Mahesan* Lord Diplock examined the case law in its historical setting. In relation to *Salford*, Lord Diplock disapproved the opinions expressed in that case that the amount recoverable from the briber was not diminished by the recovery of the bribe from the bribee, encapsulated in the passage in the headnote which was
F placed in italics in para 116 above. Lord Diplock stated that "fraud is a tort for which the damages are limited to the actual loss sustained; and if the principal has recovered the bribe from the bribed agent the actual loss he has sustained in consequence of entering into the contract is reduced by that amount" (p 381). Since the claim was for damages the amount recoverable depended on the actual loss suffered: "Damage is the gist of an action in
G fraud and any loss proved to have been sustained by the principal in consequence of entering into the contract in respect of which the bribe was given might be less or greater than the amount of the bribe" (p 382).

130 In relation to *Hovenden*, Lord Diplock stated that the judgment of Romer LJ in that case laid down three rules which "have the effect of making bribery a wrong committed by the principal which is sui generis and defies classification" (p 383). These were that (1) "the motive of the briber in
H giving the bribe is not relevant"; (2) "there is an irrebuttable presumption that the agent was influenced by the bribe"; and (3) as against the briber loss up to the amount of the bribe is to be irrebuttably presumed (p 383). It is to be noted that although Romer LJ favoured there being such an irrebuttable presumption, he did not so determine.

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131 Lord Diplock said that these rules are "merely another way of saying that they form no part of the definition of bribery as a legal wrong" (p 383) and that:

> "Upon analysis, what these rules really describe is the right of a plaintiff who has alternative remedies against the briber (1) to recover from him the amount of the bribe as money had and received, or (2) to recover, as damages for tort, the actual loss which he has sustained as a result of entering into the transaction in respect of which the bribe was given; but in accordance with the decision of the House of Lords in *United Australia Ltd v Barclays Bank Ltd* [1941] AC 1 he need not elect between these alternatives before the time has come for judgment to be entered in his favour in one or other of them." (p 383)

In relation to the latter part of that dictum, it should be noted that *United Australia Ltd v Barclays Bank Ltd* [1941] AC 1 establishes that a claimant does not have to "elect" between alternative remedies, for money had and received and for damages, in the same sense in which it is necessary to elect between inconsistent rights (e g to affirm a contract induced by fraud or to avoid it): see, for example, per Lord Atkin at pp 29–30. The alternative remedies can be sought together, as they were in the *Salford* and *Hovenden* cases, but judgment can be obtained only for one or the other.

132 Lord Diplock observed that this "extension to the briber of liability to account to the principal for the amount of the bribe as money had and received" raised "conceptual difficulties" but that it "is now, and was by 1956 [the relevant date for the purpose of forming part of the law of Malaysia], too well established in English law to be questioned" (p 383). We will return at a later point to the question whether there are conceptual difficulties. He concluded (ibid):

> "So both as against the briber and the agent bribed the principal has these alternative remedies: (1) for money had and received under which he can recover the amount of the bribe as money had and received or, (2) for damages for fraud, under which he can recover the amount of the actual loss sustained in consequence of his entering into the transaction in respect of which the bribe was given, but he cannot recover both."

133 The Privy Council's decision accordingly confirmed that (1) bribery is a civil wrong; (2) it is subject to three rules which make it sui generis; and (3) the principal has alternative remedies against the briber and the agent bribed (a) for recovery of the amount of the bribe as money had and received or (b) for damages in tort for the actual loss sustained. Lord Diplock also noted that, where the bribe was given in connection with a contract between the principal and the briber, the principal has an "equitable right" to rescission of the contract on the basis that the giving of the bribe is treated in equity as constructive fraud (p 380). This had been long established—see, for example, *Panama*.

134 Since *Mahesan* the civil wrong of bribery has been recognised in a number of cases. Notable examples, in addition to those referred to in para 112 above, include *Armagas Ltd v Mundogas SA (The Ocean Frost)* [1986] AC 717 ("*Armagas*"), where Robert Goff LJ stated at p 743 that "It is now established that the claim against the briber for damages . . . should be

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regarded as a claim in damages in tort"; *Logicrose*; *Anangel Atlas Cia Naviera SA v Ishikawajima-Harima Heavy Industries Co Ltd* [1990] 1 Lloyd's Rep 167 ("*Ananagel*"); *Arab Monetary Fund v Hashim* [1993] 1 Lloyd's Rep 543; *Fyffes Group Ltd v Templeman* [2000] 2 Lloyd's Rep 643; *Daraydan Holdings Ltd v Solland International Ltd* [2005] Ch 119 ("*Daraydan*"); *Hurstanger*; *Ross River Ltd v Cambridge City Football Club Ltd* [2008] 1 All ER 1004; *Otkritie International Investment Management Ltd v Urumov* [2014] EWHC 191 (Comm); *Al Nehayan*; *Conway v Eze* [2019] EWCA Civ 88; and *Wood*. In the decision of this court in *Republic of Mozambique v Privinvest Shipbuilding SAL (Holding)* [2023] Bus LR 1359 ("*Mozambique*") Lord Hodge DPSC set out the "components of a claim for bribery", drawing on the summary provided by Christopher Clarke J in *Novoship* at paras 104–111.

135 In recent times the civil wrong of bribery has been described as a tort. This language was apparently first used in *Fiona Trust* and is now commonly adopted. Both parties so referred to it in this case. In *Clerk and Lindsell on Torts*, 24th ed (2023), paras 17-63 to 17-64, bribery is described as giving rise to a "tortious liability". In Thomas Grant and David Mumford eds, *Civil Fraud* (2018) it is described and discussed as a "freestanding tort" at paras 7-013 to 7-015. Referring to bribery as a distinct civil wrong is helpful in two respects. First, although bribery has been treated in many of the authorities as a type of fraud, it differs from other types of fraud in that there need not be any representation made to the principal by either the payer of the bribe or its recipient, or any reliance on such a representation by the principal. Secondly, there is no requirement to prove dishonesty on the part of either the payer or the recipient of the bribe.

136 English law has long recognised the need to adopt a strict and deterrent approach to bribery. In *Parker v McKenna* (1874) LR 10 Ch App 96, 125 James LJ described the prevention of bribery as vital "for the safety of mankind". In *Boston Deep Sea Fishing and Ice Co v Ansell* (1888) 39 Ch D 339 ("*Ansell*") Bowen LJ stated at p 362:

> "This is an age, I may say, when a large portion of the commercial world makes its livelihood by earning, and by earning honestly, agency commission on sales or other transactions, but it is also a time when a large portion of those who move within the ambit of the commercial world, earn, I am afraid, commission dishonestly by taking commissions not merely from their masters, but from the other parties with whom their master is negotiating, and with whom they are dealing on behalf of their master, and taking such commissions without the knowledge of their master or principal. There never, therefore, was a time in the history of our law when it was more essential that Courts of Justice should draw with precision and firmness the line of demarcation which prevails between commissions which may be honestly received and kept, and commissions taken behind the master's back, and in fraud of the master."

In *Hovenden* Romer LJ observed at p 851:

> "The courts of law of this country have always strongly condemned and, when they could, punished the bribing of agents, and have taken a strong view as to what constitutes a bribe. I believe the mercantile

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community as a whole appreciate and approve of the court's views on the subject."

137 This remains equally true today. Lord Templeman, giving the decision of the Privy Council in *Attorney General for Hong Kong v Reid*, stated at p 330 that "Bribery is an evil practice which threatens the foundations of any civilised society". Lord Neuberger of Abbotsbury PSC in *FHR* said at para 42:

"Secret commissions are also objectionable as they inevitably tend to undermine trust in the commercial world. That has always been true, but concern about bribery and corruption generally has never been greater than it is now: see for instance, internationally, the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions 1999 and the United Nations Convention against Corruption 2003, and, nationally, the Bribery Acts 2010 and 2012. Accordingly, one would expect the law to be particularly stringent in relation to a claim against an agent who has received a bribe or secret commission."

138 More recently still, in *Wood* David Richards LJ observed at para 42:

"The law, reflecting the views of society, has for a very long time set its face against bribery as a corrosive practice, which undermines the country's social, economic and commercial values and well-being."

(iii) Should the tort of bribery be abolished?

139 Mr Rabinowitz developed an interesting, if bold, argument that the development of the tort of bribery involved the law taking a wrong turn and that it should be abolished. In summary, he submitted as follows:

(1) The common law claim for recovery of a bribe from a bribed agent is for money had and received—see *Morison v Thompson* (1874) LR 9 QB 480 and *Ansell*. This involved treating the recipient of the bribe as (or as analogous to) a trustee in respect of the money on the footing that they were obliged immediately to pay it over to the principal. It is based on the fiduciary no profit rule. This demonstrates that the existence of a fiduciary duty of loyalty is fundamental to the claim.

(2) The common law claim for recovery of a bribe from the briber is also for money had and received—see *Mahesan*. Lord Diplock rightly recognised that this raises "conceptual difficulties". These include the absence of any recognised unjust factor and that the claim is only available if the contract is affirmed, which is contrary to the basic principle that payments made under a contract cannot constitute unjust enrichment unless the contract is set aside.

(3) The common law right to rescission for bribery is founded on the procurement of a breach of the no conflict rule.

"A principal is entitled to the disinterested advice of his agent free from the potentially corrupting influence of an interest of his own. Any such private interest, whether actual or contemplated, which is not known and consented to by his principal, disqualifies him . . . The principal, having

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A been deprived by the other party to the transaction of the disinterested advice of his agent, is entitled to a further opportunity to consider whether it is in his interests to affirm it"—per Millett J in *Logicrose* at pp 1260–1261.

Again, the existence of a fiduciary duty of loyalty is fundamental to the claim.

B (4) There is no tort of procuring a breach of fiduciary duty. It is unprincipled that tortious liability should arise where such a breach is procured by one particular mechanism (a bribe) but not otherwise.

(5) It is anomalous and unprincipled for there to be tortious liability without the need to prove improper motive, inducement or actual loss (i e the three rules stated by Romer LJ in *Hovenden* and accepted in
C *Mahesan*).

(6) The strict rules of equity and its armoury of remedies provide all necessary protection. The payer of the bribe will almost invariably be liable for dishonest assistance. The recipient of the bribe will be liable on a personal and proprietary basis to the principal. There is a right to rescind in equity.

(7) The common law of bribery grew out of equitable rules and is rooted
D in the existence of fiduciary duties. It serves similar purposes to those equitable rules. Equitable remedies meet those purposes. There is no need for this anomalous, unprincipled and conceptually confused tort.

140 We reject Mr Rabinowitz's argument for a number of reasons.

141 First, although it has only recently been described as a tort, common law liability and remedies for the civil wrong of bribery are long
E established. They date back to the trilogy of Court of Appeal cases at the end of the 19th century. In 1979 *Mahesan* confirmed the law as there stated. Lord Diplock said that by 1956 the law was "too well established . . . to be questioned". That is all the more so now, nearly 70 years on from 1956.

142 Secondly, since *Mahesan* the common law wrong of bribery has become even more established not merely by the passage of time but also by the large number of cases in which it has been recognised and applied, as
F illustrated by the authorities referred to in paras 112 and 134 above.

143 Thirdly, the common law wrong of bribery was recognised by the House of Lords in *Reading v Attorney General* [1951] AC 507 and by the Supreme Court in *Mozambique*.

144 Fourthly, the argument in favour of abolition is largely based on the grounds that the tort is unprincipled and anomalous. In general, the
G circumstances in which it will be appropriate for this court to depart from long-established law are similar to those in which it will depart from a previous House of Lords or Supreme Court decision under the 1966 Practice Statement. This is usually only where the proper development of the law has been impeded or where the existing law has led to results which are unjust or contrary to public policy. There is no such suggestion in this case.

145 Fifthly, the reasons for the law's strict approach to bribery are as
H relevant today as they were at the end of the 19th century, if not more so—see, for example, Lord Neuberger PSC's comments in *FHR* cited in para 137 above.

146 Sixthly, the strict approach of the law is reinforced by the stricter remedies available at law, including, in particular, a right to rescind without

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the need for an order of the court and the right to recover the amount of the bribe without the need to prove loss.

147 Seventhly, the law recognises the fundamental role of the briber in a way that equity does not. At law the briber is a primary wrongdoer. In equity, the briber can only be made liable as a dishonest accessory—see paras 74–76 above.

148 We do not in any event accept every aspect of the analysis on which Mr Rabinowitz's submissions were based. As to his first point, although the principal's claim against the agent for the recovery of the bribe is commonly based on the agent's duty to account for it in equity as an aspect of the fiduciary no profit rule, it can also be based on the law of restitution at common law, as is recognised by Mr Rabinowitz in relation to his second point. As Bowen LJ explained in *Ansell* at pp 367–368, "there is an implied contract, if you put it as a legal proposition—there is an equitable right, if you treat it as a matter of equity—as between the principal and agent that the agent should pay it over, which renders the agent liable to be sued for money had and received" (the reference to implied contract reflecting the way in which restitutionary claims were understood at that time). The same point was made in *Reading v Attorney General*, as explained at para 175 below.

149 As to Mr Rabinowitz's second point, the principal's claim against the briber in restitution is based on the fact that the briber is presumed to have inflated the price paid by the principal by the amount of the bribe, and is not entitled to retain this overpayment. This was explained, for example by Lord Esher MR in *Salford* at p 177 ("The third person was bound to pay back the extra price which he had received"); by Collins LJ in *Grant* at p 249 ("where the buyer elects not to rescind the sale, but can nevertheless point to a specific sum over and above what must be taken as between the parties to be the real price, which has found its way into the vendor's pocket as a result of a sale so effected, he is entitled to recover it back"); and by all the members of the Court of Appeal in *Hovenden*. A L Smith LJ said in that case at p 850, "If a vendor bribes a purchaser's agent, of course the purchase money is loaded by the amount of the bribe". In the words of Romer LJ at p 851, "the court will assume as against the briber that the true price of the goods as between him and the purchaser must be taken to be less than the price paid to, or charged by, the vendor by, at any rate, the amount or value of the bribe".

150 The presumption that the briber inflated the price paid by the principal by the amount of the bribe is a special aspect of the law relating to bribery, but the legal basis of the principal's claim to recover the overpayment is conventional. As Lord Atkin explained in *United Australia Ltd v Barclays Bank Ltd* at pp 26–28, a claim to restitution has long lain in cases where the defendant has received money of the claimant to which he is not entitled, such as cases where the claimant has been deceived into paying money to the defendant. In cases where the money has been received as the result of a tortious wrong, the claimant has two alternative remedies available: one, for the recovery of the money in the possession of the defendant; and the other, for damages for the relevant tort. The cases discussed earlier, from *Salford* to *Mahesan*, have applied that established approach in the context of bribery. Hence Lord Diplock's statement in the

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A latter case at p 383 that the principal has two alternative remedies against the briber: (1) to recover the amount of the bribe, as an amount which the defendant is presumed to have wrongfully received from him, and (2) for damages for tort, under which he can recover the actual loss which he has sustained. There is no need in this context to establish an "unjust factor" such as mistake of law or failure of consideration, as in the cases on which B Mr Rabinowitz relied. The claim in restitution lies because the briber obtained the value of the bribe from the principal by committing a wrong.

151 As to Mr Rabinowitz's third and fourth points, the right to rescission at common law in cases of bribery is founded on fraud, as has been understood since at least *Smith v Sorby (Note)* (1875) 3 QBD 552, the decision in which is summarised in the headnote:

C "Where a secret gratuity is given to an agent with the intention of influencing his mind in favour of the giver of the gratuity, and the agent, on subsequently entering into a contract with such giver on behalf of his principal, is actually influenced by the gratuity in assenting to stipulations prejudicial to the interests of his principal, although the gratuity was not given directly with relation to such particular contract, the transaction is fraudulent as against the principal, and the contract is voidable at his D option."

152 As we have explained, subsequent decisions, such as *Harrington v Victoria Graving Dock Co* (para 124 above) and *Hovenden* have established that it is unnecessary to establish either the intention with which the payment was made or the effect which it had on the mind of the agent. The inference that the resulting transaction was induced by fraud, with the consequence E that it is therefore voidable at the option of the principal, is supported by the reasoning in such cases as *Salford*, where all the members of the Court of Appeal described the claim by the principal against the briber as being founded on fraud (see per Lord Esher MR at p 174, per Lindley LJ at p 180 and per Lopes LJ at p 181) and *Grant*, where A L Smith LJ also referred to fraud at pp 242, 244. In *In re A Debtor* Scrutton LJ explained at pp 376–377 F that it is on the basis of a presumption of fraud that the transaction between the principal and the briber is voidable at common law, and the principal is therefore entitled to rescind it:

"A man who is the agent of A in a transaction between A and B, and who also acts secretly for B in the same transaction, is presumed to act corruptly. Common law authorities require the court to hold that that is a G corrupt practice, and, in my opinion, the court ought to presume fraud in such circumstances . . . What then is the effect of that? It was argued that . . . the contract was wholly void . . . but I cannot agree with that contention. If the contract is voidable only it gives the innocent party a right to rescind."

153 As to Mr Rabinowitz's fifth point, the rules applied in this H context are neither anomalous nor unprincipled. Their background in long-established authority has been explained. Their practical justification is the need to deter bribery. The consequences of making an undisclosed payment to the agent of the other party to a transaction are designedly draconian, so as to deter behaviour which is destructive of commercial relations.

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154 As to the irrelevance of motive, the principle was most clearly explained by Anglin J in *Barry v Stoney Point Canning Co* at p 342:

> "The result to the agent's principal is the same whatever the motive which induced the other principal to promise the commission. The former is deprived of the services of an agent free from the bias of an influence conflicting with his duty, for which he had contracted and to which he was entitled."

155 As to the presumption that the value of the bribe is reflected in the consideration received by the briber, the bribe is evidently a cost borne by the briber, which he can generally be expected to recover through the prices which he charges, as was explained in *Hovenden*. The practical justification for the presumption is that it enables the principal to recover in a situation in which it might be difficult for him to prove any loss. The law can be expected to operate more effectively in achieving the objective of deterring bribery if the presumption laid down by Romer LJ is applied.

156 As to Mr Rabinowitz's sixth and seventh points, we refer to paras 146–147 above.

(iv) What duty relationship engages the tort of bribery?

(a) Introduction

157 The Court of Appeal proceeded in this case on the basis that it was unnecessary, in order for liability for bribery to arise at common law, that the recipient of the payment should owe a fiduciary duty to the claimant. The decision in *Wood* was treated as having established a less demanding requirement, namely that the recipient must owe the claimant a duty to provide information, advice or recommendations on a disinterested basis. Where that test was satisfied, and there had been no disclosure of the payment, common law remedies were available. Where, however, there had been partial disclosure of the payment, then following *Hurstanger* no remedy would lie at common law. Equitable remedies were available in principle where disclosure of the payment had been less than complete, but only if the recipient had been under a fiduciary duty: the duty to act disinterestedly would not suffice.

158 The result of the Court of Appeal's analysis, therefore, is that the common law and equity impose different requirements in order for remedies to be available in respect of bribery, both in terms of the nature of the duty owed by the recipient of the payment, and in terms of the disclosure required in order to avoid liability. In this section of our judgment we will consider the first of these matters: the nature of the duty required in order for liability for bribery to arise under the common law. In the next section we will consider the question of disclosure.

159 On this appeal, it is argued on behalf of the appellants that as a matter of principle, history, and authority, liability for bribery cannot arise unless the recipient of the benefit owed a fiduciary duty of loyalty to the claimant. The remedies for bribery, it is submitted, can be rationalised only as a response to that duty of loyalty and the no profit and no conflict rules inherent in it. The Court of Appeal was wrong to conclude otherwise, treating its decision in *Wood* as having recognised a novel "disinterested duty" as the basis for liability as distinct from a fiduciary duty. Properly

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A understood, it is argued, that is not the effect of *Wood*; but, if it is, then *Wood* was wrongly reasoned.

160 On behalf of the respondents, it is submitted that for the purpose of the tort of bribery, where a person adopts a role in the decision-making of another, the court imposes on that person the "disinterested duty" described in *Wood* at para 102: that is to say, "a duty to be impartial and to
B give disinterested advice, information or recommendations". This is the common law analogue of the equitable fiduciary duty. The duty is imposed, it is argued, where a person performs a role in another person's decision-making process by exercising judgement or discretion in relation to the interests and affairs of that other person, as explained by Christopher Clarke J in *Novoship*, para 108.

C (b) Fiduciary relationships

161 There is nothing inherently objectionable about paying commission, or about seeking to influence people's behaviour by giving them benefits of one kind or another. The position is different where the recipient is a fiduciary and the payment breaches the no conflict rule, as Dr Finn explained in *Fiduciary Obligations* (40th Anniversary Republication, 2016),
D para 505:

> "The second quality of a bribe is that it be given to a person in a fiduciary position . . . The reason for this requirement of a fiduciary relationship in this context is not hard to find. The payment of money or money's worth to a person to secure influence or the showing of favour is not necessarily improper per se. Where, however, the recipient of the
E payment has undertaken to act for another and the payment is made to him in that capacity, it can create an interest antagonistic to the proper performance of that undertaking. It is the creation of an antagonistic interest—an interest which could tempt the fiduciary to act otherwise than in good faith with his beneficiary—that is at the root of the second characteristic of a bribe."

F 162 That analysis is supported by a body of authority. We have already cited some of the older authorities, such as *Panama*, *Shipway v Broadwood* and *Grant*. More recently, Lord Templeman, giving the judgment of the Board in *Attorney General for Hong Kong v Reid* (a case concerned with a Crown prosecutor), treated the breach of the no conflict rule applicable to fiduciaries as a defining characteristic of a bribe (p 330): "A bribe is a gift
G accepted by a fiduciary as an inducement to him to betray his trust." The same point was also made by Millett J in *Logicrose*, when discussing the equitable right to rescission of a contract where the claimant's agent has obtained a bribe (p 1260):

> "The remedy is not confined to cases where the agent has taken a bribe or secret commission in the strictest sense. It is available whenever,
H without his principal's knowledge and consent, the agent has put himself in a position where his interest and duty may conflict. A principal is entitled to the disinterested advice of his agent free from the potentially corrupting influence of an interest of his own. Any such private interest, whether actual or contemplated, which is not known and consented to by

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> his principal, disqualifies him . . . The principal, having been deprived by the other party to the transaction of the disinterested advice of his agent, is entitled to a further opportunity to consider whether it is in his interests to affirm it."

Similarly, in *Daraydan* Lawrence Collins J said (para 52):

> "An agent should not put himself in a position where his duty and interest may conflict, and if bribes are taken by an agent, the principal is deprived of the disinterested advice of the agent, to which the principal is entitled."

As the judge had made clear in the preceding paragraph, his remarks applied to other fiduciaries as well as to agents.

163 More recent authorities are consistent with this view. In *UBS AG v Kommunale Wasserwerke Leipzig GmbH* [2017] 2 Lloyd's Rep 621 ("*UBS*") Lord Briggs JSC and Hamblen LJ, after discussing some of the leading cases on bribery, including *Panama*, *Shipway v Broadwood* and *Grant*, continued (para 112):

> "The mischief which the principle is aimed at preventing is the secret deprivation of the principal of the disinterested advice which he is entitled to expect from his fiduciary. The principal thinks he is getting the loyal and disinterested advice of his fiduciary when in truth he is not. This abuse may be achieved by a secret payment to the fiduciary by the other party to the contemplated transaction, but this is not the only way in which it can be achieved. The fiduciary may be disabled from giving disinterested advice by a multitude of surreptitious means."

164 A point which clearly emerges from *Logicrose*, *Daraydan* and *UBS* is that a fiduciary relationship can exist where the fiduciary is under a duty to give disinterested advice. Such a duty is compatible with the duty of loyalty described by Millett LJ in *Mothew* as the distinguishing obligation of a fiduciary, and by Lord Briggs in *Rukhadze* (para 2) as characteristic of a fiduciary relationship.

(c) The equitable origins of the common law of bribery

165 In our earlier discussion of the tort of bribery, we focused on the development of the common law from the late 19th century. However, the origins of the common law of bribery lie in equity, as Lord Diplock explained in *Mahesan* at p 380 and Robert Goff LJ noted in *Armagas* at p 743 (and as is discussed in detail in D Whayman, "Liability for Bribes and Secret Commissions at Common Law" (2022) 86 Conv 184, 186–191). The receipt of a bribe was objectionable in equity as a breach of the no conflict rule, as we have explained, and therefore as an equitable fraud, giving rise to an equitable right to rescission (and to other equitable remedies).

166 As Lord Diplock explained in *Mahesan* at p 381, the common law liability of the briber to the principal for the value of the bribe is a rational development from the principal's right in equity to rescission of the transaction entered into between them. If rescission were possible, the purchase price—presumed to be inflated by the value of the bribe, as we have explained—would be returned, enabling the principal to buy the goods or

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A services in the market, and leaving the principal with the value of the bribe (and possibly more). This is the amount which the principal can recover from the briber at common law, together with any consequential losses.

(d) The authorities prior to *Wood*

167 We turn next to some of the authorities through which the tort of
B bribery has developed. Most of them, such as *Grant* and *Mahesan*, have concerned well-established categories of fiduciary relationship, such as agent and principal, or director and company. However, a fiduciary obligation can also arise outside those categories, as we have explained. It is necessary to focus here particularly on the cases considered in *Wood*.

168 We will begin with *Panama*. The plaintiffs had engaged an engineer
C to inspect the cables laid for them by the defendants, and to certify that they had been laid in accordance with the contract between the parties. The defendants' right to payment under the contract depended on the issue of the certificates by the engineer. They then provided the engineer with a benefit in the form of a lucrative sub-contract. The plaintiffs successfully brought proceedings in equity for the rescission or termination of their contract with the defendants, and the recovery of the secret profits received by the
D engineer.

169 As to the nature of the relationship between the engineer and the plaintiffs, the report records that he was named in their prospectus as their engineer, and that he later resigned his position. The plaintiffs were described in the judgment of Malins VC at first instance as his "employers". He was described in the judgment of James LJ at p 526 as an agent, and at
E p 527 as a servant. He does not appear to have been authorised to enter into contracts on behalf of the plaintiffs, but his actions in issuing certificates altered their legal position in relation to the defendants, by satisfying the condition on which the defendants' contractual right to payment depended. He therefore satisfied the definition of an agent set out in *Bowstead and Reynolds on Agency*, 23rd ed (2024), para 1-001:

F
> "Agency is the fiduciary relationship which exists between two persons, one of whom expressly or impliedly manifests assent that the other should act on his behalf so as to affect his legal relations with third parties, and the other of whom similarly manifests assent so to act or so acts pursuant to the manifestation."

170 Perhaps more significantly, the engineer was acting in a capacity
G which involved his being trusted by the plaintiffs to carry out the inspection and certification of the defendants' work on their behalf, and being enabled by them to affect the course of business between them and the defendants. Mellish LJ stated that the defendants "must have known that the plaintiffs required honest and disinterested advice" and that it was "difficult to see any position more confidential" (p 528). He went on to say that the plaintiffs were "entirely at the mercy of their engineer" and "must entirely depend on
H the skill and disinterested advice of their engineer" (p 529). The relationship between the engineer and the plaintiffs had all the characteristics mentioned by Mason J in *Hospital Products* (para 94 above): the engineer undertook or agreed to act for or on behalf of or in the interests of the plaintiffs in the exercise of a power or discretion which would affect their interests in a legal

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or practical sense. Accordingly, the engineer was placed in a situation where equity recognised a fiduciary duty arising from his contractual obligations, and he could not place himself in a position where his duty and his interest might conflict. The engineer's acceptance of an undisclosed benefit from the defendants was objectionable because it created a conflict between his duty and his interest.

171 In *Shipway v Broadwood* a payment was made by the plaintiff to a veterinary surgeon who had been engaged by the defendant to inspect a pair of horses which the defendant had agreed to purchase from the plaintiff, subject to their being certified by the veterinary surgeon as sound. The facts were therefore analogous to those of the *Panama* case. The veterinary surgeon was described by Chitty and Collins LJJ at pp 372 and 373–374 respectively as an agent, and he satisfied the definition of agency given in *Bowstead and Reynolds* (para 169 above). As in *Panama*, he was acting in a capacity which enabled him to affect the course of business between his employer and the donor of a secret payment, and which involved his undertaking to his employer to perform his duty of inspection and certification on a disinterested basis. In those circumstances, equity recognised a fiduciary obligation arising from his contractual duties. His acceptance of an undisclosed payment from the plaintiff created a conflict between his duty and his interest, as Chitty LJ explained at p 373.

172 Turning next to the cases concerned with the common law, the facts of the *Salford* case were explained at para 114 above. The purchasing manager who accepted the payments from the defendant was described as the plaintiff's agent, per Lord Esher MR at pp 174–177, per Lindley LJ at p 180 and per Lopes LJ at p 181. It is not apparent from the report that he was an agent in a strict sense of the term, since he had no authority to alter the plaintiff's legal relations with third parties; and it may be that the term was being used in the sense that he was an employee. Nevertheless, as purchasing manager he was employed in a capacity which involved his advising the plaintiff in relation to tenders in its best interests, to the exclusion of his own interests. His situation was analogous to that of the engineer in *Panama* and the veterinary surgeon in *Shipway v Broadwood*. His acceptance of undisclosed payments from a tenderer created a conflict between his duty and his interest.

173 The facts of the *Grant* case were explained at para 117 above. The managing director who accepted the payment from the plaintiff was acting on behalf of the defendant in relation to the purchase, and was therefore its agent as well as its director. He was described as an agent, per A L Smith LJ at pp 239–240 and 242–243, per Collins LJ at pp 246–252 and per Vaughan Williams LJ at pp 252–255. He was plainly a fiduciary, as the court recognised. Collins LJ stated that the plaintiff dealt with "a person who was to stand in a fiduciary relation to the intended buyer, and who as such was debarred from receiving a commission from the vendor without disclosing the fact to such buyer" (p 246).

174 The facts of the *Hovenden* case were explained at para 118 above. The payments were made by the defendant to the buyers employed by the plaintiff to select and order products which it required. The position was accordingly similar to that in the *Salford* case, except that the buyers actually placed the orders on their employer's behalf, and were therefore agents in

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A the strictest sense. The buyers were described as agents by A L Smith LJ at pp 849–850, Vaughan Williams LJ at p 850 and Romer LJ at p 851. They were clearly fiduciaries.

175 The case of *Attorney General v Goddard* (1929) 98 LJ (KB) 743 concerned a police officer whose duty was to keep premises suspected of being used for unlawful purposes under observation. In return for bribes, he B submitted false reports to his superiors. Proceedings were then brought against him by the Crown to recover the bribes. Rowlatt J considered that the officer's employment "seems to me to be properly described as creating a fiduciary relationship, not because he received into his hands any property of his employers or did not, but because he was under an obligation to use the information which he got for the purpose of his employer, certainly not to use it for his own profit" (p 745). The Crown was held to have an equitable C right to recover the bribes. As the Court of Appeal explained in *Reading v Attorney General* (reported as *Reading v The King*) [1949] 2 KB 232, 237, it also had a common law right to do so.

176 In *Reading v Attorney General* the plaintiff, a sergeant in the British Army, was paid bribes as a reward for sitting in his uniform in the front seat of lorries being used to transport contraband goods through Cairo during D the Second World War, so that they avoided being inspected by the Egyptian police. The Crown was held to have a right to restitution of the amount of the bribes.

177 In the Court of Appeal, Asquith LJ said at pp 236–237:

> "But the term 'fiduciary relation' in this connexion is used in a very loose, or at all events a very comprehensive, sense. A consideration of the E authorities suggests that for the present purpose a 'fiduciary relation' exists (a) whenever the plaintiff entrusts to the defendant property, including intangible property as, for instance, confidential information, and relies on the defendant to deal with such property for the benefit of the plaintiff or for purposes authorized by him, and not otherwise (for instance, *Shallcross v Oldham* (1862) 2 J & H 609, 616 and *Attorney* F *General v Goddard* [(1929)] 98 LJ (KB) 743) and (b) whenever the plaintiff entrusts to the defendant a job to be performed, for instance, the negotiation of a contract on his behalf or for his benefit, and relies on the defendant to procure for the plaintiff the best terms available (for instance, *Lister & Co v Stubbs* [1905] 1 KB 11 and *Powell Thomas v Even Jones* (1890) 45 Ch D 1).
>
> "In such cases the defendant may accept a secret profit from a third G person in consideration, for instance, of hiring out the plaintiff's chattel, or giving away the plaintiff's secret, or awarding the plaintiff's contract, to such a third person . . . If he does so, he is bringing his duty to the plaintiff and his own interest into conflict, in derogation of the fiduciary bond . . . ."

178 Asquith LJ's description (after "(a)") of the first type of H circumstance in which a fiduciary relation exists is "whenever the plaintiff entrusts to the defendant property, including intangible property as, for instance, confidential information, and relies on the defendant to deal with such property for the benefit of the plaintiff or for purposes authorized by him, and not otherwise". That is a description of a trust: a well-established

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category of fiduciary relationship. It covers the facts in *Reading v Attorney General* itself insofar as the sergeant was entrusted with property—the uniform—for the purposes of the Crown, and not for other purposes of his own. Asquith LJ's description also covers Rowlatt J's reasoning in *Attorney General v Goddard*, where the police officer was held to have made improper use of confidential information which he was obliged to use only for the purposes of his employer.

179 Asquith LJ referred to a loose or at least comprehensive usage of the term "fiduciary relation"; but it might be said, as it is in *Meagher, Gummow and Lehane's Equity: Doctrines and Remedies*, 5th ed (2014), para 5-150, that it is not altogether easy to see why that disclaimer was necessary. The explanation of his comment, and of the similar remark by Lord Porter in the House of Lords (mentioned below), may be that one would not think of every member of the armed forces, or every police officer, as being a fiduciary. It is perhaps helpful to remember Fletcher Moulton LJ's dictum in *In re Coomber* [1911] 1 Ch 723, 728:

> "Fiduciary relations are of many different types; they extend from the relation of myself to an errand boy who is bound to bring me back my change up to the most intimate and confidential relations which can possibly exist between one party and another where the one is wholly in the hands of the other because of his infinite trust in him."

The example of the errand boy is a useful reminder that circumstances may arise which place a party to a relationship in the position of a fiduciary in a specific respect, without the full range of fiduciary obligations being engaged, or the person's being a fiduciary in relation to other aspects of his functions. We refer to our earlier discussion of these matters at paras 101–104 above.

180 Asquith LJ's description (after "(b)") of the second type of circumstance in which a fiduciary relation exists is "whenever the plaintiff entrusts to the defendant a job to be performed, for instance, the negotiation of a contract on his behalf or for his benefit, and relies on the defendant to procure for the plaintiff the best terms available". As Gibbs CJ commented in *Hospital Products* (p 71), this is too widely stated: the fact that there is a job to be performed for a person's benefit, and reliance on the person engaged to perform it, does not necessarily create a fiduciary obligation. Many ordinary commercial contracts would fall within that description, and do not involve a fiduciary relationship. However, if expressed much more narrowly, that description covers the facts of cases such as *Salford* and *Hovenden*, where the circumstances giving rise to a fiduciary obligation were not merely reliance by one person on another to perform a job, but the employment of a person in a capacity which placed him in a situation, in relation to his employer, in which equity recognised a fiduciary duty arising from his contractual obligations.

181 When *Reading v Attorney General* went on appeal to the House of Lords, Lord Porter said that he agreed with Asquith LJ "in thinking that the words 'fiduciary relationship' in this setting are used in a wide and loose sense and include, inter alia, a case where the servant gains from his employment a position of authority which enables him to obtain the sum which he receives" (p 516). That would indeed be a loose use of the term

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A "fiduciary relationship"; and, as we have explained, the decision that Sergeant Reading was a fiduciary can be justified on a narrower basis.

182 In *Mahesan* the defendant was a director and employee of the plaintiff company, whose duties including advising the plaintiff on the suitability of land for it to purchase. Having identified suitable land which was available for purchase, the defendant then entered into an arrangement B with a third party under which, in return for a bribe, the third party acquired the land and resold it to the plaintiff at a higher price. The defendant was plainly in a fiduciary relationship with the plaintiff.

183 Turning to the more recent case law, the circumstances in which the law of bribery applies were considered succinctly by Christopher Clarke J in *Novoship*. After referring to some of the leading authorities concerned with the bribery of agents by their principal's counterparty (which was the C context of the case before the judge), he continued (para 108):

> "The recipient of the bribe (or the person at whose order the bribe is paid) must be someone with a role in the decision-making process in relation to the transaction in question e g as agent, or otherwise someone who is in a position to influence or affect the decision taken by the principal."

D That dictum is interpreted by the respondents in the present appeal as meaning that it is sufficient, in order for a person to be under a duty to give disinterested advice (and, therefore, for the civil law of bribery to apply), that that person performs a role in another person's decision-making process in relation to a transaction and is in a position to influence or affect the decision taken by that person.

E 184 In our view, that is both a misreading of the judgment and an erroneous view of the law. The judge was envisaging that the recipient of the benefit was an agent or other fiduciary. Such a person is clearly subject to the fiduciary duty of loyalty. If he has a role, acting in that capacity, in relation to a transaction entered into by his principal, or is in a position to influence or affect the decision taken by the principal, then he is under a duty to give F disinterested advice. That duty flows from the fiduciary capacity in which the person is acting. It would not flow from the mere fact that he was in a position to influence or affect another person's decision. If that were the law, a duty to act disinterestedly, and remedies for the breach of that duty, would attach to a very wide range of individuals and organisations who provide information or advice without any undertaking to subordinate their interests G to those of the recipient of the information or advice. Examples range from the shop assistant or wine waiter advising a customer to the search engine which influences decisions through the order in which it displays the results of a search for a product or service.

185 A similar argument to that advanced by the respondents on this appeal, also based on the passage which we have cited from *Novoship*, was considered by the Court of Appeal, and rejected, in *Conway v Eze*. Asplin LJ H (with whose judgment Peter Jackson LJ agreed) concluded that it was "clear from the authorities that in order for the law of bribery and secret commissions to be engaged there must be a relationship of trust and confidence between the recipient of the benefit or the promise of a benefit and his principal (used in the loosest of senses) which puts the recipient in a

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real position of potential conflict between his interest and his duty" (para 39). She went on to say (para 43):

> "The real question, therefore, is whether the person receiving the benefit or the promise of a benefit was acting in a capacity which involved the repose of trust and confidence in relation to the specific duties performed rather than on some general basis and whether the payment to him in that capacity was such that a real position of potential conflict between his interest and his duty arose . . . ."

186 Accordingly, in each of the civil bribery cases which we have discussed thus far, the receipt of an undisclosed payment was objectionable because it created a conflict between the recipient's personal interests and his fiduciary duty of loyalty to his principal. As Anglin J said in *Barry v Stoney Point Canning Co* at p 342: "The fundamental principle in all these cases is that one contracting party shall not be allowed to put the agent of the other in a position which gives him an interest against his duty." The same point was made over 200 years ago by Lord Ellenborough CJ in *Thompson v Havelock* (1808) 1 Camp 527, 528, in a dictum cited by Chitty LJ in *Shipway v Broadwood* at p 373: "No man should be allowed to have an interest against his duty."

187 In every case we have cited in which a claim based on bribery was upheld, the recipient of the benefit was someone who owed a fiduciary obligation, and the receipt of the benefit resulted in a breach of the no conflict rule. That is consistent with the authorities discussed at paras 162–164 above. As we explained, in *Attorney General for Hong Kong v Reid* the breach of the no conflict rule applicable to fiduciaries was treated as a defining characteristic of a bribe. Essentially the same point was made in *Logicrose* and *Daraydan*, expressed in terms of the agent putting himself in a position where his interest and his duty might conflict, and in *UBS*, expressed in terms of the fiduciary being disabled from giving disinterested advice. It was repeated in *Conway v Eze*. Asplin LJ emphasised "the central criterion that the recipient owes fiduciary duties to the principal in relation to the transaction in question" (para 43). That was also made clear by Longmore LJ. Referring to *Grant*, he said (para 63): "What emerges from this decision is that for the law about secret commissions to be engaged, the status of the alleged agent has to be a fiduciary one in relation to his principal."

188 The conclusion that liability for bribery, at common law as well as in equity, is dependent on the recipient of the bribe being a fiduciary, means that the law avoids a problem which would otherwise arise. It has been established by the decision in *FHR* that every bribe received by an agent is held on trust for the principal, so that the principal has a proprietary remedy as well as personal remedies. If, however, payments to non-fiduciaries could also constitute a bribe, as the Court of Appeal held in the present proceedings, then no constructive trust would arise, and no proprietary remedy would lie. The remedies available in a case of bribery would therefore vary, depending on whether or not the recipient of the bribe was a fiduciary. There is no trace of such a distinction ever having been drawn, either in this jurisdiction or in any other, although bribery has featured in the law reports for more than 200 years. Nor is there any discernible reason

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why the availability of a proprietary remedy should vary from one case of bribery to another, according to whether the recipient owed a fiduciary duty or a lesser "disinterested duty". Against that background, we turn to the reasoning in *Wood*, which appears to suggest that the application of the civil law of bribery does not depend on the existence of a fiduciary duty, despite the fact that the Court of Appeal had re-affirmed "the central criterion that the recipient owes fiduciary duties to the principal in relation to the transaction in question" in *Conway v Eze* (para 187 above) only two years earlier.

(e) *Wood*

189 The case of *Wood* concerned two appeals which were heard together. In each case, a borrower sought the rescission of a mortgage agreement arranged through a broker, on the ground that the broker had received an undisclosed commission from the lender. In each case, the broker had undertaken that it would "work from a panel of lenders to enable you to select the appropriate lender and mortgage product to meet your individual circumstances and needs and we will therefore be acting on your behalf". The High Court ordered rescission in each case, together with payment by the lender of the amount of the commission, but the judges disagreed in their analysis of the requirements of the civil law of bribery: in particular, as to whether a fiduciary relationship was an essential requirement, and whether fiduciary duties could exist outside a fiduciary relationship. They agreed, however, that a fiduciary duty was essential, and that such a duty had existed and had been breached by the acceptance of the undisclosed commission. The Court of Appeal dismissed the appeals.

190 As a preliminary point, it is to be noted that orders that the lender should pay the claimants the amount of the commission, in addition to the rescission of the agreements, will result in double recovery in the common circumstance where the borrower pays for the commission through the interest rate charged on the loan. This point, recognised in the earlier authorities (eg *Grant* per Collins LJ at p 249, cited with approval in *Hovenden* at p 850; see also *Logicrose* at p 1263) was not raised on the appeal.

191 In *Wood*, the lender advanced two arguments in the Court of Appeal. The first was that the civil law of bribery only applied where there was a fiduciary relationship. The second, advanced in the alternative, was that there must exist a duty of loyalty, such that the agent must not allow personal interests to conflict with his duty to give disinterested advice. This submission was supported by the citation of *Panama*, *Grant*, *Hovenden*, *Mahesan*, *Logicrose* and *Novoship*: all cases concerned with fiduciaries, as we have explained. We should say at once that both submissions were correct. David Richards LJ, with whom Males and Elisabeth Laing LJJ agreed, rejected the first argument but accepted the second (para 50). He held that the courts below had been right to hold that the broker was "under a duty to make a disinterested selection of mortgage product", and that, "To the extent that it is necessary", they were also correct to hold that the broker "owed a fiduciary duty of loyalty" to the borrowers (para 110).

192 David Richards LJ relied on a number of authorities which he considered to be inconsistent with the contention that a fiduciary

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relationship is a precondition of civil liability for bribery. However, on analysis they were all cases in which a fiduciary relationship existed, even if, in some of the cases, it arose on an ad hoc and highly fact-specific basis, rather than from a particular status such as trustee or company director.

193 The first authority was *Panama*. David Richards LJ appears to have considered it important that the engineer was an independent contractor, and not a director or employee of the company on whose behalf he was acting (para 60). We have explained that the engineer was described in the judgments as an agent or employee of the company (para 169 above). Even if he was an independent contractor, that is not inconsistent with his having owed the company a fiduciary duty of loyalty, and having been in an ad hoc fiduciary relationship with the company. We have explained at para 170 above why such a relationship existed.

194 The second case was *Shipway v Broadwood*. David Richards LJ noted that the veterinary surgeon had been described by Chitty and Collins LJJ as the defendant's agent, but questioned in what sense he could be so described (para 66). As we have explained, the role of the veterinary surgeon in relation to the transaction in question satisfied the standard definition of agency (para 171 above). Furthermore, since the case was expressly decided on the basis that he was an agent, it was therefore decided on the basis that he was subject to the no conflict rule applicable to fiduciaries (there being no suggestion in the law at that time that some agents might not owe a fiduciary duty, as suggested by Asplin LJ in *Conway v Eze*, at para 39).

195 The third, hypothetical, case was that of a barrister instructed to advise a client. David Richards LJ considered that the barrister would owe a duty to give his client disinterested advice, but would not normally be considered to be in a fiduciary relationship with the client. Whether a barrister might owe his client a fiduciary duty would appear to us to depend on the particular facts: there can undoubtedly be circumstances in which a barrister owes his client a fiduciary duty of loyalty (as the House of Lords held on the facts of *Carter v Palmer* (1842) 8 Cl & Fin 657).

196 David Richards LJ attached significance to the references by Asquith LJ and Lord Porter in *Reading v Attorney General* to the use of the term "fiduciary" in a wide or loose sense, which we have discussed at paras 179 and 181 above. As we explained, Sergeant Reading was under a fiduciary obligation to the Crown in relation to the use which he made of his uniform, like the police sergeant in *Attorney General v Goddard* in relation to the confidential information which he received in the course of his duties, the Crown prosecutor in *Attorney General of Hong Kong v Reid*, and the member of the secret intelligence service in *Attorney General v Blake*. That is not to say that these individuals were fiduciaries in relation to all aspects of their service, or owed the full range of fiduciary obligations, any more than Fletcher Moulton LJ's errand boy.

197 David Richards LJ also derived assistance from the distinction drawn in *Hurstanger*, in relation to the requirements as to disclosure of a commission, between the receipt of a secret commission as a breach of fiduciary duty and as an actionable wrong. *Hurstanger* was the first case to suggest that the common law cause of action arose in different circumstances

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A from equitable remedies. It will be necessary to return to that case in the next section of this judgment.

198 Having considered these and other authorities, all of which concerned fiduciaries (a company director in *Logicrose*, agents in *Anangel* and *Hurstanger*, and a chief executive in *Ross River Ltd v Cambridge City Football Club Ltd* [2008] 1 All ER 1004), David Richards LJ rejected the
B first argument, that a fiduciary relationship was a precondition of civil liability for bribery. He observed that the term "fiduciary relationship" was most commonly used with respect to well-established categories of relationship, such as trustee and beneficiary or director and company (para 37). The cases before the court did not concern relationships of that kind, which without more clearly qualified as fiduciary. The precise scope of the duties of the brokers required examination by reference to their terms of
C engagement (para 47).

199 We accept that the civil law of bribery is not confined to the established categories of fiduciary relationships. However, it was in our view a mistake to hold that a fiduciary relationship was unnecessary. As we have explained, a relationship is properly described as fiduciary where one party to the relationship owes a fiduciary duty of loyalty to the other, even if
D the relationship does not fall within one of the established categories or involve the full range of fiduciary duties. Since the civil law of bribery is concerned with the breach of a fiduciary duty of loyalty, as we have explained, it follows that a fiduciary relationship is indeed an essential requirement. The authorities provide no support for a contrary view.

200 In relation to the second argument, David Richards LJ said that the
E question the court should ask and focus on was: "did the 'agent' owe a duty to be impartial and to give disinterested advice, information or recommendations?" (para 102). He continued (ibid):

> "Courts have, principally in recent cases, characterised this as a fiduciary duty of loyalty. While this may be accurate, it does not mean that in such cases courts need involve themselves in complex analyses of
F the nature of a fiduciary relationship or the duties which may be associated with a fiduciary relationship. It would be better to avoid doing so. It is enough just to ask the straightforward question stated above."

201 We understand why the Court of Appeal wished to encourage courts to focus on identifying whether the relevant obligation exists, rather than undertaking the sort of elaborate discussion of fiduciary relationships
G which had occupied the lower courts in the cases before it. It is also true to say that the expression "fiduciary duty of loyalty" is of relatively recent coinage, although the duty which it describes—to act in the principal's interests to the exclusion of one's own—has long been recognised. Furthermore, if David Richards LJ was accepting that what he called "a duty to be impartial and to give disinterested advice, information or recommendations" was another way of describing a fiduciary duty of loyalty
H ("this may be accurate"), then no error was involved. As Professor Lionel Smith has commented, this "approximates to a holding that an animal has all the characteristics of an elephant, even while we do not have to decide that it is an elephant": *The Law of Loyalty* (2023), p 49, footnote 170. However, it needs to be understood that what is critical in this context is the

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existence of a fiduciary duty of loyalty. It can be described as a duty to act disinterestedly, if by that is meant a duty to act in the interests of the person to whom the duty is owed to the exclusion of one's own interests. But it needs to be borne in mind that a purely contractual duty to give disinterested advice is different in its legal nature and consequences from a fiduciary duty of loyalty. Although it may be difficult to conceive of circumstances in which such a contractual duty might arise without there being a concurrent fiduciary duty, the focus of the civil law of bribery is on the latter and not the former, and is therefore on the question which we identified earlier: whether the putative fiduciary has undertaken or agreed to act in the interests of another person to the exclusion of his personal interests.

202 For these reasons, we disagree with a number of passages in David Richards LJ's judgment which suggest that it is a mistake to ask whether the person in question was under a fiduciary duty of loyalty (e g at paras 44–50, 79 and 92). For example, at para 48, David Richards LJ said:

> "To ask in cases of this kind whether there is a fiduciary relationship as a pre-condition for civil liability in respect of bribery or secret commissions is, in my judgment, an unnecessarily elaborate, and perhaps inaccurate, question. The question, I consider, is the altogether simpler one of whether the payee was under a duty to provide information, advice or recommendation on an impartial or disinterested basis. If the payee was under such a duty, the payment of bribes or secret commissions exposes the payer and the payee to the applicable civil remedies. No further enquiry as to the legal nature of their relationship is required."

He added, at para 50:

> "While it may sometimes be appropriate to describe a duty to give disinterested advice or information as 'fiduciary', it is not necessary to do so. It is the content of the duty, not the label attached to it, that matters."

203 We do not underestimate the importance of analysing the substance of obligations. However, to describe a duty as fiduciary is not merely to attach a label to it. In the first place, the proper classification of legal obligations is more than labelling. It is important in understanding the functions which they serve, which mark them out from other categories of obligation and explain their attracting a different name. Consequently, it is also important in identifying and understanding the legal doctrines which apply to them. In addition, in a common law system based on an incremental and iterative process of judicial development of the law, the ability to analyse obligations by reference to an established legal framework is essential to the resolution of disputes. Accordingly, the different names given to different types of legal obligation are not merely labels.

204 Fiduciary obligations are no exception. There is no authority prior to *Wood* which could be understood as implying that a purely contractual duty (or, it might be, a duty in tort, or in public law) to give disinterested advice is sufficient in itself to engage the civil law of bribery, as distinct from other torts such as fraud, conspiracy, causing loss by unlawful means or inducing a breach of contract. It would risk introducing confusion into commercial relationships if purely contractual duties were thought to have the same consequences as fiduciary duties, without any fiduciary obligation

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being established. As Lord Mustill said in *In re Goldcorp Exchange Ltd* [1995] 1 AC 74, 98:

> "No doubt the fact that one person is placed in a particular position vis-à-vis another through the medium of a contract does not necessarily mean that he does not also owe fiduciary duties to that other by virtue of being in that position. But the essence of a fiduciary relationship is that it creates obligations of a different character from those deriving from the contract itself."

205 The authorities which we have discussed also demonstrate that although the law of bribery is often concerned with situations in which a person is under a duty to give disinterested advice or information, it is not confined to such cases: see, for example, *Hovenden* (the placing of orders), *Attorney General v Goddard* (the misuse of confidential information) and *Reading v Attorney General* (the misuse of property). It would therefore be a mistake to regard a duty to give disinterested advice or information as essential to engage the civil law of bribery.

206 We should add that there need be no concern that confining the civil law of bribery to situations where a fiduciary duty of loyalty was owed will result in a lacuna in the law. If, for example, a non-fiduciary were to be bribed, as that word is used in ordinary speech—an example might be a non-fiduciary employee being paid by a competitor of his employer to sabotage an industrial process—the law would not be powerless. Cases of non-fiduciary bribery, if we can use that expression, would fall within the scope of a range of other torts, such as deceit, conspiracy, inducement of breach of contract and causing loss by unlawful means. Trying to fit such cases within a tort which has developed specifically to address the procurement of breaches of fiduciary duty would be liable to result in confusion. Retaining the fiduciary requirement has caused no serious difficulties during the past century and a half.

(f) Conclusion on the duty requirement

207 We conclude that the Court of Appeal was mistaken, in the present case, to proceed on the basis that it was unnecessary, in order for liability for bribery to arise at common law, that the recipient of the payment should owe a fiduciary duty of loyalty to the claimant. Civil liability for bribery cannot arise unless such a duty was owed. Such a duty may arise in circumstances where one person has performed a role in another person's decision-making process by exercising judgement or discretion in relation to the interests and affairs of that other person. However, whether it does so will depend on a number of factors, including whether the person undertook or agreed to act in that person's interests to the exclusion of any interest of their own.

(vi) The negation of secrecy

208 In the case law a bribe is often referred to as being synonymous with a secret commission: see paras 111–112 above. For example, in *Industries & General* at p 575, Slade J noted the various use of the words "secret commission", "surreptitious payment" and "bribe". In *Mozambique*

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the Supreme Court referred to a bribe as being "a secret payment or other inducement" (para 86).

209 Secrecy is important because, as Chitty LJ pointed out in *Shipway v Broadwood* (p 373), it is possible for the consequences of an agent's receiving a benefit from his principal's counterparty to be avoided if the benefit is disclosed to the principal. Disclosure places the principal in a position where he can take an informed decision whether to affirm the transaction in question or to seek its rescission. It is in that sense that Chitty LJ's statement in that case, that the "real evil" of bribery is "not the payment of money, but the secrecy attending it", should be understood. As we have explained, and as Chitty LJ's judgment considered as a whole makes plain, the real evil of bribery is that it creates an interest in a fiduciary which is antagonistic to his performance of his duty of loyalty: that is to say, his duty to act in the interests of his principal to the exclusion of his own interests. As Chitty LJ said in that case, the "great principle" is that "no man should be allowed to have an interest against his duty" (p 373).

210 As explained earlier, the payment of bribes and secret commissions to a fiduciary is objectionable not only as a breach of the no conflict rule, entitling the principal to equitable rescission of the resultant transaction, but also as a breach of the no profit rule. It is not a condition of a fiduciary's equitable liability to disgorge such profits, or of the principal's equitable proprietary remedies, that a profit be secret. However, the fiduciary's liability to disgorge the profit can be avoided if the profit is disclosed and the principal gives his consent to its retention.

211 It is well established that the consent which is required in order to avoid the equitable liabilities which flow from a breach of the no conflict and no profit rules must be fully informed. The burden is on the payer of the commission or its recipient, as the case may be, to prove that full disclosure was made, which means all material facts, and it is not enough to place the principal on inquiry.

212 The leading authority to that effect is *Dunne v English* (1874) LR 18 Eq 524, cited with approval in *FHR* at para 5. The case concerned the equitable rescission of a contract of sale entered into by the plaintiff and defendant as partners, on the ground that the defendant, who acted as the agent of the partnership in negotiating the sale, had failed to disclose to the plaintiff that he was in fact the ultimate purchaser, or had a share in the purchase. The plaintiff also sought the disgorgement of the defendant's profit on a resale. It was said in defence that the defendant had disclosed the fact that he was to be one of the purchasers. Sir George Jessel MR held, following earlier authorities, that "It is not enough for an agent to tell the principal that he is going to have an interest in the purchase . . . He must tell him all the material facts" (p 533). The Master of the Rolls went on to say that "It must be a full disclosure of all he knows; that, of course, means everything material which he knows" (p 534). It was not sufficient for the defendant to say that he had an interest, or to put the principal on inquiry (p 535).

213 One of the authorities relied on by the Master of the Rolls was the decision of the House of Lords in *Liquidators of Imperial Mercantile Credit Association v Coleman* (1873) LR 6 HL 189 ("*Imperial Mercantile*"), a case concerned with the payment of a commission to a director of a company in

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A connection with the placing of debentures with it. His fellow directors knew that he was a stockbroker, and he told them that he was receiving a commission, but not the amount, which was much larger than the usual stockbroker's commission. The company sought the disgorgement of the commission. Lord Chelmsford noted that the magnitude and nature of the transaction lay beyond the ordinary business of stockbrokers, and beyond B the scope of the usual stockbroker's commission, with the consequence that the disclosure which had been made "afforded very scanty information" as to the nature of the director's interest (p 202). As the decision illustrates, what amounts to the disclosure of all material facts can depend on the circumstances. It seems that the disclosure made in that case might have sufficed if the commission received had been the usual stockbroker's commission, as the information which had been disclosed would then have C been sufficient to enable the directors to form an accurate idea of their fellow director's interest in the transaction. As it was, however, the information which was disclosed did not enable them to do so.

214 Consistently with the approach taken in these cases, a number of other authorities through which the law of bribery developed refer to the need for the fiduciary to obtain his principal's "knowledge and consent". D Examples include *Parker v McKenna* per James LJ at p 124 (referring to "the general principle that . . . no agent in the course of his agency, in the matter of his agency, can be allowed to make any profit without the knowledge and consent of his principal"); *Shipway v Broadwood* per Chitty LJ at p 373 ("It was the plaintiff's duty to inform the defendant of the promise made to [the agent] if he wished to escape the consequences of having made it"); *Grant* E per A L Smith LJ at p 242 (referring to the agent's having received the commission "without the knowledge or assent" of the purchaser); *Hovenden*, where Romer LJ's description of a bribe at p 851 included that the gift was made "without the knowledge and consent of the principal"; *In re A Debtor*, where Lord Hanworth MR referred at p 373 to the need for consent; and *Reading v Attorney General*, where Lord Oaksey referred at p 518 to the need for "knowledge and consent". The same phrase was F employed by Millett J in *Logicrose* at p 1260. None of those cases raised a question as to what exactly was meant by "knowledge and consent", in the context of an allegation of bribery. However, none of them indicated any departure from the approach laid down in *Imperial Mercantile* and *Dunne v English*; and as we have explained, the reasoning in the latter case was approved by this court in *FHR*.

G 215 One modern authority in which the issue received some consideration is *Anangel*. The case concerned a naval architect who was engaged by shipowners to negotiate on their behalf the purchase of ships which they knew he had designed, from the shipbuilders who had constructed the ships. The architect received royalties from the shipbuilders for the licensing of his designs, and payments for the promotion of the sale of the ships. The shipowners then sought to recover the amount of those H payments from the shipbuilders, on the basis that the architect had been acting as their agent in relation to the purchases, and they had not known about the payments. The claim failed, on the basis that the shipowners had known all the material facts about the payments and consented to them. 216. In the course of his judgment, Leggatt J cited authorities establishing

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the need for fully informed consent, and recorded that it was "not disputed that knowledge of and consent to the fact of payment is sufficient to legitimate it, without it being necessary to prove that the principal knew the exact amounts paid, provided that they were reasonable" (p 171). He went on to find that although the shipowners never knew the amount of the payments, they knew that the shipbuilders were making payments to the architect for design and promotion on a per ship basis. The amounts paid were unexceptional, and did not affect the price paid by the shipbuilders. In those circumstances, Leggatt J concluded that the information which had not been disclosed, as to the precise amount of the payments, was "not material, so far as the plaintiffs were concerned" (p 176). The decision is a modern illustration of a point which could be inferred from the earlier authorities, notably *Imperial Mercantile*, namely that what amounts to disclosure of all material facts depends on the circumstances of the particular case: not every fact which could be disclosed is necessarily material in a particular context. The significance of the payments being "reasonable" was that the disclosure of their existence gave the shipowners, in the circumstances of that case, all the information they required in order to understand the nature and extent of the architect's interest.

217 We turn next to the case of *Hurstanger*, which concerned a regulated consumer credit agreement for a loan of £8,000, which had been arranged by a broker acting on behalf of the borrowers for a substantial fee. Before entering into the agreement, the borrowers signed a pre-contractual document issued by the lenders, which contained the statement: "In certain circumstances this company does pay commission to brokers". When the borrowers fell into arrears, and the lenders brought proceedings for possession, the borrowers sought rescission of the agreement on the ground that the broker had received a commission from the lenders of £240, which had not been disclosed.

218 The leading judgment was given by Tuckey LJ, with whom Jacob and Waller LJJ agreed. He acknowledged that the broker was a fiduciary who owed a duty of loyalty to the borrowers, and that the receipt of the commission created a conflict of interest. He accepted that equitable remedies would therefore lie unless full disclosure had been made. He also noted that what amounted to full disclosure depended on the circumstances. In the context of a consumer credit agreement of the kind with which the case was concerned, where the borrowers were likely to be vulnerable and unsophisticated, a statement of the amount which their broker was to receive from the lenders was, he thought, necessary to bring home to such borrowers the potential conflict of interest (para 36). Since no such disclosure had been made, it followed that there had therefore been a breach of fiduciary duty and that equitable remedies were in principle available.

219 Tuckey LJ then turned to the common law, stating (para 39):

> "But 'the real evil [of bribery] is not the payment of money, but the secrecy attending it': Chitty LJ in the leading case of *Shipway v Broadwood* [1899] 1 QB 369, 373. Is there a halfway house between the situation where there has been sufficient disclosure to negate secrecy, but nevertheless the principal's informed consent has not been obtained? Logically I can see no objection to this. Where there has only been partial or inadequate disclosure but it is sufficient to negate secrecy, it would be

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A unfair to visit the agent and any third party involved with a finding of fraud and the other consequences to which I have referred, or, conversely, to acquit them altogether for their involvement in what would still be breach of fiduciary duty unless informed consent had been obtained."

220 That it was sufficient, in order to exclude common law (but not equitable) remedies, to disclose that commission might be paid rather than B the fact of its payment, was explained as follows (para 43): "If you tell someone that something may happen, and it does, I do not think that the person you told can claim that what happened was a secret. The secret was out when he was told that it might happen."

221 It was further held that disclosure was sufficiently made to exclude common law remedies because the borrowers had signed the pre-contractual C document which stated that commission might be paid, and "must be taken to have understood what it said" (para 42). On the other hand, the borrower's informed consent had not been obtained, with the result that equitable relief was in principle available against the lender for procuring the broker's breach of fiduciary duty. Accordingly, the lender "did not pay the broker a secret commission but procured the broker's breach of fiduciary D duty" (para 45). The court went on to withhold equitable rescission on the ground that the remedy was discretionary (para 47), and to rescind the transaction would be unfair and disproportionate (para 50). Instead, the lender was ordered to pay equitable compensation equivalent to the amount of the commission.

222 Accordingly, in this case the Court of Appeal held, for the first time, that a lesser requirement of disclosure applied for the purposes of the E common law of bribery than in equity. In its view, it was sufficient to exclude liability at common law that there be disclosure of the possibility that a commission might be paid. Where that possibility had been disclosed, the payment could not be regarded as secret, so as to engage common law liability; but there would not be fully informed consent, so that equitable remedies remained available.

F 223 The appellants contended that *Hurstanger* should be followed. They submitted that in circumstances where English law equates bribery with fraud, it is important to ensure that serious findings of bribery are not visited upon honest defendants. In that context it is appropriate that (in addition to the payer's knowledge of the agency) there should be a distinctive standard of secrecy. That is particularly so in circumstances G where (1) obtaining the principal's fully informed consent is unlikely to be in the payer's control; yet (2) the payer can take steps to ensure that the payment is not secret from the principal, in particular by requiring the payee to disclose commissions to the principal.

224 The respondents contended that *Hurstanger* was wrongly decided and should be overruled. Nothing less than fully informed consent will do. They submitted that it is the commission itself that risks the corruption of H the agent and constitutes the breach of the disinterested or fiduciary duty. It is inconsistent with the strong stance taken against bribery, and the policy reasons in support of it, for the payer of a bribe to be afforded a defence despite the underlying transaction being tainted by a commission to which the principal did not give his informed consent. The Court of Appeal was

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wrong in *Hurstanger* to identify a separate category of case concerning partially disclosed commissions.

225 We are unable to agree with the reasoning in *Hurstanger* in relation to disclosure. We have explained that the law of bribery, both at common law and in equity, reflects the same concern: to ensure that an agent acts free from any conflict of interest. The common law action for bribery has equitable origins, and derives from the right to rescission in equity. The remedies of restitution and damages are the logical corollary of the right to rescission, as was explained by Collins LJ in *Grant* and by Lord Diplock in *Mahesan* (paras 149 and 166 above). The purpose of requiring disclosure, as a condition for excluding the law's remedial response, is also the same at common law and in equity: to negative what would otherwise be a breach of fiduciary duty. Since the need for disclosure arises for a common reason, it is incoherent for it to be governed by diverging rules.

226 The reasoning in *Hurstanger* in relation to this matter is based on a misunderstanding. Chitty LJ's remark that "the real evil" of bribery is secrecy should not be taken out of context or applied literally: see para 209 above. The real evil of bribery is the breach of the no conflict rule incumbent upon a fiduciary, as Chitty LJ clearly recognised in his judgment, when it is read in the round. In order to negative such a breach, what is required is full disclosure of all material facts, as authorities from *Imperial Mercantile* to *FHR* have repeatedly made clear. Partial disclosure has never been enough, as Tuckey LJ recognised in dealing with the question of equitable relief. That is not to say that disclosure of every fact is needed: as *Imperial Mercantile* and *Anangel* illustrate, what amount to material facts will depend on the circumstances of the particular case.

(vii) Remedies

(a) Recovery of the amount of the bribe from the briber without proof of loss or gain

227 If the appellants' case that the tort of bribery should be abolished is rejected, their fallback position was that there should be no automatic right to recovery of the bribe. They raised this point with some diffidence, as they recognised that cases decided at the highest level, namely *Mahesan* and *Mozambique*, have proceeded on the basis that such a right exists.

228 Three submissions were advanced in support of the appellant's case: (1) the automatic common law entitlement is contrary to basic principles; (2) it has its origins in the trilogy of late 19th century cases, *Salford*, *Grant* and *Hovenden*, which on analysis do not support it; and (3) neither the passage of time nor the endorsement of the rule in *Mahesan* and *Mozambique* is a reason to retain it.

229 As to (1), as *Mahesan* and cases following it make clear, the basis of the common law entitlement is money had and received or what would now be termed restitution. As explained at para 150 above, the remedy is an example of restitution for wrongs. As Sir Jack Beatson stated in *FM Capital Partners Ltd v Marino* [2021] QB 1, para 48:

> "While, over the years there have been a number of ways of conceptualising the obligation of persons to make restitution of bribes, today it is generally regarded as an example of restitution for wrongs

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A where the cause of action is the wrong and not unjust enrichment. In such a case the claimant seeks a restitutionary remedy for a tort or equitable wrong . . . ."

230 As to (2), although some doubt was expressed in *Grant* as to whether a claim lay against the briber for money had and received, in *Hovenden* A L Smith LJ clearly upheld such a claim, and Vaughan
B Williams LJ also confirmed that such a claim would lie. This was later affirmed in *Mahesan* and this approach has been followed in subsequent cases.

231 The appellants contended that *Whaley Bridge Calico Printing Co v Green* (1879) 5 QBD 109 ("*Whaley Bridge*") is authority, by implication, that there was no common law claim to recover the amount of the bribe
C from the briber before *Salford*. They further pointed out that this case was not cited in *Salford* or *Hovenden* and was not discussed in *Grant*. *Whaley Bridge* does not, however, address the question of whether there was a primary liability of a briber at common law for the bribe paid. It was concerned with the different question whether the principal could enforce the contract which the briber had made with the principal's agent for the
D payment of the bribe, on the basis that the agent must be taken to have been acting on the principal's behalf (the briber being unable to plead that the contract was fraudulent). It was the trilogy of cases which developed that common law remedy. As such, it is not surprising that it should not be referred to in earlier authorities and neither *Whaley Bridge*, nor any other case we were shown, is authority against there being such a claim.

232 It is correct that none of the trilogy of cases decide that there is an
E irrebuttable presumption of enrichment up to the value of the bribe and that, in each of them, it was clear on the facts that the briber was in fact enriched in (at least) that amount because it was possible to identify the amount by which the contract price had been inflated as a result of the bribe. Romer LJ, however, stated a clear preference for the presumption being irrebuttable and this was confirmed to be the law in *Mahesan*. As there stated, this is
F better analysed in terms of the ingredients of the wrong rather than in terms of a presumption.

233 The justification for this lies in the law's strict approach to bribery and the need for deterrence. There is a clear deterrent effect if any would-be briber knows that he or she is to be automatically liable for the amount of any bribe paid. Conversely, if liability depends on identifying and proving
G precisely how the bribe has been factored into the briber's gain, the difficulty and expense of establishing this would seriously undermine such deterrence.

234 As to (3), the reasons why it would not be appropriate to overturn the long-established law that bribery is a common law wrong equally apply to this established aspect of that law. Again, there is no suggestion that the proper development of the law has been impeded or that this aspect of the existing law has led to results which are unjust or contrary to public policy.
H

235 Further, this feature of the law was recently confirmed by this court in *Mozambique*. As explained in the judgment of Lord Hodge DPSC: "The law assumes that the price of the goods and services purchased by or on behalf of the principal was increased by at least the amount of the bribe" (para 87), citing with approval Lawrence Collins J in *Daraydan* at para 53.

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236 For all these reasons we do not consider that it would be appropriate to dispense with this established feature of the common law of bribery.

(b) Rescission

237 The appellants contended that there was no right to rescind at common law because there is or should be no tort of bribery. It was not, however, disputed that if there is a tort of bribery then a common law right to rescission would lie.

238 The significance of there being a common law right to rescind is that it is a self-help remedy that does not depend on there being an order of the court or on any discretionary considerations. Its usefulness as a remedy is, however, limited by the strict common law requirements as to counter-restitution. If it is too late to rescind, there remains a right to bring the transaction to an end for the future—see *Logicrose* per Millett J at p 1260 and *Armagas* per Robert Goff LJ at p 744.

239 As to the equitable right to rescind in cases of bribery, both parties endorsed the analysis of Dixon CJ, Webb, Kitto and Taylor JJ in the High Court of Australia judgment in *Alati v Kruger* (1955) 94 CLR 216, 223–224 which was approved by the Court of Appeal in *O'Sullivan v Management Agency and Music Ltd* [1985] QB 428, 457 per Dunn LJ. There is a concurrent jurisdiction to rescind in equity in a case of bribery, and equity's more flexible approach to counter-restitution means that rescission may be ordered even if it is no longer an available remedy at common law—see generally, O'Sullivan, Elliott and Zakrzewski, *The Law of Rescission*, 3rd ed (2023), paras 10.04 and 10.44–10.45.

(c) Double recovery

240 The appellants criticised the Court of Appeal for seemingly ordering both a monetary remedy in the amount of the commission and rescission, as this would allow for double recovery. The respondents accepted, however, that this is not permissible. They pointed out that the consequences of rescission are yet to be determined. If, however, it was necessary to prevent double recovery, credit would be given for the commission payment provided for in the Court of Appeal's order as part of counter-restitution.

(3) Statutory intervention

241 Part of the context in which the obligations of the car dealers are to be assessed is the statutory and regulatory regimes to which they were and are subject.

242 The existence of statutory controls is not a reason for cutting down rights conferred by the common law: *United Utilities Water Ltd v Manchester Ship Canal Co Ltd* [2025] AC 761, para 14 per Lord Reed PSC and Lord Hodge DPSC. But the courts when developing the common law strive to make it coherent with a statutory regime in its field of application. There are many examples of the court showing restraint in the development of the common law or declining to develop it if it would be inconsistent with a statutory regime: see, for example, *Johnson v Unisys Ltd* [2003] 1 AC 518,

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paras 56–59 per Lord Hoffmann, para 80 per Lord Millett. In addition, the courts do not have the institutional competence to make regulatory rules: *Philipp v Barclays Bank UK plc* [2024] AC 346, paras 22–24 per Lord Leggatt JSC. The historical role of equity in restraining the unconscionable exercise of common law rights or making up for deficiencies in the common law where it operated unfairly does not give the courts such institutional competence. The statutory and regulatory rules which govern the behaviour of the car dealers and finance companies are an important part of the context in which equity operates, and in which the question whether equity should recognise any undertaking to act selflessly needs to be addressed.

243 The first statutory regulation of hire purchase transactions was contained in the Hire-Purchase Act 1938 ("the 1938 Act"), which was later amended and extended by the Hire Purchase Act 1964 ("the 1964 Act"). So far as is relevant to the questions on this appeal, from the outset of this statutory regulation the person who let goods to the hirer ("the owner") had to state in writing to the prospective hirer the cash price at which the goods might be purchased (section 2 of the 1938 Act). The 1938 Act also imposed duties on the owners and sellers to supply documents and information to the hirer about the sums paid and remaining payable by the hirer (section 6). The 1964 Act conferred on the hirer a right of cancellation of the hire purchase contract to be exercised shortly after the contract was finalised (section 4) and deemed the dealer to be the agent of the owner or seller in relation to representations made to the hirer with respect to the goods in the course of the pre-contractual negotiation of the hire purchase contract (section 10). We discuss section 10(2) of the 1964 Act below.

244 Hire purchase legislation was consolidated in the Hire-Purchase Act 1965 which was in turn repealed by the CCA, which introduced a new regulatory framework for consumer credit agreements. The tripartite arrangements between the customer, the lender and the dealer are a form of restricted-use credit agreement and a debtor-creditor-supplier agreement under sections 11(1)(a) and 12(a), and are a sub-set of credit agreements under the CCA: see section 8. We discuss the deemed agency of the dealer in section 56 of the CCA in paras 248–250 below.

245 Part IX of the CCA provides for judicial control and confers on the court powers to grant remedies in relation to unfair relationships between debtors and creditors arising out of a credit agreement. We discuss the claim by Mr Johnson under sections 140A–140C of the CCA at paras 291–338 below.

(i) The statutory agency under the CCA

246 In its Tenth Report (on *Innocent Misrepresentation*) (Cmnd 1782) published in July 1962, the Law Reform Committee had occasion to consider hire purchase contracts introduced to customers by dealers to finance the acquisition of consumer products. At paras 19–20 the Committee recommended (so as to give effective remedies to customers for misrepresentation) that statute should provide that where negotiations for a hire purchase contract are in fact conducted by a dealer he shall, notwithstanding any agreement to the contrary, be deemed to be the agent of the finance company for the purpose of any representations in respect of the goods which are the subject-matter of the contract. In so recommending the

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Committee regarded such an agency as not only "right", but "in accordance with the realities of the situation". A

247 Parliament responded with section 10 of the 1964 Act, which provided as follows:

"(1) Where a person (in this section referred to as 'the owner or seller') lets goods under a hire-purchase agreement to which the principal Act applies, or sells goods under a credit-sale agreement to which that Act applies, any representations with respect to the goods to which the agreement relates which were made, either orally or in writing, to the hirer or buyer by a person other than the owner or seller in the course of any antecedent negotiations conducted by that other person shall be deemed to have been made by him as agent of the owner or seller. B

"(2) Nothing in this section shall exonerate any person from any liability (whether criminal or civil) to which he would be subject apart from this section." C

248 Section 10 of the 1964 Act was in due course replaced by section 56 of the CCA. It provides (so far as is relevant) that:

"(1) In this Act 'antecedent negotiations' means any negotiations with the debtor or hirer— (a) conducted by the creditor or owner in relation to the making of any regulated agreement, or (b) conducted by a credit-broker in relation to goods sold or proposed to be sold by the credit-broker to the creditor before forming the subject-matter of a debtor-creditor-supplier agreement within section 12(a), or (c) conducted by the supplier in relation to a transaction financed or proposed to be financed by a debtor-creditor-supplier agreement within section 12(b) or (c), and 'negotiator' means the person by whom negotiations are so conducted with the debtor or hirer. D E

"(2) Negotiations with the debtor in a case falling within subsection (1)(b) or (c) shall be deemed to be conducted by the negotiator in the capacity of agent of the creditor as well as in his actual capacity.

"(3) An agreement is void if, and to the extent that, it purports in relation to an actual or prospective regulated agreement— (a) to provide that a person acting as, or on behalf of, a negotiator is to be treated as the agent of the debtor or hirer, or (b) to relieve a person from liability for acts or omissions of any person acting as, or on behalf of, a negotiator." F

249 It was submitted for the lenders that a deemed statutory agency of the dealer for the lender sat uneasily with the respondent customers' case that, in obtaining a finance package for customers, dealers were acting as their fiduciary (or disinterested) agents. In our view this initially attractive submission fails to account for the wording in subsection (2) of the CCA "as well as in his actual capacity". We consider that, as was made even clearer in section 10(2) of the 1964 Act, this statutory deemed agency was enacted to augment consumers' rights in relation to pre-contractual misrepresentations and questions of the fairness of the credit relationship under section 140A (*R (Clydesdale Financial Services Ltd) v Financial Ombudsman Service Ltd* [2025] Bus LR 1323 ("*Clydesdale*"), paras 314–369 per Kerr J) but not to detract in any way from such rights as they might have under the general law G H

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as the result of an ad hoc fiduciary duty for the purposes of the equitable claim, or for the purpose of the tort of bribery.

250 Nonetheless the view of the Law Reform Committee that such an agency did no more than reflect the realities of the situation, to which the successive statutory provisions were plainly designed to give effect, does at least suggest that, to distinguished observers in 1962, the realities of the typical dealer-lender-customer hire purchase negotiation did not place the dealer in the position of undertaking a duty of single-minded loyalty to the customer, in relation to the obtaining of a suitable finance package.

(ii) The regulatory context

251 The other statutory and regulatory regimes which provide the context in which the obligations of the dealers fall to be assessed are the relevant provisions of the CCA and the regulatory regime created by FSMA. Since 1 April 2013 the FCA, which is an intervener in this appeal, has been the relevant regulator under FSMA; its predecessor was the Financial Services Authority ("FSA"). Before 1 April 2014 the regulator responsible for consumer credit under the CCA was the OFT. The OFT issued guidance, including *Irresponsible lending—OFT guidance for creditors* (March 2010, updated in February 2011) ("the ILG"), and the *Credit brokers and intermediaries* guidance (November 2011) ("the CBG"), giving its views on the standards which it expected of lenders and credit brokers. Those two guidance documents, which are discussed in the *Clydesdale* judgment, are, so far as relevant, not materially different in their substance from the rules and guidance of the FCA. In its consultation paper of March 2013 on *High-level Proposals for an FCA Regime for Consumer Credit* the FSA explained that it intended to replicate the substance of the OFT guidance (para 7.4) with the implication that firms that already complied with it would be unlikely to need to change their behaviour. Therefore, while the OFT guidance is relevant to the claim of Ms Hopcraft, whose transaction predated the involvement of the FCA, we concentrate for the sake of brevity on the FCA's rules and guidance, which are relevant to the claims by Mr Johnson and Mr Wrench, and cross-refer to the OFT provisions in that discussion.

252 On 1 April 2014, the FCA assumed responsibility over consumer credit, and consumer credit activities were included as regulated activities by amending the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 ("the 2001 Order").

253 Hire purchase agreements and conditional sale agreements are regulated credit agreements: see article 60B of the 2001 Order, which makes entering into a regulated credit agreement as lender a regulated activity and defines a credit agreement as "an agreement between an individual or relevant recipient of credit ('A') and any other person ('B') under which B provides A with credit of any amount". Article 36A(1)(a) of the 2001 Order makes credit broking a regulated activity and includes within credit broking "effecting an introduction of an individual or relevant recipient of credit who wishes to enter into a credit agreement to a person ('P') with a view to P entering into by way of business as lender a regulated credit agreement . . ." As a result, lenders and dealer brokers fall within the FCA's regulatory regime.

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254 Section 1B of FSMA gives the FCA the strategic objective of ensuring that the relevant markets function well and sets out three operational objectives: (1) the consumer protection objective, (2) the integrity objective, and (3) the competition objective. On this appeal we are concerned with the consumer protection objective, which is set out in section 1C. That section provides so far as relevant:

> "(1) The consumer protection objective is: securing an appropriate degree of protection for consumers.
>
> "(2) In considering what degree of protection for consumers may be appropriate, the FCA must have regard to— (a) the differing degrees of risk involved in different kinds of investment or other transaction; (b) the differing degrees of experience and expertise that different consumers may have; (c) the needs that consumers may have for the timely provision of information and advice that is accurate and fit for purpose;(d) the general principle that consumers should take responsibility for their decisions; (e) the general principle that those providing regulated financial services should be expected to provide consumers with a level of care that is appropriate having regard to the degree of risk involved in relation to the investment or other transaction and the capabilities of the consumers in question; . . . (h) any information which the scheme operator of the ombudsman scheme has provided to the FCA pursuant to section 232A."

255 Section 137A of FSMA empowers the FCA to make general rules which apply to authorised persons with respect to their carrying on of both regulated activities and activities that are not regulated. These general rules may make provision applying to authorised persons even though there is no relationship between them and the persons whose interests are protected by the rules: section 137A(3). Section 139A of FSMA empowers the FCA to give guidance. The FCA's rules and guidance are published in the FCA Handbook, in which rules are set out with the suffix "R" and guidance with the suffix "G". Most of the rules create binding obligations, the breach of which can lead to enforcement action and an action for damages.

256 Among the rules are the "Principles for Businesses" which set out standards at a high level of generality and provide the framework for the FCA's more specific rules. Three principles in PRIN 2.1.1R are relevant to this appeal. They are:

> "6. A firm must pay due regard to the interests of its customers and treat them fairly.
>
> "7. A firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair, and not misleading.
>
> "8. A firm must manage conflicts of interest fairly, both between itself and its customers . . ."

Those principles, which are rules, do not mirror the more rigorous duties of a fiduciary in relation to the exclusion of self-interest, the disclosure of information and the avoidance of conflicts of interest. While it is not relevant to the claims with which this appeal is concerned, on 31 July 2023 a

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new consumer duty (Principle 12) was introduced which requires firms to deliver good outcomes for retail customers. To the extent that Principle 12 now applies, Principles 6 and 7 do not: PRIN 2A.1.3G.

257 Part of the FCA Handbook is the Consumer Credit Sourcebook (defined above as "CONC") which applies to a firm carrying on credit-related regulated activities. As discussed below in para 262, certain parts of the CONC rules and guidance were changed on 28 January 2021. The provisions set out in paras 258–260 below applied at the times relevant to these appeals.

258 CONC 1.2.2R provides that a firm must ensure that its employees and agents comply with CONC and take reasonable steps to ensure that other persons acting on its behalf do so. Chapter 2 of CONC is entitled "Conduct of business standards: general" and includes in CONC 2.5.3R the obligation on a firm to explain the key features of a regulated credit agreement to enable the customer to make an informed choice, to take reasonable steps to satisfy itself that a product is not unsuitable for the customer's needs and circumstances, and to advise the customer to read and allow sufficient opportunity to consider the terms of a credit agreement.

259 Chapter 3 of CONC addresses a firm's communications with its customers. Of particular relevance is CONC 3.3.1R which provides that a firm's communications to customers must be "clear, fair and not misleading", "balanced", "presented in a way that is likely to be understood" and "does not disguise, omit, diminish or obscure important information, statements or warnings". In its guidance in CONC 3.7.4G the FCA Handbook provided at the relevant time (1) that a credit broking firm should "make clear, to the extent an average customer of the firm would understand, the nature of the service that the firm provides", (2) indicate in a prominent way the existence of any financial arrangements with the lender that might impact upon the firm's impartiality in promoting a credit product, (3) only describe itself as independent if it is able to provide access to a representative range of credit products, and (4) ensure that any disclosure about the extent of its independence is prominent, clear and easily comprehensible.

260 Most directly relevant to these appeals are the pre-contractual requirements set out in Chapter 4. We quote two rules in full. First CONC 4.5.3R, headed "Commissions: credit brokers" stated:

> "A credit broker must disclose to a customer in good time before a credit agreement or a consumer hire agreement is entered into, the existence of any commission or fee or other remuneration payable to the credit broker by the lender or owner or a third party in relation to a credit agreement or a consumer hire agreement, where knowledge of the existence or amount of the commission could actually or potentially:
>
> "(1) affect the impartiality of the credit broker in recommending a particular product; or
>
> "(2) have a material impact on the customer's transactional decision.
>
> "[Note: paragraph 3.7i (box) and 3.7j of *CBG* and 5.5 (box) of *ILG*]"
>
> (This is substantially the same as the OFT's guidance in CBG at para 3.7. See also, in relation to lenders, ILG at para 5.5 and footnote 26.)

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CONC 4.5.4R stated:

> "At the request of the customer, a credit broker must disclose to the customer, in good time before a regulated credit agreement or a regulated consumer hire agreement is entered into, the amount (or if the precise amount is not known, the likely amount) of any commission or fee or other remuneration payable to the credit broker by the lender or owner or a third party.
>
> "[Note: paragraph 3.7i (box) of CBG]"
>
> (This is substantially the same as the guidance in the OFT's CBG at para 3.7 and in relation to lenders in ILG at para 5.5 and footnote 26.)

261 It is clear that the regulatory regime differed from the obligations of disclosure of a fiduciary. CONC 4.5.3R required the disclosure of the existence of a commission or fee or other remuneration paid to the broker only where the remuneration had the potential to affect the broker's recommendation or would have a material impact on the customer's decision whether to transact. The focus was on enabling the customer to make an informed decision. Similarly, CONC 4.5.4R required the disclosure of the amount of the remuneration only if the customer requested.

262 The FCA explained in its intervention that concern about high levels of non-compliance with its provisions for the disclosure of commissions prompted it to conduct a review of the motor finance sector and to amend the rules as from 28 January 2021. It explained that the changes made to CONC 3.7.4G and CONC 4.5.3R were intended to be clarification rather than changes in substance. Among the changes made were that in both CONC 3.7.4G and CONC 4.5.3R disclosure of the "existence" of remuneration was replaced by disclosure of the "existence and nature" of the remuneration. The wording of CONC 3.7.4G was also expanded to require the disclosure of the existence and nature of any financial arrangements with the lender not only (as before) when it might affect the firm's impartiality but also when it might "if disclosed by the firm to the customer, affect the customer's transactional decision in relation to the credit product". The obligation of disclosure in CONC 4.5.3R was also amended to require "prominent" disclosure. At the same time the FCA banned discretionary commission arrangements which linked the broker's commission to the interest rate under the credit agreement and gave the broker discretion to set or adjust the interest rate, as this gave an incentive to the broker to increase the customer's interest rate. See now CONC 4.5.6R and 4.5.7G.

263 The obligations of disclosure under the current regulatory regime remain essentially the same as those which applied at the time of the transactions which are the subject of these appeals. Those obligations continue to differ materially from those of a fiduciary. In particular, the provisions of CONC do not mandate the disclosure of the amount of a broker's remuneration in all cases, in contrast with the no profit rule, which requires a fiduciary to obtain the informed consent of his or her principal to the receipt of remuneration.

264 The FCA also explained that it did not treat a customer as vulnerable merely because he or she required car finance. As section 1C(2)(a)–(d) of FSMA, which we have set out in para 254 above, shows, Parliament has

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provided that the FCA in considering the appropriate degree of consumer protection in its regulation must take into account the different levels of transactional risk, differing degrees of experience and expertise of consumers and the general principle that consumers should take responsibility for their decisions.

265 It is clear therefore that the regulatory regime, which the FCA operates on statutory authority, is not premised on car dealers when acting as credit brokers being subjected to the no profit and no conflict rules and having the obligations of full disclosure of a fiduciary. The regime seeks to provide consumer protection in a nuanced way by requiring the car dealer to disclose information to assist the customer where the information would materially affect his or her decision to enter into the transaction, and to disclose the amount of remuneration received from the finance company *if* the customer requests such information before entering into the transaction.

266 This disclosure regime, and the protection against unfair relationships which we discuss in paras 291–338 below, are the statutory and regulatory framework which is part of the objective context in which contentions that dealers were and are under fiduciary duties need to be assessed.

5. The law applied to the facts

267 We stated at the outset of this judgment that, save in relation to the single surviving claim under the CCA, the outcome of this appeal turns on the question whether, having regard to the typical features of tripartite transactions of this kind, the law recognises a no conflict duty, owed by the dealer to the customer, that is a duty to avoid a conflict between its interest and the interest of the customer in relation to the dealer's role in the obtaining and negotiation of a finance package for the customer, such as would make the receipt of an undisclosed commission from the lender otherwise than with the customer's fully informed consent a bribe at common law, or such a receipt by a fiduciary, a breach of that duty giving rise to equitable remedies.

268 The typical features of the four transactions described in detail at paras 14–44 above, which the parties have put forward as relevant to the determination of this issue, are as follows. First, each of the three participants in the negotiation of the transaction was separately engaged at arm's length from the other participants in the pursuit of a separate commercial objective of their own. The dealer was seeking to sell a car, at a price (and on any other relevant terms such as warranties) sufficient to make an appropriate contribution to the profitable carrying on of its business. The lender was seeking to deploy loan finance to a reasonably creditworthy customer on terms as to interest and security sufficient to contribute to a profitable lending business. The customer was seeking to acquire the use of a suitable car at an affordable price (in terms of periodic and other payments) which compared attractively with the terms available for the acquisition of other cars, available either from the same or from a different dealer. Inevitably, the pursuit of each of those separate objectives had the propensity to come into conflict with the pursuit of the others. Such a conflict could result in the abandonment of the negotiation at any time before completion of the tripartite transaction, leaving the dealer to have to sell the car to

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another customer, and the customer to seek to acquire a cheaper or more competitively priced car either from the same or another dealer. Or it could lead to a renegotiation of the terms for the sale of the same car, such as a reduction of the price, or an adjustment of the balance between the deposit and periodic payments to suit the customer's means, in which each of the three parties would have a separate interest. Neither the parties themselves nor any onlooker could reasonably think that each of the participants to such a negotiation was doing anything other than considering their own interests.

269 Secondly, although, viewed separately, the activity of the dealer as an intermediary between customer and lender in seeking a suitable finance package for the customer from among its panel of lenders might be regarded as a form of credit brokerage, this service was not being provided by the dealer as a distinct and separate service in its own right, as the service was in cases such as *Hurstanger* and *Wood*. It was simply a means whereby the dealer could make use of its knowledge and contacts in the car finance market to oil the wheels of what was for it essentially a sale transaction from start to finish. It was something which was ancillary to the sale of the car, like a delivery service, an extended warranty or some additional equipment sourced from a third party such as a tow bar or a roof rack. It was not a service provided to the customer under any contract or even for a separate reward.

270 Thirdly, at no time in the negotiation of any of these transactions did the dealer give any kind of express undertaking or assurance to the customer that in finding a suitable credit deal for the customer it was putting aside its own commercial interest in the transaction as seller. In the Johnson transaction the dealer did state in writing (in the Suitability Document) that it would seek the most suitable finance package from among its panel of lenders, and a similar statement was made orally to Mr Wrench. But neither of these statements involved the dealer undertaking to exclude consideration of its own continuing commercial interest in the transaction. On the contrary, in three out of the four transactions (i e excluding the Hopcraft transaction) there was disclosure that a commission might be paid by the lender to the dealer, but we do not treat that as typical, or essential to our reasoning. Rather the point is that there was no express undertaking or assurance by the dealer to put its commercial interest aside in seeking a finance package for the customer. Whether there was any implied undertaking is a matter of law, to which we will return.

271 Fourthly, there was no agency undertaken by the dealer for the customer in the negotiation of the finance package with the lender, in the sense in which agency is a term used in the law (rather than just a loose label where someone agrees to do something for someone else). The dealer did not have the authority of the customer to enter into legal relations with the lender. Those legal relations were entered into by the customer personally signing the hire purchase or other finance agreement. The dealer did obtain confidential information about the customer's financial position to enable the lender to appraise the credit risk of lending to the customer. But this intermediary activity did not require or even point to the dealer assuming the mantle of agent for the customer. It is equally consistent with the dealer

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being an agent for the lender, or just a pure intermediary with no relationship of agency with either.

272 Furthermore, there were important respects in which the dealer typically intermediated between customer and lender as the agent of the lender in relation to the finance package. We have already noted (at para 246 above) that the view of the Law Reform Committee that the statutory agency for the lender which they recommended should be imposed upon intermediaries like the dealers in the present cases did no more than express the existing reality. That deemed statutory agency does not exclude the possibility that the dealer might be the agent of the customer, but there is force in the underlying assumption by the Law Reform Committee that the real agency is in fact in line with the statutory deeming.

273 More to the point, it appears that in two of the transactions under review (Wrench (2) and Johnson) the dealer had the authority of the lender actually to choose the interest rate which was to be chargeable under the hire purchase agreement being negotiated. But again this does not appear to be a universal feature of this type of transaction, so we place no particular reliance upon it. The point which is typical is that, apart from handing over financial information, the dealer had no authority to bind the customer to legal relations with the lender in relation to the finance package.

274 Fifthly, there may typically be at least an element of dependency upon or vulnerability to the dealer affecting the customer in relation to the finance package. There is typically a large differential in their knowledge of the relevant part of the consumer finance market. We say "an element" advisedly because, as is illustrated by the Johnson transaction, there is nothing to stop customers arranging their own finance packages if they wish to do so, or comparing the package offered by the dealer with the best which they can find online, or by ringing around. But dependency or vulnerability are not, as we have already explained, indicia of a fiduciary relationship, in the absence of an undertaking of loyalty.

275 Finally, we do not doubt the conclusion of the Court of Appeal that the way in which a dealer may proffer the service of finding a suitable finance package for the customer may engender an element of trust and confidence reposed by the customer in the dealer, in the sense that the customer may assume that the dealer will locate the most suitable finance package for the customer's particular needs. But we do not consider that the evidence shows that this typically goes beyond that which may frequently arise between commercial parties negotiating at arm's length, such as that which the customer might repose in advice received from a shop assistant or wine waiter, or in the advice which the dealer might give as to the best roof rack to source from the market and add to the car.

276 We now examine whether those typical features of the transactions under review give rise to a fiduciary duty (and therefore no conflict and no profit duties), sufficient to give rise to liability for bribery either at common law or in equity. In our judgment they do not. The typical features of the transactions are incompatible with the recognition of any obligation of undivided or selfless loyalty by the dealer to the customer when sourcing and recommending a suitable credit package.

277 The assumption by the dealer of the position of intermediary or broker between the customer and the lender is, of itself, neutral as to

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whether an obligation of undivided loyalty is being undertaken by the dealer. The position of intermediary is not, nor is it analogous with, that of a trustee, company director, partner or agent. But the continuing status of the dealer as an arm's length party to a commercial negotiation pursuing its own separate interests is anything but neutral. It is irreconcilably hostile to the recognition of a fiduciary obligation owed to another party in that negotiation. No reasonable onlooker would think that, by offering to find a suitable finance package to enable the customer to obtain the car, the dealer was thereby giving up, rather than continuing to pursue, its own commercial objective of securing a profitable sale of the car.

278 Mr Weir sought to overcome this apparently insuperable obstacle by submitting that the typical transaction should be viewed as if it had two separate stages. Stage one consisted of the negotiation of a disposal, subject to finance, of the car to the customer at an agreed price, in which the dealer and the customer were at arm's length. Stage two was the subsequent sourcing and entry into the requisite finance package, in which customer and dealer shared exactly the same interests, and stood side by side together in negotiating with the lender. The fiduciary obligation arose only at stage two, with no continuing arm's length commercial negotiation to get in the way.

279 We cannot accept that two-stage analysis. In cases where the customer needed finance to obtain the car (rather than just buying it outright), a finance package on acceptable terms was always going to be an integral part of what had to be negotiated to bring the transaction to fruition, and there could be no agreed disposal of the car to the customer unless and until finance terms acceptable to the customer were hammered out. Until then the dealer faced the risk that the negotiation would fail, or that it might need to reduce the price to enable it to proceed. The dealer's separate interest (potentially in conflict with the interests of the customer) would persist until completion of the whole transaction.

280 When the court put an example of this to Mr Weir, he submitted that in a case where the proffered finance package proved to be unacceptable (or unaffordable) to the customer, the dealer would be released from its stage two fiduciary obligation of loyalty to the customer, to enable it to resume an arm's length commercial negotiating position. We regard that analysis as commercially and legally unrealistic. In our view the dealer remains a separate player in the negotiation from start to finish, free to pursue its own interests at arm's length from the interests of the customer, subject only to the usual common law constraints (e g against misrepresentation), and to such regulatory constraints as may from time to time be imposed.

281 In three of the transactions under review there was, as already noted, a statement by the dealer to the customer that it would seek the most suitable finance package for the customer's requirements. This does not amount to an undertaking of fiduciary loyalty. An offer to find the best deal is not the same as an offer to act altruistically. If made as part of a contract it might give rise to contractual remedies if not performed. If made with no honest intention to do so, it might perhaps sound in misrepresentation. But it cannot be used as a way of inserting a fiduciary obligation into an arm's length commercial relationship, any more than in the case of the shop assistant or the wine waiter. Furthermore, it was in those same three

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transactions that the dealer disclosed that it might be taking commission from the selected lender, with no suggestion that it would seek the customer's consent before doing so. That is a factor which points away from the dealer's undertaking a fiduciary duty to the customer: a duty which would be inconsistent with the taking of commission without the customer's fully informed consent.

282 Nor is the role of the dealer in selecting and negotiating a suitable finance package for the customer one in relation to which a fiduciary obligation of loyalty can be implied, with or without such a statement of intent by the dealer. It is not to be implied by law, because the role is not one which the law (or equity) treats as habitually or even usually containing such an obligation (unlike the role of trustee, company director, partner or agent), nor is it analogous with any of those established relationships. It is not to be implied in fact because it is incompatible with the arm's length position of the dealer from start to finish of the negotiation of the transaction.

283 While we accept that a relationship of trust and confidence is frequently a consequence of a fiduciary relationship, it is not, for the reasons already given, an invariable pointer to a fiduciary obligation, still less something which of itself gives rise to a fiduciary duty. Relationships of trust and confidence arise in many circumstances. In some, such as between spouses in connection with the raising of security on co-owned property, it may give rise to a risk or presumption of undue influence, but not to a fiduciary duty. An element of trust and confidence is a widespread feature of many types of commercial transactions, far removed from any fiduciary content. The particular kind of trust and confidence that may point towards a fiduciary relationship is, as we have already explained, trust and confidence that the alleged fiduciary will act with single-minded loyalty towards the claimant, to the exclusion of his or her own interests. Trust and confidence that the dealer on the other side of an arm's length negotiation will secure the best available finance package for the customer is not of that type.

284 Nor is the existence of an element of dependency or vulnerability such a pointer, for the reasons explained in the *Galambos* and *Naaman* cases.

285 So we conclude that, to the extent that the Court of Appeal's judgment and the respondents' case depends upon the recognition of a fiduciary obligation of undivided loyalty on the part of the dealer when selecting and negotiating a finance package for the customer, they are wrong. In particular, the weight which the Court of Appeal placed upon findings of subjective trust and confidence, and of vulnerability, as indicative of a fiduciary relationship, at paras 90–91, 95, 100 and 103 of its judgment was wrong in law.

286 The outcome might be different in a case where the very nature of the service undertaken can only sensibly be provided by a person who puts their own personal interests aside. Then it would satisfy the necessity test for implication. But it is in our judgment inherent in the arm's length status of the dealer at all times during the negotiation of the typical transaction that it retains its own interest as seller, i e that it continues throughout to pursue its own commercial interests, free of any undertaking, express or implied, to act selflessly in the finding and negotiation of a finance package. The customer

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is not bound to accept the finance package offered. It is simply something which the dealer proffers in his own self-interested desire to get the whole transaction past the finishing post.

287 The alternative basis of the Court of Appeal's decision was (in relation only to bribery) to recognise the existence of what is in the *Wood* case called a "disinterested" duty on the dealer when selecting and negotiating a finance package for the customer.

288 We have concluded, contrary to the Court of Appeal's analysis, that the tort of bribery is not engaged by anything other than the receipt of a benefit by a person who is subject to a fiduciary duty to which the beneficiary of that duty has not given fully informed consent.

289 For all those reasons the claims of the customers in each of the four transactions in equity and in bribery must fail, and the lenders' appeals on that ground allowed.

290 That outcome makes it unnecessary for us to apply to the facts any of the other of our conclusions on the many issues of law raised by this appeal. Issues as to the adequacy of the disclosures made to the customers about possible commissions, the availability of a restitutionary remedy against the briber and the availability of rescission at law or in equity no longer arise, and any attempt to determine them on the hypothetical basis that there did exist the necessary fiduciary duty would be obiter, and best left to an occasion when they really mattered.

6. Mr Johnson's claim under section 140A of the CCA

291 This ground arises only in relation to the claim by Mr Johnson. We approach this ground on the basis that no breach of fiduciary duty has been established in his case and that FirstRand is under no accessory liability.

292 The facts relating to Mr Johnson's claim against FirstRand are set out in detail at paras 39–44 above. It is convenient to refer to the following matters at this point. In July 2017 Mr Johnson wished to purchase a car and located a second-hand Suzuki Swift at The Trade Centre Wales. The agreed cash price of the vehicle was £6,499. Mr Johnson paid Trade Centre Wales a non-refundable deposit of £100 to secure the vehicle at that price for three days. He required finance to purchase the car. The Trade Centre Wales told him that it could arrange finance from a panel of lenders. On 29 July 2017 Mr Johnson signed a Suitability Document prepared by The Trade Centre Wales. He also completed and signed a Finance Proposal Form and entered into a credit agreement with FirstRand. The credit agreement comprised two elements: a hire purchase agreement and a personal loan agreement ("the Johnson Credit Agreement"). The amount of credit for the hire purchase element was £4,803.69 and that for the personal loan agreement was £1,595.31, totalling £6,399. FirstRand paid The Trade Centre Wales commission of £1,650.95 for the introduction of Mr Johnson.

(1) The statutory provisions

293 It was conceded at the trial of Mr Johnson's claim that, because of the personal loan element of the Johnson Credit Agreement, there were antecedent negotiations within section 56(1)(c) of the CCA and, as a result, negotiations with Mr Johnson were deemed by section 56(2) to be conducted

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A by The Trade Centre Wales in the capacity of agent of FirstRand as well as in its actual capacity.

294 Section 140A of the CCA provides in material part:

"(1) The court may make an order under section 140B in connection with a credit agreement if it determines that the relationship between the creditor and the debtor arising out of the agreement (or the agreement B taken with any related agreement) is unfair to the debtor because of one or more of the following— (a) any of the terms of the agreement or of any related agreement; (b) the way in which the creditor has exercised or enforced any of his rights under the agreement or any related agreement; (c) any other thing done (or not done) by, or on behalf of, the creditor (either before or after the making of the agreement or any related C agreement).

"(2) In deciding whether to make a determination under this section the court shall have regard to all matters it thinks relevant (including matters relating to the creditor and matters relating to the debtor)."

295 Section 140B(9) of the CCA places the burden of proof in relation to unfairness on the creditor: "If, in any such proceedings, the debtor or a D surety alleges that the relationship between the creditor and the debtor is unfair to the debtor, it is for the creditor to prove to the contrary."

296 Section 140B sets out the available remedies:

"(1) An order under this section in connection with a credit agreement may do one or more of the following— (a) require the creditor, or any associate or former associate of his, to repay (in whole or in part) any sum E paid by the debtor or by a surety by virtue of the agreement or any related agreement (whether paid to the creditor, the associate or the former associate or to any other person); (b) require the creditor, or any associate or former associate of his, to do or not to do (or to cease doing) anything specified in the order in connection with the agreement or any related agreement; (c) reduce or discharge any sum payable by the debtor or by a F surety by virtue of the agreement or any related agreement; (d) direct the return to a surety of any property provided by him for the purposes of a security; (e) otherwise set aside (in whole or in part) any duty imposed on the debtor or on a surety by virtue of the agreement or any related agreement; (f) alter the terms of the agreement or of any related agreement; (g) direct accounts to be taken, or (in Scotland) an accounting to be made, between any persons."

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297 The test of the unfairness of the relationship of debtor and creditor is stated in general terms which permit courts to take account of a very broad range of factors. The application of the test in each case will, inevitably, be a highly fact-sensitive exercise (see *Plevin v Paragon Personal Finance Ltd* [2014] 1 WLR 4222 ("*Plevin*"), per Lord Sumption JSC at paras 10 and 29; *Smith v Royal Bank of Scotland plc* [2024] AC 955 ("*Smith*"), per Lord H Leggatt JSC at para 22).

298 Pursuant to section 137A(1) of FSMA the FCA has the power to make such rules in respect of the carrying on of regulated activities by authorised persons as appear to the FCA to be necessary or expedient for the purpose of advancing one or more of its operational objectives. The rules

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applicable to consumer credit related activities including credit broking are contained in the Consumer Credit Sourcebook of the FCA (which we have already defined as "CONC"). Reference is made below to the CONC rules in force in July 2017 when Mr Johnson entered into these arrangements.

(2) Mr Johnson's pleaded case in relation to section 140A

299 In his particulars of claim dated 18 November 2021 Mr Johnson alleged the following breaches by FirstRand and The Trade Centre Wales of their regulatory obligations under CONC which made the relationship between Mr Johnson and FirstRand unfair under section 140A of the CCA:

(1) FirstRand, in breach of CONC 1.2.2R, failed to ensure that its employees and agents complied with CONC and failed to take reasonable steps to ensure that other persons acting on its behalf complied with CONC.

(2) The Trade Centre Wales, acting as agent for FirstRand, in breach of CONC 2.3.2R, failed to explain key features in such a way as to provide Mr Johnson with an informed choice by failing to explain the existence and/or amount of the Discretionary Interest Commission or Fixed Fee Commission.

(3) The Trade Centre Wales, acting as agent for FirstRand, in breach of CONC 2.5.8(13)R, allowed preference to be given to a particular credit product, with the object of personal gain, rather than in the best interest of Mr Johnson.

(4) The Trade Centre Wales, acting as agent for FirstRand, in breach of CONC 3.3.1R, communicated in an unfair manner by failing to explain the existence and/or amount of the Discretionary Interest Commission or Fixed Fee Commission.

(5) The Trade Centre Wales, acting as agent for FirstRand, in breach of CONC 3.7.4G, failed to indicate to Mr Johnson in a prominent way the existence of any financial arrangements with a lender that might impact upon the firm's impartiality in promoting a credit product to a customer, by failing to explain the existence and/or amount of the Discretionary Interest Commission or Fixed Fee Commission.

(6) FirstRand, in breach of CONC 4.5.2G, failed to ensure that the interest rate ultimately charged and the commission payment were justified based on the extra work of the firm involved in that business.

(7) The Trade Centre Wales, acting as agent for FirstRand, in breach of CONC 4.5.3R, failed to communicate to Mr Johnson in good time (or at all), by failing to explain the existence and/or amount of the Discretionary Interest Commission or Fixed Fee Commission, thereby failing to disclose matters which did or could affect the impartiality of The Trade Centre Wales in recommending a particular product, or have a material impact on Mr Johnson's transactional decision.

300 It was alleged that the breaches of CONC rules were actionable under section 138D of FSMA. It was further alleged that Mr Johnson had suffered loss and damage in the form of increased credit charges.

301 Mr Johnson also relied in this regard upon his pleaded case on a secret commission. He alleged an express or implied representation that the Johnson Credit Agreement was competitive and represented the most advantageous terms for Mr Johnson. It was alleged that the existence and amount of the commission payment had not been expressly communicated

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A to Mr Johnson and he was not aware that a commission would or might be paid to The Trade Centre Wales.

302 In addition Mr Johnson relied in this regard on his case of breach of fiduciary duty by The Trade Centre Wales and accessory liability by FirstRand.

303 It was therefore alleged that, by reason of these matters, the B relationship between Mr Johnson and FirstRand was unfair pursuant to section 140A of the CCA.

304 Further or in the alternative, it was alleged that:

> "the failure of the Broker and/or Defendant in not communicating the existence or level of commission and/or that there existed a Discretionary Interest Commission or Fixed Fee Commission meant that the Claimant C was not placed into an informed position, causing an unfair relationship between the Claimant and Defendant."

(3) The judgments below

(a) Judgment of DDJ Sandercock

305 DDJ Sandercock held that the commission was not a discretionary D interest commission or fixed fee commission. He held that, as a result, the pleaded allegations relating to those forms of commission failed. He found that the commission was based on the capital, not the interest rate, and that the interest rate of 8% was the lowest rate the lender offered for cars up to five years old. He went on to hold that there was nothing unfair in the agreement or the surrounding circumstances which would cause the court to E consider making an order under section 140B. He made the following findings in relation to fairness, at para 65:

> "a. I find that the claimant displayed an almost wilful disregard of the precontract information and the terms and conditions of the agreement . . .
>
> "b. The claimant persisted in the mistaken assertion that the amount of F commission was based on the interest payable under the agreement. I accept Mr Irving's evidence that the commission was based entirely on the amount of the capital of the loan.
>
> "c. It was submitted on the claimant's behalf that if the commission had been less the instalments would have been lower. There was no evidence to support this submission. I find that it was illogical in any G event because the only variable in the arrangements between both claimant and defendant and defendant and TCW was the range of interest which the broker could have applied. Having applied the minimum rate available the claimant could not have paid any less.
>
> "d. [T]he claimant's instalments would have been the same regardless of the amount of commission or if no commission was payable at all[.]
>
> "e. [T]he claimant is not entitled to claim against the defendant if he H has made a bad bargain over the price of the car. This is not an issue relating to the fairness of the credit agreement.
>
> "f. There was no evidence that the dealer/broker had caused the claimant to enter into an agreement for a higher sum of money than he needed. Had this applied it might have been an argument that the

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commission was inflated but this is not the case. It is not for the court to speculate about what might have happened in hypothetical circumstances.

"g. The defendant had complied with CONC.

"h. The claimant had made himself aware of interest rates and repayments and was content to enter into this agreement on its particular terms[.]

"i. [T]here is nothing in the agreement which is itself unfair.

"j. [T]he antecedent documents and clause 13.6 of the Terms and Conditions provided ample information and opportunity for the claimant to understand his position exactly but he chose not to read them."

306 As the Court of Appeal pointed out (at para 163), the approach of DDJ Sandercock was unduly affected by the fact that the pleadings alleged that the commission was a Discretionary Interest Commission or Fixed Fee Commission when it was not. This led the DDJ to reject pleaded allegations of breaches of the CONC rules which were in fact made out on the facts. Furthermore, he made no findings as to whether the dealer had disclosed the following important aspects of the agreement between the dealer and the lender (identified by the Court of Appeal at para 150):

(1) The dealer was entitled to payment of a commission if the agreement was concluded.

(2) The agreement between the dealer and the lender required the dealer to offer all its business to the lender which had first refusal.

(3) The agreement guaranteed the dealer a commission which amounted to 25% of the total sum advanced.

(b) Judgment of Judge Jarman KC

307 Mr Johnson appealed against the order of DDJ Sandercock dismissing his claim. The appeal was heard by Judge Jarman KC, who was concerned that the DDJ had dealt inadequately with the claim under section 140A of the CCA. Focusing on whether the failure to confirm that a commission was paid or the amount of it rendered the relationship between Mr Johnson and FirstRand unfair, Judge Jarman noted that the DDJ had not made a finding on whether the dealer had disclosed the commission. Bearing in mind the observation of Lord Sumption JSC in *Plevin*, para 17, that the overall consideration of fairness under the breadth of section 140A involves a wide range of considerations and forensic judgment, he concluded, entirely correctly in our view, that a finding as to whether or not the dealer made such disclosure might well have a material impact on the overall consideration of whether the relationship between Mr Johnson and the lender was fair. Accordingly, he remitted the consideration of the fairness of the relationship for a finding of whether such disclosure was made by the dealer and a reconsideration of the overall issue of fairness in this context. He did not consider it appropriate to remit just one or more points on this issue, given that they were part of an overall consideration of fairness.

308 We note, as did the Court of Appeal (at para 164), that the Suitability Document and the Dealer Terms of Business were not expressly drawn to the attention of either DDJ Sandercock or Judge Jarman.

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(c) Appeal to the Court of Appeal

309 On the appeal to the Court of Appeal, that court concluded that Judge Jarman had been in a position to make a determination as to whether Mr Johnson was entitled to protection under section 140A of the CCA, as was the Court of Appeal. It considered that this was a very clear case of an unfair relationship. In its view, the "very high" commission to the broker, which was 25% of the sum advanced, was a key fact.

310 The Court of Appeal also made findings of unfairness which had not formed part of Mr Johnson's positive case on unfairness.

311 First, it considered that the sum borrowed and paid to the dealer was much more than the car was worth. It is correct that the cash price of the vehicle (£6,499) exceeded its value according to Glass's Guide. Because FirstRand would only offer hire purchase contracts for up to 100% of the Glass's Guide retail price for a vehicle under five years old and in good condition, a personal loan agreement was necessary. In the result, credit of only £4,803.69 was provided under the hire purchase element of the Johnson Credit Agreement. Mr Johnson paid a deposit of £100 but did not provide a vehicle in part exchange. A personal loan was therefore necessary to fund the difference of £1,595.31. This was provided under the personal loan element of the Johnson Credit Agreement. However, whether Mr Johnson made a bad bargain in the sense of paying considerably above the market value of the car was not pleaded, and the discrepancy between the sale price and the Glass's Guide price was not explored at the trial. As Mr Howard points out on behalf of FirstRand, there could be many possible explanations. While in other cases the supply of a vehicle at an inflated price could be highly relevant to whether the relationship of lender and customer was unfair, in our view the Court of Appeal erred in taking account of this discrepancy when assessing the fairness of the relationship between Mr Johnson and FirstRand. On behalf of Mr Johnson, Mr Weir has expressly disavowed reliance on this ground of unfairness.

312 Secondly, the Court of Appeal considered (at para 161) that the difference between the sum borrowed and paid to the dealer and the actual value of the car "was largely accounted for by commission". It proceeded on the basis that the discrepancy between the cash price of the car and the Glass's Guide valuation, as reflected in the personal loan of £1,595.31, was largely accounted for by the payment of the commission of £1,650.95. It considered (at para 154) that the proceeds of the additional personal loan were, in effect, required to pay the dealer the commission, and that if the commission had not been payable Mr Johnson would have been able to fund the purchase at the actual Glass's Guide price using the hire purchase agreement which the lender offered. However, linking the two in this way was a factual error on the part of the Court of Appeal. On behalf of Mr Johnson, Mr Weir accepts that the similarity in amount between the commission paid by FirstRand and the personal loan was a coincidence, and he did not seek to support the Court of Appeal's conclusion on unfairness on that ground.

313 Thirdly, the Court of Appeal concluded (at para 170) with regard to the contractual tie between FirstRand and The Trade Centre Wales, that the true nature of the relationship between the lender and the broker was not disclosed by the lender.

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314 Fourthly, the Court of Appeal concluded (at paras 169 and 170) with regard to the Suitability Document, that the relationship between the lender and the broker was falsified by the broker and actively concealed by the broker acting as agent for the lender by virtue of section 56 of the CCA.

315 It is submitted on behalf of FirstRand that the further third and fourth findings should not have been made by the Court of Appeal because they were not pleaded, nor were they based on findings by DDJ Sandercock. We reject this submission for the following reasons:

(1) In assessing the fairness of a relationship under section 140A it is necessary to take into account all matters the court considers relevant (section 140A(2); *Plevin* per Lord Sumption JSC at para 10; *Smith* per Lord Leggatt JSC at para 22).

(2) The burden is on FirstRand to show that the relationship is not unfair (section 140B(9)).

(3) It was pleaded on behalf of Mr Johnson that the relationship was unfair by reason of breaches of CONC. Mr Johnson expressly relied on CONC 2.5.8(13)R (duty on a firm not to give preference to the credit products of a particular lender where the object of doing so is for, or can reasonably be concluded as having been for, the personal gain of the firm rather than in the best interests of the customer) and CONC 3.7.4G (duty on a firm in a communication with a customer to indicate in a prominent way the existence of any financial arrangements with a lender that might impact upon the firm's impartiality in promoting a credit product to a customer) (particulars of claim, paras 21, 23, 25(2)(4), 50).

(4) Reference has been made above to the fact that the Suitability Document and the Dealer Terms of Business were not expressly drawn to the attention of either DDJ Sandercock or Judge Jarman. The Suitability Document was in Mr Johnson's list of documents but FirstRand did not seek inspection.

(5) It is correct that DDJ Sandercock found that Mr Johnson did not read the documents. The Court of Appeal acknowledged this (at para 168). However, the Court of Appeal's conclusions in relation to the Suitability Document did not proceed on the basis that Mr Johnson had been misled but on the basis that the Suitability Document was objectively misleading. The further significance of Mr Johnson failing to read the documents is considered at para 336 below. Crucially, these aspects of unfairness on which the Court of Appeal additionally relied did not involve any real risk of procedural unfairness to the lender in the sense that something which it might have raised in evidence was excluded. Indeed, the two main features of the transaction on which we focus below—the size of the undisclosed commission and the tie—are incontrovertible.

(6) Accordingly, we consider that the Court of Appeal was both entitled and required to take account of these matters when considering the fairness of the relationship.

316 However, the errors on the part of the Court of Appeal identified at paras 311 and 312 above vitiate its decision on the issue of unfairness under section 140A of the CCA. Accordingly, it is for this court to decide the issue or to remit it to a district judge.

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(4) Was the relationship unfair?

317 On this further appeal to the Supreme Court, FirstRand submits that the issue whether the relationship between FirstRand and Mr Johnson was unfair should be remitted for decision by a district judge. Mr Johnson submits that this court should uphold the conclusion of the Court of Appeal on this ground.

318 In *Plevin* Lord Sumption JSC provided the following guidance (at para 10):

> "Section 140A is deliberately framed in wide terms with very little in the way of guidance about the criteria for its application, such as is to be found in other provisions of the Act conferring discretionary powers on the courts. It is not possible to state a precise or universal test for its application, which must depend on the court's judgment of all the relevant facts. Some general points may, however, be made. First, what must be unfair is the relationship between the debtor and the creditor. In a case like the present one, where the terms themselves are not intrinsically unfair, this will often be because the relationship is so one-sided as substantially to limit the debtor's ability to choose. Secondly, although the court is concerned with hardship to the debtor, subsection 140A(2) envisages that matters relating to the creditor or the debtor may also be relevant. There may be features of the transaction which operate harshly against the debtor but it does not necessarily follow that the relationship is unfair. These features may be required in order to protect what the court regards as a legitimate interest of the creditor. Thirdly, the alleged unfairness must arise from one of the three categories of cause listed at sub-paragraphs (a) to (c). Fourthly, the great majority of relationships between commercial lenders and private borrowers are probably characterised by large differences of financial knowledge and expertise. It is an inherently unequal relationship. But it cannot have been Parliament's intention that the generality of such relationships should be liable to be reopened for that reason alone."

319 In its helpful written case the FCA, while observing that a relationship will not be unfair merely because a commission was paid of which a borrower was unaware, has identified the following as relevant factors pointing towards unfairness. The court agrees that the factors in this non-exhaustive list will normally be relevant: the size of the commission relative to the charge for credit; the nature of the commission (because, for example, a discretionary commission may create incentives to charge a higher interest rate); the characteristics of the consumer; the extent and manner of the disclosure (including by the broker insofar as section 56 is engaged); and compliance with the regulatory rules.

320 The agreement between FirstRand and The Trade Centre Wales governing their business relationship was contained in FirstRand's letter dated 18 July 2017. It provided in clause 1.15:

> "Commission Disclosure. You agree to disclose to the customer early in the sales process in relation to each regulated finance agreement that commission may be payable to you for acting as a credit broker and/or credit intermediary. If requested to do so by the customer you will inform

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the customer of the amount of any commission and or other benefits payable by us to you in relation to the prospective or actual regulated (sic)".

Before entering into the hire purchase agreement with FirstRand, Mr Johnson was given by the dealer a document entitled "Suitability Document". This included the following statement: "We do not charge a fee for handling your application for Consumer Credit, but we may receive a commission from the product provider." Mr Johnson then signed the hire purchase agreement with FirstRand. In doing so, Mr Johnson made a standard form declaration that his attention had been drawn to the provisions of clause 10 of FirstRand's standard terms and conditions and that he had received and read the pre-contract information. Clause 10 concerned the liability of FirstRand and is of no particular relevance to the present issue. However, clause 13.6 of FirstRand's standard terms and conditions, to which attention was not expressly drawn, provided: "A commission may be payable by us to the broker who introduced this transaction to us. The amount is available from the Broker on request." It was Mr Johnson's evidence at trial that the payment of commission was not disclosed to him orally and that he was not aware of it because he did not read the Suitability Document or FirstRand's terms and conditions. In his witness statement he said that he was handed an enormous amount of paperwork and asked to sign the agreement. He said that the whole process felt very rushed and he did not really feel he could take time to read through the paperwork. It is clear that the commission was not disclosed. Nevertheless, we agree with the FCA and Court of Appeal (para 20) that the mere fact that there has been no disclosure of the commission, or only partial disclosure, will not necessarily suffice of itself to make the relationship between lender and customer unfair for the purposes of the CCA. It is a factor to be taken into account in the overall balancing exercise required under section 140A.

321 We have referred above to the possibility that Mr Johnson may have made a bad bargain in that the cash price for the purchase of the vehicle was substantially in excess of its market value according to Glass's Guide. However, as explained at para 311 above, the reason for this discrepancy has not been established and so the point cannot assist Mr Johnson.

322 The particulars of claim make reference to CONC 2.3.2R, which provides that a firm must explain the key features of a regulated credit agreement to enable the customer to make an informed choice. The pleaded breach of that provision was expressed in terms of the alleged failure to explain the existence and/or amount of the Discretionary Interest Commission or Fixed Fee Commission, for which, it is now accepted, there was no basis. To the extent that Mr Weir relied on this provision in support of a wider case, it appears that Mr Johnson was made aware of the cash price, the APR, the monthly payments and the total amount he was paying for credit. Mr Johnson was given a document entitled "Pre-Contract Credit Information" which contained the information required by section 55 of the CCA. However, Mr Johnson was not made aware of the commission or the dealer's tie to FirstRand, matters considered further below.

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A (i) The size of the commission

323 The commission paid by FirstRand to The Trade Centre Wales was £1,650.95. This must be compared with the total amount payable by Mr Johnson under the credit agreement of £9,422.20 (17.5%), the advance of credit of £6,399 (26%), the total charge for credit (comprising interest and fees) of £3,023.20 (55%) and the interest payments alone of £2,635.20 (63%).

B 324 In support of his case on the size of the commission Mr Weir, on behalf of Mr Johnson, relies heavily on the decision of this court in *Plevin*. That case was concerned with payment protection insurance ("PPI") which was taken out by Mrs Plevin in conjunction with a loan from the lender's designated PPI provider. The lender paid commission to the broker in respect of both the loan and the PPI and itself received commission from the PPI provider. As a result, 71.8% of the PPI premium was made up of C commission, not disclosed to the claimant, which was shared by the broker and the lender. Lord Sumption JSC, with whom the other members of the Supreme Court agreed, noted (at para 18) that Mrs Plevin must be taken to have known that some commission would be payable to intermediaries out of the premium before it reached the insurer. However, Lord Sumption JSC explained, at some point commissions may become so large that the D relationship cannot be regarded as fair if the customer is kept in ignorance. Wherever the tipping point may lie, the commissions paid in that case were a long way beyond it. Mrs Plevin did not have to take PPI at all. Any reasonable person in her position who was told that more than two thirds of the premium was going to intermediaries would be bound to question whether the insurance represented value for money. The fact that she was E left in ignorance made the relationship unfair.

325 Mr Weir submits, by reference to *Plevin*, that the question is whether the commission was so high that it was unfair to leave Mr Johnson in ignorance of the amount because he would be unable to make an informed decision whether to enter into the credit agreement. He accepts that the context is critical to an assessment of whether the size of the commission renders the relationship unfair. He submits that in the present case the size F of the commission was clearly relevant to the claimant's decision-making, not least because most people would assume a commission of this size must have had an effect on the amount they were paying under the credit agreement. He submits that the interest and other charges (which make up the APR) represent the cost of finance and are the appropriate comparator. He submits that the fact that the commission was 55% of the total charge for G credit equates to the position in *Plevin* where the commission was 71.8% of the cost of the PPI policy premiums. It is his case that Mr Johnson was in no better position to assess the true value for money of his credit agreement by reference to the APR than Mrs Plevin was her PPI agreement by reference to the premium, and the fact that he needed finance to acquire the car made him more vulnerable.

H 326 The analogy between the facts of *Plevin* and those of the present case is imprecise and it is not possible simply to apply the reasoning of the Supreme Court in *Plevin* to the present case. The two cases are concerned with different products on different markets. In particular, as Mr Howard points out on behalf of FirstRand, the decision to enter into a finance agreement was not optional for Mr Johnson, because without finance he

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could not pay for the car. He had to decide whether to purchase the car at all and, if so, with which finance product. He had been provided with information as to the price of the car and the cost of the finance agreement (interest rate, fees, APR and monthly repayments). He was, at least, in a position to compare the cost of the finance agreement offered to him with other options available on the market.

327 Nevertheless, the fact that the undisclosed commission was so high is a powerful indication that the relationship between Mr Johnson and FirstRand was unfair. If he had been told the fact and the amount of the commission, Mr Johnson would have been able to ask why it was so high. It was his evidence at trial that he had been told by his solicitors that FirstRand made a commission payment to The Trade Centre Wales in the sum of £1,650.95 which he understood represented almost 70% of the cost of credit. His evidence was that he had no idea that commission was commonly paid in this industry and he was very surprised to learn how much commission was paid under his agreement. He understood that he paid interest as part of the agreement and assumed that all of the charges under the agreement were that interest. He had always thought that car dealerships made their money by making a profit on the cars they sell rather than by arranging finance. He added: "If I had been told that the overwhelming majority of the cost of this agreement to me was just a commission payment to the dealer, I simply would have walked away and gone to a different dealership." Even when allowance is made for exaggeration in this evidence, it is clear that the amount of the undisclosed commission would have been a major consideration in Mr Johnson's mind had he been made aware of it at the time of entering into the arrangements, as it would be to any similar customer. In any event, it is not necessary for him to prove that he would not have proceeded with the transaction had he been made aware of the fact and amount of the commission (see *Plevin* per Lord Sumption JSC at para 20; *Smith* per Lord Leggatt JSC at paras 25 and 29).

328 DDJ Sandercock accepted the evidence of Mr Irving, called on behalf of FirstRand, that the commission was based entirely on the amount of the capital of the loan. We take this to mean that it was calculated on the amount of the capital of the loan. DDJ Sandercock rejected the submission that if the commission had been less the instalments would have been lower, on the grounds that there was no evidence to support it and that it was illogical as Mr Johnson was already paying the lowest rate of interest permitted under the arrangement between the dealer and FirstRand. It is correct that the cost of the commission was not added directly to the cost of credit to Mr Johnson. Furthermore, it was not added directly to the cost of the vehicle, the price for which had already been agreed. Nevertheless, as Mr Howard accepted in his submissions, the cost to FirstRand of paying the commission was a part of FirstRand's overheads and must have been recovered indirectly from borrowers, including Mr Johnson, within the charges FirstRand made for credit. Indeed, Mr Irving accepted in cross examination that the commission was paid out of the interest which Mr Johnson paid. In this way the commission was recovered by FirstRand.

329 The failure to disclose to Mr Johnson the existence of the commission was a breach of CONC 4.5.3R which provided at the relevant time:

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A "4.5.3R A credit broker must disclose to a customer in good time before a credit agreement or a consumer hire agreement is entered into, the existence of any commission or fee or other remuneration payable to the credit broker by the lender or owner or a third party in relation to a credit agreement or a consumer hire agreement, where knowledge of the existence or amount of the commission could actually or potentially:

B "(1) affect the impartiality of the credit broker in recommending a particular product; or

"(2) have a material impact on the customer's transactional decision."

(ii) The commercial tie

330 The existence of a commercial tie between The Trade Centre Wales and FirstRand and its non-disclosure to Mr Johnson is a further consideration C highly material to the issue of the unfairness of the relationship between Mr Johnson and FirstRand under section 140A.

331 The Suitability Document, given to Mr Johnson by The Trade Centre Wales prior to his signing the hire purchase agreement with FirstRand, states that The Trade Centre Wales is authorised and regulated by the FCA and is permitted to advise on and arrange consumer credit D contracts. It states in material part:

"We will undertake an assessment of your Demands and Needs for Consumer Finance and provide an illustration of the Consumer Finance product that best meets your individual requirements based upon the answers you provide . . .

"We do not offer a whole market option for Consumer Credit; we offer E products from a select panel of lenders, details of which can be seen below: . . ."

The document then sets out the names and addresses of 22 lenders, all of which save those of FirstRand have been redacted in the copy of the document disclosed in these proceedings. FirstRand appears eleventh in the F list. The document then continues:

"The following pages provide a record of the responses given by you during the assessment of your Demands and Needs for Consumer Finance. The answers provided have been used to generate the following illustration of the Consumer Finance product that best meets your individual requirements."

G The document then sets out some of the terms of the proposed hire purchase agreement with FirstRand, including its duration (60 months), the option to purchase fee (£20), the initial payment (£153.72), the monthly payments (£153.72), the final payment (£352.72) and the flat rate for credit (8%).

332 In fact, the relationship between FirstRand and The Trade Centre Wales was the subject of a tie. Clause 2.1 of the Dealer Terms of Business of H FirstRand (trading as MotoNovo Finance) provided:

"Providing Credit

"The Dealer shall introduce Applicants to MNF by submitting Proposals to MNF using the online system or by fax or by any other agreed means (solely at the discretion of MNF). The Dealer agrees not to

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refer any Applicant to any party other than MNF unless the Dealer has first submitted a Proposal in relation to the Applicant to MNF and MNF has declined to accept such Proposal.

"The Dealer shall use reasonable endeavours to introduce Applicants to MNF in line with the rates and terms agreed from time to time."

We note that the Dealer Terms of Business with FirstRand did not include a term requiring the dealer to draw the tie to the attention of customers.

333 Neither the Suitability Document nor any other document provided by The Trade Centre Wales to Mr Johnson disclosed the existence of the tie. We agree with the Court of Appeal (at para 155) that this omission of a key fact was a suppression of the truth. The Suitability Document created, and was clearly intended to create, the false impression that the dealer was offering "products from a select panel of lenders" and recommending "the Consumer Finance product that best meets your individual requirements based upon the answers you provide". The reality was very different. Mr Johnson was not receiving the benefit of access to a range of possible lenders nor was he receiving advice as to which of their products best met his individual requirements. The Trade Centre Wales was simply putting forward the terms offered by FirstRand and acting in compliance with its undisclosed contractual obligation to FirstRand.

334 Here we agree with the conclusions drawn by the Court of Appeal (at para 166):

"In fact, the reality was that the Trade Centre Wales made no attempt to be impartial between different lenders in the interests of the consumer. All the business was offered to FirstRand. The dealer gave the customer the Suitability Document which actively concealed the reality. The dealer offered no service to Mr Johnson as a broker at all except to introduce him to one lender to whom it was tied by Clause 2.1 of the Dealer Terms of Business and from whom it took a lavish commission. The existence of the relationship between lender and dealer in this case was such as to require honest and accurate disclosure so that the customer could decide whether he wanted to buy a car with finance obtained through a dealer/credit broker who would conduct at least some review of what the credit market, or a panel of lenders within it, might offer him."

335 The statements in the Suitability Document were made in negotiations which are deemed to have been conducted by The Trade Centre Wales in the capacity of agent of FirstRand as well as in its actual capacity, by virtue of section 56(2) of the CCA. Furthermore, there were breaches of the following provisions of CONC in force at the relevant time:

"3.3.1R A firm must ensure that a communication or a financial promotion is clear, fair, and not misleading."

"3.7.3R A firm must, in a financial promotion or a document which is intended for individuals which relates to its credit broking, indicate the extent of its powers and in particular whether it works exclusively with one or more lenders or works independently."

"3.7.4G A firm should in a financial promotion or in a communication with a customer:"

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A "(2) indicate to the customer in a prominent way the existence of any financial arrangements with a lender that might impact upon the firm's impartiality in promoting a credit product to a customer; . . ."

(iii) Mr Johnson's failure to read the documents

336 In deciding whether to make a determination of an unfair
B relationship between creditor and debtor under section 140A, the court is required to have regard to all matters it thinks relevant. The assessment involves a balancing of relevant factors. In the present case an important item to be placed on the other side of the scales is Mr Johnson's failure to read any of the documents provided by The Trade Centre Wales either before concluding the agreements or during the 14 day withdrawal period which
C followed. DDJ Sandercock concluded that Mr Johnson "displayed an almost wilful disregard of the precontract information and the terms and conditions of the agreement". Had Mr Johnson read in detail the Suitability Document or the standard terms and conditions attached to the hire purchase agreement he would have been informed of the possibility that a commission might be payable by FirstRand to The Trade Centre Wales. Had he decided to pursue the matter he was likely to have discovered the amount of the commission. In
D fairness to Mr Johnson, however, it must be pointed out that he was commercially unsophisticated. It must be questionable to what extent a lender could reasonably expect a customer to have read and understood the detail of such documents. Furthermore, no prominence was given to the relevant statements in these documents. In the case of FirstRand's standard terms and conditions, clause 13.6 was surrounded by a mass of other terms.
E It should also be pointed out that particular attention was drawn to clause 10 of the terms and conditions but not to clause 13.6. A customer would not expect that a commission of this size would be payable and, as a result, a term of the importance of clause 13.6 is required to be displayed more prominently and the customer's attention expressly drawn to it. (In this regard see, generally, *Thornton v Shoe Lane Parking Ltd* [1971] 2 QB 163 per Lord
F Denning MR at p 170C, a decision on incorporation of extravagant terms as opposed to their fairness.) So far as the contractual tie between The Trade Centre Wales and FirstRand is concerned, there was nothing in the documentation which could have alerted Mr Johnson to the true position. On the contrary, the documentation created a false impression that the dealer had access to a selected panel of 22 lenders and had selected the deal which
G was most suitable for Mr Johnson.

(iv) Conclusion on the CCA issue

337 In the light of the errors made by the Court of Appeal, set out at paras 311–312 above, we have given careful consideration to whether the issue of unfairness under section 140A should be remitted for decision by a district judge or whether it is open to this court to decide the matter. We take
H the latter course for the following reasons:

(1) There are no outstanding factual disputes in relation to this issue. This court is fully informed and has had the benefit of very detailed and expert submissions on the relevant law and its application to the facts. We consider that we are as well placed as a district judge would be to decide it.

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(2) It would be contrary to the overriding objective to remit this issue. It would be a disproportionate use of court time and the parties would incur further costs unnecessarily in this individual case of relatively low value.

(3) We note the submission on behalf of the FCA that the public interest in achieving finality and clarity in the law under section 140A in the motor finance context and that consistency in respect of the many thousands of pending complaints and claims would be aided by an authoritative ruling by this court. The FCA submits that the prospect of a remittal should not be permitted to delay the resolution of these issues.

(4) For all the reasons set out above, we have come to the very clear view that the relationship between Mr Johnson and FirstRand was an unfair relationship within section 140A of the CCA.

338 So far as remedies are concerned, section 140B of the CCA confers very wide powers. We consider that the commission of £1,650.95 should be paid to Mr Johnson, with interest at an appropriate commercial rate from 29 July 2017, the date of the agreement.

7. Overall conclusion

339 As we have explained, the dealers in the present cases were not subject to any fiduciary duty towards their customers. It follows that the customers' claims against the lenders in equity and in bribery cannot succeed. The lenders' appeals in the Hopcraft and Wrench cases, and in the Johnson case so far as it was based on bribery or on equity, are therefore allowed.

340 The relationship between Mr Johnson and FirstRand was unfair within the meaning of section 140A of the CCA, by reason in particular of the size of the commission, the failure to disclose the commission, and the concealment of the commercial tie between the dealer and FirstRand. Mr Johnson is therefore entitled to succeed in his claim on that basis. However, the order made in his favour by the Court of Appeal was vitiated by mistakes. FirstRand's appeal must therefore be allowed so as to substitute an order in Mr Johnson's favour on different terms from that made by the Court of Appeal.

Appeals allowed.
Order accordingly.

ISABELLA MARSHALL, Barrister

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ITEM NO. 166

JA-52

Neutral Citation Number: [2025] EWHC 2316 (Ch)

Case Numbers: CR-2021-001548, CR-2022-000144 & BL-2024-001058

IN THE HIGH COURT OF JUSTICE
BUSINESS AND PROPERTY COURTS OF ENGLAND AND WALES
INSOLVANCY AND COMPANIES LIST (ChD) and BUSINESS LIST (ChD)

7 Rolls Buildings
Fetter Lane, London, EC4A 1NL
Date: 10 September 2025

Before:

THE HONOURABLE MR JUSTICE THOMPSELL

- -

IN THE MATTER OF CORE VCT PLC (IN LIQUIDATION), IN THE MATTER OF CORE VCT IV PLC (IN LIQUIDATION), IN THE MATTER OF CORE VCT V PLC (IN LIQUIDATION) AND IN THE MATTER OF THE INSOLVENCY ACT 1986

BETWEEN: **1. LAURENCE PAGDEN (as Liquidator of Core VCT IV plc and Core VCT V plc)**
~~2. SIMON JAMES UNDERWOOD~~
3. DAVID ROBERT BAXENDALE
4. STEVEN ANTHONY SHERRY (as Joint Liquidators of Core VCT plc) **Applicants**

- and -

1. MARK ROBERT FRY
2. NEIL JOHN MATHER
(as former Joint Liquidators of Core VCT plc, Core VCT IV plc, and Core VCT V plc) **Respondents**

AND BETWEEN: **1. CORE VCT PLC (in liquidation)**
2. CORE VCT IV PLC (in liquidation)
3. CORE VCT V PLC (in liquidation) **Claimants**

- and –

1. SOHO SQUARE CAPITAL LLP
(formerly ESO Capital Advisors LLP and, before that, Core Capital Partners LLP)
2. Mr WALID KHALIL FAKHRY
3. STEPHEN PETER EDWARDS
4. MARK ROBERT FRY
5. NEIL JOHN MATHER
6. BEGBIES TRAYNOR (CENTRAL) LLP
7. BTG ADVISORY LLP (formerly BTG Financial Consulting LLP)
~~8. BEGBIES TRAYNOR GROUP PLC~~
9. SOHO SQUARE CAPITAL I LP (formerly Core Capital I LP)
10. SOHO SQUARE CAPITAL II LP (formerly Core Capital Partners II LP)
11. RHONDA NICOLL
12. DAVID JOHN ALEXANDER STEEL
~~13. PETER MENZIES SMAILL~~ **Defendants**

Ms Catherine Addy KC, Daniel Lewis and **Charles King** (instructed by **Harcus Parker Limited** and from 3 September 2025, **Michelmores LLP**) for the **Claimants**

Mr Adam Deacock (instructed by **Reynolds Porter Chamberlain LLP**) for the **Defendants**

Hearing dates: 18-19 June 2025

- -

APPROVED JUDGMENT

- -

This judgment was handed down remotely at 10.30am on 10 September 2025 by circulation to the parties or their representatives by e-mail and by release to the National Archives

Mr Justice Thompsell:

1. INTRODUCTION

1. Can liquidators or their firms dealing with a members' voluntary liquidation limit their liability? This question is at the heart of the matter that has been argued before me in a two-day trial of a preliminary issue which I describe in more detail below (the "**Preliminary Issue**"). The Preliminary Issue has arisen in connection with a lawsuit being brought by the three claimant companies (the "**Claimant Companies**") following their restoration to the Companies Register though their new liquidators.

2. This litigation is being brought against, amongst others, the following defendants (collectively, the "**Begbies Defendants**"):

   i) the Fourth and Fifth Defendant (respectively "**Mr Fry**" and "**Mr Mather**", and collectively the "**Former Liquidators**");

   ii) the Sixth Defendant, Begbies Traynor (Central) LLP ("**Begbies LLP**") being a firm within which the Former Liquidators operated; and

   iii) the Seventh Defendant, BTG Advisory LLP, formerly BTG Financial Consulting LLP, ("**BTG Advisory**") being a firm associated with Begbies LLP.

3. A trial of the preliminary issue was directed pursuant to the Order of HH Judge Davis-White KC dated 4 December 2024. The Preliminary Issue for the Court's determination is:

> "Whether clause 13.2.3 of the Sixth Defendant's Standard Terms of Business ("the **Terms**") and Clause 7 of their letters of engagement dated 5 and 6 March 2015 ("the letters of engagement") limits the liability of the Fourth to ~~Eighth~~Seventh Defendants ("the Begbies Defendants") and each of them to an aggregate sum of £1 million in respect of the breaches of duty alleged in paragraphs 155-158 of the Particulars of Claim (in their original form or as amended by the Amended Particulars of Claim) or any of them."

4. Although the Preliminary Issue as ordered referred to the Fourth to Eighth Defendants, the Claims against the Eighth Defendant have been dismissed by consent.

5. The Preliminary Issue is to be determined by reference to a Schedule of Assumed Facts and Matters which has been agreed for the purposes of this Preliminary Issue. This has been agreed only for such purpose, and nothing in this judgment should be seen as making any determination in respect of such assumed facts or matters.

2. BACKGROUND

6. Given the narrow nature of the matters to be determined, there is no need to describe in detail the matters that are the subject of the wider litigation. It is sufficient to note that the Begbies Defendants are subject to various claims arising out of the conduct of a Members Voluntary Liquidation, and that they aver that any liability that any of them may have is limited under the terms of signed Letters of Engagement (each an "**LoE**").

7. In a little more detail, but still in overview, the Assumed Facts and Matters are:

   i) Begbies LLP provided final LoEs to the directors of the Claimant Companies in early March 2015;

   ii) the Former Liquidators owed relevant fiduciary, tortious, and contractual duties to the Claimant Companies and assumed all decision taking responsibilities in relation to the Claimant Companies including a duty "to ensure the transaction [a sale of the principal assets of the Claimant Companies] is conducted at fair value, without prejudice to any shareholder*"* ;

   iii) representations were made to the meeting of shareholders on 10 August 2016 by Mr Fry that "a valuation report was completed by his firm*"* and "considerable consideration was given to the sale process, valuations, control and realising the best value in a realistic timescale*"*, and statements were made by the Former Liquidators to members that they had applied a significant level of scrutiny to the transfer of assets and were satisfied it was in the best interests of the shareholders;

   iv) Begbies LLP owed a contractual duty to the Companies under clause 13.1 of the terms of business attached to the LoEs (the "**Terms**") to exercise reasonable skill and care in the provision of services by it to the Companies, further or alternatively a like tortious or equitable duty;

   v) BTG Advisory owed a tortious, contractual and equitable duty to exercise reasonable skill and care in the course of its retainer;

   vi) that in various specific respects the Former Liquidators acted in breach of their fiduciary, tortious and contractual duties;

   vii) that Begbies LLP and BTG Advisory are vicariously liable for those breaches;

   viii) that Begbies LLP and BTG Advisory breached their own duties to exercise reasonable care and skill by reason of the actions of the Former Liquidators; and

   ix) that the Claimant Companies have sustained loss and damage by reason of such breaches of duties.

8. Again, I emphasise that these Assumed Facts and Matters are assumed, rather than admitted or determined by this court.

9. It is common ground between the parties that an LoE was written in identical form between each of the Claimant Companies and Begbies LLP, and in each case attaching the Terms. I will deal in more detail with the provisions of the LoEs and of the Terms later in this judgment, but meanwhile it is enough to note that they purported to restrict the liability of Begbies LLP and persons associated with them to £1 million (per Claimant Company).

10. The Begbies Defendants argue that they are all protected by this limitation. The Claimants argue, on various grounds, that no such protection applies. In summary, they argue that:

    i) it is impossible for a liquidator to enjoy limited liability;

    ii) even if that were possible, no such limitation could be agreed by the directors of the relevant company;

    iii) in any case, on a true construction of the LoEs, the LoEs do not provide for the limitations of liabilities to extend to the Former Liquidators, or to any other of the Begbies Defendants who might be liable for anything done by the Former Liquidators; and finally

    iv) in any case even if a limitation could be and had been validly agreed, the Limitation Clause is rendered invalid by the Unfair Contract Terms Act 1977 ("**UCTA**").

11. As regards this last point, the parties agreed, and I also agreed, that the trial of the Preliminary Issue (which has been ordered on the basis that no oral evidence is to be heard) was not a suitable forum for determining the effect that UCTA might have in the circumstances, as this may depend on evidence that may need to be tested. Accordingly, this point is left outstanding. Nothing in this judgment should be seen as making any determination in relation to that point.

12. I will take the arguments raised on behalf of the Claimants individually.

3. THE CLAIMANTS' CASE THAT IT IS IMPOSSIBLE FOR LIQUIDATORS TO LIMIT THEIR LIABILITY

13. The Claimants' first argument is that it is impossible for liquidators to limit their liability on the grounds (if I may state these broadly) that the statutory framework under which they are appointed makes no provision for limitation of liability. The Claimants argue that, against a background that:

    i) they were appointed by each of the Claimant Companies in general meeting;

    ii) their remuneration is set by each Claimant Company in general meeting;

iii) they are required to be registered to act as liquidators and are subject to a scheme of regulation;

iv) they are fiduciaries holding the assets of each Claimant Company on a statutory trust; and

v) they are subject to the jurisdiction of the court,

the court should conclude that as there is no express power anywhere within the regulatory framework that specifically allows a limitation of their liability, it may be inferred that no such limitation is possible.

14. I discern three main strands in relation to the argument that it is impossible for a liquidator's liability to be restricted, even with the express consent of shareholders:

i) the law makes no provision for the shareholders (or the court) to limit the liability of a liquidator, and therefore the liquidator can only be appointed, and afforded remuneration, as approved by the company in question in general meeting and no other terms can be agreed: his or her appointment and rights to remuneration are set by shareholders or by the court and the extent of his duties follows as a matter of law and not as a matter of any contract;

ii) that a liquidator is a fiduciary administering a statutory trust and the statutory arrangements make no provision for the liquidator's liability to be limited;

iii) to limit the liability of a liquidator would be an attempt to oust the jurisdiction of the court; and

iv) other considerations also point to this conclusion.

15. I will address these arguments individually, but will try not to lose sight of their cumulative effect.

(a) The argument that the statutory regime does not provide for, and therefore excludes limitations of liability

16. The Claimants' primary argument is that s.92(1) Insolvency Act 1986 ("**IA 1986**") provides that it is the company in general meeting that fills any vacancy arising by death, resignation or otherwise in the office of liquidator (although, in addition, s.108 IA 1986 provides that in any voluntary winding up if there is no liquidator acting, the court may appoint a liquidator and that the court may, on cause shown, remove a liquidator and appoint another). Upon their appointment as joint liquidators pursuant to IA 1986, the Former Liquidators assumed a statutory role and any liability for their conduct in that role (as distinct from under any contract they might subsequently enter into with a third party on behalf of any of the Claimant Companies) arises under a framework created by statute and is a matter for the jurisdiction of the court. Neither their role nor their potential liability could be limited otherwise than in accordance

with the legislation; it could not be circumscribed or constrained by means of any contract entered into with the relevant company either prior to or upon their appointment.

17. A further plank of this argument is that only licensed insolvency practitioners may be appointed as liquidators (s.230(3) IA 1986); only individuals (not firms) may be insolvency practitioners (s.390(1) IA 1986); and insolvency practitioners must be a member of a professional body recognised for these purposes and authorised by that body to act as a liquidator (s.390(2) IA 1986).

18. In my view this plank does not add substantially to the argument. It has not been suggested to me that any relevant body has used its rules or regulations to limit the ability of a liquidator to benefit from any limitation of liability.

19. The proposition that it is individuals who are appointed as liquidators is clearly correct as a matter of law. However, the proposition is somewhat at odds with the commercial reality that liquidators are chosen because they work for a particular firm which has the resources and expertise to support liquidators.

20. This was commented on in *Re Sankey Furniture* [1995] 2 B.C.L.C. 594 ("***Sankey***") where Chadwick J (as he then was) was considering the question whether the court should approve a change of a liquidator in circumstances where one of the liquidators was moving firms or whether the matter needed to be referred back to a meeting of creditors (this was an insolvent liquidation). He found (on page 600) that:

> "… the problem arises, as it seems to me, because the practice in relation to the administration of insolvency, at least in the case of large firms with many skilled and experienced employees, may not fit easily into the current legislative framework. The 1986 Act provides that a person who is not an individual cannot be qualified to act as an insolvency practitioner (see 390 (1))…. The effect is that, in law, appointment as a liquidator or trustee in bankruptcy is an appointment which is personal to the individual who accepts it. It is not an appointment to the firm of which he or she happens, for the time being, to be a member. But in large firms containing a number of partners and employees who are qualified as insolvency practitioners it is not unlikely that the work comes to the firm rather than to the individual. It is the collective expertise of the firm which attracts the appointment … The day-to-day administration is carried out by employees of the firm."

21. Surprisingly, given the importance of this issue and the length of time for which the office of liquidator has been present, there is next to no authority that clearly determines whether the Claimants' argument is correct or not. However, to make good their proposition, the Claimants' counsel refer me to the decision of Maugham J in *In Re Home & Colonial Insurance Co Ltd* [1930] 1 Ch. 102 ("***Home & Colonial***").

22. In that case, a liquidator in a voluntary winding up who was accused of not properly performing his duties sought to rely on a provision in the articles of the relevant company excluding liability for directors/other officers of the company as a defence in misfeasance proceedings.

23. Maugham J (at pages at 126-127) held there was "no evidence whatever that the respondent was appointed to be liquidator on the condition that art. 157 should apply" and that:

> "it seems hardly possible that art. 157 can afford any protection to a liquidator in proceedings for the benefit of creditors of the company, since the liquidator has a statutory duty towards them which the Article cannot affect; and this forms an additional reason for not extending the Article to the acts of a liquidator".

24. This last comment does suggest that the judge was not relying only on the conclusions he had already reached (that the liquidator was not a party to the articles and that it was unlikely that he had contracted on the implicit understanding that he would be protected "for the grossest negligence, idleness or incapacity") but was making an additional point that it was not possible to contract out of the liquidator's statutory duties.

25. Ms Addy KC also referred me to *Re Rhino Enterprises Properties Ltd* [2020] EWHC 2370 (Ch); [2021] BCC 18 at [101]–[109]. Here it had been argued that a claim under paragraph 75 of Schedule B1 of the IA 1986 against former joint administrators by contributories was barred by a term within a Company Voluntary Arrangement ("**CVA**") (the route of exit from the administration) to which the company had agreed, and which released the former joint administrators from liability.

26. HH Judge Simon Barker QC accepted an argument to the effect that the release, having been formulated and proposed to creditors by the joint administrators for their own benefit, was in breach of the rule that powers must be exercised for the purpose for which they are granted and in breach of the joint administrators' fiduciary obligations. As such, it was ineffective and unenforceable.

27. The submissions accepted by the court included that:

> "[i]t would be inconsistent with the scheme of Sch.B1 to allow an office-holder to exclude liability or the risk of liability expressly provided for and preserved after release by the statute itself" and that it was "improper for an administrator to use the machinery of a CVA to exclude a liability after the event which could not be excluded before or during the event".

28. This case largely turned on the proposition that it was misfeasance on the part of the liquidators to use their powers to benefit themselves through causing the company to approve a CVA which provided them with exculpation, and so it is distinguishable from the case before me, where it was the directors of the

Claimant Companies who agreed the limitation of liability. I would not rely on it by itself as establishing the proposition that the Claimants are trying to establish here, but certainly the reasoning is not inconsistent with the case that they are making, particularly as it appears that the party seeking to avoid the exculpation clause in that case had argued that it would be inconsistent with the scheme of Schedule B1 to allow an office-holder to exclude liability or the risk of liability expressly provided for and preserved after release by the statute itself.

29. Next, Ms Addy referred me to *Fulham Football Club (1987) Ltd v Richards and another* [2011] EWCA Civ 855 ; [2012] Ch. 333, and in particular dicta of Patten LJ expressed at [74] to the effect that the members of a company cannot, whether by contract or otherwise, in advance of liquidation override the exercise of the liquidator's powers under sections 238 to 239 of the Insolvency Act 1986. This a reference to powers rather than to duties (or to liability for breach of duties), but nevertheless is consonant with the theme that the Claimants seek to establish.

30. Finally in relation to this point, Ms Addy cited *Insolvency Practitioners, Appointments, Duties, Powers and Liability* (second edition) at paragraph 8.45 as follows:

> "Once an IP takes office, they become subject to the supervision of the court and the statutory requirements of their role. It is not possible for the IP to limit the scope of their duties or otherwise to limit their liability in the context of carrying out their role as office-holder, since to do so would otherwise have the potential to conflict with the IP's duties under the statutory scheme. This would amount to an attempt to oust the jurisdiction of the court. However, the IP is not prevented from limiting or excluding liability under contracts entered into as office-holder, provided that such terms do not interfere with the statutory scheme."

(b) The argument based on a statutory trust

31. In *Fakhry v Pagden* [2020] EWCA Civ 1207; [2021] B.C.C. 46, a case arising out of the same facts as the case before me, but in relation to a different aspect, concerning alleged procedural irregularities in restoring the Companies to the register, David Richards LJ (as he then was) explained (at [28]) that:

> "In all types of liquidation, the beneficial interest in the assets is suspended and they are held on a statutory trust to be dealt with in accordance with the statutory scheme".

32. The statutory trust is explained in *Goode on Principles of Corporate Insolvency Law* (5th edition) ("*Goode*") at paragraph 3-09 as follows:

> "Although winding-up does not of itself divest the company of legal title to its assets, it ceases to be the beneficial owner and

> holds the assets on trust to apply them in discharge of the company's liabilities in accordance with the statutory scheme of distribution.

33. The case usually cited for this proposition is a tax case in the House of Lords, *Ayerst (Inspector of Taxes) v C. & K. (Construction) Ltd* [1976] A.C. 167 ("***Ayerst***").

34. As *Goode* goes in to explain at paragraph 3-10, this is a particular type of trust that does not confer on creditors beneficial co-ownership or, indeed a proprietary interest of any kind in the assets until completion of the liquidation. Rather:

> "The company thus holds the assets for statutory purposes, not for persons."

35. Clearly, as the trustee of a statutory trust, a liquidator is a fiduciary and owes corresponding fiduciary duties, such as a duty not to profit otherwise than through the remuneration allowed in statute – see *Re Gertzenstein Limited* [1937] 1 Ch 115; and a duty of care - see *Top Brands Limited & Another v Sharma & Another* [2014] EWHC 2753 (Ch); [2015] 2 All E.R. 581.

36. These considerations allow the Claimants to argue their point in a separate way. Liquidators as fiduciaries holding assets on a statutory trust are subject to the terms of that trust. That trust is created by statute, and the statute makes no provision for trustees to limit their liabilities. As the trust is a trust to hold the beneficial interest in the assets for the statutory purposes and not for particular beneficiaries, it is not open to anybody to change the terms of that trust.

(c) The argument based on ousting the powers of the court

37. Section 212 IA 1986 confers upon the court jurisdiction to compel a liquidator who has misapplied or retained, or become accountable for, any money or other property of the company, or been guilty of any misfeasance or breach of any fiduciary or other duty in relation to the company –

> "(a) to repay, restore or account for the money or property or any part of it, with interest at such rate as the court thinks just, or
>
> (b) to contribute such sum to the company's assets by way of compensation in respect of the misfeasance or breach of fiduciary or other duty as the court thinks just."

38. Subsection 212(2) makes it clear that:

> "any misfeasance or breach of any fiduciary or other duty in relation to the company includes, in the case of a person who has acted as liquidator of the company, any misfeasance or breach of any fiduciary or other duty in connection with the carrying out of his functions as liquidator of the company".

39. Under s.212(4), the court's jurisdiction under that section may be exercised even after the liquidator has had their release pursuant to s.173 IA 1986 if leave is given by the court (as has been the case in these proceedings).

40. Counsel for the Claimants argue that any attempt to limit or exclude the potential liability of the Former Liquidators in their capacity as appointed liquidators would be an attempt to oust the court's jurisdiction under the IA 1986 and to alter the legislative scheme. Accordingly, even if a monetary liability cap had been purportedly resolved by the shareholders upon appointing the Former Liquidators (which did not happen), it would be ineffective.

41. In support of this analysis the counsel for the Claimants have referred me to *Aribisala v St James Homes (Grosvenor Dock) Ltd* [2007] EWHC 1694. In that case Alan Steinfeld QC, sitting as a deputy judge of the Chancery Division, was considering s.49(2) of the Law of Property Act 1925 ("**LPA 1925**"), which provided that:

> "[w]here the court refuses to grant specific performance of a contract, or in any action for the return of a deposit, the court may, if it thinks fit, order the repayment of any deposit").

42. He found, at [33] that:

> "The section is not in terms of conferring a right upon either party to the contract. What it is doing is conferring jurisdiction on the court, exercisable at its discretion, to order the repayment of any deposit, obviously necessarily paid by the purchaser. On its face, it seems to me that a provision in a contract that purports to exclude the section, as clause 1.2 of the conditions of sale of the contract in this case purports to do, is a provision that is purporting to oust the jurisdiction of the court under that section and that is, accordingly, on well-established authority void and of no effect on the ground of public policy."

43. Counsel for the Claimants submit, likewise, that, it is not open to a company (whether acting through its directors or through its shareholders) to oust the statutory jurisdiction of the court by way of contract, particularly given that the relationships created by a liquidation cannot be considered to be bilateral relationships but have an effect on members and creditors. They argue that any attempt to do so must similarly be void and of no effect as a result of public policy.

(d) Further arguments

44. Counsel for the Claimants argue further that their contention is supported by the following points:

i) Whether a person can waive performance of a statutory requirement, and whether a person bound by a statutory requirement can effectively contract out of complying with it, depends on legislative intention;

Bennion, Bailey and Norbury on Statutory Interpretation (8th edition), at 9.6.

ii) There is a well-established "general principle that parties cannot contract out of the insolvency legislation" (*Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 A.C. 383 at [1] (Lord Collins)).

iii) It cannot have been the legislative intention that a prior decision of the directors or any resolution by members/creditors (that could be passed only by a majority) to limit the potential future liability of a liquidator, could operate to oust the jurisdiction of the court that is available under the legislation to all members and creditors.

45. As to the argument that it might operate harshly on a liquidator to have unlimited liability in relation to his provision of services for which he may have charged only a small fraction of the value for which he might be held responsible, the Claimants argue that:

i) under the legislative and regulatory framework, all insolvency practitioners appointed as liquidators will necessarily have both professional indemnity insurance (or other appropriate arrangements in place to meet claims arising from being in public practice); and

ii) where appropriate, a liquidator can guard against personal exposure by applying to the court for directions under s. 112 IA 1986. As noted by Maugham J in *Home & Colonial* at page 125, a liquidator owes a high standard of care because:

> "He is of course paid for his services ; he is able to obtain wherever it is expedient the assistance of solicitors and counsel; and, which is a most important consideration, he is entitled, in every case of serious doubt or difficulty in relation to the performance of his statutory duties, to submit the matter to the Court, and to obtain its guidance".

46. The Claimants point out also that a liquidator will have provided a bond in the form required pursuant to section 390(3) IA 1986. Pursuant to the *Insolvency Practitioners Regulations 2005*, paragraph 12 and Schedule 2, such bond must contain provision whereby a surety undertakes to be jointly and severally liable for losses arising from the fraud or dishonesty of the insolvency practitioner up to an aggregate sum in respect of each appointment equal to at least the value of the assets at the date of appointment, up to a maximum of £5m.

47. I do not see, however, how this last point advances their case: the bond is provided for the benefit of the members and creditors of the company in liquidation, not for the benefit of the liquidator, who remains jointly liable for his default. If anything, I see this point as weakening the case since it shows that the legislators were happy to see a limit afforded by the bond.

4. THE DEFENDANTS' CASE THAT IT IS POSSIBLE FOR LIQUIDATORS TO LIMIT THEIR LIABILITY

48. In this section I will consider the arguments made on behalf of the Defendants that it is possible for liquidators to limit their liability by reference to the different strands that I have recognised in relation to the Claimants' arguments.

(a) The argument that the statutory regime does not provide for, and therefore excludes limitations of liability

49. In response to the argument that the statutory regime does not provide for, and therefore excludes, limitations of liability, the Defendants argue that in other contexts where shareholders appoint an officer, or a particular role can be said to be the creation of statute, the general law has not recognised or implied any inherent prohibition on appointees limiting their liability. Rather, it has been necessary for there to be specific legislation restricting limitations on liability.

50. For example s.232 of the Companies Act 2006 ("**CA 2006**") renders void any provision to exempt a director to any extent from any liability that would otherwise attach to him in connection with any negligence, default, breach of duty or breach of trust in relation to the company.

51. Similarly, CA 2006 s.532 stipulates that any provision for exempting an auditor of a company (to any extent) from any liability that would otherwise attach to him in connection with any negligence, default, breach of duty or breach of trust in relation to the company occurring in the course of the audit of accounts is void, subject to certain exceptions.

52. The Defendants make the point that Parliament clearly knows well how to legislate to prevent any exclusions or limitations of liability by statutory officeholders but has chosen to make no such provision in the case of liquidators.

53. To support his point that the mere fact that an office has been created and/or regulated by statute, does not of itself impose any prohibition on the ability of the parties to agree that an office-holder might limit his liability, Mr Deacock, for the Defendants referred me to *Re City Equitable Fire Insurance Company* [1925] Ch. 407 ("***City Equitable***").

54. In this case, the Official Receiver as liquidator, brought a misfeasance summons under s.215 of the Companies (Consolidation) Act, 1908 ("**CCA 1908**"). Section 215 was a precursor to s.212 IA 1986 and in similar terms (although differently formatted). The Official Receiver was seeking to make the respondent directors and auditors liable for negligence in respect of losses occasioned by investments and loans and the payments of dividends out of capital dishonestly brought about by the managing director. The directors (other than the managing director) and the auditors had acted honestly throughout. They sought to rely on provisions in article 150 of the company's articles of association. This provided an indemnity to the directors, auditors, secretary and other officers for the time being of the company (amongst others)

and the trustees (if any) for acting in relation to any of the affairs of the company. The indemnity covered all actions, costs, charges, losses, damages and expenses incurred in the execution of their duty, except where the liability arose through their own wilful neglect or default. The article also provided that none of them shall be answerable for the acts, receipts, neglects or defaults of the other or others of them.

55. Romer J (at page 442), faced with an argument that the rights given by s.215 CCA 1908 are independent of and cannot be modified by any provision contained in the articles of association, refused to accept that argument and instead followed the decision in *In re Brazilian Rubber Plantations and Estates, Ltd*. [1911] 1 Ch. 425. In that case, Neville J had considered that it was not unlawful for a company to engage its directors upon such terms and found accordingly:

> "I do not think, therefore, that an action by this company against its directors for negligence, where no dishonesty was alleged, could have succeeded. It appears to me that an application under s. 215 of the Companies (Consolidation) Act, 1908, stands on the same footing."

56. On this basis Romer J found (at page 500) that, whilst the auditors and the respondent directors failed in some matters to perform their strict duty, and, but for the provisions of art. 150, he would have had to grant some relief to the Official Receiver, he would not do so, as if he were to do so he would:

> "... in effect, be depriving them to a material extent of the protection which that article affords, and for which they must be deemed to have stipulated as a condition of the service that they undertook to render".

57. The Official Receiver appealed from this decision so far as it affected the auditors. Pollock M.R. gave the leading judgment in the appeal. It had been argued before him that article 150 could not amend rights given by statute. In this context, he noted (at page 507) that s. 215 CCA 1908 deals only with procedure and does not give any new rights. It provides a summary mode of enforcing existing rights. He went on to consider the statutory duties of auditors (under s.113 CCA 1908) to produce a report to shareholders. In summary, he considered that the auditors did meet their statutory requirements but were negligent in part in how they went about doing this. This negligence was covered by the exculpation from liability under article 150 such that the auditors were not to be liable for any "loss, misfortune, or damage which may happen in the execution of their respective offices or trusts, or in relation thereto, unless the same shall happen by or through their own wilful neglect or default respectively". He considered that the article was not *ultra vires* and did not offend against s.113.

58. Sargant LJ agreed noting at page 528:

> "We have therefore to consider whether if the company here had brought an action against the auditors for neglect or default the defendants would have been entitled to avail themselves of the protection given to them by the article in question. I can see no reason why they should not do so. The article does not limit the nature or extent of the auditor's duties under s. 113. It is in no way contrary to the scheme of the Act, and such cases as In re Peveril Gold Mines, Ld. (1) and Payne v. The Cork Co. (2) seem to me to have no application whatever to this case. The article merely operates to limit the liability of the officers of the company by relieving them from the consequences of certain kinds of neglect or default. It might as well be said that a clause of this kind in trust deeds should be inoperative, because it would tend to induce trustees to be negligent of the interests of their cestuis que trust. The truth is that such restrictions on liability may, and I think often do, operate to protect rather than harm beneficiaries, because they prevent honest and responsible persons from being frightened away from accepting an office which might otherwise involve them in various unmerited and unexpected losses notwithstanding perfect honesty on their part."

59. Mr Deacock also took me to the two cases referred to in that passage, *In re Peveril Gold Mines Ltd* [1898] 1 Ch. 122 and *Payne v. The Cork Co.* [1900] 1 Ch. 308, which provided examples of clauses which were seeking to oust rights given in the legislation in contrast to merely providing an additional jurisdiction to the court.

60. I agree with Mr Deacock that two points can be taken from this judgment:

    i) s. 215 CCA 1908 dealt only with procedure and does not give any new rights; the same must be true of s.212 IA 1986, which is in similar terms; and it follows that an exemption clause that is affecting directors' liability is not modifying a statutory provision (at least in relation to s.212): it is modifying liabilities under the general law (for example for negligence or breach of duty);

    ii) where a statute defines a required responsibility or role (as did s.113 in *City Equitable* in relation to auditors), a distinction is to be made between:

        a) a clause which modifies the duties required by statute (which cannot be modified or attenuated by contract, unless the statute provides that they can be); and

        b) a clause which seeks to limit liability for aspects of performance of the role (which may be possible, subject to other considerations such as UCTA).

61. As regards liquidators, an example of the first case might be a clause purporting to relieve them of the obligation to make a report required by statute or by the Insolvency Rules. Another would be a clause seeking to vary the way that they are obliged under statute and the Insolvency Rules to distribute the assets of the company. As regards the second case, Mr Deacock argues that this would include an exemption clause of the type that we are considering.

62. As regards this part of the argument, I can see the logic of Mr Deacock's reasoning, but, as I discuss below, I consider that it fails once one deals with the implications of the statutory trust.

(b) The argument based on a statutory trust

63. By reference to various cases Mr Deacock has sought to persuade me that there is a bilateral relationship between a liquidator and the company in liquidation, and therefore it is open to those parties to agree a limitation on the liquidator's liability.

64. The cases he has referred me to include, first *Oldham & Ors v Kyrris & Anor* [2003] EWCA Civ 1506; [2004] BCC 111 ("***Oldham***"). This concerned the appointment of an administrator and considered the point whether an administrator owes a common law duty of care to general creditors. The matter came to the Court of Appeal and the Court of Appeal decided that point (by reference to the established position in relation to the liability of directors) in the negative (see Jonathan Parker's LJ judgment at [141]-[145]).

65. Jonathan Parker LJ quoted approvingly from the judgment of Mummery LJ in *Peskin v Anderson* [2001] BCC 874 (at [31] –[34] ("***Peskin***"). Mummery LJ in *Peskin* confirmed that in general directors owed their duties to their company, not to shareholders, although he acknowledged there may be special circumstances which would create the existence of additional fiduciary duties owed by a director to a shareholder which may be breached by the director personally causing loss to the shareholder directly (as distinct from loss sustained by a diminution in the value of his shares).

66. The Court of Appeal in *Oldham* decided that the same analysis would apply in relation to a common law duty of care as it would to a breach of fiduciary duty and to an administrator as it did to a director (see at [143]) and concluded at [146]:

> "Given the nature and scope of an administrator's powers and duties, I can for my part see no basis for concluding that an administrator owes a duty of care to creditors in circumstances where a director would not owe such a duty to shareholders. In each case the relevant duties are, absent special circumstances, owed exclusively to the company.

67. This decision, of course, related to administrators, who are not trustees of the assets of the company, but are managers of the company's assets, in a similar

position to directors. Mr Deacock drew my attention, however, to the judgment at [149] where Jonathan Parker LJ said:

> "My conclusion is also consistent with Romer J's decision *in Knowles v Scott* [1891] 1 Ch 717, where he held that a liquidator is not a trustee for the creditors or contributories of a company in liquidation. At p.723 Romer J said this:
>
> 'In my view a voluntary liquidator is more rightly described as the agent of the company – an agent who has no doubt cast upon him by statute or otherwise special duties . . . If this be the true position of a liquidator, and I think at any rate agency more nearly defines his true position than trusteeship, it is clear that he could not as agent be sued by a third party for negligence apart from misfeasance or personal misconduct.'"

68. Whilst this case remains good authority for the proposition for which Jonathan Parker LJ was relying upon it (that a liquidator is not a trustee for the creditors or contributories of the company in liquidation), it now needs to be read in the context of the statutory trust found in *Ayerst*. I do not think that it remains good authority for the proposition that the liquidator's role is best seen as that of an agent for the company (as would be the case for an administrator): the liquidator now must be seen as being a fiduciary holding assets on a trust to be administered according to statute, and not giving any beneficial ownership right to creditors, to contributories or indeed to the company itself.

69. Mr Deacock ended his survey of these cases with the submission that "To say that the company could not waive a right is tantamount to saying that the duty is not really owed to the company". But, that is exactly what *Ayerst* tells us. The duties of a liquidator arising out of the statutory trust are not duties owed to a company. They are the obligations of a fiduciary to carry out the purposes of the statutory trust. They therefore cannot be waived by the company, either acting through its directors or even through its body of shareholders.

70. Having regard in particular to the point regarding the statutory trust, I find, therefore, that the Claimants are correct in saying that the Company, whether acting through its directors or its shareholders, could not modify the responsibilities or liability of the Former Liquidators.

71. The existence of the statutory trust also distinguishes the position of liquidators from that of directors or auditors, and so explains why the reasoning in *City Equitable* (which I consider formed the main plank of the argument that Mr Deacock was making) cannot be read across to the position of liquidators.

72. Whilst none of the cases that to which I have been referred by Ms Addy that have included an objection to liquidators limiting their liability, have mentioned the statutory trust, it seems to me that if the matter is analysed in the detail that I have been obliged to analyse it as a result of the arguments put to me, that is the true basis of the objection, as it explains why a limitation of liability was allowed under the general law for directors and auditors but

cannot be given to liquidators, as Maugham J found in *Home and Colonial,* quoted at [23] above.

73. Whilst the law has moved on from the proposition that a liquidator in general owes duties to the creditors or members, and *City Equitable* shows us that there may be a distinction between performing a statutory duty (such as that of auditors) and liability for failing to perform that duty to a particular standard, nevertheless the instinct of Maugham J was a good one: the statutory duties of liquidators are not owed, or at least not owed purely, to the company in question, and therefore the company cannot modify the liability of liquidators for performing them negligently .

74. Having reached my conclusion on this basis, there is no reason for me to consider in more detail the other arguments advanced by the Claimants, but for completeness I will, as far as I can, deal with them.

(c) The argument based on ousting the powers of the court

75. I have already quoted at length from *City Equitable* and have reached the conclusion that s.212 (like s.215 CCA 1908 before it) is a jurisdictional provision providing a particular way of accessing the court, rather than a section that provides any particular powers of the court. To that extent, I agree with Mr Deacock that the liabilities that the Former Liquidators were hoping to exclude were not liabilities created by statute, but the natural incidents of their appointment arising under the general law and equity. There is, therefore, no ouster of the court's jurisdiction that arises from a provision purporting to limit these liabilities as these are not liabilities created by the statute.

76. Ms Addy points out that s.212(3) appears to go beyond jurisdiction and specifically to provide the court with powers to examine the conduct of particular persons (including liquidators) and to compel liquidators to repay, restore or account for money; or to contribute as the court sees fit". Under s.214(4), with the leave of court, this could include applications made after a liquidator has had his release. However, in this respect it is no different to s.215 CCA 1908, and so it does not seem possible to distinguish *City Equitable* on this point.

77. Ms Addy drew my attention to s.112 IA 1986 as a further example of a provision providing the court with control over liquidators. This provision allows a liquidator or any contributory or creditor to apply to the court to determine any question arising in the winding up or to exercise any of the powers which the court might exercise if the company were being wound up by the court. This seems to me to be a similar jurisdictional provision, and I cannot see how a limitation of liability could be seen as an ouster of the powers of the court under this section.

78. It is difficult to square the decision in *City Equitable* with that in *Aribisala* (referred to at [41]-[43] above). In *Aribisala*, the Deputy Judge, having found that s.49(2) LPA 1925 was a clause conferring jurisdiction on the court (rather than rights on a purchaser of land), considered that it followed that it was

against public policy to allow the parties to contract out of the operation of the clause.

79. Mr Deacock made an argument that the difference between these two cases was that the jurisdiction conferred by s.49(2) LPA 1925 inevitably interfered with whatever contractual rights the parties had agreed, so that it was obvious that they could not contract out of the provision, whereas s.215 CCA 1908 (and now s.212 IA 1986) was purely about providing a means of accessing the court to enforce rights that already existed otherwise than under the statute.

80. I see merit in this argument, but even if this is not correct, if I have to choose between the two cases, then I must choose *City Equitable* as binding on me as a Court of Appeal decision, particularly as it seems that this case was not cited in *Aribisala*.

81. In conclusion on this point, I do not accept that the argument that allowing the parties to limit liability would operate as an ouster of the court's jurisdiction itself provides a sound basis for the conclusion that it is impossible for the liability of liquidator to be limited. However, as I have found other grounds to support that conclusion the point is of academic interest only.

(d) The Defendants' answer to the Claimants' further arguments

82. As regards the Claimants' point that whether a person can waive performance of a statutory requirement depends on legislative intention, having found that there is an established legislative intention to create a statutory trust, that question does not arise. It is established that that trust is a trust to fulfil the statutory purposes, not a trust of assets on behalf of particular persons. There is, therefore, no person who is able to waive performance of the statutory trust.

83. As to the argument that it might operate harshly on a liquidator to have unlimited liability in relation to his provision of services for which he may have charged only a small fraction of the value for which he might be held responsible, that is not a basis on which I could find for the Defendants. There is a policy point for legislators here as to whether it would be a good thing or not for insolvency practitioners to be able to limit their liability when acting as liquidators. There are arguments both ways as noted by Sargant LJ in *City Equitable* in the passage that I have reproduced at [58] above. I must apply the law as I find it, and I have found that on the basis of the law as it stands, there is no ability for provision to be made for liquidators to limit their liability.

5. WOULD ANY POWER TO LIMIT LIQUIDATORS' BE FOR ONLY FOR SHAREHOLDERS TO EXERCISE?

84. The Claimants' fallback argument, if I did not accept their primary argument that there is no way in which the liability of liquidators can be limited, is that any ability to limit the liability of liquidators in the case of a solvent members winding-up would be in the hands of shareholders rather than directors. It is the company through its shareholders in general meeting (or the court) that appoints a liquidator, and which fixes the remuneration of the liquidator and

therefore only that body that could approve a provision modifying the liability of the liquidator.

85. As I have found for the Claimants in relation to their primary argument as regards the liquidators, this question becomes otiose. Nevertheless, for completeness I will say something about the point, on the assumption that, contrary to my finding, there could be a power to limit the liability of liquidators.

86. Clearly it is correct that a company must act through its shareholders in appointing a liquidator (see s. 84(1)(b) IA 1986, and s.91(1) IA 1986).

87. The Claimants argue that, once appointed, whatever their business relationship with the Company may have been previously, the individual's role thereafter is that of a liquidator appointed under the statutory framework and, upon their appointment, all the powers of the directors cease, except in so far as the company in general meeting or the liquidator sanctions their continuance (section 91(2) IA 1986).

88. This is all correct, but of itself I do not see this argument to be determinative of the question.

89. First, the fact that the powers of the directors cease on the appointment of a liquidator does not of itself nullify any agreement that the directors (lawfully) entered into on behalf of the Company. If one of those agreements was that if the liquidators were to be appointed they (and/or the firm supporting them) would benefit from limited liability in certain circumstances, why does the fact that the liquidators now exercise all the powers previously exercised by the directors nullify that agreement?

90. Secondly, why should the fact that the shareholders undertake the appointment nullify that agreement, particularly in a case (not this one) where the shareholders appoint a liquidator in the knowledge that these terms have been agreed on behalf of the company. After all, where shareholders appoint a director, the director may serve on the basis of a director's service contract on behalf of the company.

91. The Claimants refer me to *Bethell v Trench Tubeless Tyre Co* [1900] 1 Ch 408. The facts of this case were that the company passed a subjoined resolution for the voluntary winding up of the company and the appointment of a Mr Walker as liquidator. Notice was given to the shareholders that there would be a further meeting to consider confirming the winding-up and the appointment through separate special resolutions. At that meeting the first resolution was passed but the second failed for want of a seconder and a resolution was then proposed and carried that someone else, a Mr Marreco, should be appointed as liquidator. The case turned on the question whether Mr Marreco had been duly appointed – the argument being that the shareholders had not been given notice of any proposal to appoint him. It was decided that the appointment was valid on the basis that once a resolution had been passed to wind up the company it was competent for the company without notice to proceed to appoint a liquidator.

92. The Claimants refer me in particular to a comment at page 410 made by Lord Lindley, who gave the leading judgment, when he said that to hold otherwise:

> "… we do in substance give to directors power to palm off upon the company the liquidator of their nomination, unless the company consents to postpone the meeting and give fresh notice."

The Claimants argue that self-evidently, much greater concern would arise if the directors had power to limit the liability of the liquidator.

93. I do not agree that this proposition is self-evident or follows from that case.

94. I do not think that this observation provides a reason why, if a liquidator is willing to act, but only on the basis of his or her enjoying a limitation of liability previously agreed by the directors, that appointment could not be put to the shareholders and, if approved by the shareholders, remain a valid appointment.

95. In the case before me, it may be objected that the shareholders were not told about the limitation of liability, and the fact that they gave their sanction to the appointment was therefore not made on an informed basis. The Defendants argue that this makes no difference. If there was a failure in the explanations given to the shareholders when voting on this resolution, that point goes only to the culpability of the directors in allowing this failure, and does not affect the validity of the resolution to appoint them or to the agreement made on behalf of the Claimant Companies, that if appointed, it would be on terms providing for limitation of liability.

96. These are difficult points and did not get much airing within the hearing. In the light of this, and in view of my finding for the Claimants in relation to their principal argument, which anyway renders this argument otiose as regards the appointment of the liquidators, I will not seek to resolve this point.

6. DO THE LOES AND TERMS HAVE EFFECT AFTER THE APPOINTMENT OF THE LIQUIDATORS?

97. The fact that I have found that the provisions in the LoEs (taken with the Terms) cannot and do not affect liability of the Former Liquidators deals with only part of the Preliminary Issue that I am required to answer. The Former Liquidators are the Fourth and Fifth Defendants. It remains possible, despite that finding, that these provisions may limit the liability of the other Begbies Defendants both before the appointment of the Former Liquidators as liquidators and after that appointment.

98. That an officeholder's firm may, separately from the officeholder themselves, owe duties on a contractual or tortious basis was accepted by Jacob J in *A & J Fabrications (Batley) Ltd v Grant Thornton* [1999] BCC 807, at 810 where he said:

> "It is true that it is employees of the firm who were the liquidators, but they only took their position as such by virtue of the contract between the plaintiff and Grant Thornton. Grant Thornton, in accepting the consideration of £5,000, were contracting to put their man in as liquidator. Of course once in as liquidator he would owe his duties to the company. But there is nothing inconsistent between the pleaded contract and the employee having duties to the company. The pleaded contract is, in short, that the employee/liquidator undertakes to do a proper job as liquidator. That is what Grant Thornton contracted would happen."

99. The Claimants maintain (I have found correctly) that a liability cap could not apply to claims against the Former Liquidators. They argue also that a liability cap cannot apply to any vicarious liability for the conduct of the Former Liquidators on the part of Begbies LLP and/or BTG Advisory. However, they acknowledge that insofar as Begbies LLP and BTG Advisory are themselves separately liable to the Claimant Companies for their own breaches of contract (including by reason of the conduct of the Former Liquidators), it is possible that a liability cap could apply to those claims.

100. However, whilst the Claimants acknowledge this last point in theory, they argue that on their proper construction, the LoEs and Terms do not limit the liability of any of the Begbies Defendants as regards anything done within the liquidation. This is the point that I consider next.

(a) The arguments relating to construction

101. Some relevant provisions of the LoEs (which were in the same form for each of the Claimant Companies) are set out below.

102. The LoEs begin:

> "We are pleased to accept your instructions to act for you in relation to placing the Company into members' voluntary liquidation and for Mark Robert Fry and Neil John Mather to act as Joint Liquidators of the Company pursuant to the provisions of the Insolvency Act 1986."

103. The second (unnumbered) paragraph of the LoEs states that

> "…It is important that you read this letter and the attached standard Terms of Business carefully prior to signing and returning to us the duplicate letter enclosed. In Particular, we draw to your attention the paragraph headed "Limitation of Liability".

104. Numbered paragraph 1 of the LoEs provides as follows

"**1. Nature of advice and services to be provided**

We are instructed by you to provide advice and assist you in all matters relating to placing the Company into members' voluntary liquidation. This will include:

1.1 Undertaking pre-appointment due diligence work in relation to the Company;

1.2 Advising the directors on the matters that they need to consider prior to liquidation;

1.3 Assistance with the preparation of the statutory declaration of solvency and the statement of assets and liabilities of the Company;

1.4 Assistance with the holding of meetings of the directors and members, preparation and circulation of the relevant notices to convene a meeting of members and all notices, minutes and resolutions relating to the same;

1.5 Providing the services of Partners and/or Directors of Begbies Traynor (Central) LLP who are qualified to act as licensed insolvency practitioners and who are able to accept an appointment as Joint Liquidators of the Company.

1.6 Providing the services of members of staff of an appropriate grade to undertake work on the assignment (further details of which are provided in the paragraph headed "Fees and Costs"); and

1.7 During the course of the liquidation we shall deal with the following:

1.7.1 protection and realisation of all of the Company's assets;

1.7.2 ascertainment and agreement of creditors' claims;

1.7.3 payment of dividends to creditors and shareholders;

1.7.4 convening meetings of the Company, if appropriate;

1.7.5 agreeing tax liabilities with H M Revenue & Customs (with the support of the Company's existing tax advisers);

1.7.6 carrying out any other matters that the Joint Liquidators may, by law, be required to do; and

1.7.7 preparing the Joint Liquidator's final report for the Company's shareholders.

> "For the avoidance of doubt, our advice is being provided to the Board of Directors of the Company and is not being provided to the directors of the Company in their personal capacities"

105. Numbered paragraph 7 (the "**Limitation Clause**") provides as follows:

> "**Limitation of Liability**
>
> 7.1 For the purposes of clause 13 of our Terms of Business, we limit the aggregate liability of Begbies Traynor and Begbies Traynor Persons (as defined in our Terms of Business) in any circumstances whatsoever, whether in contract, tort, statute or otherwise and howsoever caused (including our negligence) for loss or damage in connection with provision of the Services (as defined in our Terms of Business) to the sum of £1 million excluding costs and interest.
>
> 7.2 If you require a higher limit on liability please inform us immediately and we shall consider your request with our Technical and Compliance Team."

106. The signature section for the Company is prefaced by the words

> "Terms of Engagement agreed and accepted on behalf of the Company and its Directors and in agreeing and accepting these Terms of Engagement, we acknowledge and confirm our acceptance of the limitation of liability of Begbies Traynor and Begbies Traynor Persons contained in this letter"

107. The Terms include inter alia the following :

> "1.2 In the Terms, the following words and phrases shall (where the context so permits) have the following meanings:-
>
> ….
>
> "Begbies Traynor" "we" or "us" means Begbies Traynor (Central) LLP a limited liability partnership, registered in England No OC306540, registered office 340 Deansgate, Manchester, M3 4LY
>
> ….
>
> "Begbies Traynor Persons" means Begbies Traynor and each and all of our members, partners, directors, employees, consultants and agents;"
>
> ….
>
> "Services" means the services to be provided by Begbies Traynor in accordance with the Services Contract; and

> "Services Contract" means the contract between the Client and Begbies Traynor, the terms of which are recorded in the Terms and in the Engagement Letter, together with any documents or other terms applicable to the Services to which specific reference is made in the Engagement Letter or in the Terms.
>
> …
>
> **3. Services**
>
> The scope of the Services to be provided by us is detailed in the Engagement Letter, as amended or supplemented from time to time. Begbies Traynor shall not be responsible for providing any service or advice outside that scope unless it agrees to do so in writing.
>
> …
>
> 13.2.2 Nothing in the Terms or Engagement Letter will limit any liability that we may have to you in respect of any loss caused by our fraud, fraudulent misrepresentation or reckless disregard of our professional obligations or in any other situation where the law prohibits us from excluding or limiting our liability to you, including in respect of any death or personal injury resulting from our negligence.
>
> 13.2.3 Subject to clause 13.2.2 the aggregate liability of Begbies Traynor and Begbies Traynor Persons in any circumstances whatsoever, and however caused (including as a result of our negligence) for loss or damage arising from or in connection with the provision of the Services shall be limited to the sum specified in the Engagement Letter, or, if no sum is specified, a sum equal to the limit of our professional indemnity insurance at the time the claim is notified to us.
>
> ….
>
> **17.2 Sub-Contracting and novation**
>
> In appropriate circumstances Begbies Traynor will use third parties (including, where appropriate, other members of the Begbies Traynor Group) to assist us in providing any part of the Services. Any reference to our employees in the Services Contract includes these third parties."

108. For the principles of construction, the Claimants' counsel have referred me to the summaries given by Popplewell J (as he then was) in *Re Lukoil Asia Pacific Pte Ltd v Ocean Tankers (Pte) Ltd* [2018] EWHC 163 (Comm) at [8]; by Carr LJ in *ABC Electrification v National Rail Infrastructure* Ltd [2020] EWCA Civ 1645, at [17]–[19] and in *Lewison* on *Interpretation of Contracts*, 8th edition, at 12.145 to 12.149.

109. The Claimants' Counsel suggest that in view of the legislative background addressed above and having regard to the contractual documents as a whole, a reasonable person, having all the background knowledge that would have been available to Begbies LLP and the Claimant Companies, would have understood that the liability cap now sought to be relied upon by the Begbies Defendants in respect of each of the Claimant Companies would not apply to any conduct of Messrs Fry and Mather when (and if) they were appointed to their envisaged future role as liquidators.

110. I disagree. Clearly the Begbies Traynor Defendants did not understand that there could be no limitation on the liability of a liquidator or they would have drafted the provisions differently. The analysis based on the background depends on a reasonable person having knowledge of the case law that I have gone through and having reached the same conclusion that I have. I do not think that it is correct to equate the knowledge and understanding of a reasonable person with that of a High Court Judge who has had two days of argument on the point.

111. However, I think the Claimants are on surer ground when they note in particular that clause 13.2.2 of the Terms disapplies any limit of liability "where the law prohibits us from excluding or limiting our liability to you". As I have found that the law does not allow an exclusion or limitation of a liquidator's liability, this clause (if needed) is in my view effective contractually to exclude the Former Liquidators from the protection of the Limitation Clause.

112. This provision does not, however, prevent the Limitation Clause applying to any of the other Begbies Defendants. It is necessary, therefore, to address the other arguments that are made on behalf of the Claimants to the effect that the Limitation Clause does not apply to anything that happened after the Former Liquidators were appointed.

113. In summary, these arguments are as follows.

114. The "nature and services to be provided" listed in clause 1 of the LOEs all fell under the heading "to provide advice and assist you in all matters relating **to placing** the Company into members' voluntary liquidation" (*emphasis added*) and concerned the necessary preparatory steps for that purpose, including:

i) "pre-appointment due-diligence work" (clause 1.1);

ii) advising "the directors" on matters "prior to liquidation" (clause 1.2);

iii) assistance with preparing the statutory declaration of solvency and statement of assets and liabilities (clause 1.3) (both being responsibilities of the directors to be fulfilled prior to the relevant meetings of shareholders);

iv) assistance with convening, holding and other formalities relating to the relevant meetings (clause 1.4);

v) providing persons "who are able to accept an appointment as Joint Liquidators" (clause 1.5); and

vi) providing the services of members of staff at an appropriate grade "to undertake work on the assignment".

115. This last point, it seems to me, was capable of continuing past the appointment of the Former Liquidators. The Claimants make the point that the role of liquidator could not be assigned to Begbies LLP by the LoE, or at all, but I do not see how this affects the point that Begbies LLP could agree to provide staff during the liquidation to assist the liquidators.

116. Clause 1.7 "[d]uring the course of the liquidation we shall deal with the following…", clearly envisaged services being provided after the liquidation had commenced, but the Claimants invite me to conclude from the use of the future tense "shall" that these matters did not form part of the assignment, but was rather an explanation of what things would happen in the future, not as a result of the assignment and therefore outside the scope of the Limitation Clause.

117. This, to my mind, is a strained interpretation. Mr Deacock, for the Defendants makes what I consider to be better points. He points out that the "Services" is defined as the services to be provided by Begbies LLP in accordance with the Services Contracts (being the contracts created by the LoEs read together with the Terms and any other documents or terms referred to in either of them). To identify what are the "Services" one must look at the list of services in the LoEs under the heading, "1. Nature of advice and services to be provided". This list includes those services listed at 1.5 to 1.7, all of which are either envisaged to take place during the course of, or partly during the course of, the liquidation. Given that these services are specifically and clearly enumerated as being included amongst the services to be provided by Begbies LLP under the Services Contracts, the introductory words "relating to placing the Company into members' voluntary liquidation" cannot be given an interpretation that restricts these services being included. I agree with Mr Deacock on this point and I see no ambiguity in this drafting.

118. Ms Addy put forward a second argument, which was that essentially after the liquidators are appointed the liquidation is undertaken by them and by their staff, leaving no room for Begbies LLP to undertake anything. Whilst it was no doubt correct that members and staff of Begbies LLP would assist the Former Liquidators, technically when they did so they were doing so as the staff of the Former Liquidators, and not on behalf of or as staff of Begbies LLP.

119. This brings us to the gap between theory and reality that was commented on by Chadwick J in *Sankey* in the passage that I have reproduced at [20] above. For the purposes of IA 1986, the staff working on the liquidation are regarded as being the Former Liquidators' staff, and the amounts paid in respect of their services is regarded as being part and parcel of the Former Liquidators' remuneration. But in the real commercial world these staff were staff or

members of Begbies LLP and would look to Begbies LLP for their remuneration and employment rights. Also, in the real world it appears that the remuneration that was in theory payable to the Former Liquidators was in fact invoiced by Begbies LLP and received by Begbies LLP. (Although the matter is slightly confused because of changes in the letterhead used for VAT invoices which sometimes referred to Begbies Global, the VAT invoices consistently refer to payment to a bank account which I consider must be that of Begbies LLP.) Certainly the payments were not received into the personal accounts of the Former Liquidators.

120. In my view, the LoEs were an attempt to bridge the gap between the theory of liquidation and commercial reality by providing that Begbies LLP would provide the services of members or employees who were qualified to act as liquidators. This, of course was subject to such persons being appointed by the relevant Claimant Company acting through its members. Begbies LLP was agreeing also to provide suitably qualified staff of each grade to work on the assignment to assist such liquidators. This, of course, was subject to the appointed liquidators requiring the assistance of such staff, which had to remain at the discretion of those liquidators.

121. As regards payment during the period of the liquidation, the provisions in the LoEs at numbered paragraph 6.1 are slightly inconsistent – the clause starts by talking about the remuneration of the Joint Liquidators and the staff, to be paid by reference to the prevailing hourly charge out rates of Begbies LLP or payable on a fixed fee basis, but then ends by saying it is proposed that "our fees" (in context those of Begbies LLP) were proposed to be calculated on a time costs basis.

122. This inconsistency, I consider, arises from the difference between theory and commercial reality that I have mentioned. In practice, it appears that the work was all invoiced by Begbies LLP.

123. As a matter of commercial reality, I consider that Begbies LLP through the LoEs was committing itself to put forward members or employees that were suitable to be appointed as liquidators and are able to accept the appointment, and, if those liquidators were appointed, to provide their services (in the sense of allowing their services to be provided and taking responsibility for ensuring that the Former Liquidators continued in the appointment). It also undertook to make staff available during the liquidation.

124. Of course, if the liquidators were not appointed, or if the liquidators chose not to use the staff of Begbies LLP, Begbies LLP could not insist that they were used, but by signing the LoEs, Begbies LLP was providing the Claimant Companies with the reassurance that suitable liquidators would be available and would be supported by suitable staff. I see no reason why Begbies LLP and the Claimant Companies, acting through their respective members or directors, could not enter into such an agreement and if they did enter into such agreement, why (subject to any argument under UCTA) they could not limit the liability of Begbies LLP and their staff (other than the Former Liquidators themselves for the reasons that I have given).

125. The Claimants make the point that the LoEs were addressed to the Board of Directors of each of the Claimant Companies, rather than to the Claimant Companies themselves. I do not think it follows that the agreements concluded on the terms of the LoEs (taken with the Terms) were personal to the directors, rather than intended to bind the Claimant Companies. It is common when addressing a company to address the letters to the directors of the company so that it is known who should deal with the letter. That does not mean that the letter is intended for the directors personally to the exclusion of the company involved. In fact, the LoEs were countersigned underneath a rubric to say that the Terms of Engagement were "agreed and accepted on behalf of the Company and its directors", as well as specifically agreeing and accepting the limitation of liability of Begbies Traynor and Begbies Traynor Persons contained in the LoEs. It is clear that the intention was to bind the Claimant Companies.

126. Accordingly, I find that there is nothing in the Claimants' arguments as regards the construction of the LoEs that states that they are not to apply in accordance with the terms.

127. Accordingly, I think it is clear that they are effective to limit any separate liability that Begbies LLP or Begbies Traynor Persons may have under the LoEs, except that, for the reasons that I have given they are not effective to limit the liability of the Former Liquidators and I have reserved the question of whether they might be invalidated under UCTA.

128. There remain, however, one or two outstanding issues to discuss before I can claim to have addressed everything that I have been directed to consider.

(b) The possibility of limiting vicarious liability

129. The first is whether these provisions are effective to limit any vicarious liability that Begbies LLP may have for the actions (or inactions) of the Former Liquidators.

130. As regards vicarious liability, I need to be somewhat circumspect as I have not been asked to make any findings about vicarious liability, and I will avoid doing so. I have been asked to assume vicarious liability, but I have not been given the basis on which this assumption applies.

131. As I cannot determine within the scope afforded to me at this stage whether Begbies LLP or any Begbies Traynor Persons (as each is defined in the Terms) are vicariously liable for the acts of the Former Liquidators, all I can say is:

i) it does not follows from my finding that there can be no limitation of liability for liquidators that a corporate entity or other employer of a liquidator could not limit its vicarious liability for acts of the liquidator;

ii) it appears to me that the limitation of liability in numbered paragraph 7 of the LoEs (excluding liability "in contract, tort, statute or otherwise and howsoever caused (including negligence)", taken with clause 13 of

the Terms is wide enough to cover vicarious liability including vicarious liability for the acts or omissions of the Former Liquidators.

132. I can see that there is a potential corollary to one of the arguments pursued by the Claimant before me that could be used as an argument against the being vicarious liability.

133. This is the argument that the Former Liquidators were acting as independent persons under the appointments respectively by the Claimant Companies, and not under the provisions of the LoEs and not on behalf of or in pursuance of the business of Begbies LLP or BTG Advisory. However, I understand that as regards Begbies LLP at least the Claimants are looking to deploy an argument made under the specific wording of provisions of the Limited Liabilities Partnerships Act 2000.

134. Those arguments will need to be pursued in another forum.

(c) Can BTG Advisory can benefit from the limitations of liability?

135. The second question is whether BTG Advisory can benefit from the limitations of liability.

136. I have not found any principle of law that would stop BTG Advisory from benefiting from a limitation of liability. I can say also, that on the wording of the LoEs taken with the Terms, it appears that BTG Advisory could be in scope.

137. The definition of "Begbies Traynor Persons" who are covered by the Limitation Clause refers to Begbies LLP "and each and all of our members, partners, directors, employees, consultants and agents". Perhaps unexpectedly, it does not refer to other members of the Begbies Traynor Group. However, clause 17.2 of the Terms extends the definition to include third parties (which may include other members of the Begbies Traynor Group) that Begbies LLP may use to assist it in providing any part of the Services, deeming them to be "employees" and so covered by the Limitation Clause.

138. I note, however, that this could only cover BTG Advisory if it was assisting Begbies LLP in providing one of the Services in numbered paragraph 7 of the LoEs (and not, for example if it was separately appointed by the Former Liquidators in its own right). I note further that even if this extension to the definition applies, it only protects BTG Advisory itself and not its employees, or directors.

139. However, that is as much as I can say. This hearing has not been the place to determine whether, on the construction of the LoEs and the Terms that I have indicated to be correct, BTG Advisory is covered by these provisions. This matter will depend on various factors that will need to be established such as: the detail of the relationship between the Former Liquidators and BTG Advisory, and whether any services said to be provided by BTG Advisory fall within the scope of the LoEs or resulted from a separate appointment, or were merely an instance of the Former Liquidators or one of them performing his

duties as Liquidator. These are all matters that will need to be played out within another forum. It is not within the scope of this hearing to determine any such facts.

(d) The application of clause 13.2.4 of the Terms

140. There is one final matter that is not strictly within the scope of what I have been asked to determine, but which I think has been affected by what I have determined, and on which I feel I should say something.

141. This relates to the application of clause 13.2.4 of the Terms, which provides as follows:

> "The extent to which any loss or damage will be recoverable by you from us will also be limited so as to be in proportion to our contribution to the overall fault for such loss or damage, taking into account any contributory negligence by you and any negligence by your other advisers and/or third-party responsible to you and/or liable in respect of such loss or damage."

142. As I have been not asked to deal with this, and have not received any substantive submissions from either side in relation to this clause, I make no determination about how this clause may apply in relation to this action. However, without making any determination, I think I can point out that:

i) there is a logic to the proposition that the arguments that I have accepted as to why the liability of liquidators cannot be limited would apply equally to any proposed application of this provision to the Former Liquidators; and

ii) there is equally a logic to the proposition that the arguments that I have accepted as to why other Begbies Defendants may nevertheless be protected by a clause limiting liability would also apply equally to any proposed application of this provision to the other Begbies Defendants who may come within its scope.

143. The points made in the previous paragraph should be regarded as *obiter dicta* and will not be binding on a future judge considering this case. However, I hope they will offer a useful starting place for thinking about these issues.

7. CONCLUSION

144. In my view, HH Judge Davis-White KC has assisted the parties by directing a trial of the Preliminary Issue. With my reasoned findings above, I have been able to provide the parties with authoritative guidance that:

i) the Former Liquidators are not protected by clause 7 of the LoEs and clause 13.2.3;

ii) the remainder of the Begbies Defendants may be protected by these provisions if they were involved in providing services (including services provided after the appointment of the Former Liquidators), subject to their being able to show that what they were doing was within the scope of the services provided under the LoEs (following the interpretation that I have given);

iii) these provisions are wide enough to cover vicarious liability but whether or not they are effective in doing so may depend on basis on which it is established (if it is) that vicarious liability applies, and that argument is outside the scope of this judgment.

145. Whilst there is still much to determine within this action, I hope that the clarity afforded by this judgment might assist the parties in reaching a negotiated solution.

ITEM NO. 167

JA-53

[2014 (1) CILR 314]

IN THE MATTER OF ICP STRATEGIC CREDIT INCOME FUND LIMITED and ICP STRATEGIC CREDIT INCOME MATER FUND LIMITED

Grand Court, Financial Services Division

(Jones, J.)

4 April 2014

Companies—liquidators—control by court—court only to sanction commencement of litigation if has reasonable prospect of success and in creditors' best interests—not in creditors' best interests merely because likely to be successful—court to consider how litigation funded—liquidators not permitted to commence unmeritorious litigation for sole purpose of obtaining settlement

Companies—liquidators—funding of litigation—court may sanction liquidator's entering into contingency fee agreement under Companies Winding Up Rules, O.25, r.2(1) if governed by Cayman law and performed entirely in foreign jurisdiction where agreement legal and compliant with rules of conduct

Companies—liquidators—funding of litigation—liquidators entitled to assign fruits of litigation to third party, provided no assignment of ability to control litigation (whether directly or indirectly)—indirect control includes ability to terminate contract, cease paying legal fees, or insist on continuation of claim after liquidators decide to discontinue action

The joint official liquidators of the funds applied for the court's sanction of their decision to bring an action against a US bank and a US law firm for assisting in a breach of trust committed by the funds' CEO.

The funds were part of a master/feeder structure and were both owned and controlled by C. C also owned I, the master fund's manager, which was based in New York, and a further company, T. The master fund invested heavily in collateralized debt obligations—secured by residential mortgage backed securities and financed by the US bank—offered by T. When the housing market collapsed, however, the security reduced in value and T became liable to the bank for margin payments. During 2008–2009, C directed I to use money from the master fund to meet T's obligations to the bank. The bank, on the basis of the payments from the master fund, waived T's obligation to pay the debt—although it reserved the ability to demand payment from T if any claim or demand for repayment of the money from the master fund were made.

The funds went into liquidation and the joint official liquidators were granted leave to bring an action against C, I and T. They further wished to enter into a contingency fee agreement with US attorneys, R, to enable them to bring an action against the bank and the New York law firm, D, which had provided legal advice to I. Under the Companies Law (2013 Revision), Schedule 3, Part I, para. 1, however, the liquidators could only commence litigation if sanctioned by the court.

The liquidators submitted that the court should sanction their decision to commence proceedings as they had a good, arguable case against both the bank and D. The limitation period for a legal malpractice claim in New York was three years, but US law allowed the liquidators to bring the action in any state in which the law firm had an office. As the time limit in the District of Columbia, in which D had an office, did not begin to run until the client actually suffered damage from the malpractice (and there was scope for arguing that the damage could not have been discovered until the JOLs had been appointed in 2010), the court should sanction the commencement of proceedings. Further, the court should sanction the decision to enter into the contingency fee agreement. The agreement complied with the Companies Winding Up Rules, did not violate the principles of champerty and maintenance, and the liquidators had the final and exclusive right to make settlement decisions (subject to the court's sanction). Further, the Grand Court was entitled to decide any dispute relating to the agreement and R was fully able to meet its financial obligations under the agreement.

Held, sanctioning the agreement:

(1) The court would sanction the commencement of the litigation. The proposed cause of action had a reasonable prospect of success and the proceedings were in the creditors' best interests. As officers of the court, the liquidators were required to perform their duties fairly and would not be allowed to threaten or commence litigation in order to obtain a settlement. There was, however, evidence showing that they had a good, arguable case against the bank and D. The bank, by issuing the waiver, had implicitly shown that it knew that the money was from the master fund and that the fund might attempt to reclaim the money. Further, D had continued to act for I despite knowing that the master fund was not individually represented and having drafted letters for C relating to the master fund's payments to the bank. It was therefore arguable that D had acted despite being subject to a conflict of interest. Although this claim had expired in New York, the court accepted that the liquidators could commence the litigation in the District of Columbia. This did not, however, automatically mean that the litigation was in the creditors' best interests. There was still a risk that the liquidators might lose the case and that the associated costs would deplete the liquidation fund. The court would therefore be required to consider how, and by whom, the litigation was financed (paras. 6–11).

(2) There were three distinct forms of agreements for funding litigation: (a) a litigation funding agreement, under which a third party, whether or not it had an interest in the liquidation, advanced money to the liquidators in exchange for a share of any sums awarded; (b) a contingency fee agreement, under which a law firm agreed to conduct a cause of action on the ground that its remuneration would be limited to a share of any proceeds of the claim; and (c) a conditional fee agreement, under which a law firm agreed to conduct a cause of action, reducing their hourly fee in the event that the claim is unsuccessful and uplifting it should it be successful. The attorneys would be remunerated whether they won or lost in both a litigation funding agreement and a conditional fee agreement, but not in a contingency fee agreement. A contingency fee agreement would therefore cause a conflict of interest for the attorney and would be against Cayman public policy. The court was not able to authorize a liquidator to enter into a contract which was against public policy and, further, such authorization would be unable to validate the agreement as it would be otherwise void and unenforceable. The court would therefore refuse to sanction a contingency fee agreement if it related to proceedings taking place in Cayman (paras. 12–13; paras. 19–22).

(3) When entering into a litigation funding agreement, there was nothing to prevent the liquidators from assigning the "fruits of the action" to a third party. They were not, however, entitled, under the Companies Law, Schedule 3, Part I, para. 3 (which gave the power to sell the company's property), to assign a cause of action which was personal to the company. Further, they were not entitled to assign the proceeds of an action which had been vested in them in their role as liquidators (*e.g.* a preference claim). Such a claim did not form part of the company's property, which was limited to the property owned by the company at the time that it entered liquidation, and any assignment of the liquidator's fiduciary power would necessarily be contrary to public policy. Further, any funding agreement which gave the third party the ability to control the litigation would be void on the grounds of maintenance and champerty. This included the ability to indirectly exert undue influence or control. Such an agreement risked the integrity of the litigation process and, accordingly, corrupted public justice. The party who provided the funding must not, therefore, be entitled to terminate the contract, cease paying the legal fees or cease providing legal services. Further, it must not be able to insist upon the continuation of the legal claim if the liquidators no longer wish to pursue it, or demand payment for services already rendered should the liquidator decide to discontinue the action. The proposed agreement did not allow D to control the litigation in any way and allowed the court to determine any disputes arising from the agreement. Further, the court was satisfied that D had enough financial resources to complete the litigation (paras. 14–18; paras. 27–29).

(4) The court would sanction the contingency fee agreement. A contract which was contrary to domestic public policy would not be invalid if it were entirely performed in a foreign country where its performance was not contrary to public policy—although the court could refuse to sanction the agreement if the public policy concerns were of such fundamental importance that they had to be given universal application. The public policy concerns, however, only related to the protection of integrity in domestic courts and there was nothing to suggest that a contingency fee agreement was so wrong in principle that it was impossible for rules of court and conduct to protect the administration of justice. Further, New York law allowed parties to enter into contingency fee agreements and the New York professional code of conduct for attorneys included rules to protect the integrity of the profession in such circumstances. Contingency fee agreements did not, therefore, violate New York public policy. Although the Companies Winding Up Rules, O.25, r.1(4) excluded the possibility of sanctioning a fee agreement governed by New York law, O.25, r.2(1) stated that the court could sanction the engagement of lawyers on "some other" basis of remuneration than a time-spent basis. The court was therefore able to sanction a contingency fee agreement, provided that it was governed by Cayman law and would be entirely performed in a country where such an agreement was legal and in compliance with the local law and rules of conduct. As the agreement was governed by Cayman law, but would be entirely performed in New York and the District of Columbia, the court was therefore able to sanction the contingency fee agreement (paras. 23–26).

Cases cited:

(1) *Giles v. Thompson*, [1993] 3 All E.R. 321, applied.

(2) *Glegg v. Bromley*, [1912] 3 K.B. 474, applied.

(3) *Grovewood Holdings PLC v. James Capel & Co. Ltd.*, [1995] Ch. 80; [1995] 2 W.L.R. 70; [1994] 4 All E.R. 417; [1994] 2 BCLC 782; [1995] BCC 760, considered.

(4) *Greenhaven Motors Ltd., Re*, [1999] 1 BCLC 635; [1999] BCC 463, applied.

(5) *Guy v. Churchill* (1888), 40 Ch. D. 481, referred to.

(6) *Latoya v. Att. Gen.*, C.A., February 14th, 2012, unreported, considered.

(7) *London & Regional (St. George's Court) Ltd. v. Ministry of Defence* (2008), 121 Con. L.R. 26; [2008] All E.R. (D.) 249; [2008] EWHC 526 (TCC), followed.

(8) *Oasis Merchandising Ltd., In re*, [1998] Ch. 170; [1997] 2 W.L.R. 764; [1997] 1 All E.R. 1009; [1997] 1 BCLC 689; [1997] BCC 282, applied.

(9) *Quayum v. Hexagon Trust Co. (C.I.) Ltd.*, 2002 CILR 161, followed.

(10) *Ruttle Plant Ltd. v. Environment, Food & Rural Affairs Secy. (No. 3)*, [2009] 1 All E.R. 448; [2008] BPIR 1395; [2008] EWHC 238 (TCC), applied.

(11) *Wallersteiner v. Moir (No. 2)*, [1975] Q.B. 373; [1975] 2 W.L.R. 389; [1975] 1 All E.R. 849, applied.

Legislation construed:

Companies Law (2013 Revision), Third Schedule, Part 1, para. 1: The relevant terms of this paragraph are set out at para. 10.

Third Schedule, Part 1, para. 8: The relevant terms of this paragraph are set out at para. 15.

Companies Winding Up (Amendment) Rules 2013, O.25: The relevant terms of this order are set out at para. 23.

D.F. Hughes for the applicant.

1. **JONES, J.:**

Introduction

This is a sanction application by which the joint official liquidators ("the JOLs") of the ICP Strategic Credit Income Fund Ltd. ("the offshore feeder fund") and the ICP Strategic Credit Income Master Fund Ltd. ("the master fund") seek the court's authority to commence litigation in the United States against Barclays Bank PLC ("Barclays") and DLA Piper LLP ("DLA") on the basis that its prosecution will be funded pursuant to the terms of a contingency fee agreement made with the New York law firm Reid Collins & Tsai LLP ("RCT"). On May 28th, 2013, I made an order by which the JOLs were authorized to commence the proceedings and adjourned the rest of the application so that counsel could prepare further written submissions about the legal issues which arise in connection with litigation funding agreements in general and contingency fee agreements in particular. Having considered two further written submissions, I made an order on July 18th, 2013 by which the JOLs were authorized, *inter alia*, to enter into a contingency fee agreement with RCT on behalf of the offshore feeder fund and the master fund, by which RCT will conduct the proceedings against both Barclays and DLA.

2. The points of law addressed by counsel for the JOLs concerning litigation funding agreements and contingency fee agreements are not novel and have been considered by this court in connection with other liquidation proceedings, both before and after the decision in this case. Nevertheless, I was subsequently asked to put my reasons into writing, which I now do, on the basis that a written judgment addressing this subject would be helpful to insolvency practitioners generally.

Factual background

3. Together with the ICP Strategic Credit Income Fund LP ("the onshore feeder fund"), the funds comprise a typical master/feeder structure which

was launched in September 2005. The investment objectives of the master fund, as described in its offering documents, was to invest in a variety of mortgage backed securities and similar debt instruments, the performance of which was highly dependent upon the US residential property market. The offshore feeder fund was incorporated under the Companies Law as the vehicle through which non-US investors and US tax-exempt investors would make their investments. The onshore feeder fund was established as a limited partnership under Delaware law as the vehicle through which US taxable investors would make their investments. The two feeder funds invested substantially all of their capital (either directly or indirectly via an exempted limited partnership established under Cayman law) in the master fund. Their respective shareholdings in the master fund are recorded as 78.77% for the offshore feeder fund and 21.12% for the onshore feeder fund (the balance of 0.11% is recorded in the name of ICP Credit Partners LLC GP). The circumstances in which the offshore feeder fund was put into compulsory liquidation are described in my judgment of August 10th, 2010. The master fund was put into voluntary liquidation by a unanimous written resolution of its shareholders and a supervision order was made on December 23rd, 2010. The current position is that Messrs. Hugh Dickson of Grant Thornton Specialist Services (Cayman) Ltd. and Stephen Akers of Grant Thornton UK LLP serve as joint official liquidators of both the master fund and the offshore feeder fund. For the purposes of this application, I shall use the expression "the funds" to mean the offshore feeder fund and the master fund, being the two companies subject to liquidation proceedings in this court. I shall use the expression "the ICP funds" to refer to all three entities comprised in the master/feeder structure.

4. The ICP Funds were promoted by ICP Asset Management LLC ("ICP Management"), an asset management business based in New York and ultimately owned and controlled by Mr. Thomas C. Priore. It acted as investment manager of the funds pursuant to an investment management agreement dated October 25th, 2006 and an affiliated company was the general partner of the onshore feeder fund. The key person in this management structure was Mr. Priore. He was instrumental in founding the ICP group of companies and acted as chief executive officer of all the constituent entities. By an order made on October 19th, 2011, this court authorized the JOLs to commence an action in the name of the funds against ICP Management, Mr. Priore and Triaxx Funding High Grade I, Ltd. ("Triaxx") in connection with the misuse of US$36.5m. of the master fund's money for the purpose of meeting margin payments required to be paid by Triaxx to Barclays. The action was duly commenced in the Supreme Court of the State of New York on February 10th, 2012. By their summons dated May 17th, 2013, the JOLs now seek the sanction of the court to commence further proceedings arising out of the same transaction against Barclays and DLA, which is a large and well-known law firm.

Instead of instructing their existing US lawyers, Pachulski Stang Zeihl & Jones LLP, to conduct this litigation on a time-spent basis, the JOLs seek the court's sanction to engage a second law firm, RCT, on the terms of a contingency fee agreement. In order to put these applications in their proper context, it is necessary to understand the causes of action which arise out of a series of margin payment transactions.

The misuse of $36.5m. of the master fund's money

5. Triaxx was managed by ICP Management and Mr. Priore. In 2006, it issued four multi-billion dollar collateralized debt obligations ("the CDOs") secured by residential mortgage backed securities. The issue of the CDOs was financed by Barclays pursuant to a master repurchase agreement. During 2007, the residential mortgage market in the United States began to collapse. As a result of the falling value of the underlying collateral, Barclays became entitled to issue margin calls against Triaxx, which was unable to meet its obligations. Between October 29th, 2008 and August 31st, 2009, ICP Management (acting on the instructions of Mr. Priore) used US$36.5m. of the master fund's money for the purpose of meeting Triaxx's obligations to make margin payments to Barclays. The documentary evidence available to the JOLs reflected that these payments were made (a) without the authority of the master fund's board of directors, (b) at a time when the residential mortgage market was collapsing, (c) even though neither of the funds had any contractual obligation to meet Triaxx's margin calls, (d) without any consideration to the master fund, and (e) without any security or promise of repayment. The only connection between the master fund and Triaxx is that they had the same manager and a large part of the master fund's assets were invested in the Triaxx CDOs. The complaint claims damages of US$36.5m. against Mr. Priore for breach of fiduciary duty in his capacity as a director of the funds, ICP Management for breach of its obligations under the investment management agreement, and Triaxx for unjust enrichment.

6. The master fund made ten separate payments directly to Barclays between October 29th, 2008 and August 31st, 2009. In respect of each payment, Mr. Priore signed a "direction letter" addressed to LaSalle Bank NA (in its capacity as trustee of the CDOs) by which it was stated that the master fund had made a payment to Barclays and that Barclays had waived Triaxx's obligation to provide collateral for that amount. Barclays issued "waiver letters" by which it waived Triaxx's obligation on the basis of having received payment from the master fund. It follows that Barclays knew that it was receiving the master fund's money. It is now proposed that the master fund should commence an action, in the US District Court for the Southern District of New York, against Barclays for, *inter alia*, aiding and abetting the breach of fiduciary duty committed by ICP Management and/or Mr. Priore. In order to establish this cause of action as

a matter of New York law, it will be necessary to prove that Barclays had actual knowledge of the breach of fiduciary duty, that Barclays knowingly participated in or induced the breach, and that the master fund suffered damage as a result. It is not suggested that the mere fact of knowing that the money was paid by the master fund is, by itself, sufficient to establish liability against Barclays. However, the waiver letters state that—

"Barclays reserves all rights under the repurchase agreement other than to declare a default based on this funding obligation so long as none of the funds provider [*i.e.* the master fund] or any person or entity requests or makes any claim or demand for repayment, reimbursement or claw-back of the margin payment (other than any payment that would have been payable to the issuer [*i.e.* Triaxx] under the repurchase agreement had the issuer made the margin payment to Barclays in accordance with the repurchase agreement)."

To my mind, this statement is evidence tending to suggest that Barclays knew that it was not entitled to receive the master fund's money and might have to repay it.

7. DLA's New York office provided legal advice to ICP Management in connection with these transactions. It is said to have been involved in drafting the directions letters to the trustee and the waiver letters issued by Barclays. DLA has denied having any attorney–client relationship with the funds, a proposition which is somewhat surprising bearing in mind that they must have known that the master fund and Triaxx had common management and that arrangements had not been made for the two entities to have separate legal advice. DLA drafted the direction letter and so must have understood the nature of the transactions. Yet it appears that DLA continued to act without drawing the obvious conflict of interest to the attention of the board of directors. The advice obtained by the JOLs is that, under New York law, the existence of an attorney–client relationship does not depend upon the existence of a formal retainer agreement or the payment of a fee. Instead, the court will examine the factual circumstances and may infer the existence of an attorney–client relationship where the evidence establishes the existence of an explicit undertaking to perform a specific task—in this case drafting the directions letters addressed to the LaSalle Bank NA, among other things.

8. Under New York law, the proposed actions against Barclays and DLA for aiding and abetting a breach of fiduciary duty are subject to a 6-year limitation period which had not expired at the time this court made its first order in May 2013. Actions for legal malpractice are subject to a 3-year limitation period calculated from the date upon which the malpractice took place, rather than the date upon which it was discovered or the date upon which the resulting damage occurred. Subject to some form of equitable tolling, the cause of action against DLA would therefore appear

to be statute-barred under New York law. However, the JOLs have been advised that it is possible for a legal malpractice action to be commenced against DLA in any state in which the firm has an office. Under the law applicable in the District of Columbia, in which the firm does have an office, the 3-year limitation period does not begin to run until the client actually suffers damage resulting from the malpractice. Unlike New York, the law applicable in the District of Columbia also recognizes various equitable tolling doctrines encompassing "the discovery rule," "the lulling doctrine" and "the continuous representation doctrine." In circumstances where ICP Management and Mr. Priore were acting against the interests of the funds in breach of their fiduciary duties and DLA were (allegedly) aiding and abetting the breach, there is obvious scope for arguing that the funds did not discover the legal malpractice until after the appointment of the JOLs in 2010.

Application to sanction the commencement of proceedings

9. The JOLs sought the sanction of the court to commence proceedings in the names of the funds against both Barclays and DLA. The Third Schedule to the Companies Law (2013 Revision) identifies whether particular powers of official liquidators are exercisable with or without the sanction of the court. The decision whether or not to sanction the exercise of a power which falls within Part I of the Third Schedule is a decision for the court. It is not a decision which can be taken by the official liquidator in the absence of the court's sanction. In deciding whether or not to sanction a proposed transaction or course of action of this sort, the court must consider whether the interests of the creditors or contributories (as the case may be) are likely to be best served by permitting it or not permitting it. In cases falling within Part II, the court is asked to control the exercise of a power for which the official liquidator does not require the sanction of the court. If the official liquidator has taken a decision which he is entitled to take without its sanction, the court should only interfere if the official liquidator is not acting *bona fide* or his decision is one which no reasonable liquidator could take in the circumstances of the case. This is the approach adopted by the English Court of Appeal in *Re Greenhaven Motors Ltd.* (4). Although there are material differences between the insolvency legislation applicable in the United Kingdom and the Cayman Islands, the reasoning of Chadwick, L.J. (who is now president of the Cayman Islands Court of Appeal) in *Greenhaven* is followed in this jurisdiction.

10. By Part I, para. 1 of the Third Schedule, an official liquidator's power to "bring or defend any action or other legal proceeding in the name and on behalf of the company" is exercisable only with the sanction of the court. In deciding whether or not to sanction the commencement of proceedings in the names of the funds as plaintiff, the court must be

satisfied that they do have causes of action against the proposed defendants with a reasonable prospect of success and that the interests of the creditors will be best served by allowing proceedings to be commenced. As officers of the court, official liquidators are expected to behave in an exemplary manner and to perform their duties and exercise their powers fairly. The court will not allow its official liquidators to threaten or commence litigation speculatively as a means of extracting a settlement from a party against whom there is no genuine cause of action or no evidence from which to infer that a possible cause of action has any real prospect of success. For the reasons which I have already explained, I am satisfied that there is a good arguable case against both Barclays and DLA. In the case of DLA, I am also satisfied that there is an arguable basis upon which the limitation defence can be met, at least if the proceeding is commenced in the District of Columbia.

11. However, this conclusion is not, by itself, sufficient to justify making the order sought by the JOLs. Even though the court is satisfied that good arguable causes of action do exist, it does not necessarily follow that the interests of the stakeholders would be best served by commencing proceedings. Although it may ultimately be to their advantage if litigation is successfully prosecuted and a judgment obtained in favour of the company, there are concomitant risks. An adverse outcome is likely to result in the depletion of the funds which would otherwise be available for distribution, even if the litigation can be conducted in a jurisdiction in which the loser will not be ordered to pay the winner's costs. There may be circumstances (which do not arise in this case) in which the downside risks of litigation would fall upon the creditors, whereas the upside benefit would go, in part, to shareholders who bear no corresponding risk. It follows that the court's decision to sanction the commencement of litigation can never be entirely divorced from questions about how and by whom it will be financed.

Law relating to litigation funding agreements and contingency fee agreements

12. In the present context, I use the expression "litigation funding agreement" to mean a contract made between an official liquidator and a funder (who may or may not have an interest in the liquidation as a creditor or contributory) by which the funder will advance money to the official liquidator for the purpose of funding the prosecution of a cause of action belonging to the company on terms that the funder's return is limited to the receipt of a share of the proceeds of the claim that is being funded. The funder's obligation is to advance money which the official liquidator will use to pay legal fees and other litigation expenses. Depending upon the jurisdiction in which the action is commenced, the funded expenses may include the provision of security for adverse costs orders. A

litigation funding agreement (as defined) is therefore a species of limited recourse loan agreement by which the lender's recourse is limited to sharing in the proceeds (if any) of the litigation. I use the expression "contingency fee agreement" in a narrow sense to mean a contract made between an official liquidator and a (foreign) law firm by which it agrees to conduct a cause of action belonging to the company on terms that the law firm's right to be remunerated arises only if the litigation is successful and is limited to a share of the proceeds of the claim. The law firm's obligation is to provide advice and perform all the work reasonably and properly required to litigate the action to a final conclusion. Typically, the law firm's obligation is limited to the performance of work and the official liquidator will have an obligation to fund the out-of-pocket expenses, including the fees payable to expert witnesses. One of the distinctions between these two types of funding arrangement, which is important from a public policy perspective, is that a litigation funding agreement enables the official liquidators' lawyers to be paid (at the firm's normal hourly rates) in any event, whereas under a contingency fee agreement their right to receive any remuneration at all is contingent upon the outcome of the litigation.

13. It is also relevant to mention "conditional fee agreements." I use this expression to mean an agreement by which the amount of a law firm's fee is expressed to be conditional upon the outcome of the litigation. By such agreements, the law firm is paid on a time-spent basis but the amount payable is subject to an uplift or bonus in the event that the litigation is deemed to have been successful. The uplift or bonus is usually expressed as a percentage uplift in respect of the total time charges or an enhanced scale of hourly rates. The law firm will be paid in any event. It may be said that the law firm is financing the litigation only to the extent that it is offering discounted hourly rates in consideration for the chance of earning enhanced rates (in excess of the firm's "normal" hourly rates) in the event that the pre-determined success criteria have been achieved. In this case I am concerned only with a proposal to enter into a contingency fee agreement (as narrowly defined).

14. Historically, the funding of litigation by third parties who have no interest in the dispute has been characterized as maintenance or champerty, and such funding arrangements have been held to be unlawful. However, in the context of insolvent liquidation proceedings, it has been recognized by the English courts, at least since 1888 in *Guy* v. *Churchill* (5), that creditor-funded litigation did not contravene the common law principles of maintenance and champerty. Official liquidators have a statutory power to sell the company's property, which includes power to assign the proceeds (or a share in the proceeds) of a cause of action belonging to the company. There is a distinction between a transfer or assignment of property which carries with it, as a matter of course, the

right to prosecute any cause of action closely related to that property and the assignment of a bare cause of action, meaning a purely personal right to claim damages for a tortious wrong, unconnected with any property rights. The former may be the subject of an absolute legal assignment whereby the assignee can sue in his own name. The latter is not assignable, but a distinction is also drawn between a cause of action and the proceeds (or fruits) of a cause of action. In *Glegg* v. *Bromley* (2), Fletcher Moulton, L.J. said ([1912] 3 K.B. at 488): "We are all agreed that you cannot assign a cause of action for a personal wrong," but went on to hold that there is no objection to assigning the fruits of the action, provided that the assignee is not in a position to control the litigation. It follows that a litigation funding agreement made between an official liquidator and a funder, who has no interest in the liquidation as a creditor or shareholder, will only contravene the principles of maintenance and champerty if the funder is in a position to control or exercise a significant degree of influence over the conduct of the litigation. In *Grovewood Holdings PLC* v. *James Capel & Co. Ltd.* (3), an official liquidator of an insolvent company, who had failed to obtain litigation funding from the creditors and shareholders, entered into an agreement with an anonymous sponsor by which the sponsor agreed to fund the litigation in consideration for 50% of the proceeds. Lightman, J. stayed the action, on the application of the defendants, on the ground that the agreement was contrary to public policy because it purported to give the funder the right to conduct the litigation in the name of the company "without being subject to the control or interference of the liquidator." It was held ([1995] Ch. at 87) that the official liquidator's statutory power to sell the company's property did not apply to a sale of the proceeds of a bare cause of action and therefore did not constitute a statutory exception to the principles of maintenance and champerty.

15. There is a further distinction between the causes of action belonging to a company in liquidation which are assignable and the statutory rights of action available only to official liquidators personally which are not assignable. An official liquidator's power under para. 8 of Part I of the Third Schedule to the Companies Law to "sell any of the company's property" means the assets which are the property of a company at the time of the commencement of the liquidation and the property representing it, including rights of action which might have been pursued by the company itself prior to the liquidation. Statutory rights of action available only to the official liquidator as a result of the winding-up order having been made, such as the right to pursue preference claims, do not form part of the "company's property" which official liquidators are empowered to sell because such rights are an incidence of office and must be exercised by the officeholder personally, subject to the supervisory control of the court. *In re Oasis Merchandising Ltd.* (8) concerned a litigation funding agreement made between an official liquidator and a litigation funding

company called London Wall Litigation Claims Ltd. ("LWL") for the purpose of financing wrongful trading proceedings against the company's former directors. The agreement provided that LWL would finance the litigation in consideration of a share of the proceeds. The action was to be commenced in the name of the official liquidator, but on terms that LWL would be entitled to exercise a high degree of control over the manner in which the litigation would be conducted. The Court of Appeal upheld Walker, J.'s decision that the proceeds of a wrongful trading action did not form part of the "company's property," with the result that the official liquidator could not rely upon the statutory power of sale as authority to enter into a champertous agreement. The underlying policy, which justified granting the directors' application for a stay of the action, was described by Peter Gibson, L.J. in the following terms ([1998] Ch. at 186):

"As a matter of policy we think that there is much to be said for allowing a liquidator to sell the fruits of an action provided that it does not give the purchaser the right to influence the course of, or to interfere with the liquidator's conduct of, the proceedings. The liquidator as an officer of the court exercising a statutory power in pursuing the proceedings must be free to behave accordingly. We are far from happy with the right of interference given to L.W.L. . . to dictate how the liquidator is to conduct the action . . . Indeed, despite [counsel's] argument to the contrary, it seems to us to enable L.W.L. to prevent the liquidator from exercising his statutory power . . to apply to the court for directions in relation to this litigation."

16. The decision in *In re Oasis Merchandising Ltd.* was recently followed by Ramsey, J. in *Ruttle Plant Ltd.* v. *Environment, Food & Rural Affairs Secy. (No. 3)* (10). The plaintiff was the purported assignee of the fruits of statutory rights of action vested in the official liquidator of Farm Assist Ltd. pursuant to a litigation funding agreement, the terms of which permitted it to conduct the proceedings "in as full a manner as the Company or the Liquidator could have done and free from all control [or] any interference by the Liquidator." The defendant's challenge to the validity of the agreement was upheld on the ground that it amounted to an unlawful surrender by the official liquidator of his fiduciary powers and on the ground that it was champertous. Ramsey, J. said ([2009] 1 All E.R. 448, at para. 43):

"In my judgment the reason why the assignment is objectionable is because the liquidator is assigning the rights he has under the 1986 Act and is thereby assigning a discretionary power which, being part of the statutory powers of a liquidator, is personal to the liquidator, just as is his appointment: see *Re Sankey Furniture Ltd. ex p. Harding* [1995] 2 BCLC 594 at 600. The intention in this case, as demonstrated by the deed, is that the liquidator's right to prosecute and carry on the action is passed to a third party so as to deprive the

liquidator of any control or 'interference' in those proceedings. In such circumstances, I respectfully adopt what Lightman, J. said in *Grovewood Holdings PLC* v. *James Capel & Co. Ltd.* [1994] 4 All E.R. 417 at 425, [1995] Ch. 80 at 89: '*I cannot see how a liquidator can properly or at all surrender his fiduciary power to control proceedings commenced in the name of the company.*'" [Emphasis supplied.]

17. The present state of the English law on the subject of litigation funding agreements generally was summarized by Coulson, J. in *London & Regional (St. George's Court) Ltd.* v. *Ministry of Defence* (7) as follows (121 Con. L.R. 26, at para. 103):

"(a) The mere fact that litigation services have been provided in return for a promise in the share of the proceeds is not by itself sufficient to justify that promise being held to be unenforceable . . .

(b) in considering whether an agreement is unlawful on grounds of maintenance or champerty, the question is whether the agreement has a tendency to corrupt public justice and that such a question requires the closest attention to the nature and surrounding circumstance of a particular agreement . . .

(c) the modern authorities demonstrated a flexible approach where courts have generally declined to hold that an agreement under which a party provided assistance with litigation in return for a share of the proceeds was unenforceable . . .

(d) the rules against champerty, so far as they have survived, are primarily concerned with the protection of the integrity of the litigation process in this jurisdiction."

Whether or not point (a) reflects Cayman law in the light of Smellie, C.J.'s decision in *Quayum v. Hexagon Trust Co. (C.I.) Ltd. (9)* (discussed at para. 20 below) is not something which I have to decide for the purposes of this case.

18. In the context of liquidation proceedings, I would add the following points to Coulson, J.'s summary of the law. First, an outright sale by an official liquidator, by way of legal assignment, of a cause of action where the price is expressed to be a percentage of the proceeds of the action is a valid exercise by the official liquidator of his statutory power to sell the company's property. Secondly, an assignment of a percentage of the proceeds of a cause of action pursuant to a litigation funding agreement is a valid exercise of the official liquidator's statutory power to sell the company's property, provided that the funder is given no right to control or interfere with the conduct of the litigation. It follows that where this court is asked to sanction a litigation funding agreement, its terms will be carefully scrutinized to ensure that it does not directly confer upon the funder any right to interfere in the conduct of the litigation or indirectly put the funder in a position in which it will be able, as a practical matter,

to exert undue influence or control over the litigation. Thirdly, a purported assignment of a right of action or the proceeds of a right of action vested in the official liquidator personally, such as the right to assert preference claims, is not authorized under the statutory power to sell the company's property. It would be an unlawful surrender by the official liquidator of his fiduciary power and would be contrary to public policy.

19. I now turn to examine the circumstances in which this court can properly allow an official liquidator to enter into a contingency fee agreement, which is a particular kind of litigation funding agreement in which the prosecution of the company's cause of action is financed by the lawyers themselves in consideration of a share in the proceeds. It follows that the considerations which apply to litigation funding agreements generally apply equally to contingency fee agreements, but there is an additional public policy consideration which renders all contingency fee agreements (as narrowly defined) unlawful and unenforceable if they relate to litigation which will be conducted in this jurisdiction. In *Wallersteiner* v. *Moir (No. 2)* (11), Buckley, L.J. explained the public policy question in this way ([1975] Q.B. at 402):

"It may, however, be worthwhile to indicate briefly the nature of the public policy question. It can, I think, be summarised in two statements. First, in litigation a professional lawyer's role is to advise his client with a clear eye and an unbiased judgment. Secondly, a solicitor retained to conduct litigation is not merely the agent and adviser of his client, but also an officer of the court with a duty to the court to ensure that his client's case, which he must, of course, present and conduct with the utmost care of his client's interests, is also presented and conducted with scrupulous fairness and integrity. A barrister owes similar obligations. A legal adviser who acquires a personal financial interest in the outcome of the litigation may obviously find himself in a situation in which that interest conflicts with those obligations."

20. The attitude in England towards contingency fee arrangements generally has changed very significantly since Buckley, L.J. made this statement, but it was quoted by Smellie, C.J. in *Quayum (9) (2002 CILR 161, at para. 35*) and accepted as the reason why contingency fee agreements (as narrowly defined) continue to be regarded as contrary to Cayman Islands public policy. However, Smellie, C.J. went on to say (*ibid., at para. 37*) that "there is, however, another equally important and competing public interest: that of ensuring that everyone has access to justice." This observation was made in the context of a case in which the plaintiffs were employees of an insolvent bank who had been defrauded of money which should have been invested in their staff benefit trust. They were unemployed and ineligible for legal aid, with the result that they did not have the means to fund their proposed "salvage claim" against the

trustee. They therefore entered into an agreement with a local firm of attorneys that it would be paid on a time-spent basis at enhanced hourly rates (which later turned out to be no more than the normal rates) if the litigation were successful. The local attorneys engaged English counsel on terms that he would be paid an uplift of 50% over his normal hourly rates in the event that the litigation was successful. The attorneys and counsel were to be paid nothing in the event that the litigation was unsuccessful. Smellie, C.J. characterized these arrangements as a "conditional fee agreement," as opposed to what I have called a "contingency fee agreement"—the distinction being that the fees were to be determined on a time-spent basis, not as a percentage of the proceeds of the litigation. The defendant trustee contended that the agreement constituted maintenance and was effectively champertous, although the amount payable to the attorneys and counsel was not expressed as a share in the proceeds. Smellie, C.J. accepted that the common law principles of maintenance and champerty form part of the common law of the Cayman Islands but held that the agreements did not fall foul of these principles as they applied to the attorney–client relationships in question. He reached this conclusion by finding that the uplift was not a disguised share in the proceeds of the litigation but, rather, recognition of the risk of non-payment in the event of failure. He concluded that conditional fee agreements would be valid and enforceable if approved by the court, whereas contingency fee agreements are not justified by public policy and therefore continue to be void.

21. In *Latoya* v. *Att. Gen.* (6), the Court of Appeal considered the decision in *Quayum* in the context of a different, but related issue. The question was whether the amount payable by the successful plaintiff to his lawyers pursuant to a conditional fee agreement (which had been sanctioned by the court in accordance with the guidance laid down in *Quayum*) was recoverable on taxation pursuant to an order for costs made against the unsuccessful defendant. The Court of Appeal held that, on a true construction of the applicable Rules and Practice Direction 1/2001, *Guidelines Relating to the Taxation of Costs*, this sum was not recoverable from the unsuccessful party. In so doing, the Court of Appeal made no observation about the broader public policy issues and the correctness of the decision in *Quayum* because it was not necessary to do so and (*per* Chadwick, P.) because it would also be inappropriate to do so bearing in mind that the matter has been referred to the Law Reform Commission.

22. I think that I should follow *Quayum* and conclude that contingency fee agreements (as narrowly defined) are contrary to Cayman Islands public policy and therefore void and unenforceable. It is also self-evidently right to say that the court cannot properly authorize an official liquidator to enter into any contract which would be contrary to Cayman Islands public policy. Furthermore, the court's sanction could not validate a contract made by an official liquidator which would otherwise be void

and unenforceable in accordance with its proper law. However, this does not necessarily lead to the conclusion that I must refuse to sanction the JOLs' decision to enter into a contingency fee agreement (as narrowly defined) with the New York law firm RCT for the purpose of conducting the actions against Barclays and DLA in the United States. I was referred to the *New York Rules of Professional Conduct* applicable in the New York State Unified Court System, from which it is clear that the actions against Barclays and DLA do fall within those categories of litigation which are permitted to be conducted pursuant to contingency fee agreements in the New York courts.

23. Official liquidators are empowered to engage lawyers, whether domestic or foreign, only with the sanction of the court (under para. 11 of Part I of Schedule 3 to the Companies Law) and only on terms of engagement which comply with the requirements of the Companies Winding Up Rules, as amended by the Companies Winding Up (Amendment) Rules 2013, O.25, r.1, the material parts of which provide as follows:

"(2) The terms upon which lawyers are engaged by the official liquidator must be stated in writing and shall be signed by both parties.

(3) Every engagement letter or retainer agreement shall contain particulars of the basis upon which the lawyers will be remunerated, including, if applicable, a statement of the agreed hourly rates.

(4) The official liquidator shall not retain (whether directly or indirectly) any foreign lawyer unless he (being a sole practitioner) or the firm of which he is a partner or employee has signed an engagement letter or retainer agreement which expressly states that—

(a) the contract is governed by Cayman Islands law;

(b) the lawyer/law firm submits to the exclusive jurisdiction of the [Grand Court of the Cayman Islands] for all purposes in connection with the engagement . . ."

Order 25, r.2(1) is also relevant in that it provides: "All lawyers engaged by the official liquidator shall be remunerated on a time spent basis (at agreed hourly rates which are stated in the engagement letter) unless the Court has sanctioned some other basis of remuneration."

24. CWR, O.25 says nothing expressly about contingency fee agreements. Rule 1(4)(a) excludes any possibility of giving sanction for the JOLs to enter into a contingency fee agreement expressed to be governed by New York law. However, it seems to me that r.2(1) leaves open the possibility of sanctioning official liquidators to engage foreign lawyers to

conduct litigation in a foreign court in consideration of a share in the proceeds if such a contract would be binding and enforceable in accordance with Cayman law as well as the law of the country in which it will be performed. In my view, a contract expressed to be governed by Cayman law, which would be contrary to public policy if performed in this jurisdiction, is capable of being valid and enforceable if its terms require that it be performed wholly outside the Cayman Islands and in a foreign country where its performance would not be contrary to the public policy of that country. Whether such a contract is regarded as valid will depend upon the nature and scope of the public policy considerations raised by the contractual terms in question.

25. The editors of Dicey, Morris & Collins, 2 *The Conflict of Laws*, 14th ed., at para. 32–233 (2010) recognize that "some rules of public policy are concerned only with cases having a connection with England, or based upon considerations which are purely domestic." I think that the common law rules relating to champerty clearly fall into this category. The learned authors go on to state (*op. cit.*, para. 32–238, at 1630) that—

"where a contract is governed by English [or Cayman] law, the application of the usual principles of public policy may require some modification if the place of performance is abroad. Thus it will not be contrary to English [or Cayman] public policy to contract to oust the jurisdiction of a foreign court, and it may not be contrary to English [or Cayman] public policy to contract to stifle a foreign prosecution."

Where a contract is required by its terms to be performed wholly outside the Cayman Islands, it seems to me that it will only be void on public policy grounds if the public policy in question is regarded as being of such fundamental importance that it must be given universal application. The public policy considerations relating to conditional fee agreements and contingency fee agreements do not fall into this category because they relate only to the administration of justice in our domestic courts. There is no suggestion in any of the modern case law that any kind of fee agreement which gives a litigant's lawyer a direct or indirect financial interest in the outcome of the litigation is so fundamentally wrong in principle that it would be impossible to devise rules of court and rules of professional conduct capable of countering any tendency for the proper administration of justice to be undermined. To the contrary, Smellie, C.J. concluded in *Quayum (9)* that conditional fee agreements, which give rise to the same general public policy concerns as contingency fee agreements, can be regulated by the court in a way which meets these concerns. Chadwick, P. recognized in *Latoya* v. *Att. Gen.* (6) that the balance of public policy about contingency fee agreements might change, but expressed the view that it would be more sensible for such change to be brought about by legislation rather than through judicial re-interpretation

of the common law. It seems to me that in both *Quayum* and *Latoya* v. *Att. Gen.* there was judicial recognition of the proposition that contingency fee agreements (as narrowly defined) are not regarded as so manifestly and fundamentally wrong in principle that the public policy against such arrangements must be recorded as having universal application. I think that the public policy underlying the Cayman common law of champerty relates only to litigation conducted in our domestic courts.

26. I find support for this conclusion in the *dictum* of Steyn, L.J. in *Giles* v. *Thompson* (1) ([1993] 3 All E.R. at 332):

"The doctrine is further limited in application to the extent that it only applies to agreements governing English litigation: see *Re Trepica Mines Ltd.* [1962] 2 All E.R. 351 at 354–355, [1963] Ch. 199 at 218. An agreement of a champertous nature made in England is valid if it relates to litigation in a country where champerty is lawful. This illustrates that one is not dealing with an overriding public policy, which applies wherever the agreement is made or to be performed, such as an agreement to pay a bribe abroad. It is designed to protect the integrity of the English judicial system.

Contingency fee agreements are nowadays perhaps the most important species of champerty. Such agreements are still unlawful. Yet an English solicitor may share in a contingency fee earned in foreign litigation. . Thi s reinforces the point that the doctrine of champerty serves to protect only the integrity of English public justice. It is based not on grounds of morality but on a concern to protect the administration of civil justice in this country."

It follows that a contingency fee agreement (as narrowly defined), which is expressed to be governed by Cayman law, will be valid and enforceable, provided that its terms require that it will be performed wholly in a foreign country where its performance will be lawful and permissible in accordance with the applicable local law and rules of professional conduct.

27. It is therefore open to the court to sanction the contingency fee agreement intended to be made between RCT and the funds (acting by the JOLs) for the purpose of pursuing the claims against Barclays and DLA in the US Federal District Court for the Southern District of New York or the District of Columbia, provided that the following criteria are met. First, the proposed agreement must comply with the requirements of CWR, O.25, r.1 and I am satisfied that it does. I would add that contingency fee agreements concluded between official liquidators and foreign lawyers should normally take the form of detailed commercial contracts, not simple engagement letters, even though the latter might be sufficient to comply with the rules of professional conduct applicable in the jurisdiction in which the litigation will be conducted. Secondly, the performance

of the agreement in question must be permitted by the law and professional conduct rules applicable in the country in which the litigation is to be conducted. I am satisfied that there is nothing in this agreement which is in any way inconsistent with the rules of professional conduct applicable to the conduct of litigation in New York or the District of Columbia. Thirdly, the official liquidator must not fetter his fiduciary power to control the litigation. The court must be satisfied that the terms of the agreement will not, as a practical matter, tend to inhibit the official liquidator from exercising complete control over the manner in which the litigation is conducted. This necessarily involves the court engaging in a careful review of the contractual terms. The JOLs are proposing to enter into two separate agreements—one relating to the prosecution of the claims against Barclays and DLA in the District Court and another agreement relating to an ancillary petition to the Bankruptcy Court pursuant to ch. 15 of the Bankruptcy Code. The terms are materially different. The first is a contingency fee agreement pursuant to which RCT will be paid a percentage of the proceeds in the event of a successful outcome. The second agreement provides for RCT to be paid on a time- spent basis at the firm's ordinary hourly rates irrespective of the outcome of the ch. 15 application, but it is a limited recourse agreement in that the firm has a right to receive payment only out of the proceeds of the other litigation.

28. Counsel for the JOLs drew my attention to the following salient points. RCT expressly recognizes that the JOLs have the final and exclusive right to make settlement decisions, subject to obtaining this court's sanction. The parties agree that this court shall have exclusive jurisdiction to determine any dispute relating to the agreement through the mechanism of a sanction application, for which purpose it is agreed that RCT and its co-counsel shall have a personal right (to the extent permitted by law) to attend and be heard on any such application. The capital adequacy of the counterparty to any litigation funding agreement or contingency fee agreement will always be an important consideration for the official liquidator. The court will be concerned to satisfy itself that appropriate due diligence has been conducted. This litigation is likely to last several years and consume thousands of hours of work on the part of a team of lawyers and support staff. The agreement does contain appropriate representations and warranties on the part of RCT that it does have the financial and human resources to enable it to conduct the litigation to a final conclusion. The court also needs to be satisfied, as I am, that the JOLs are in a position to fulfil the financial obligations imposed upon the funds to set aside and maintain an expense fund of $500,000 from which to meet RCT's out-of-pocket expenses.

29. Contingency fee agreements should expressly address the scope of the law firm's reporting obligations. Typically, the foreign law firm will be

expected to prepare or assist in the preparation of reports to creditors/shareholders, the liquidation committee and the court. The lead lawyers may be expected to appear in person in connection with sanction applications made to this court in connection with the conduct or settlement of the litigation. This agreement does express RCT's reporting obligation in an appropriate way. The court will always be concerned to ensure that the termination provisions are appropriate. The counterparty to a litigation funding agreement or contingency fee agreement should have no right to terminate the contract and cease paying legal fees or undertaking legal work, as the case may be, without the consent of the liquidator or the sanction of the court. Conversely, a foreign law firm should have no right to insist upon continuing to prosecute a claim which is no longer considered by the official liquidator to be meritorious. Nor should the foreign law firm be in a position to insist upon payment of a fee calculated on a time-spent basis in the event that the liquidator gives instructions for the action to be discontinued. This subject is addressed appropriately in this agreement, which provides that any issue as to whether it has been terminated with or without cause and any dispute as to RCT's right to remuneration in the event of termination shall be determined by this court.

30. I am satisfied that the court can properly sanction the commencement of proceedings against Barclays and DLA in the US courts on the basis that it will conducted by RCT in accordance with a contingency fee agreement. I am also satisfied that the terms of this agreement comply with the requirements of CWR, O.25 and meet the criteria necessary to obtain the court's sanction.

Orders accordingly.

Conyers Dill & Pearman for the applicants.

ITEM NO. 168

JA-54

[2019 (2) CILR 382]

ARNAGE HOLDINGS LIMITED and FOUR OTHERS v. WALKERS (a firm)

GRAND CT. (Smellie, C.J.) July 24th, 2019

Attorneys-at-Law — obligations towards client — lawyer–client relationship — on application for summary judgment against attorney on liability for breach of contractual and fiduciary duties of confidence, trust and loyalty, client must establish existence of lawyer–client relationship, existence of attendant duties, actionable breaches of duties and proof of causation of some loss

The plaintiffs brought proceedings against the defendant for breach of contractual and fiduciary duties of confidence, trust and loyalty, and tortious duties of care.

The plaintiffs were companies and individuals who represented the interests of the Rabellos, a prominent Brazilian family. The Rabellos held extensive business interests in Brazil and elsewhere, including in banking, land holding, finance, hospitality and other areas of industry, in the form of a conglomerate named the "Rural Group." Banco Rural was the flagship of the group, operating more than 100 branches throughout Brazil and with subsidiaries abroad. The family also owned Trade Link Bank ("TLB"), a licensed Cayman bank incorporated by the defendant to conduct investments for the Rabello family.

The first and second plaintiffs were Cayman Islands companies which were owned and controlled by the fourth plaintiff, Katia Rabello, who represented her family's interests as well as her own. The third plaintiff was a Cayman Islands company of which the registered shareholder was the fifth plaintiff, Fernando Toledo, a close and trusted friend and business associate of the Rabellos. The defendant was a major Cayman Islands law firm which provided legal services in the Cayman Islands and other jurisdictions. The plaintiffs claimed that there was a longstanding lawyer–client relationship with the defendant, which the defendant had betrayed by acting for a Dr. Braga, a Brazilian court-appointed trustee-in-bankruptcy. The defendant largely denied the existence of a lawyer–client relationship and entirely denied any liability for the alleged losses.

The evidence revealed that there had been a longstanding lawyer–client relationship between the defendant and the Rabellos, including Katia Rabello and Fernando Toledo. Many retainers and engagements had been undertaken by the defendant over the course of a number of years. The

relationship began in 1984 when the defendant was engaged by Katia Rabello's father to incorporate TLB. In 1998, the third plaintiff ("EFHL") was incorporated by the defendant, instructed by Katia Rabello's father, to hold the family's majority shares in TLB. Following the father's death, the defendant transferred the share in EFHL to Fernando Toledo. The defendant also acted for the Rabello family for the transmission of the father's estate in the Cayman Islands. In 2000, the defendant acted for the first and second plaintiffs and TLB in connection with a note facility (the note purchase transaction) by which Securinvest Holdings S.A. provided a $40m. note to the first and second plaintiffs for onward sale to TLB, in return for financing from TLB for the carrying out of Securinvest's business in Brazil. That involved the defendant being satisfied that, as was in fact the case, the common interest purpose and beneficial ownership of all parties for whom it acted were held in common with the Rabello family (including Katia Rabello as 50% beneficial owner of the first and second plaintiffs and 50% ultimate beneficial owner of Securinvest).

Dr. Braga alleged collusion between Katia Rabello's father and the principal of a different group of companies, the Petroforte Group. Dr. Braga alleged that Katia Rabello's father had used Securinvest and another Rural entity in collusion with the principal of the Petroforte Group (which was later placed into bankruptcy) to defraud creditors of Petroforte. A transaction ("the Sobar transaction") had been entered into in 2000 when Petroforte, the parent of Sobar, was alleged to have become bankrupt. It was alleged that Katia Rabello's father and the principal of Petroforte colluded to strip away Sobar assets from the Petroforte Group, putting them out of reach of creditors by use of a Rural Group entity and, later, Securinvest.

In 2006, the Brazilian Central Bank contacted the Cayman Islands Monetary Authority in respect of its investigation into links between the Rabello family, Banco Rural and TLB. The CIMA provided information as to the shareholdings in TLB, namely that the majority shareholder was Katia Rabello's father until November 1998, after which it was EFHL, represented by Katia Rabello's father. In 2007, CIMA, on behalf of the BCB, issued a formal direction to TLB to provide documents, including a copy of the register of officers and directors of TLB. In May 2007, the defendant was engaged by a Mr. Macaulay (Miami counsel) on behalf of TLB to provide legal advice on resisting the CIMA direction. This was expressly stated to be to maintain the confidentiality of any further connections between TLB and the Rabello family. The BCB, in breach of its undertaking to CIMA, publicly disclosed the information provided, which linked the Rabello family to TLB. The information was used in criminal proceedings against Katia Rabello and other family members. In August 2009, the defendant was again engaged, this time to seek his advice on obtaining the possible intervention of the Cayman Islands Attorney General and/or CIMA, with the BCB or the Brazilian courts to prevent the CIMA disclosure from being further "abused" in the criminal proceedings, to the detriment of the Brazilian defendants.

The defendant was retained by Dr. Braga in April 2010 in the context of a long-running battle between Dr. Braga as trustee-in-bankruptcy of the Petroforte Group and the Rabello family and their Rural Group, concerning the alleged stripping away of the Sobar assets. Although the Rural Group claimed the Sobar transaction was not a sham and had in fact been approved by the Brazilian courts, Dr. Braga had commenced a revocation action in 2006 and obtained a secured lien over the Sobar assets. Dr. Braga commenced bankruptcy proceedings against Securinvest, seeking to bring all Securinvest assets into the Petroforte bankruptcy, relying on the Brazilian legal theory of "common economic group." The legal theory would be established unless it could be shown that Securinvest (as the destination of the Sobar assets) was itself owned by third parties having no connection to either the Rural Group or the Petroforte Group. Dr. Braga persuaded a Brazilian judge to make an order *ex parte* in August 2007 extending the Petroforte bankruptcy over Securinvest. Securinvest appealed against the August 2007 bankruptcy order but the Tribunal de Justicia de São Paulo affirmed the order. Securinvest also appealed unsuccessfully to the Superior Tribunal de Justicia ("STJ"). Evidence was presented to the STJ on behalf of Securinvest which sought to show that there was no interest on behalf of the Rabellos or the Rural Group in Securinvest which, it was argued, was ultimately owned by Costa Rican individuals through Costa Rican companies, as the registered owners of the first and second plaintiffs. In reality, that structure was an artifice put in place on the instructions of Katia Rabello. When this came to light, Dr. Braga persuaded the STJ that he should be allowed to come to the Cayman Islands to investigate further into the ultimate beneficial owner of Securinvest, through the first and second plaintiffs.

Katia Rabello explained that her reason for lying to the STJ by obscuring her status as the owner of the first and second plaintiffs, and thus the ultimate beneficial owner of Securinvest, was not to defraud creditors of Petroforte but to prevent the wholesale confiscation of Securinvest's assets and even greater harm to the Rabellos' interests.

Dr. Braga retained the defendant. The first application made on Dr. Braga's behalf relying on the *Norwich Pharmacal* principle sought orders addressed to Equity Trust for disclosure of information held on behalf of the first and second plaintiffs (as the registered owners of Securinvest). The application was made *ex parte.* It resulted in orders in May 2010 for the disclosure to Dr. Braga of confidential information showing *inter alia* that Katia Rabello was the ultimate beneficial owner of Securinvest through the first and second plaintiffs. A "gagging" order was obtained, preventing Equity Trust from notifying the plaintiffs of the existence of the proceedings and the orders. A second such application was made to CIBC as a previous service provider, resulting in an order directed to CIBC for disclosure. The information sought and obtained in the orders exceeded that which showed the ultimate beneficial owner of Securinvest and included other information held by the respondents about the plaintiffs' financial affairs. The court required Dr. Braga to give certain

undertakings to limit the use and disclosure of the confidential information obtained.

Dr. Braga deployed the Cayman disclosure in support of a new *ex parte* petition in Brazil for the extension of the Petroforte bankruptcy to Katia Rabello personally and other identifiable entities of the Rural Group, which petition was granted. The Cayman disclosure was also placed before the STJ. The Cayman disclosure was provided to the Brazilian Central Bank which it was pleaded resulted in regulatory action against Banco Rural, with punitive damages sought against Banco Rural and Katia Rabello personally. The plaintiffs claimed that the consequences of the defendant's breach of duties to them had been catastrophic.

The plaintiffs claimed that the longstanding lawyer–client relationship with the defendant had been betrayed by the defendant's breach of contractual and fiduciary duties, causing massive loss. It was alleged that the breaches of duty related to obtaining confidential information for Dr. Braga relating to the first and second plaintiffs and the note purchase transaction, along with information revealing that Katia Rabello was the ultimate beneficial owner of Securinvest through the first and second plaintiffs.

There were two cross-applications presently before the court. The first was that of the plaintiffs for summary judgment on liability on the basis that the defendant had no arguable defence to their claims. The second was an application by the defendant to strike out the plaintiffs' claims on the basis that the claims had no prospect of success and were an abuse of process of the court.

The plaintiffs submitted that (a) in relation to the May 2007 retainer, the defendant could not have been in any doubt as to its obligation to maintain and protect the confidentiality of the information when approached by Dr. Braga; (b) in relation to the August 2009 retainer, it should also have been clear that the defendant's clients were those, including Katia Rabello, facing possible conviction in Brazil as a result of the abuse of the CIMA disclosure by the BCB; (c) while she had never dealt personally with the defendant, Katia Rabello had relied on the defendant to act on her behalf regarding all Cayman legal matters that affected her; (d) the defendant had betrayed the trust and confidence between it and the Rabello family by disloyally acting on behalf of Dr. Braga; (e) that amounted to a serious and flagrant breach of the defendant's fiduciary, contractual and tortious duties and was a gross breach of confidence; (f) the extensive disclosure of the confidential information obtained by Dr. Braga in the Cayman Islands with the assistance of Dr. Braga directly influenced the rejection of the appeal against the extension of the Petroforte bankruptcy to Securinvest as it was pivotal in the finding that there was a common economic group; (g) the consequences of the defendant's breaches had been catastrophic for the plaintiffs, leading to multiple legal proceedings in various countries, an investigation by the BCB and extremely harmful publicity in Brazil, and ultimately leading to Banco Rural being taken over by the BCB; (h) significant losses had unarguably been incurred both in terms of legal

costs and damages, so that summary judgment should be granted though quantum could be assessed later; (i) the court should also exercise its supervisory jurisdiction and order compensation for breach of the professional conduct rules; and (j) there was no collateral attack on the Brazilian judgments or invitation to conclude that the Brazilian judgments were wrong.

The defendant submitted that (a) although it was admitted that there was a fiduciary duty to existing clients not to prefer the defendant's own interests over those of the existing clients, that duty had not been breached; (b) the fiduciary duty did not apply in relation to Katia Rabello and Fernando Toledo as the defendant's lawyer–client relationship was with the corporate plaintiffs rather than their beneficial owners; (c) the defendant had not breached its duty of confidentiality in relation to the May 2007 retainer by later acting for Dr. Braga; (d) every retainer with the plaintiffs had expired apart from the 2000 note purchase transaction retainer; (e) it was an impermissible collateral attack upon the judgments of the Brazilian courts to submit that the common economic group theory was misapplied; (f) there was no causation of loss to Katia Rabello as she would ultimately have been released from the Petroforte bankruptcy if Securinvest itself had been ultimately released; (g) the loss was also the result of Katia Rabello's own misconduct in trying to obfuscate the fraudulent relationship between Securinvest and Petroforte; (h) the position was to be considered according to a hypothetical "reasonably competent" attorney, and any other competent attorney would have inevitably obtained the disclosure that Katia Rabello was the ultimate beneficial owner of Securinvest; and (i) the plaintiffs were required to elect between remedies before obtaining summary judgment on liability.

Held, granting summary judgment for the plaintiffs on liability:

(1) The evidence showed that there was a longstanding lawyer–client relationship between the defendant and the Rabellos including Katia Rabello and, through Fernando Toledo's dealings with the defendant on his own behalf and on behalf of the Rabellos, with him as well. This conclusion emerged from an examination of many retainers and engagements undertaken by the defendant over the course of a quarter of a century (paras. 39–40; paras. 139–140).

(2) The plaintiffs' arguments—that, had they been given notice of the defendant's applications to the Grand Court on behalf of Dr. Braga, they could at least have applied for protective measures to contain the unwarranted misuse of the information in Brazil, or to have persuaded the court to refuse or revoke the orders for disclosure—were well grounded in probability. In essence, the claim of the plaintiffs was for loss of opportunity to seek remedial relief as a result of the defendant's actions in obtaining the *ex parte* orders on behalf of Dr. Braga. It was established for the purposes of summary judgment on liability that, at a minimum, there was as pleaded a loss of the earliest opportunity for the plaintiffs to defend themselves in the context of the proceedings before the Grand Court. The

loss of opportunity arose from the defendant's actions on behalf of Dr. Braga. The denial of opportunity buttressed the plaintiffs' claims for breach of duty and consequential damages. Ultimately the plaintiffs would also need to establish to the civil standard of proof the various alleged losses as the result of the averred loss of opportunity (paras. 173–175; paras. 195–200).

(3) For the grant of summary judgment, the plaintiffs had to establish the existence of the lawyer–client relationship, the existence of the attendant duties, actionable breaches of those duties and proof of causation of some loss.

(4) Whether there was a lawyer–client relationship in respect of each plaintiff was an exercise to be undertaken by an examination of all the circumstances of the case. The lawyer–client relationship was based on general concepts of contract and the specific contract of a retainer. Whether a relationship existed was a question of fact. There was no need for a person to formally retain a lawyer by way of a letter or other document, nor for an account to be rendered or a bill paid. The court must look to a number of factors to ascertain whether such a relationship existed. The relevant indicia were: (i) a contract or retainer; (ii) a file opened by the lawyer; (iii) meetings between the lawyer and the party; (iv) correspondence between the lawyer and the party; (v) a bill rendered by the lawyer to the party; (vi) a bill paid by the party; (vii) instructions given by the party to the lawyer; (viii) the lawyer acting on the instructions given; (ix) statements made by the lawyer that the lawyer was acting for the party; (x) a reasonable expectation by the party about the lawyer's role; (xi) legal advice given; and (xii) any legal documents created for the party. Not all indicia needed to be present, rather the question was whether a reasonable person in the position of a party with the knowledge of all the facts would reasonably have formed the belief that the lawyer was acting for a particular party. Further, the indicia were not exhaustive. Other indicia could include a situation where a lawyer acted for a company knowing that its interests were identical or closely aligned with the interests of its beneficial owners who themselves came to depend on the lawyer–client relationship. In the present case it was obvious that, when applied to the facts, the indicia served to identify each of the plaintiffs as clients of the defendant. The circumstances of the present case required the lifting of the corporate veil to prevent the defendant from denying the existence of the relationship of trust and confidence which had clearly developed, not merely between the incorporated plaintiffs and the defendant, but also between the individual plaintiffs (Katia Rabello and Fernando Toledo) and the defendant. The fiduciary nature of the lawyer–client relationship imposed duties on the fiduciary beyond the duty not to disclose confidential information. It included a duty of loyalty and good faith not to act against the interests of the client (paras. 300–305; paras. 312–316).

(5) As the court found the defendant's assertion that Katia Rabello and Fernando Toledo were never its clients to be wrong, the defence had no prospect of success as against those plaintiffs' claims for breaches of duty. That conclusion was unavoidable in light of the continuing nature of the duty of confidence. That a duty of confidence had arisen as owed by the defendant to the plaintiffs when their confidential information was imparted to the defendant was indisputable. A duty of confidence arose when confidential information came to the knowledge of a person in circumstances where he had notice, or was held to have agreed, that the information was confidential, with the effect that it would be just in all the circumstances that he should be precluded from disclosing the information to others. In light of the existence of the lawyer–client relationship with the plaintiffs and the patent conflict of interest in acting for Dr. Braga, the defendant's denial of the breach of duty was completely untenable. Irrespective of the existence of a formal or express contractual retainer, a lawyer would owe and continue to owe the fiduciary duties and obligations of trust, confidence and loyalty if the circumstances of his relationship with his client gave rise to those duties. In the present case, there were two express contractual retainers: the May 2007 retainer (to contain the impact of the CIMA disclosure to the BCB) and the August 2009 retainer (to protect the Brazilian defendants). The other retainers also incontrovertibly existed, as evidenced by their circumstances, including correspondence between the defendant and Fernando Toledo or Mr. Macaulay. Each retainer gave rise to the lawyer–client relationship and to the attendant duties and obligations of trust, confidence and loyalty, which survived the expiry of any retainer which had in fact expired. In light of the court's conclusions that the August 2009 retainer obviously covered all those persons known to the defendant to have been in jeopardy in Brazil, especially Katia Rabello and Fernando Toledo, and that it continued until well after the Braga retainer, it must be concluded that the defendant placed itself into an irreconcilable conflict of duty and interest when it accepted the Braga retainer. In so doing, the defendant acted in breach of its duties owed to Katia Rabello and Fernando Toledo. The defendant throughout remained under a continuing duty of trust and confidence in respect of all retainers not to disclose, nor take steps contrary to its clients' interests to disclose, their confidential information. It followed that the defendant should not have accepted the Braga retainer. In acting for Dr. Braga against the plaintiffs and their interests, the defendant had breached the duties and obligations of trust, confidence and loyalty owed to the plaintiffs. While the court did not find that the defendant had acted knowingly and deliberately in breach, the breaches were nonetheless serious and clear. No explanation had been offered by the defendant (paras. 321–341).

(6) As the conduct of the defendant in acting for Dr. Braga was the subject of the plaintiffs' claim, the position of a hypothetical "reasonably competent" attorney was not relevant to the outcome. The defendant's proposition that it should be excused from liability for its own breaches of

duty because some other attorney not owing those duties would have achieved the same results for Dr. Braga was untenable. The court was satisfied that the defendant did owe to each plaintiff the contractual and fiduciary duties of care, confidence and loyalty and that these duties were breached by the defendant. The breach was, for present purposes, proven not just by the obtaining and disclosure of the Cayman disclosure, but also by enabling or facilitating its adverse use against the plaintiffs (paras. 342–359).

(7) The defendant argued that whatever breaches it might have committed, there was a break in the chain of causation of loss when Katia Rabello's lie was revealed resulting in the STJ's final dismissal of Securinvest's appeal. The defendant's argument went only to the question of Katia Rabello's duty of disclosure to the STJ and her failure to meet that duty. The argument did not address the case in relation to the loss of opportunity to appear before this court and to prevent the wider abuse of the Cayman disclosure in Brazil against Katia Rabello and Fernando Toledo and the consequences arising from that wider abuse. This argument of the defendant on causation could be relevant, if at all, only to the loss of Securinvest's assets as that was the issue affected by the duty of disclosure to the STJ. That was so notwithstanding the defendant's further argument that had Securinvest been released from the Petroforte bankruptcy, so would Katia Rabello have been released. The converse situation had to be considered as well: had she not been taken into the Petroforte bankruptcy in the first place as a result of the abuse of the Cayman disclosure, she would not have remained in it, whatever the outcome for Securinvest. Moreover, if Securinvest was ultimately released and consequentially Katia Rabello as well there would still have been significant losses sustained in the meantime such as could be attributed to the defendant's breaches of duty. The assessment of quantum would proceed on the basis of the court's conclusion that the Cayman disclosure was the cause of the losses to be quantified (paras. 365–371).

(8) The fourth element to be established by the plaintiffs beyond argument was that some loss was caused by the defendant's breaches of duty. Given the size of the claim, this must be significant in amount. If the plaintiffs could at this stage establish only some *de minimis* amount, it would be an abuse of process to allow the action to proceed (para. 390).

(9) Each of the plaintiffs claimed, in the alternative, (i) damages; (ii) equitable compensation; or (iii) an account of profits. As regarded (ii) and (iii), there was an election to be made by the plaintiffs. The basic principle was that the plaintiff must choose when, but not before, judgment was given in his favour and the judge was asked to make orders against the defendant. The plaintiffs were not required to elect between remedies before obtaining summary judgment on liability (paras. 396–400).

(10) In respect of the available remedies, as the defendant had been found liable for breaches of fiduciary as well as contractual duties, the

plaintiffs were entitled to claim compensation on two different bases: equitable compensation or damages at common law. Equitable compensation was now firmly recognized in English law as a remedy for breaches of fiduciary obligations. There was a clear distinction to be observed between the traditional remedies for breach of fiduciary duty involving non-disclosure by the fiduciary of his interest in a transaction affecting a client or for a fraudulent breach of trust and a claim for damages for breach of fiduciary duty. In the former set of circumstances, the non-disclosure rendered the transaction voidable at the election of the client and considerations as to the causative effect of the non-disclosure did not arise. In the latter set of circumstances, the case law explained the requirement for showing a causal link such that it would be inappropriate to regard there as being a contrary principle of general application. Accordingly, in their claims for compensation for loss caused by the defendant's breaches of fiduciary duty, the plaintiffs must establish causation. However, in assessing compensation, the objective was to compensate for the consequences of the breach of fiduciary duty and in so doing a common-sense view had to be taken of what loss occurred from the breach and so fell to be compensated. The remedy was truly compensatory, not punitive and so there was no power to make an exemplary award. Any claims for compensation for breach of the contractual duties (or in negligence for breach of tortious duties of care if pursued) must be proven on the usual common law bases (paras. 404–419).

(11) The plaintiffs also claimed that the defendant's conduct was such that the court should exercise its supervisory jurisdiction and order compensation for breach of the professional conduct rules. While there were compelling arguments on which to respond to the allegations in the defence, the court was not persuaded that they provided the distinct and separate basis required for the invocation of the court's supervisory jurisdiction leading to the making of an award of compensation or an award of wasted costs. Given the supervisory and summary nature of the jurisdiction to impose wasted costs orders, as well as the debatable question whether it might be used to make an extensive award for unliquidated damages of the sort claimed by the plaintiffs in the present case, this was not a suitable case for its application, egregious though the breaches of duty appeared to be. The plaintiffs had other clear remedies of equitable compensation for breaches of fiduciary duties or damages for breaches of contractual duties open to them (para. 421; paras. 426–427).

(12) The court was satisfied that the plaintiffs had shown that they had suffered some loss. The court was satisfied for the purposes of summary judgment on liability (and subject to specific proof at assessment of quantum), that the plaintiffs had suffered the following pecuniary losses, connected to legal fees and disbursements caused by the litigation engendered by the Cayman disclosure: (i) legal fees and disbursements incurred by Brazilian counsel in respect of (a) the court proceedings in Brazil; (b) the BCB investigation; and (c) proceedings outside Brazil in excess of

US$15m.; (ii) legal fees and disbursements incurred by Cayman Islands counsel in the Cayman Islands proceedings and assisting in proceedings outside the Cayman Islands in excess of US$850,000; (iii) legal fees and disbursements incurred by US counsel in connection with the US proceedings and assisting in proceedings outside the US in excess of US$1m.; (iv) legal fees and disbursements incurred by BVI counsel in connection with BVI proceedings and assisting in proceedings outside the BVI in excess of US$100,000; and (v) legal fees and disbursements incurred in Belize in connection with Belize proceedings and assisting in proceedings outside Belize in excess of US$25,000. Other much larger claims, such as for the loss of the assets of Securinvest or Banco Rural, must satisfy the causation tests (paras. 428–430).

The defendant's strike-out application

(13) It was an inescapable conclusion that the presentation of the Costa Rican structure to the STJ was—as Katia Rabello admitted when pressed in the present proceedings—an artifice capable of misleading the STJ. The issue in the present proceedings was whether her lie to the STJ could be invoked by the defendant in support of its *ex turpi causa* defence, to the extent of striking out the plaintiffs' claims because they failed to disclose a reasonable cause of action or were an abuse of the process of the court. Katia Rabello's explanation for her lie to the STJ was highly relevant. She claimed that her lie had no fraudulent intent primarily because, had the STJ been misled, the result would not have been the successful extraction of the contentious Sobar assets from Petroforte. Instead, had the STJ acted on her misrepresentations, allowed Securinvest's appeal and reversed the extension of the Petroforte bankruptcy over it, the validity of the Sobar transaction would have remained to be resolved in the context of the revocation action. Further, that Dr. Braga would then have been obliged not merely to allege fraud but to prove it in the revocation action. Securinvest's non-Sobar assets, to which he could have had no entitlement to claim, would therefore very likely have remained where they belonged (with Securinvest) because he would not have been able to prove the alleged fraudulent intermeddling in the Petroforte estate. The *bona fides* of Katia Rabello's explanation was a matter of fact which could not be resolved without a trial, including cross-examination as to her intentions. The plaintiffs' case was therefore not amenable to being struck out simply because (on the defendant's view) it depended on Katia Rabello's intention to deceive the STJ. In light of her explanation, the defendant could not have succeeded with its strike-out application on the summary basis relying solely on its interpretation of her intentions in lying to the STJ. The defendant needed to show that her explanation was not an arguable or plausible response to its allegations of illegality. The onus was on the defendant to do so and, given her untested and therefore as yet unrefuted explanations, the onus was not discharged. As a recent judgment of the UK Supreme Court (*Patel* v. *Mirza*) had explained, a claim could no longer be dismissed simply by reliance on the doctrine of *ex turpi causa.* Applying those principles, it readily became apparent why the defendant's

strike-out application based on the *ex turpi causa* doctrine was bound to fail. Moreover, there were no allegations of illegality on the part of EFHL or Fernando Toledo. Accordingly, to the extent that those plaintiffs could show loss or damage caused by the Cayman disclosure, the defendant could not argue that their claims were unsustainable or an abuse of process. In so far as Katia Rabello was concerned, she had made no admission of illegal conduct nor had she been convicted of any in relation to the pivotal issue of the extension of the Petroforte bankruptcy. Her transgression appeared to have been the fact of her beneficial ownership of Securinvest and her lie to the STJ about that fact. There was no reliance in her pleaded case on any illegality as between herself and anyone (including the defendant). Her case was that the defendant had breached its duties and obligations owed to her and that those breaches resulted in loss and damage, in turn the result of court and regulatory actions in Brazil. She did not rely on her own impugned conduct. The defendant had failed to explain why the plaintiffs' claims should be barred on the basis of the modern restatement of the illegality principle. Any fraudulent intent behind Katia Rabello's lie to the STJ was a matter for cross-examination at the assessment of loss stage and could only go to the question of causation of loss, not to the defendant's liability for breaches of duty (paras. 434–465).

(14) The court had a well-settled jurisdiction (both as a matter of its inherent powers and expressly from GCR O.18, r.19) to strike out claims which amounted to an abuse of its process. The categories of conduct which might render a claim liable to being struck out for being frivolous, vexatious or otherwise an abuse of process were not closed but depended on all the relevant circumstances, and considerations of public policy and the interests of justice might be very material. The defendant argued that the plaintiffs' claims were a collateral attack on the Brazilian judgments and that in effect the plaintiffs sought to re-litigate the consequences of those judgments by challenging the correctness of the judgments under Brazilian law as well as the integrity of the judges who decided them. The plaintiffs claimed that it was not a challenge to the validity of the Brazilian judgments to seek to recover from the defendant the losses which were incurred as the result of the defendant's actions resulting in those judgments. It was difficult to see why the plaintiffs' claims should be struck out as an abuse of process. Despite the critical tenor of much of the plaintiffs' pleadings and arguments, as the plaintiffs' case did not depend on the court having to conclude in any way contrary to the Brazilian judgments, there could be no finding of a collateral attack on those judgments. The defendant's strike-out application for abuse of process would be dismissed (paras. 466–468; paras. 479–483).

Cases cited:

(1) *AB Jnr.* v. *MB*, 2013 (1) CILR 1, considered.

(2) *AIB Group (UK) plc* v. *Mark Redler & Co. Solicitors*, [2014] UKSC 58; [2015] A.C. 1503; [2014] 3 W.L.R. 1367; [2015] 1 All E.R. 747;

[2015] 2 All E.R. (Comm) 189; [2015] WTLR 187; (2015), 18 ITELR 216, referred to.
(3) *Al-Ibraheem v. Bank of Butterfield Intl. (Cayman) Ltd.*, 2000 CILR 88; further proceedings, 2000 CILR 277; further proceedings, 2000 CILR 507, referred to.
(4) *Al-Sabah v. Maples & Calder*, 1994–95 CILR 471, considered.
(5) *Associated Bulk Carriers Ltd.* v. *Koch Shipping Inc.*, *The Fuohsan Maru*, [1978] 2 All E.R. 254; [1978] 1 Lloyd's Rep. 1; (1978), 7 B.L.R. 24, referred to.
(6) *Att. Gen.* v. *Blake (Jonathan Cape Ltd., third party)*, [2001] 1 A.C. 268; [2000] 3 W.L.R. 625; [2000] 4 All E.R. 385; [2001] IRLR 36, *dicta* of Lord Nicholls of Birkenhead followed.
(7) *Att.-Gen.* v. *Guardian Newspapers Ltd. (No. 2)*, [1990] 1 A.C. 109; [1988] 3 All E.R. 545, referred to.
(8) *Attorney-at-Law, In re an*, 1988–89 CILR *N*–1, referred to.
(9) *Bankers Trust Co.* v. *Shapira*, [1980] 1 W.L.R. 1274; [1980] 3 All E.R. 353, referred to.
(10) *Bolkiah (Prince Jefri)* v. *KPMG*, [1999] 2 A.C. 222; [1999] 2 W.L.R. 215; [1999] 1 All E.R. 517; [1999] 1 BCLC 1; [1999] C.L.C. 175; [1999] P.N.L.R. 220, *dicta* of Lord Millett considered.
(11) *Bristol & West Bldg. Socy.* v. *Mothew*, [1998] Ch. 1; [1997] 2 W.L.R. 436; [1996] 4 All E.R. 698, referred to.
(12) *Campbell* v. *MGN Ltd.*, [2004] UKHL 22; [2004] 2 A.C. 457; [2004] 2 All E.R. 995, referred to.
(13) *Canson Enterprises Ltd.* v. *Boughton & Co.*, [1991] 3 SCR 534; 1991 CanLII 52 (SC); 85 DLR (4th) 129; [1992] 1 WWR 245; 1 BCLR (2d) 1, referred to.
(14) *Carl Zeiss Stiftung* v. *Rayner & Keeler Ltd. (No. 2)*, [1967] 1 A.C. 853; [1966] 3 W.L.R. 125; [1966] 2 All E.R. 536, referred to.
(15) *Castrique* v. *Imrie*, [1861–73] All E.R. Rep. 508; (1870), L.R. 4 H.L. 414; 39 L.J.C.P. 350; 3 Mar. L.C. 454; 19 W.R. 1, referred to.
(16) *Castro* v. *Murray* (1875), L.R. 10 Ex. 213, referred to.
(17) *Chiefs of Ontario* v. *Ontario*, 2003 CanLII 32351; [2003] O.J. No. 580, referred to.
(18) *Clark Boyce* v. *Mouat*, [1994] 1 A.C. 428; [1993] 4 All E.R. 268, considered.
(19) *Dane* v. *Mortgage Ins. Corp.*, [1894] 1 Q.B. 54, referred to.
(20) *Davey* v. *Bentinck*, [1893] 1 Q.B. 185, referred to.
(21) *Dawkins* v. *Prince Edward of Saxe Weimar*, *Willis* v. *Earl Beauchamp* (1886), 11 P. 59, referred to.
(22) *Deutsch-Südamerikanische Bank A.G. v. Codelco*, 1996 CILR 1, referred to.
(23) *Douglas* v. *Hello! Ltd. (No. 3)*, [2005] EWCA Civ 595; [2006] Q.B. 125; [2005] 3 W.L.R. 881; [2005] 4 All E.R. 128; [2005] 2 FCR 487; [2005] HRLR 27, referred to.
(24) *Drabinsky* v. *KPMG* (1998), 41 OR (3D) 565, *dicta* of Ground, J. followed.

(25) *Drummond-Jackson* v. *B.M.A.*, [1970] 1 W.L.R. 688; [1970] 1 All E.R. 1094, referred to.
(26) *Edwards* v. *Davis* (1888), 4 T.L.R. 385, referred to.
(27) *European Asian Bank AG* v. *Punjab & Sind Bank (No. 2)*, [1983] 1 W.L.R. 642, [1983] 2 All E.R. 508; [1983] 1 Lloyd's Rep. 611; [1983] Com LR 128, referred to.
(28) *Fennoscandia Ltd.* v. *Clarke*, [1999] 1 All E.R. (Comm) 365, considered.
(29) *Gartside* v. *Outram* (1857), 26 L.J. Ch. (N.S.) 113, *dictum* of Wood, V.-C. referred to.
(30) *Goddard* v. *Gray* (1870), L.R. 6 Q.B. 139, referred to.
(31) *Gray* v. *Lewis*, *Parker* v. *Lewis* (1873), 8 Ch. App. 1035, referred to.
(32) *Grovewood Holdings plc* v. *James Capel & Co. Ltd.*, [1995] Ch. 80; [1995] 2 W.L.R. 70; [1994] 4 All E.R. 417; [1994] 2 BCLC 782; [1995] BCC 760, referred to.
(33) *Harris* v. *Digital Pulse Pty. Ltd.*, [2003] NSWCA 10, referred to.
(34) *Henderson* v. *Henderson*, [1843–60] All E.R. Rep. 378; (1843), 3 Hare 100; 67 E.R. 313, considered.
(35) *Hilton* v. *Barker Booth & Eastwood (a firm)*, [2005] UKHL 8; [2005] 1 W.L.R. 567; [2005] 1 All E.R. 651; [2005] P.N.L.R. 23, referred to.
(36) *House of Spring Gardens Ltd.* v. *Waite*, [1991] 1 Q.B. 241; [1990] 2 All E.R. 990, referred to.
(37) *Hunt* v. *R.M. Douglas (Roofing) Ltd.*, [1990] 1 A.C. 398; [1988] 3 W.L.R. 975; [1988] 3 All E.R. 823, referred to.
(38) *Hunter* v. *Chief Const. (West Midlands)*, [1982] A.C. 529; [1981] 3 W.L.R. 906; [1981] 3 All E.R. 727, considered.
(39) *Johnson* v. *Gore Wood & Co.*, [1999] BCC 474; on appeal, [2002] 2 A.C. 1; [2001] 2 W.L.R. 72; [2001] 1 All E.R. 481; [2001] 1 BCLC 313, followed.
(40) *ICP Strategic Credit Income Fund Ltd., In re*, 2014 (1) CILR 314, referred to.
(41) *Les Laboratoires Servier* v. *Apotex Inc.*, [2014] UKSC 55; [2015] A.C. 430; [2014] 3 W.L.R. 1257; [2015] 1 All E.R. 671; [2014] Bus. L.R. 1217; [2015] R.P.C. 10, considered.
(42) *London Loan & Savings Co.* v. *Brickenden*, [1934] 3 D.L.R. 465, followed.
(43) *Lunnun* v. *Singh*, *The Times*, July 18th, 1999, English C.A., 1999 WL 477360, applied.
(44) *Maes Finance Ltd.* v. *A. Phillips & Co.*, English High Ct., March 12th, 1997, unreported, referred to.
(45) *Martin Boston Co.* v. *Roberts*, [1996] P.N.L.R. 45, referred to.
(46) *Midland Bank* v. *Hett, Stubbs Kemp*, [1979] Ch. 384; [1979] 3 All E.R. 571, referred to.
(47) *Moore* v. *Lawson* (1915), 31 T.L.R. 418, referred to.
(48) *Myers* v. *Elman*, [1940] A.C. 282; [1939] 4 All E.R. 484; (1939), 162 L.T. 113; 56 T.L.R. 177; 109 L.J.K.B. 105, considered.

(49) *Nassau Steam Press* v. *Tyler* (1894), 70 L.T. 376, referred to.
(50) *National Comm. Bank Jamaica Ltd.* v. *Olint Corp. Ltd.*, [2009] UKPC 16; [2009] 1 W.L.R. 1405; [2009] Bus. L.R. 1110; [2009] 1 CLC 637; [2009] 5 LRC 370, applied.
(51) *Nocton* v. *Ashburton (Lord)*, [1914] A.C. 932; [1914–15] All E.R. Rep. 45, referred to.
(52) *Norwich Pharmacal Co.* v. *Customs & Excise Commrs.*, [1974] A.C. 133; [1973] 3 W.L.R. 164; [1973] 2 All E.R. 943; [1974] R.P.C. 101; [1973] F.S.R. 365, considered.
(53) *Omni Secs. Ltd. (No. 3), In re*, 1998 CILR 275, referred to.
(54) *Patel* v. *Mirza*, [2014] EWCA Civ 1047; [2015] 1 Ch. 271; [2015] 2 W.L.R. 405; [2015] 1 All E.R. 326; [2014] WTLR 1567; [2015] 1 BCLC 256; on appeal, [2016] UKSC 42; [2017] A.C. 467; [2016] 3 W.L.R. 399; [2017] 1 All E.R. 191, followed.
(55) *Quayum* v. *Hexagon Trust Co. (C.I.) Ltd.*, 2002 CILR 161, referred to.
(56) *R.* v. *Speid*, 1983 Carswell Ont 1333; [1983] O.J. No. 2441, referred to.
(57) *R & T Thew Ltd.* v. *Reeves (No. 2)*, [1982] Q.B. 1283; [1982] 3 W.L.R. 869; [1982] 3 All E.R. 1086, considered.
(58) *R.P. Howard Ltd.* v. *Woodman Matthews & Co.*, [1983] BCLC 117; [1983] Com. L.R. 100, considered.
(59) *Rankin* v. *Scott*, 2008 CILR *N* [9], referred to.
(60) *Ratiu* v. *Conway*, [2005] EWCA Civ 1302; [2006] 1 All E.R. 571, followed.
(61) *Roberts* v. *Plant*, [1895] 1 Q.B. 597, referred to.
(62) *Robinson & Co.* v. *Lynes*, [1894] 2 Q.B. 577, referred to.
(63) *Safeway* v. *Twigger*, [2010] EWCA Civ 1472; [2010] 3 All E.R. 577, referred to.
(64) *Stephens* v. *Hill* (1842), 10 M & W 28, referred to.
(65) *Swain* v. *Hillman*, [2001] 1 All E.R. 91; [2001] C.P. Rep. 16; [1999] C.P.L.R. 779; [2000] P.I.Q.R. P51; [1999] T.L.R. 745, referred to.
(66) *Swindle* v. *Harrison*, [1997] 4 All E.R. 705; [1997] 2 P.N.L.R. 641, considered.
(67) *Tang Man Sit* v. *Capacious Invs.*, [1996] A.C. 514, considered.
(68) *Target Holdings Ltd.* v. *Redferns*, [1996] A.C. 421; [1995] 3 W.L.R. 352; [1995] 3 All E.R. 785; [1995] CLC 1052, considered.
(69) *Thomas, In re*, [1894] 1 Q.B. 747, referred to.
(70) *Thomas* v. *Bunn*, [1991] 1 A.C. 262; [1991] 2 W.L.R. 27; [1991] 1 All E.R. 193, referred to.
(71) *Tinsley* v. *Milligan*, [1994] 1 A.C. 340; [1993] 3 W.L.R. 126; (1994), 68 P. & C.R. 412, considered.
(72) *Trillium Motor World Ltd.* v. *General Motors of Canada Ltd.*, 2015 ONSC 3824, followed.
(73) *Turner* v. *Toleman*, English C.A., January 15th, 1999, unreported, referred to.

(74) *Udall (t/a Udall Sheet Metal & Co.)* v. *Capri Lighting Ltd.*, [1988] 1 Q.B. 907; [1987] 3 W.L.R. 465; [1987] 3 All E.R. 262, considered.
(75) *Wenlock* v. *Moloney*, [1965] 1 W.L.R. 1238; [1965] 2 All E.R. 871, referred to.
(76) *Yat Tung Inv. Co. Ltd.* v. *Dao Heng Bank Ltd.*, [1975] A.C. 581, referred to.

Legislation construed:
Grand Court Rules, O.14, r.1:
"1. (1) Where in an action to which this rule applies a statement of claim has been served on a defendant and that defendant has given notice of intention to defend the action, the plaintiff may, on the ground that the defendant has no defence to a claim included in the writ, or to a particular part of such a claim, or has no defence to such a claim or part except as to the amount of any damages claimed, apply to the Court for judgment against the defendant.
(2) This rule applies to every action begun by writ in the Court other than—
(a) an action which includes a claim by the plaintiff for libel, slander, malicious prosecution or false imprisonment;
(b) an admiralty action in rem; or
(c) an action to which Order 86 applies."
O.14A, r.1: "(1) The Court may, upon the application of a party or of its own motion, determine any question of law or construction of any document arising in any cause or matter at any stage of the proceedings where it appears to the Court that—
(a) such question is suitable for determination without a full trial of the action; and
(b) such determination will finally determine (subject only to any possible appeal) the entire cause or matter or any claim or issue therein.
(2) Upon such determination the Court may dismiss the cause or matter or make such order or judgment as it thinks just.
(3) The Court shall not determine any question under this Order unless the parties have either—
(a) had an opportunity of being heard on the question; or
(b) consented to an order or judgment on such determination.
(4) Nothing in this Order shall limit the powers of this Court under Order 18, rule 19 or any other provision of these Rules."
O.18, r.19(1): The relevant terms of this sub-rule are set out at footnote 4.

A. Day, Q.C., *A. Akiwumi* and *R. Annette* for the plaintiffs;
M. Simpson, Q.C., *S. Said* and *A. Snead* for the defendant.

1 **SMELLIE, C.J.:** The plaintiffs are companies and individuals who represent the interests of the Rabellos, a prominent Brazilian family.

2 The first and second plaintiffs are Cayman Islands companies which are owned and controlled by the fourth plaintiff, Katia Rabello. She represents her family's interests, as well as her own, in this action. The third plaintiff is another Cayman Islands company of which the registered shareholder is the fifth plaintiff, Fernando Toledo. Fernando Toledo is a close and trusted friend and business associate of the Rabellos, regarded by them as a *de facto* member of the family. He has personal claims and supports the claims of the Rabellos in this action.

3 Lying at the heart of the dispute before the court is the plaintiffs'—and through them the Rabellos'—claim to a longstanding lawyer–client relationship with the defendant. It is a relationship which the plaintiffs claim existed for many years and which the defendant betrayed. This alleged betrayal is pleaded to have resulted in massive losses which the plaintiffs seek to recover in this action.

4 The defendant is a major Cayman Islands law firm which provides legal services in the Cayman Islands and in other jurisdictions. It largely denies the existence of the lawyer–client relationship with the plaintiffs, and denies entirely any liability for the alleged losses.

5 Before the court for resolution now are two cross-applications. The first is that of the plaintiffs for summary judgment on liability, on the basis that the defendant has no arguable defence to their claims. The second, that of the defendant for the striking out of the plaintiffs' claims, is presented on the basis that the claims have no prospect of success and are an abuse of the process of the court.

6 These antithetical and opposing applications are emblematic of this hostile litigation which has been marred throughout by allegations and counter-allegations of abuse.[1]

7 Despite that history, the arguments in support of the claims and those for the defence must now be addressed on these cross-applications.

8 The plaintiffs sue, more particularly, for breach of contractual and fiduciary duties of confidence, trust and loyalty and tortious duties of care;[2] claims which are said to have arisen from the defendant's betrayal of their lawyer–client relationship.

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1 Including two earlier contested hearings before this court, one by the plaintiffs successfully challenging orders for disclosure (about which more below) and the other, a strike-out application brought by the defendant against the plaintiffs, alleging that the plaintiffs had abused the process of this court by failing to disclose and deliberately suppressing highly relevant evidential material about proceedings in Brazil. That acrimonious application consumed 14 days of court time in April–May 2016 and confrontational cross-examination of witnesses. It was eventually rejected for reasons given in a judgment delivered on August 10th, 2016.

2 Although no claims in tort for breaches are particularized, claims for contractual and fiduciary breaches of duty are at pp. 52–54. In the statement of claim in the prayers at pp. 68–69, there are however, what appear to be claims in tort for "aggravated and exemplary damages" and "damages for breach of duty of care." In so far as these may depend upon the defendant's breaches of the duty of confidence, the English Court of Appeal have said that an action for breach of confidence did not fall to be considered as a "tort" for the purposes of English law: see *Douglas* v. *Hello! Ltd. (No. 3)* (23). Note however, as the authors of *Jackson & Powell on Professional Liability*, 7th ed. (2012), comment (at 101) that Lord Nicholls in *Campbell* v. *MGN Ltd.* (12) ([2004] UKHL 22, at, *inter alia* para. 14), referred to the cause of action for breach of confidence as a tort, at least in the context of a claim which concerned the misuse of private information. In the context of this case, it will be necessary for the plaintiffs to prove their losses under any one of the proven heads of liability. There are also pleaded claims for damage to the reputation of Katia Rabello said to have arisen from the publication of the Cayman disclosure in Brazil (paras. 194–196 of the statement of claim) about which I expressed strong doubts during exchanges with counsel at the hearing as these appear to be tantamount to claims in defamation and to which the usual defences would apply.

9 The focus of the plaintiffs' grievances is the conduct of the defendant in acting for a third party, a Dr. Afonso Braga, a Brazilian court-appointed trustee in bankruptcy. Dr. Braga is regarded by the plaintiffs as their arch nemesis, he having pursued and rendered the Rabello family interests, including Katia Rabello herself and her interests, bankrupt in Brazil.

10 It is uncontroverted that in aid of Dr. Braga's campaign against the plaintiffs, the defendant obtained the disclosure of the plaintiffs' confidential information in this jurisdiction by way of *ex parte* (without notice) applications to this court and provided that information to be deployed by Dr. Braga against them in Brazil.

11 This conduct of the defendant is the basis upon which the plaintiffs seek summary judgment on liability, asserting, as already mentioned, that the defendant has no arguable defence[3] to their claims.

12 Upon being granted summary judgment on liability, the plaintiffs would next move for the trial and assessment of the quantum of the consequential losses.

13 The defendant for its part either denies the existence of the lawyer–client relationship or where, in the case of any of the plaintiffs, it is either admitted or is to be found to have existed, denies any breach of duty and pleads that the plaintiffs, by their own unlawful conduct in Brazil, are the authors of their own misfortune.

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3 Citing Grand Court Rules, O.14, r.1.

14 This, the defendant pleads, is largely the result of Katia Rabello having been found by the Brazilian courts to be complicit in fraudulent misconduct, including having been found to have deceived the Brazilian courts. This is misconduct which the defendant also pleads was the justification for Dr. Braga's campaign in bankruptcy against the Rabello interests.

15 On that basis, says the defendant, the plaintiffs' claims against it are for losses which are the consequences of fraudulent conduct and cannot be maintained without either raising an impermissible collateral attack upon judgments of the Brazilian courts or without reliance upon their own, and in particular Katia Rabello's, illegal conduct. That, for those reasons also, the defendant is entitled to the striking out of the plaintiffs' claims now.[4]

16 Framed in those conflicting terms, it was immediately apparent that the plaintiffs' application for summary judgment and the defendant's strike-out cross-application were not readily given to resolution on the summary basis upon which such applications are typically to be heard and decided. For even while important matters of fact were incontrovertible (and so not requiring of trial to proof),[5] some factual issues were complicated. Complex issues of law also arose for determination but none which could not also be determined without the need for a full trial and as contemplated by the rules where the determination of points of law could result in the disposal of the entire case or of an important aspect of the case.[6]

17 Accepting that allowing the entire dispute to go instead to a full trial on all the issues would certainly have involved a more costly and acrimonious exercise, I acceded to the taking of the cross-application at this stage.

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4 Citing Grand Court Rules, O.18, r.19(1) which states, as relied upon by the defendant here:

"19. (1) The Court may at any stage of the proceedings order to be struck out or amended any pleading or the indorsement of any writ in the action, or anything in any pleading or in the indorsement, on the ground that—

(a) it discloses no reasonable cause of action or defence, as the case may be; or

. . .

(d) it is otherwise an abuse of the process of the court . . ."

5 Very importantly in this regard for the purposes of establishing liability on the summary basis, is the fact that there was a very limited number of documents to be examined, comprised in less than 100 pages and compiled at my request by the plaintiffs' attorneys and presented in a single bundle entitled "Plaintiffs' selection of documents relating to various retainers." The contents of these documents very much speak for themselves.

6 See Grand Court Rules O.14A, r.1.

18 I was satisfied, on the basis of the settled principles for the taking of such applications, and as a matter of better case management, that the issues of liability (on the plaintiffs' case) and the strike-out arguments (on the defendant's case) were sufficiently amenable to resolution on the incontrovertible facts to allow for their summary determination at this stage.

19 I was also satisfied that proper case management in the case called for a split trial of liability and quantification of loss, the latter being likely to itself involve a substantial hearing once liability was established.

20 The plaintiffs' application for summary judgment on liability is predicated upon the absence of a reasonable defence.[7] This is the test to be applied to the assessment of the pleadings and the evidence as to liability, without the need for a trial of facts which may properly be disputed.[8] The policy of GCR O.14 is to prevent delay in cases where there is no real defence. See *European Asian Bank AG* v. *Punjab & Sind Bank (No. 2)* (27),[9] *per* Goff, L.J. (as he then was). And where, in an action for unliquidated damages such as the present, the *liability* of the defendant can be clearly and readily established, the case law is also clear that the court should give judgment for the plaintiff with costs for damages and interest thereon to be assessed. In those circumstances, the statutory interest[10] on the damages awarded will run, not from the date of judgment on liability, but from the date of the judgment which assessed or recorded the damages payable to the plaintiff, see *Thomas* v. *Bunn* (70).[11]

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7 See Grand Court Rules O.14, r.1(1) which states:

"Where in an action to which this rule applies a statement of claim has been served on a defendant and that defendant has given notice of intention to defend the action, the plaintiff may, on the ground that the defendant has no defence to a claim included in the writ, or to a particular part of such a claim, or has no defence to such a claim or part except as to the amount of any damages claimed, apply to the Court for judgment against the defendant."

8 See variously, *Roberts* v. *Plant* (61); *Robinson & Co.* v. *Lynes* (62); *Dane* v. *Mortgage Ins. Corp.* (19); *Nassau Steam Press* v. *Tyler* (49); *Edwards* v. *Davis* (26).

9 [1983] 1 W.L.R. at 654. See also as an example of the application of the principles in the local case law: *In re Omni Secs. Ltd. (No. 3)* (53) and *Rankin* v. *Scott* (59), citing *Swain* v. *Hillman* (65).

10 To be awarded in this jurisdiction pursuant to s.34 of the Judicature Law (2017 Revision).

11 The Notes to RSC O.14(4)(2) explain that, in relation to costs, such interest will run from the date of the judgment or order for costs, even though this is before the costs have been taxed (*Hunt* v. *R.M. Douglas (Roofing) Ltd.* (37)). And, where unliquidated damages are claimed but there is a triable issue as to the quantum of damages, the court has no power to give judgment for part of the damages or to give conditional leave to defend in respect of part of the damages, unless the court is satisfied that such part of the damages can be clearly identified and quantified and that such ascertained part of the damages is undisputedly due (*Associated Bulk Carriers Ltd.* v. *Koch Shipping Inc.* (5)). On the other hand, in such a case, the court has power to make an order for an interim payment of such amount as it thinks just, not exceeding a reasonable proportion of the damages which the plaintiff is likely to recover.

21 In the case of the defendant's strike-out cross-application on grounds of abuse of process, proper case management also called for its resolution now. A primary consideration here was that the issues would be largely subsumed within those to be heard on the plaintiffs' case for summary judgment.

22 The hearings on the cross-applications commenced on May 22nd–24th, 2018 when they were adjourned, part-heard, to December 5th, 2018.[12] They eventually concluded on December 20th, 2018, after a total of 14 days of argument (involving also the cross-examination of one important witness, Mr. Robert Macaulay, about whom more below). These circumstances developed because, in order to ascertain whether the defendant had an arguable or reasonable defence to the claims on liability, and without usurping the functions of a trial judge, it was necessary to make some assessment of the evidence supporting the plaintiffs' claims in this regard. Indeed, it was also necessary to determine the defendant's strike-out application based as it was on the proposition of the plaintiffs' having no prospect of success and their case being an abuse of the process.[13]

23 Having acquired a sufficient understanding of the facts and law to be able to arrive at a determination of both applications on the summary basis, this is the judgment on both, with reasons for my conclusions.

The plaintiffs' burden

24 As discussed above, and as will be more fully explained below in the factual context, the plaintiffs, without the court having to be called upon to try disputed issues of fact, each needed to establish that the defendant has no arguable or reasonable defence to the essential elements of their respective claims on *liability* for the breaches of duty claimed.

25 These elements, to be fully examined below, are (i) the existence of the lawyer–client relationship and the concomitant duties of confidence, loyalty and care; (ii) breaches of those duties; (iii) the causation of loss arising from the breaches; and (iv) as further regards causation at this stage, proof that *some* identifiable loss was caused for which the respective plaintiff would be entitled to compensation.

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12 Due primarily to my unavailability taking another complex trial.
13 See for this approach in principle, as discussed in *In re Omni* (53) (1998 CILR at 279–280 and 291).

26 In respect of each plaintiff, I am satisfied that these elements of claim have been proven, such that each plaintiff is entitled to the pronouncement of summary judgment on liability against the defendant, with the assessment of quantum of loss to be set for trial.

27 It follows that the defendant failed in its strike-out cross-application which required establishing that the plaintiffs' claims disclosed no reasonable cause of action and were an abuse of the process of the court.[14]

28 However, for reasons which will also be explained, the defendant will remain entitled, at the trial of quantum, to challenge the plaintiffs' claims as they allege any particular causative link between the conduct of the defendant and any particular head of loss. This, as the plaintiffs accept, will all be subject to the principles of the case law on equitable compensation or damages, on the basis that the duties proven to have been breached by the defendant were fiduciary or contractual in nature.

29 While at this summary judgment stage the plaintiffs were able, as required, to establish that some significant losses were sustained as the result of the defendant's breaches of duty, in respect of the largest heads of claim for loss, the causative links between the defendant's breaches and those losses remain to be established to the civil standard of proof. Those remain as a primary subject of the trial to come on quantum, as will also be further explained below.

The factual background to the plaintiffs' claim to the lawyer–client relationship

30 While all the plaintiffs, including the incorporated entities, are linked to the Rabello family, the nature and extent of the relationship between the defendant and the Rabellos themselves is of central importance to the dispute.

31 The Rabellos held extensive business interests in Brazil and elsewhere, in banking (Banco Rural), land holding, finance, hospitality, and other areas of industry, in the form of a conglomerate named the Rural Group.[15]

32 Banco Rural was the flagship of the group. It operated more than 100 branches throughout Brazil and had a number of subsidiaries abroad, such

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14 See GCR O.18, r.19, to be discussed below.

15 Apart from Banco Rural, other notable Rural entities include Rural Leasing S.A. Arrendamento Mercantil ("Rural Leasing"), Rural International Inc., a Florida corporation ("Rural International"), Rural Securities Inc., another Florida corporation ("Rural Securities") and Investcred Companhia Securitizadora de Creditos Financeiros ("Investcred") which was renamed in May 2003 as Securinvest Holdings S.A. ("Securinvest"). Securinvest figured prominently in events in Brazil.

as Banco Rural Europa S.A. (Portugal); Rural International Bank ("RIB") in Nassau, Bahamas, and IFE Banco Rural in Uruguay.

33 The majority shareholder in Banco Rural was Trapezio S.A., a Brazilian company which was itself majority owned and controlled by the Rabello family.

34 The family also owned Trade Link Bank ("TLB"), a licensed Category B Bank in this jurisdiction. While neither a subsidiary nor a legal affiliate of Banco Rural (which, as a Brazilian entity was separately regulated in Brazil), the family's interests in TLB carried significant repercussions in Brazil and these must also be examined.

35 As Mr. Toledo avers in his first affidavit—following almost three years of materially adverse regulatory, financial and reputational consequences, Banco Rural was placed into compulsory liquidation by the Brazilian Central Bank ("the BCB") in August 2013.

36 Banco Rural's demise is sought to be attributed by the plaintiffs, at least in significant part, to the defendant's breaches of duty. However, the plaintiffs' losses in this regard, as in regard to other heads of losses, are not yet fully particularized. The plaintiffs, through Mr. Akiwumi, acknowledged during the hearing that full particulars will have to be pleaded once the case is set for trial on quantum.[16]

37 It was nonetheless accepted by Mr. Akiwumi that it was essential at this stage for the grant of summary judgment on liability, that—given the size of the claim—some significant loss must be proven. This was, therefore, the basis upon which this summary judgment application was taken.

The defendant's admissions

38 While the defendant makes no admission as to breach of duty or any consequential loss, it makes limited admissions as to the existence of the lawyer–client relationship. It admits that such a relationship existed in relation to the first, second and third plaintiffs but denies its existence in relation to the fourth and fifth plaintiffs—Katia Rabello and Fernando Toledo.

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16 It is also appropriate to note here that upon the assessment of quantum of losses, the court will be called upon to address the question of what is the proper basis. Will it be equitable compensation for breach of the fiduciary duties of confidence and loyalty (as the plaintiffs claim) or will it be the common law "but for" test which will require the respective plaintiff to establish the causative link between the breaches of duty and any particular head of loss (as the defendant asserts)? This too will be discussed below.

39 The undisputed evidence reveals, however, that there was, indeed, a long-standing relationship between the defendant and the Rabellos, including Katia Rabello and through Fernando Toledo's dealings with the defendant on his own behalf and on behalf of the Rabellos, with him as well.

40 This conclusion emerges from an examination of many retainers and engagements undertaken by the defendant over the course of a quarter of a century.

The TLB retainer in 1984

41 The relationship began in late 1984 when the defendant was engaged by Sabino Rabello (Katia Rabello's father and the patriarch of the family), to establish TLB in this jurisdiction.

42 TLB was incorporated by the defendant on January 2nd, 1985. It was established to operate as an offshore investment bank, at first headquartered in Miami[17] where it conducted investments on behalf of the Rabello family and a book of other clients largely based in Brazil.

43 Mr. Toledo began working for the Rural Group in Miami in 1991. Beginning in 1996, the majority of Mr. Toledo's work was related to TLB, which established its headquarters office in Grand Cayman in 1993. As Mr. Toledo took on increasing responsibility within the Rural Group, he travelled frequently to the Cayman Islands. In particular, he managed the Rabello family's offshore investments (and those of other clients) through TLB. In May 2003, Mr. Toledo became a director of TLB. In January 2005, upon the death of Sabino Rabello, Mr. Toledo became President and Managing Director of TLB.

44 In 1998, East Farthing Ltd. (the third plaintiff, "EFHL") was incorporated in this jurisdiction by the defendant on the instructions of Sabino Rabello to hold the family's majority shares in TLB.

45 The shareholding in EFHL itself (issued as a single share) was first held by a partner of the defendant as nominee[18] but was later transferred to Sabino Rabello. Upon his passing in 2005, the share in EFHL was transferred by the defendant to Mr. Toledo acting on the instructions of Sabino's widow, Mrs. Jandyra Rabello, herself acting as personal representative of the estate of Sabino Rabello.

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17 As explained by Mr. Fernando Toledo in his first affidavit.
18 Acting by David Whittome, a partner of the defendant—see Register of Members kept by the defendant.

46 By resolution of its board at a meeting convened by the defendant, Mr. Toledo was also appointed sole director of EFHL on May 4th, 2005.[19] As can be seen from the Register of Directors and Officers of EFHL, its initial directors were Sabino Rabello, Junia Rabello, Jandyra Rabello, Nora Rabello and Katia Rabello. Walkers SPV, an affiliate of the defendant, provided registered offices services and acted as corporate secretary.

47 The defendant also acted for the Rabello family for the transmission of Sabino Rabello's estate in this jurisdiction,[20] in particular in respect of the devolution of the share in EFHL (as mentioned above) and thus in respect of the devolution of TLB itself.

48 Despite this background (and more to be examined below in respect of TLB, EFHL, and the other two incorporated plaintiffs, Arnage Holdings Ltd. and Brooklands Holdings Ltd. ("Arnage" and "Brooklands")), the defendant, as already mentioned, does not admit that either Katia Rabello or Fernando Toledo was a client.

49 As regards Katia Rabello, this is also despite it being no longer disputed that the defendant acted on behalf of Arnage and Brooklands, of which she was at all material times the 50% beneficial owner (until her father's death in January 2005) or 100% beneficial owner (after her father's death). This action by the defendant was in respect of a significant note purchase transaction in which context, to be explained below, it could not have been overlooked or misunderstood that she was the 50% beneficial owner.

Incorporation of Arnage and Brooklands and Securinvest

50 In May 2000, Arnage and Brooklands were incorporated in this jurisdiction and together became the registered shareholders of a Brazilian company named Investcred,[21] which was soon afterwards incorporated in Brazil on May 17th, 2000 (later renamed Securinvest Holdings S.A. ("Securinvest")). The Canadian Imperial Bank of Commerce (Cayman

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19 Register of Directors kept by the defendant.

20 As is asserted by Katia Rabello and admitted by Mr. Diarmad Murray, a partner of the defendant, in his letter of September 22nd, 2011, to Mr. Toledo's affidavit. In that letter there appears the following general admission of the lawyer–client relationship at least in respect of TLB:

"Walkers acted as Cayman counsel for Trade Link Bank ('TLB') from its incorporation until its liquidation. The firm received instructions to assist in setting up of TLB from Sabino Rabello and had an ongoing relationship with Mr. Rabello and TLB as a result . . . The last matter this firm dealt with on behalf of the Rabello Family was the estate of Sabino Rabello, in respect of which Walkers obtained a grant of probate."

21 Full name: Investcred Companhia Securtizadora de Creditos Financeiros.

Islands) ("CIBC") served as corporate administrator for Arnage and Brooklands until this role was later transferred, on the instructions of Katia Rabello, to Equity Trust (Cayman) Ltd. ("Equity Trust").

51 This change of administrator would prove to be a crucial change of circumstances in relation to Dr. Braga's campaign against the family in Brazil because Katia Rabello, through her ownership of Arnage and Brooklands, had become the ultimate beneficial owner of Securinvest ("UBO"). These very consequential circumstances are also to be more fully examined below.

Arnage and Brooklands—the June 2000 retainer—the note purchase transaction and its connection to Banco Rural and the Rural Group

52 In June 2000, the defendant acted for each and all of Arnage, Brooklands and TLB in connection with a note facility ("the note purchase transaction") by way of a letter agreement dated June 27th, 2000. By this arrangement, Securinvest provided a $40m. note to Arnage and Brooklands for onward sale to TLB, in return for financing from TLB for the carrying out of Securinvest's business in Brazil.

53 That business included the acquisition of bad loans and other non-performing assets from Banco Rural and the realization of those assets on behalf of Banco Rural and the wider Rural Group.

54 In agreeing to act for all the Cayman corporate parties to the note purchase transaction,[22] the defendant would have had to satisfy itself that in doing so it would act under no conflict of interest. This meant that the defendant must have been satisfied, as indeed was the case, that the common interest purpose and beneficial ownership of all parties for whom it acted were held in common within the Rabello family (including Katia Rabello as 50% beneficial owner of Arnage and Brooklands and as 50% UBO of Securinvest).

55 Following its review of the transactional documentation, the defendant issued its opinion to CIBC and Canadian Imperial Bank of Commerce, Toronto Office, dated June 27th, 2000, approving of the transaction on behalf of Arnage and Brooklands.

56 Thus, it is apparent that as Mr. Toledo asserts in his first affidavit:

> "The Note Purchase Transaction was essentially an inter-group transaction whereby TLB loaned funds to Securinvest to purchase distressed assets from the Rural Group.

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22 It is admitted by the defendant that it acted on behalf each and all of Arnage, Brooklands and TLB in this transaction.

> My understanding is that the above-mentioned corporate structure of incorporating a Brazilian company (Securinvest) owned by two Cayman Islands companies (Arnage and Brooklands) was proposed by Banco Rural executives working with the Brazilian representatives of CIBC, which provided nominee directors, shareholders and a registered office of Arnage and Brooklands. I instructed the TLB General Manager (Ricardo Bermudez) to obtain advice from the Defendant as to whether the proposed structure was advisable under Cayman Islands law and whether it would fit with the overall offshore structure that the Defendant had already established in the form of TLB. At all times, the Defendant was fully aware of the reasons why Arnage and Brooklands were incorporated and accordingly, their ultimate beneficial ownership by the Rabello family . . .
>
> All of the Plaintiffs are inter-related as was their relationship with the Defendant: Arnage and Brooklands were incorporated to act as shareholders in Securinvest and for the purpose of the inter-group Note Purchase Transaction entered into with TLB; EFHL held Sabino Rabello and my shares in TLB. I was ultimately the Managing Director of TLB and I am now the sole director of Arnage, Brooklands and EFHL. Katia Rabello is the ultimate beneficial owner of Securinvest, through Arnage and Brooklands. I and the Rabello family, at all material times, owned and/or controlled TLB. The Defendant was fully aware of all of these inter-relationships, having acted on behalf of all of the Plaintiffs as well as the Rabello family generally."

57 The breaches of duty claimed by the plaintiffs relate in important part to the obtaining by the defendant on behalf of Dr. Braga of the disclosure of confidential information relating to Arnage and Brooklands and to the very same note purchase transaction involving TLB and Securinvest (including the defendant's legal opinion itself), along with information revealing Katia Rabello's status as UBO of Securinvest through Arnage and Brooklands. This, along with other confidential information, came to be disclosed to Dr. Braga pursuant to orders obtained by the defendant from this court in May and July 2010. The disclosed information was quickly deployed by Dr. Braga against Katia Rabello, Securinvest and other Rural Group entities in Brazilian bankruptcy proceedings. These proceedings will be considered in some detail below.

Other relevant events in Brazil

58 Against the foregoing background of the lawyer–client relationships, and before turning to look in more detail at the Brazilian bankruptcy proceedings and the related court proceedings in this jurisdiction, it is necessary at this stage to look at an earlier concatenation of events in Brazil, as they came to involve the Rabello family.

59 Katia Rabello is a ballerina. Her primary calling was as patron of a ballet school in her home city of Belo Horizonte, in the State of Minas Gerais. This was her occupation until 1999 when she became a director of Banco Rural upon the tragic death of her elder sister Junia (who had been groomed by their father Sabino to succeed him at the helm of the Rural Group).

60 Later, in October 2001, Katia became President of Banco Rural and still later, upon the passing of her father in January 2005, she became President of Banco Rural's Administrative Council.

61 By then there had been underway in Brazil, a Joint Parliamentary Commission of Enquiry into the infamous "Mensalao affair." This enquiry revealed payments for vote-buying in Brazil's Congress in return for the corrupt promotion and passage of preferential legislation. The scandal raised widespread allegations of corruption against the Government of Luiz Inacio Lula da Silva.

62 It came to light that certain of the Mensalao payments had been made or arranged through Banco Rural. As a result, Katia Rabello, as its novice President, found herself summoned before the Joint Parliamentary Commission in September 2005.

63 Unsurprisingly, there was intense publicity about Mensalao in Brazil and overseas, including adverse publicity relating to Banco Rural and Katia Rabello as its President.

64 As a result, states Mr. Toledo, the legal and political environment within which the Rabellos, Banco Rural and the Rural Group were operating became very hostile.

65 Despite her protestations of personal innocence while admitting to knowledge that her bank had been involved in the passing of certain payments, Katia Rabello was indicted, along with some 40 others implicated, on March 30th, 2006 by the Supreme Federal Prosecution Office. She was much later convicted in September 2013 for offences of conspiracy, mismanagement of a financial institution, money laundering and fraudulent transmission of moneys abroad. Eventually, after final appeal to the Supreme Federal Tribunal,[23] she was sentenced in November 2013 in relation to the Mensalao affair. She was imprisoned from November 2013 to December 2016.

66 It is of some significance now, however, that she asserts that the charges in relation to the Mensalao affair had no connection to the allegations which were later promoted by Dr. Braga to engulf the Rabellos

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23 About which more below.

and their interests in the bankruptcy proceedings of a different group of companies, the Petroforte Group. In this regard, Dr. Braga came to allege collusion between her father and Mr. Ari Natalino, the then principal of the Petroforte Group. Dr. Braga alleged that Sabino Rabello used Securinvest and another Rural entity, Rural Leasing, in collusion with Ari Natalino—using his Petroforte Group (which was later placed into bankruptcy)—to defraud the creditors of Petroforte. This allegation, when accepted by the Brazilian courts, as will be seen below, later became the basis upon which Dr. Braga was able to extend the Petroforte bankruptcy over the Rabello interests and which later became the basis for his allegations of collusion against Katia Rabello herself.

The Cayman connection to events in Brazil and the defendant's further involvement: the May 2006 retainer

67 The Mensalao affair itself had revealed no immediate connection to the Rabello family's affairs in the Cayman Islands but other related events did.

68 In its capacity as regulator of Banco Rural and other Brazilian banks implicated, the BCB had commenced its own investigation into the Mensalao affair.

69 In August 2005, the use of a TLB account by a well-known publicist of the Workers' Party (the party of President Lula da Silva) was disclosed by a leading Brazilian newspaper and this linked TLB to Mensalao, attracting the attention of the BCB.

70 While TLB was an entirely unrelated Cayman entity having no legal relationship with Banco Rural, this revelation resulted, as Mr. Toledo explains, in heightened press and regulatory scrutiny of Banco Rural's overseas holdings and affiliates. The BCB then commenced an investigation into TLB itself.

71 On May 2nd, 2006, Mr. Robert Macaulay, acting on behalf of the Rabellos as their Miami based overseas counsel, emailed Mr. Mark Lewis, a partner of the defendant, requesting a call to discuss corporate and banking issues relating to EFHL (and by obvious implication TLB).

72 On May 15th, 2006, following a teleconference with the defendant (described by Mr. Macaulay as having taken place in response to his email and which the defendant neither denies nor admits), another email was sent by Mr. Macaulay to another associate attorney of the defendant's, Mr. Winston Conolly. This email requested that—

> "we urgently need from Walkers (Secretaries) Limited certificates substantially in the forms attached confirming that none of Mr. Rabello's heirs is or has been a member/shareholder of the Company [EFHL] or TLB."

73 The plaintiffs assert through Mr. Macaulay that a meeting in May 2006 (also neither admitted nor denied by the defendant) was held in Grand Cayman between Mr. Macaulay and Mr. Toledo on behalf of the Rabello family and Mark Lewis and Winston Connolly of the defendant. Mr. Toledo avers that at that meeting both he and Mr. Macaulay explained the implications for TLB and the Rabellos of the Mensalao affair, in light then of the BCB's involvement as regulator of Banco Rural.

74 According to Mr. Toledo, discussions were focused on—

> "developing a strategy with the Defendant to protect the Rabello family and TLB given the problems that were developing; the Rabello family's objective being to try to ensure that its links to TLB were kept confidential given the political climate in Brazil."

75 Instructions were given to the defendant to take steps to transfer the shareholding in EFHL to Mr. Toledo and discussions were had around the ultimate closure of TLB, the essential objective being to "distance the Rabello family from TLB (especially given the Mensalao investigations)."

76 Confirmatory of these discussions and instructions, it appears that the defendant (*per* Mark Lewis) then issued notarial certificates dated May 31st, 2006 to certify that certain named members of the Rabello family (excluding Sabino Rabello who was by then deceased but including Katia Rabello) "do not and have not appeared on the Register of Members of the Company [respectively EFHL and TLB] as members of the Company at any time since incorporation of the Company."

77 This was of course, a technically correct certification as it did not speak to ultimate beneficial ownership of either EFHL or TLB.

78 Mr. Toledo avers that the defendant was specifically informed that these notarial certificates were intended to be presented to the Brazilian authorities, an averment which, again, the defendant neither admits nor denies.

79 In the event, the notarial certificates provided by the defendant were presented to the BCB and their purpose would have been clearly understood by the defendant.

The defendant acted in other contexts relating to Sabino Rabello's estate

80 It is also uncontroverted that the defendant acted in other contexts on behalf of one or other of the plaintiffs or on behalf of the Rabello family as a whole.

81 As already mentioned, the defendant advised the family and Mrs. Jandyra Rabello, as personal representative of Sabino Rabello's intestate estate, in particular, in the context of administration proceedings in this

jurisdiction. This was against the background according to Mr. Toledo, of advice from the defendant that in order to transfer the share in EFHL to him, it was first necessary to apply to this court for a grant permitting Mrs. Jandyra Rabello to deal with the estate in this jurisdiction.

82 The defendant therefore acted for the family in applying to this court for resealing of the Brazilian letters of administration, to permit Mrs. Rabello to act on behalf of her husband's estate in this jurisdiction.

83 This then involved the heirs (including Katia Rabello) entering into a deed of variation to vary the normal entitlements upon intestacy and so to relinquish any claims they might have had to an interest in EFHL. A copy of the deed of variation which was drafted by the defendant is propounded in evidence, as entered into by each of the relevant family members, including Katia Rabello. Further written consents from each of the relevant family members (again including Katia Rabello) to the transfer of the share in EFHL were provided and copies are also propounded in evidence. The transfer was approved by the EFHL board and executed by Mrs. Jandyra Rabello, effectively transferring Sabino Rabello's interest in EFHL, and so in TLB, to Mr. Toledo, all on the advice of the defendant.

The BCB investigation in Brazil and the May 2007 retainer

84 Apprehensions expressed by Mr. Toledo and Mr. Macaulay on behalf of the family to the defendant at the May 2006 meeting turned out to be all too well founded. In February 2006 (and unknown at the time to the Rabellos[24]) the BCB had contacted the Cayman Islands Monetary Authority ("CIMA")—its Cayman Islands counterpart—in respect of its investigation into links between the Rabello family, Banco Rural and TLB. The BCB requested from CIMA any information relating to the shareholding in TLB.

85 Having extracted undertakings from the BCB by way of letter dated June 28th, 2006 that any information provided would be used only for regulatory purposes, CIMA provided to the BCB information from its own records which showed the shareholdings in TLB from its date of incorporation, and specifying that the majority shareholder was Sabino Rabello up to November 1998 and, thereafter, that the shareholder was EFHL "represented by Sabino Rabello."

86 But even that revealing disclosure proved inadequate for the BCB's purposes and so, on November 30th, 2006, the BCB requested further information from CIMA relating to TLB, expressly including any documents showing "current outstanding operations between TLB and any

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24 According to Mr. Toledo at para. 129 of his first affidavit.

company of the Rural Conglomerate" which was defined as including Banco Rural. The BCB informed CIMA that the purpose of the investigation was "to identify common ownership between Banco Rural and TLB." This was implicitly, it must have been understood, to further establish an ownership link between the Rabello family and TLB.

87 The letter dated November 30th, 2006 again confirmed that the information was sought only for the BCB's regulatory purposes, including civil and administrative (*i.e.* not criminal) proceedings.

88 In response, CIMA informed the BCB[25] that not all the information sought was in their possession and accordingly that CIMA would have to issue a "direction" under s.34(9) of the Monetary Authority Law (MAL). However, that before so doing (in addition to the assurances earlier given) CIMA required from the BCB—

> "an undertaking that the information provided will not be used in criminal proceedings against any person(s) providing the information, other than proceedings for an offence under section 34 (17) of the (MAL) or an offence of perjury."

89 By way of letter dated February 23rd, 2007, the BCB gave that undertaking.

90 Accordingly, on April 30th, 2007, CIMA, on behalf of the BCB, issued a formal direction to TLB to provide documents pursuant to s.34(9) of the MAL, including a copy of the Register of Officers and Directors of TLB.

The May 2007 retainer

91 Immediately, in response to CIMA's April 30th direction, in early May 2007 the defendant was engaged by Mr. Macaulay on behalf of TLB (and therefore as Mr. Toledo avers, on behalf also of TLB's directors, officers and shareholders) to provide legal advice on resisting the CIMA April 30th direction. This was stated expressly in order to maintain the confidentiality of any further connections between TLB and the Rabello family.

92 The defendant's engagement letter contains an expressed obligation on its part to "take such steps as we in good faith think fit to preserve confidential information from misuse both during and after termination of the Engagement."

93 This is acknowledged by the defendant as having given rise to an ongoing duty of confidentiality beyond the termination of the May 2007

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25 By letter dated January 16th, 2006 (but meant as January 2007).

retainer itself. Nonetheless, it is a duty which, as I understand its case, the defendant insists it did not breach in later acting for Dr. Braga.

94 But more to the point here of what the defendant must have understood and appreciated about the predicament in which the Rabellos found themselves in the context of events unfolding in Brazil, including the BCB inquiry, the following appears in the letter written by the defendant on May 3rd, 2007 to CIMA, on behalf of those whom it considered to be its clients. This was in response to CIMA's April 30th direction and confirmatory of the wide ambit of the May 2007 retainer as Mr. Toledo avers (NB: the interchangeable use of the plural and singular "clients" and "client"):

> "Our clients are aware that other of their documents provided by foreign government sources to the Brazilian authorities under conditions of confidentiality have, within a short period of time, appeared in the Brazilian press as a result of what appear to have been deliberate leaks. We would therefore, be grateful if you would please confirm that to the best of your knowledge the request is not in respect of criminal proceedings contemplated being brought against TLB or any of its current or former directors, officers or agents and that the request is not being made for the benefit of another branch of the Brazilian government. In light of the above please also confirm the measures that CIMA has taken to satisfy itself that the information enclosed herewith will be kept confidential and not further disseminated by the BCB to anyone outside of that institution, whether in the press, another branch of the Brazilian government or otherwise.
>
> We have enclosed on behalf of our clients the information requested—'The Register of Officers and Directors for Trade Link Bank'—in a complete and redacted version. The redacted version simply sets forth the current officers and directors—Messrs. Toledo and Jacobson, citizens of the USA and UK respectively, neither of whom resides in Brazil—and confirms that they have been the sole officers and directors of TLB since inception in 2005. The complete version reflects all officers and directors of TLB since inception in 1985. The additional information contained in the complete version cannot in our client's view be relevant to any legitimate regulatory enquiry. The only possible use for that information, in our client's view, would be non-regulatory legal and other actions to be taken against individual Brazilian residents who are former TLB officers and directors. In our client's view no such legitimate claims arise.
>
> Based on the foregoing, we respectively request that you produce to BCB only the redacted register of TLB officers and directors. We

would be pleased to meet with you at your earliest convenience to discuss this matter further if you think it appropriate . . ."

95 As it happened, CIMA did not accede to that request to disclose only the redacted register of TLB to the BCB but, instead, presented the BCB with the full unredacted version.

96 Worst fears were realized when the BCB, in breach of its undertaking to CIMA, publicly disclosed the information provided which linked the Rabello family to TLB and gave it over for deployment to the detriment of Katia Rabello and other family members, for use in criminal proceedings against them. These were proceedings in which Mr. Toledo was also named although not indicted. More about these criminal proceedings will be examined below in the context of a further retainer of the defendant in August 2009.

97 At this juncture, it is important to note that while no complaint has been raised against the defendant in relation to their conduct of this, the May 2007 TLB/CIMA retainer, the plaintiffs assert that the defendant could not—when later approached by Dr. Braga in April 2010 to act for him—have been in any doubt about the nature of the predicament facing the family in Brazil in relation both to the Mensalao affair and then contemporaneously, the BCB enquiry. The defendant could therefore have been in no doubt, say the plaintiffs, about its obligation to maintain and protect their confidentiality when Dr. Braga came along.

98 This is an unanswered averment and one which I regard as unanswerable.

The August 2007 retainer: dissolution of TLB

99 The plaintiffs' grievance is further contextualized by other retainers by which the defendant had acted for one or other of the plaintiffs before Dr. Braga came along. Next there was the August 2007 retainer for the dissolution of TLB which had stopped trading, although it was then still a solvent entity. The following uncontroverted account of this retainer comes from Mr. Toledo:[26]

"Between August 2007 and November 2007, there were a number of further discussions between Mr. Macaulay, myself and both Mark Lewis and/or Nick Rogers (another Partner) of the Defendant. By this stage TLB had effectively ceased trading and, given both the BCB investigation into links between the Rabello family and TLB and increased regulatory scrutiny due to the Mensalao Affair, in which the indictment of Katia Rabello had been accepted by the STF

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26 First affidavit at para. 152.

> [Supreme Federal Tribunal[27]] in August 2007, the Defendant was instructed to advise upon dissolving TLB . . .
>
> . . . in its capacity as general Cayman Islands legal counsel to TLB and also pursuant to the May 2007 Retainer and the August 2007 Retainer, I believe that the Defendant was fully aware that any links between the Rabello family (and/or Banco Rural) and TLB were strictly confidential, subject to regulatory investigation by the BCB and that the Defendant should take all reasonable steps to prevent disclosure of such material.
>
> TLB was dissolved on 17 September 2009."

100 This was the culmination, as regards TLB, of the concerns raised at the May 2006 meeting and which led to the subsequent retainers of the defendant in relation to the BCB.

The August 2009 retainer

101 Next followed the August 2009 retainer. As mentioned above, this arose when, as anticipated and feared by the Rabellos and Mr. Toledo, the information relating to TLB's officers and directors which had been provided to the BCB by CIMA, was disclosed by the BCB and used by the Brazilian authorities as the basis for criminal proceedings (despite the undertakings given to CIMA by the BCB).

102 In that regard, on December 15th, 2008, a criminal complaint[28] was issued by the office of Federal Public Prosecutions in the State of Minas Gerais against Katia Rabello and seven other defendants (including three other members of the Rabello family). This complaint alleged the making of false representations to the BCB and expressly relied upon the information provided by CIMA to the BCB.

103 The persons indicted included controlling shareholders in Banco Rural and its senior management. Among the "Facts" particularized in the complaint, at item 1 reads as follows (translated):

> "The accused offered falsified information to the Central Bank of Brazil when denying the existence of stockholding (either direct or indirect) and/or joint management in Banco Rural S.A. and the Trade Link Bank (TLB) financial institution, headquartered in the Cayman Islands, incurring in the crime of false representation reported by private document 9 articles 299 and 298 of the Penal Code . . ."

104 And at item 5:

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27 Brazil's highest court for the determination of constitutional and criminal cases.
28 Referred to herein interchangeably as "complaint" or "indictment."

> "By conclusively proving the shareholding by the Directors of Banco Rural S.A in Trade Link Bank, the Cayman Islands (CIMA) Monetary Authority, meeting the request made by the Central Bank, sent a graph showing the evolution of the TLB shareholders on the period from 08.31.1984 (the TLB incorporation) to 02.09.2004 (pages 318/323). From that list it is found that Banco Rural's controllers, administrators and former administrators are or were TLB shareholders, including periods with joint shareholding in both . . ."

105 On August 5th, 2009, Mr. Macaulay (according to Mr. Toledo, at his request) sent an email to partner Mark Lewis of the defendant setting out the background relating to this criminal complaint stating:

> ". . . new criminal proceedings have been opened in Brazil utilizing confidential documents relating to TLB provided by CIMA to the Brazilian Central Bank (BCB) purportedly for the purpose of civil regulatory functions. This use of the confidential information for criminal proceedings is in violation of the applicable provisions of the Cayman Monetary Authority Law,[29] the MOU between Brazil and Cayman[30] and the correspondence between the BCB and CIMA. *We need assistance from you and/or the appropriate persons at your firm to immediately address this issue and limit the harm to the Brazilian defendants* who have been prejudiced by the unlawful disclosure." [Emphasis added.]

106 On the same day, Mr. Macaulay received separate emails from partner Mark Lewis and associate James Austin-Smith of the defendant. They confirmed that the retainer had been accepted and that the firm (including the partner Mr. Diarmad Murray who was then Managing Partner) had the necessary experience and competence to deal with the matter.

107 By way of letter of the next day (August 6th, 2009), Mr. Macaulay provided the defendant with correspondence between CIMA and the BCB which had been disclosed in the context of the ongoing proceedings in Brazil. This included the correspondence between CIMA and the BCB exchanged in 2006 in relation to the disclosure of the legal and beneficial ownership of TLB discussed above and which was relied upon to advance

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29 Section 50 of the Monetary Authority Law (2004 Revision) is cited in Mr. Toledo's affidavit at para. 165 in support.

30 The MOU s.8.1 is also cited as containing provisions restricting the use of disclosure provided by CIMA to the BCB to the exercise of BCB's "regulatory functions" and s.5.4 as restricting that use to the specific defined purposes disclosed to CIMA when requesting the information.

the BCB's objective of establishing any affiliation, business operations or connections between TLB and Banco Rural.

108 Mr. Macaulay's letter of August 6th, 2009 also included a copy of the criminal complaint which named the "Brazilian defendants," including Katia Rabello.

109 The objective of Mr. Macaulay's letter, gleaned from its terms, was, in effect, to seek the defendant's advice on obtaining the possible intervention of the Cayman Attorney General and/or CIMA, with the BCB or the Brazilian courts, to prevent the CIMA disclosure from being further "abused" in the criminal proceedings, to the detriment of the Brazilian defendants.

110 On August 7th there followed an email from Mr. Austin-Smith to Mr. Macaulay in these terms:

> "I am putting together an engagement letter now. Is the *ultimate client* TLB or the various individuals facing prosecution? If the latter can you indicate which." [Emphasis added.]

111 In response, Mr. Macaulay sent an email later that day to the defendant in these terms:

> "Your *ultimate clients* for purposes of this matter should be *East Farthing Holdings Ltd*, a Cayman corporation which was the sole shareholder of TLB upon liquidation, *and Fernando Toledo*, the sole shareholder of East Farthing." [Emphasis added.]

112 Then followed the August 2009 retainer letter itself, which begins in these terms:

> "You have asked us to assist East Farthing Holdings Ltd in preventing the use of material provided by the Cayman Islands Monetary Authority to Banco Central Do Brasil in a criminal prosecution in Brazil ('the Engagement')."

113 This engagement letter goes on at paras. 35 and 36 to confirm that the defendant would vouchsafe the confidentiality of the "clients'" information, in terms identical to those in the May 2007 retainer set out above at para. 92.

114 It is the defendant's position that notwithstanding the context and background of the criminal proceedings in Brazil, the only client for which it was by this August 2009 retainer engaged was EFHL. The defendant thus invites the narrowest construction of the phrase "ultimate client" from Mr. Macaulay's email of August 7th (above).

115 Unsurprisingly, the plaintiffs do not accept this.

116 For one matter, while the engagement letter in terms refers only to EFHL, Mr. Toledo was its sole shareholder. And while Mr. Toledo was not indicted, he was named in the Brazilian indictment.

117 Moreover, say the plaintiffs, it was obvious from Mr. Macaulay's letter of August 6th, 2009 that the purpose of this retainer was to "protect the Brazilian defendants"—the natural persons who were the subject of the indictment, and which made no mention of EFHL. The obvious concern was to ameliorate the impact of the CIMA disclosure (which revealed the connection between the Rabello family, Banco Rural and TLB) upon those persons identified as subjects of the indictment.

118 The defendant, say the plaintiffs, could therefore have been under no misunderstanding that its true clients in this context were those, especially Katia Rabello, facing possible conviction in Brazil, as the result of the abuse of the CIMA disclosure by the BCB.

119 It is also to be noted that Mr. Toledo became listed by the defendant as a client,[31] in its internal records relating to the August 2009 retainer. This is a fact which the defendant at first sought, it seems mistakenly, to deny by averring in its defence[32] that EFHL was named as the sole client in its marketing and billing database.

120 Still further, it does appear from the letter written by the defendant (*per* Mr. Austin Smith) to CIMA on September 9th, 2009, that the defendant regarded itself as acting on behalf of those persons in jeopardy in Brazil.

121 At para. 5 this letter states:

> "We have subsequently been informed that criminal proceedings have been brought by the Federal Public Prosecutors office in Brazil based on the information provided by CIMA. We attach (in original and English translation) a document prepared in those court proceedings by the Federal Public Prosecutors office in Minas Gerais. In particular we would draw your attention to the comments made at paragraphs 5 and 6, in which the document makes it quite clear that material provided by CIMA is not only to be used as evidence in

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31 See reply 10.1 to the reply to the request for further and better particulars of the amended defence dated December 5th, 2014. See also the second affidavit of Ms. Feena Christian (*née* Cray) which suggests that the listing of Mr. Toledo as a client could not have been by "mistake," as the defendant sought to aver. Also, in the affidavit of Antonia Hardy filed on behalf of the defendant, she attests that no conflict check was ever carried out, by the defendant in its clients' database, against the names of Katia Rabello or Fernando Toledo.

32 Paragraph 47.4 of the amended defence (now withdrawn by the defendant).

> these criminal proceedings but, in fact, forms the backbone of the case against the Defendants."

122 Thus, this letter clearly raises the concern that documentation provided by CIMA to the BCB for regulatory purposes was being used in the Brazilian criminal proceedings and, as it goes on to conclude, that the manner in which information had been obtained by the BCB had—

> "deprived those now facing serious criminal charges of the protections imposed by the Cayman Islands legislature through the Monetary Authority Law (and other statutes).
>
> In the circumstances we would appreciate if you could confirm that our understanding of the position is accurate so that this breach of the law and the MOU can be brought to the attention of both the trial court and the authorities in Brazil."

123 As a further sign of the ongoing lawyer–client relationship, throughout this period in late 2009 and subsequently, as Mr. Toledo avers, the defendant regularly sent fee invoices to Mr. Macaulay to be settled on behalf of its clients.[33] Those invoices were settled, save for the final one dated June 7th, 2011 which was, quite remarkably, issued more than a year after the defendant had accepted Dr. Braga's retainer and started acting for him in April 2010.[34]

124 The full factual context to the August 2009 retainer, including the historical significance of earlier retainers, must be analysed for the application of the common law criteria for the identification of the lawyer–client relationship and its duties and obligations, including the ongoing duty of confidence which it engendered. This analysis will be undertaken below.

125 The narrative on the August 2009 retainer can be concluded here by noting that despite CIMA's attempts at intervention, the BCB denied having acted contrary to its undertakings and the indictment was nonetheless prosecuted against the Brazilian defendants, including Katia Rabello, to their conviction.

126 Katia Rabello was, however, later acquitted on her appeal in relation to this indictment, the Brazilian appellate courts having found that the allegation of "misrepresentation on documents" as raised by the BCB was unjustified.

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33 Albeit that these invoices state the matter as "Trade Link Bank—CIMA Request." The fees were incurred by and/or on behalf of Mr. Macaulay's client (the defendant's past submissions that Carlton Fields (Mr. Macaulay's firm) were the clients, was abandoned).

34 Fee invoice dated June 7th, 2011, first affidavit of Fernando Toledo.

Katia Rabello as client

127 As regards her status as client, Katia Rabello avers in her witness statement[35] that while she never dealt personally with the defendant, given the defendant's longstanding relationship with her family, the Rural Group and TLB, she relied on the defendant to act on her behalf regarding all Cayman Islands legal matters that affected her and understood that they would act to protect her interests in this regard.

128 This relationship began where she was concerned, in 1998. This was when her father set up EFHL as the holding company for his interests in TLB. The defendant handled the legal work, including naming herself, her sisters Junia and Nora and their mother Jandyra, as directors of EFHL. She also avers to her belief that the defendant must have regarded her as a client when it acted on her behalf as a beneficial owner of Arnage and Brooklands and as a UBO of Securinvest (as it indisputably did at least on behalf of the Cayman incorporated parties) in relation to the note purchase transaction.

Winding up of EFHL—retainer in February 2010

129 As a further post-script and for completeness—in addition to acting for EFHL in connection with the August 2009 retainer, in early 2010 the defendant began advising on the potential dissolution of EFHL.

130 This is apparent from a chain of emails between Mr. Macaulay and attorney Charles Kirkconnell of the defendant beginning on February 1st, 2010, in which Mr. Macaulay stated that "the client has decided to dissolve the company as it is no longer needed due to the completion of the liquidation of Trade Link Bank."

131 Mr. Macaulay asserts, and to my mind it is plain, that that reference to "the client" must have been understood to be a reference at least to Mr. Toledo, but also as well to the Rabellos as the persons implicated with TLB in the BCB inquiry and the resultant criminal proceedings in Brazil.

132 There then followed a number of email exchanges between the defendant and its associate Walkers Corporate Services Ltd. on the one hand and Mr. Macaulay on behalf of "the client" on the other, in relation to the dissolution of EFHL.

133 Having read them, it is safe to say that nothing in those email exchanges suggests a contrary understanding on the part of the defendant.

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35 Dated January 22nd, 2015, at para 10.

The significance of historical retainers

134 The May 2006 retainer, the May 2007 retainer, the August 2007 retainer, the August 2009 retainer and the February 2010 EFHL retainer, like those before them relating to the setting up of TLB and EFHL and advice to Arnage and Brooklands (in relation to the note purchase transaction), are of significance now for specific purposes.

135 First, they provide the factual background for the legal examination of the existence of the lawyer–client relationship between the defendant and the plaintiffs which the plaintiffs claim. The retainers also reveal, as the plaintiffs complain, that the defendant must have been aware of the vulnerable position of the Rabello interests in Brazil—vulnerability both in the public and regulatory arenas—which was widely known. It follows that the defendant must therefore have been aware of the dire implications for the Rabello interests when the defendant decided to act for Dr. Braga against them. Thus, the retainers set the context for the finding of the lawyer–client relationship, as well as for the examination of the allegations of breaches of duty arising from the relationship.

Summary of evidence showing the lawyer-client relationship—Katia Rabello and Fernando Toledo

136 The defendant, through Mr. Simpson, has admitted the existence of the relationship with the first three plaintiffs—Arnage, Brooklands and EFHL.

137 The evidence in support was undeniable in any event, as discussed above.

138 I think I need therefore summarize here only the evidence which in my view shows the relationships with Katia Rabello and Fernando Toledo.

139 As regards Katia Rabello, the only conclusion to be reached from the events discussed above is that Katia Rabello was a client of the defendant as at the date when the defendant agreed to act for Dr. Braga ("the Braga retainer"). This is undeniable given not only the many years of the defendant having acted as the Cayman attorneys for the Rabello family, including Katia Rabello, but also more particularly on account of the following:

(a) The explicit instruction given on August 5th, 2009 by Mr. Macaulay for the defendant to act so as to limit the harm to the Brazilian defendants in the Brazilian criminal proceedings which, to the defendant's knowledge, included Katia Rabello.

(b) The fact that a clear purpose of the August 2009 retainer was to assist Katia Rabello in her defence to the Brazilian criminal proceedings.

(c) The August 2009 retainer (entered into only some eight months before the Braga retainer) was ongoing at the time of the acceptance of the Braga retainer. As set out at paras. 77 and 78 of the statement of claim and paras. 193–201 of Mr. Toledo's first affidavit, whilst the Braga retainer was being pursued by the defendant, the defendant was simultaneously:

(i) advising Katia Rabello's US Attorneys on her behalf as to the progress being made under the August 2009 retainer;

(ii) taking further instructions in relation thereto;

(iii) liaising with CIMA in furtherance of Katia Rabello's interests in this regard; and

(iv) providing further advice for her benefit as to Cayman Islands law as regards the CIMA disclosure to the BCB.

(d) The defendant's own work-product and correspondence with CIMA clearly demonstrates its own understanding that it was acting on behalf of the defendants in the Brazilian criminal proceedings. See for example, the defendant's letter to CIMA of September 9th, 2009, discussed in detail above.

(e) Finally, the two references and connections[36] to Katia Rabello in the defendant's own client database as explained by Feena Christian in her second affidavit and in respect of which she acknowledged, very belatedly on behalf of the defendant, that upon the acceptance of the Braga retainer, a conflicts check had not been conducted in relation to Ms. Rabello. This is an oversight which occurred although Katia Rabello was expressly named as a respondent to the second application brought on behalf of Dr. Braga and for which the defendant has also belatedly, apologized.

140 As regards Fernando Toledo:

(a) The defendant's own records indicate that he was a client in respect of the August 2009 retainer. A simple search of the defendant's systems would again have revealed multiple references to him, including the express reference to him as "client."

(b) Mr. Macaulay's email of August 7th, 2009 to the defendant expressly named Mr. Toledo as a client.

(c) Mr. Toledo's known position as managing director of TLB.

(d) Mr. Toledo's position as sole shareholder of TLB through EFHL, making him to the defendant's knowledge, the beneficial owner of both TLB and EFHL.

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36 There were a number of connections in the defendant's client database to the Rural Group and TLB which were majority owned by the Rabello family.

(e) His undisputed evidence that he met with the defendant on several occasions and regularly communicated with the defendant for many years in the context of TLB and Rabello family business, including both (i) the voluntary dissolution of TLB, and (ii) the probate process whereby he inherited the TLB shares through the transfer of EFHL shares previously owned by Sabino Rabello.

(f) The defendant's belated admission and apology for not having carried out a conflicts search regarding Mr. Toledo, despite the fact that he was expressly named by the defendant as a subject of the applications made by it on behalf of Dr. Braga. By this belated admission, the defendant has confirmed that a conflicts search would have disclosed him as a client under the August 2009 retainer and would have shown his connections with TLB, the Rabello family and the Rural Group (Banco Rural and Rural Leasing both being named specifically as related entities in the applications brought on behalf of Dr. Braga). Mr. Toledo was also recorded in the defendant's systems as a director of Rural International Inc., equally with his connections to TLB and EFHL.

(g) The earlier suggestion by the defendant that Carlton Fields (Mr. Macaulay's firm) was the client is no longer being asserted. Contrary to that earlier position advanced in court, it is now admitted that Carlton Fields "has never been recorded as a client in Walkers' systems."

(h) As in the case of the other plaintiffs, many confidential documents relating to Mr. Toledo were obtained by the defendant and disclosed to Dr. Braga.

The Braga retainer and the Brazilian bankruptcy proceedings

141 Even before their difficulties with the BCB began in about 2006, problems for the Rabellos had arisen from the allegedly dishonest involvement of Sabino Rabello with Ari Natalino of the Petroforte Group, in what became known as the Sobar S.A. Álcool e Derivados ("Sobar") sale/leaseback transaction ("the Sobar transaction").

142 The Sobar transaction was entered into in 2000 at a time when Petroforte,[37] the parent of Sobar, is alleged to have become bankrupt. It gave rise to allegations that between them, Sabino Rabello and Ari Natalino had colluded to strip away Sobar assets from the Petroforte Group, putting them out of reach of its creditors, through the use of the Rural Group entity Rural Leasing and, later, by using Securinvest.

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37 Petroforte Brasileiro De Petroleo Ltda., once one of the largest distributors of petroleum and ethanol products in Brazil.

143 The defendant came to be retained by Dr. Braga in April 2010,[38] in the context of a long-running battle between Dr. Braga, as trustee-in-bankruptcy of the Petroforte estate on one side, and the Rabello family and their Rural Group on the other. This battle had been engaged in the Brazilian courts over the alleged stripping away of the Sobar assets (a sugar plantation and ethanol plant valued at some US$100m.).

144 In proceedings filed by him before the Brazilian courts to revoke the Sobar transaction ("the revocation action"), Dr. Braga averred that the Sobar transaction was a sham, and that its effect which was to fraudulently deprive the Petroforte estate of the Sobar assets.

145 In 2000, prior to Petroforte having been placed into bankruptcy, Rural Leasing and Sobar had, in fact, entered into a contract for the sale/leaseback of the Sobar assets. Pursuant to the terms of the contract, Sobar transferred to Rural Leasing the Sobar assets which were subsequently leased back to Sobar by Rural Leasing for a contracted price to be paid by instalments.

146 Due, at least ostensibly, to the non-payment of instalments under the contract, Rural Leasing commenced litigation against Sobar and those proceedings were settled.

147 In 2003, Rural Leasing commenced a further action to repossess the Sobar assets given that again at least ostensibly, Sobar had not made any further payments.

148 This repossession of the assets by Rural Leasing was eventually, and the plaintiffs say finally—and the revocation action notwithstanding—approved by the Brazilian courts.

149 Subsequent to the Brazilian courts' approval, the Sobar assets were sold to Securinvest and then by Securinvest to a Brazilian company named Turvo Participacoes Ltda. ("Turvo").

150 Notwithstanding Rural Group's protestations that the Sobar transaction was not a sham and had in fact been approved by the Brazilian courts, Dr. Braga, having become appointed as trustee over the Petroforte Group, commenced the revocation action in 2006 and immediately obtained from the court a secured lien over the Sobar assets. This lien was described by him to the Brazilian court as needed to prevent risk of the dissipation of those assets.

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38 The defendant has confirmed that it was first contacted, in respect of acting for Dr. Braga, by email from the BVI law firm Martin Kenney & Co. on April 28th, 2010 to Diarmad Murray who was then Managing Partner of the defendant and the same Mr. Murray who is shown to have been referenced in correspondence with Mr. Macaulay on behalf of the plaintiffs.

151 For reasons which still remain unexplained in these proceedings, despite having commenced the revocation action, Dr. Braga commenced a new action by way of bankruptcy proceedings against Securinvest itself. By this action he has sought to bring all Securinvest assets (not only those which were Sobar related), into the Petroforte bankruptcy. For these purposes, as I understand it, Dr. Braga relied (and continues in the course of ongoing appeals in Brazil to rely) upon the Brazilian legal theory of the "common economic group." This is that such a common group came into existence to comprise Securinvest and Petroforte because of the alleged collusion between Sabino Rabello and Ari Natalino for the stripping away of the Sobar assets from the Petroforte Group to the Rural Group using Rural Leasing, Securinvest and Turvo.

152 A pivotal point for the extension of the Petroforte bankruptcy to the Rural Group ultimately through Securinvest was the fact that Sabino Rabello and Ari Natalino were both found to be the shareholders in Turvo.[39] This was said to be the pivotal connection for the application of the legal theory of "common economic group," as I understand it.

153 The legal theory would thus be established unless it could be shown that Securinvest (as the destination of the Sobar assets), was itself owned by third parties having no connection to either of the Rural or Petroforte Groups.

154 On the basis of his petition against Securinvest (supported by his alleged but then as yet unproven connection between Securinvest and Petroforte), Dr. Braga persuaded Judge Beethoven of the São Paulo Bankruptcy Court to make an order *ex parte* (*i.e.* without notice) in August 2007, extending the Petroforte bankruptcy over Securinvest ("the August 2007 bankruptcy order"). This order, even while the revocation action remained unresolved, then allowed Dr. Braga (through a court-appointed receiver) to take control of all of Securinvest's assets going well beyond Sobar. These assets include the Hotel Nacional in Brasilia; a BR$100m. note payable to Securinvest from a television network (Rede TV),[40] along with various other land holdings and a private plane.

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39 As discussed in the earlier judgment of this court of May 20th, 2011 in which the Cayman disclosure orders were reviewed (reported at 2011 (1) CILR 402, *sub nom.* *Braga* v. *Equity Trust Co.* ("the May 2011 judgment")).

40 Pleaded as a note for R100,000 at para. 202 of the statement of claim and summary of losses, but this is explained by the plaintiffs' attorney Mr. Annette as being a typographical error.

155 These non-Sobar Securinvest assets[41] are alleged by the plaintiffs to be worth in the order of US$300m. and as will be further explained, form the core of the losses sought to be recovered from the defendant. And when including the claim relating to the loss of Banco Rural (also to be further explained below), the claim rises to over US$400m.

156 The defendant's liability is claimed to have arisen from subsequent events in this jurisdiction after it started acting under the Braga retainer. These are events to which I now turn.

Chronology leading to the disclosure of the plaintiffs' confidential information to Dr. Braga in the Cayman Islands ("the Cayman disclosure")

157 While the August 2007 bankruptcy order against Securinvest was obtained from Judge Beethoven prior to the Braga retainer (which arose later in April 2010), the Cayman disclosure and the claim against the defendant relating to it, relates to the ultimate rejection of Securinvest's appeal in August 2011.[42] The rejection of Securinvest's appeal is averred by the plaintiffs to have been directly influenced by the Cayman disclosure—the disclosure of confidential information obtained by Dr. Braga in this jurisdiction, acting through the defendant.

158 The procedural chronology, in brief, was as follows.

159 Securinvest had appealed against Judge Beethoven's August 2007 bankruptcy order to the Tribunal de Justicia de São Paulo ("the TJSP") but on September 30th, 2008, the TJSP affirmed the judge's order.[43] In his judgment on behalf of the TJSP, it was Judge Akel who, for the first time, made reference to a common economic group having come to comprise Petroforte and the Rural Group.

160 In his earlier judgment issued on August 24th, 2007, Judge Beethoven had, however, made very damning conclusions against Securinvest and the wider Rural Group. It is important for present purposes to record aspects of this judgment here because an important element of the defendant's causation defence is that the crucial conclusions reached by the Brazilian courts, adverse to the plaintiffs, had been reached prior to the Braga retainer and the defendant's actions taken on behalf of Dr. Braga. Accordingly, that there was therefore no causal link

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41 The plaintiffs' claim for US$100m. in respect of loss of the Sobar assets was abandoned during the arguments having regard to the disputed entitlement to them which is the subject of the revocation proceedings.

42 By the Superior Tribunal de Justicia ("the STJ"), the highest appellate court for non-constitutional questions of federal law and about which more below.

43 The TJSP's order *per* Judge Elliot Akel, being filed on October 16th, 2008.

between the defendant's actions and the plaintiffs' loss, at any rate in relation to Securinvest.

161 Having noted in his judgment that Dr. Braga had applied for the extension of the effects of the Petroforte bankruptcy over Securinvest and had requested that the BCB be notified (because the Sobar transaction was also seen as linked to Banco Rural), Judge Beethoven continued:

> "In reality, based on the petition . . . there is serious evidence that the very leaseback operation, as alleged, was *a flagrant sham* involving Rural Leasing . . . and the company Sobar (once the debt had been passed on to Securinvest, Banco Rural obtained title to the factory for a small amount representing a fraction of its true worth . . . These leaseback operations were highly prejudicial to Petroforte's creditors . . .
>
> Thus the intention to defraud Petroforte's creditors is proven . . . All that has exposed (the fraudulent) practices here has been the effort of the brilliant administrator in bankruptcy supported by the good work of the Public Prosecutor's Office of Sao Paulo. They took note of the operation thus involving Sobar. The commercial leaseback agreement was concluded for sky high values. Hence Sobar ended up owing Rural Leasing more than BRL 20 million . . . It followed the covert sale to Securinvest, in which the spurious link between Petroforte Group and Rural Group is obvious. Finally, it lends credence to the further operations effected and legal actions brought, listed by the Administrator at [illegible] 6 et seq of these case papers. All this was designed to frustrate the rights of the creditors in addition to the agreements between the companies, and in addition to the offshore companies belonging to Banco Rural. There is no doubt of the suspect behavior involved in the transactions with Petroforte Group . . . Clearly the Rural Group is liable given the well-known bankrupt status of Petroforte Group . . .
>
> In view of the foregoing, I hereby determine that a copy of this order and of the Administrator's statements shall be served on the Central Bank, and also on the Public Prosecutor's office, so that each may take measures within its competence against Rural Group, in view of what is found herein, and that all useful documents be placed at the disposal of the Central Bank at its simple request.
>
> Based on these facts, as a guarantee to the estate's creditors, I ORDER SEIZURE of all assets listed on pages 22 and 23 of these case papers [Sobar as well as the other Securinvest assets mentioned above] *in view of the mixing of the relations and assets now inferred. The case papers demonstrate the fraud, the perversion of the corporate object and the bad faith of those involved. Hence it is appropriate, as a preliminary, to disregard the legal personality of all these associated*

> *companies, and to extend to them the bankruptcy of the Petroforte Group, in view of the embezzlement of assets and the erosion of capital which the financial group promoted, in collusion with Mr. ARI NATALINO. The management of Rural Group were included in this aspect. In light of the Consumer Defence and Civil Codes, the personal assets of the defrauders are liable for the company's debts, given the willful misconduct identified above.*
>
> I therefore rule that the effects of the bankruptcy shall be extended to all the companies listed on page 02, and that the usual procedure shall be followed.
>
> I order that an on-line stop be placed on all accounts of the companies and persons involved, the amount of which shall be as stated on page 40.
>
> I order the appointment of Mr. ALEXANDRE CURY DE REZENDE, a person trusted by this court, as MANAGER of the company SOBAR S.A. . . . The commission requested shall be issued for that purposes. The Military Police shall take action for the requested purposes. The brief shall be carried out by the Administrator in Bankruptcy, and the manager shall lend support and write a report of the proceedings and of the measures taken . . . ANAC[44] is to take action to ground the aircraft."

162 A number of arguments were raised on behalf of the plaintiffs in relation to this judgment of Judge Beethoven. First, it is said that its real rationale was the finding that the Sobar transaction was a "flagrant sham" and that it was on that basis the judge decided to "disregard the legal personality of these associated companies and extend to them the bankruptcy of the Petroforte Group." Further, that nowhere did the judge purport to rely upon the common economic group theory. Rather, as mentioned above, it was Judge Akel of the TJSP who first invoked the theory in relation to Securinvest and Petroforte.

163 It was therefore also contended in argument and by Mr. Macaulay in his evidence on behalf of the plaintiffs, that Judge Beethoven got the facts and the law wrong when he made this judgment. As to the law, based on Brazilian legal advice, Mr. Macaulay contends that under Brazilian law, a third party (in this instance the Rural Group, including Securinvest) and its assets may be brought into another company's bankruptcy proceedings *only* if:

(a) The bankrupt entity and the third party acted with an intent to defraud creditors; *and*

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44 The National Civil Aviation Agency of Brazil.

(b) The two companies were part of a "common economic group," *i.e.* acting under common ownership and control.

164 While insisting that the Sobar transaction is not a sham (which he emphasized is the very issue joined before another Brazilian court in the revocation action yet to be determined), Mr. Macaulay contends that the evidence, including the Cayman disclosure which was obtained by Dr. Braga in this jurisdiction with the aid of the defendant, confirmed that there was in reality no factual basis for a finding of "common economic group" as between Securinvest and Petroforte and/or between Banco Rural and Petroforte, as that concept is to be understood at Brazilian law. As Mr. Macaulay contends, the concept requires there to be common ownership between Securinvest and Petroforte, a state of affairs that never, in fact, existed as the Cayman disclosure merely proved that Katia Rabello is (and always has been, with her father or individually) the UBO of Securinvest.

165 This is a criticism which was maintained in the plaintiffs' pleadings in respect of the Brazilian judgments, including the TJSP's judgment of September 30th, 2008, all the way up to the final decision of the STJ in August 2011. The plaintiffs also emphasize that the final STJ decision (to be considered below) itself followed after Dr. Braga's obtaining of the Cayman disclosure and so must have been influenced by it.

166 The plaintiffs aver that in this way, the Cayman disclosure was pivotal in the erroneous finding of common economic group being ultimately upheld. They say that although Judge Beethoven had already made his judgment before the Cayman disclosure was obtained, the ultimate outcome before the STJ was undoubtedly influenced by the Cayman disclosure.

167 There is no dispute that the STJ certainly had access to the Cayman disclosure.

168 This criticism that the common economic group theory was misapplied by the Brazilian courts is strongly rejected by the defendant through Mr. Simpson. He characterizes it as an impermissible collateral attack upon the judgments of the Brazilian courts, judgments to which he argued, this court is, by principles of comity, obliged to defer and respect.

169 An important consideration of this duty of comity, insists Mr. Simpson, is the fact that the STJ, as the final appellate court, was bound by the findings of fact by the courts below and that both Judge Beethoven and the TJSP had concluded that the factual basis for the extension of the Petroforte bankruptcy over Securinvest was proven.

170 Faced with these arguments, and when pressed by this court during the latter days of the hearing, Mr. Akiwumi sought to explain that no criticism of the Brazilian judgments themselves is intended by the

plaintiffs. Rather, that what the plaintiffs contend is that the obtaining *ex parte* of the Cayman disclosure by the defendant and the unilateral and unwarranted[45] deployment of it by Dr. Braga before the Brazilian courts, as well as its release to the BCB and ultimately to the media, deprived the plaintiffs of the opportunity to contain its harmful impact and the ultimate prejudice which it caused to them, in the different arenas in Brazil.

171 The plaintiffs claim that had they been allowed notice of the defendant's applications to this court on behalf of Dr. Braga (instead of being denied notice due to the gagging orders obtained by the defendant),[46] the plaintiffs could and would have applied to this court for, at least, protective measures to contain the unwarranted misuse of the information in Brazil. Had they had this opportunity, that at the very least they would have limited the consequences of the defendant's actions in acting for Dr. Braga, in breach of its duties to them.[47]

172 They might well, say the plaintiffs, even have managed to persuade this court to refuse or revoke entirely the orders for disclosure, had they had the opportunity to explain that the revocation action instituted by Dr. Braga himself was still pending and therefore that the allegations of fraud raised against them and relied upon by Dr. Braga in his applications to this court were yet to be determined by the Brazilian courts. In this regard therefore, this court might have thought it proper to require Dr. Braga to first obtain the adjudication of the revocation action before entertaining his applications. The most telling factor against the plaintiffs in Dr. Braga's applications to this court, were the allegations of fraud upon the Petroforte creditors. Yet, neither Dr. Braga nor the defendant disclosed

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45 In the sense of not being authorized by this court.

46 Which prevented Equity Trust and CIBC as the respective respondents to the *Norwich Pharmacal* applications from notifying the plaintiffs, their clients.

47 See statement of claim para. 85(xi), para. 94(ix) and (x) (in relation to the absence of urgency which negated the need for *ex parte* applications which excluded the plaintiffs); para. 110 (citing the consequence of the *ex parte* action taken by the defendant which was that the plaintiffs were unaware of the defendant's actions until November 2010 after the Cayman disclosure had been deployed against them in the proceedings in Brazil, the United States, Belize and the British Virgin Islands ("BVI"); paras. 117, 125 and 127(iii), 133 and 135 (alleging again, the failure to notify the plaintiffs). Finally, and most expressly on this point, para. 136 pleads that—

"By reason of the Defendant's wrongful conduct in failing to inform the Plaintiffs of the (Norwich Pharmacal applications and orders) [the plaintiffs] had no knowledge of the First Norwich Pharmacal Order when it was made. In those circumstances and by reason of the Defendant's wrongful and unlawful conduct, the Plaintiffs were unable to apply to Court to seek relief prior to either (i) the Defendant's egregious breaches of contract, fiduciary duty and/or its duty of care; or (ii) prior to the wrongful consequential disclosure of confidential documents being made to the Defendant on behalf of Dr. Braga."

when seeking the *Norwich Pharmacal* orders that these were as yet merely unproven allegations.

173 I am persuaded that these arguments and pleadings are well grounded in probability. In its May 2011 judgment (reported as *Braga* v. *Equity Trust Co. (Cayman) Ltd.* (2011 (1) CILR 402)), this court, when reviewing the orders for disclosure and disapproving of most (even while approving of some) of the Cayman disclosure:

(i) expressly referenced the fact that the allegations of fraud against the Grupo Rural interests remained unproven; and,

(ii) moreover, found that there had been no risk of dissipation of assets belonging to the Petroforte estate such as could justify the wider disclosure that had been obtained;

(iii) and held that in any event, the urgency contended for by Dr. Braga in getting the disclosure and gagging orders[48] was unfounded in light of Judge Beethoven's injunctive order and appointment of a manager/receiver over all Securinvest assets, including over Sobar, the only alleged Petroforte asset identified; and

(iv) was concerned that Dr. Braga could be regarded as operating under a conflict of interest in light of the incentivized scheme for his and his court-appointed investigator OAR's[49] remuneration—remuneration which was based upon the amount of the recoveries achieved on behalf of the Petroforte estate. This especially was a very sensitive fact says the plaintiffs, which this court was entitled to be informed about from

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48 As set out in his first affidavit at paras. 14–15:
"This application is urgent. The reasons for the urgency are that the Brazilian Superior Court has given me a limited time in which to provide it with evidence as to the true beneficial owners of Securinvest. It has imposed a limited time window for that evidence to be provided, which is due to expire on Tuesday, 6 July 2010 . . . In addition . . . If those who are improperly seeking to avoid the turnover of a potential US$500 million of value to the Petroforte Estate are aware of my enquiries in Costa Rica, I suspect they are likely to take steps to frustrate my enquiries elsewhere, including in the Cayman Islands . . ."And further, at para. 43: "As I have explained above, one of the reasons this Application is so urgent is because of the value of the assets vested in Securinvest . . ."

49 OAR Consultantes Consultoria Ltda., the private investigatory firm engaged by Dr. Braga to assist in his investigation in Brazil and overseas with the aim of finding and "repatriating" to the Petroforte Estate, any assets belonging to any of a long list of Rural Group and Petroforte companies. OAR, by cl. 5 of its agreement with Dr. Braga, was expressly to be remunerated only on the contingency of recoveries, at 20% of value and at 30% of value, depending on whether it simply produced evidence which enabled the confiscation of known assets or whether it actually discovered and assisted in the recovery of unknown assets.

the outset, when assessing Dr. Braga's credibility as the sole witness who gave evidence in support of his application for the far-reaching disclosure orders which were obtained, important aspects of which were later, upon review, reversed by this court for being "premature, unjustified and impermissibly wide."[50] It is also remarkable that this court also then made an order for the retrieval of most of the Cayman disclosure.

174 Thus, in essence, the claim of the plaintiffs is for loss of opportunity to seek remedial relief as a result of the defendant's actions in obtaining the *ex parte* orders on behalf of Dr. Braga. I will return to consider the claims as framed in these terms, when dealing with the pleadings on breach and causation and the law relating to them.

175 An important marker to lay down here is that this aspect of the claim *does not involve* this court having to consider any alleged "collateral attack" upon the judgments of the Brazilian courts. It is trite, and I accept, that any remedial relief in respect of its own orders would have been a matter for this court to grant either to pre-empt the use of the Cayman disclosure in Brazil (and in Florida, USA, the BVI and Belize where it was also used to the detriment of the plaintiffs) or to delimit its use in those jurisdictions. It is to be noted in this context as to the probable outcomes, that when this court made its retrieval order on July 25th, 2011 in respect of most of the Cayman disclosure, the Brazilian courts did, at least, purport to comply.[51]

176 I return here to the chronology of events in Brazil.

177 Having failed in its appeal to the TJSP, Securinvest appealed finally against Judge Beethoven's August 2007 judgment to the STJ where it did indeed contend, among other things, that Judge Akel's finding of "common economic group" was wrong.

178 Evidence was presented to the STJ on behalf of Securinvest which sought to show that far from there being any Rabello, Rural Group (or for that matter Natalino) interest in Securinvest, that company, while owned by Arnage and Brooklands, was ultimately owned by Costa Rican individuals through Costa Rican companies, as the registered owners of Arnage and Brooklands.

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50 See the May 2011 judgment (above), in which this court also held that in light of the revocation action already instituted and the appointment of a receiver by Judge Beethoven over all Securinvest assets, there was no risk of dissipation and no urgency to justify Dr. Braga's seeking the breath of disclosure that he obtained.

51 See the certificate to the Grand Court, sent by the Brazilian court, certifying that the retrieval order had been implemented. "Purport to comply," because the BCB was nonetheless allowed to use the Cayman disclosure to the detriment of the plaintiffs.

179 This was a state of affairs which had come, at that time, to be reflected on the share registers of Arnage and Brooklands maintained in this jurisdiction ("the Costa Rican structure").

180 But the Costa Rican structure was, in reality, an artifice put in place before, on the instructions of Katia Rabello.[52] By those means, the Costa Rican individuals came to hold the shares in Arnage and Brooklands merely as her nominees but the Costa Rican structure was presented to the STJ as the real beneficial ownership of Securinvest.

181 Informed by OAR from their investigation in Costa Rica that the Costa Rican individuals were "people of straw," Dr. Braga persuaded the STJ (in circumstances to be more closely examined below) that he should be allowed to come to the Cayman Islands to investigate further into the UBO of Securinvest, through Arnage and Brooklands.

182 The STJ gave directions to allow him to do so and this was how he came to engage the defendant to act for him in this jurisdiction.

Katia Rabello's reasons for lying to the STJ

183 This court insisted upon an explanation from Katia Rabello of her reasons for devising the Costa Rica structure. In response, she filed her third witness statement in these proceedings. The creation of the Costa Rican structure to obscure her status as the owner of Arnage and Brooklands, and so as the UBO of Securinvest as well, she contends before this court, was not intended to defraud Petroforte's creditors by misleading the STJ over the existence of the "common economic group" issue. Instead, she contends that it was meant only to prevent the wholesale confiscation of all Securinvest assets (wider than just Sobar) and even greater harm to the Rabellos' interests—harm which she correctly anticipated would result from the public disclosure of her status as UBO of Securinvest in Brazil.

184 This is a contention which is sought to be explained on the basis also of her Brazilian legal advice, which is that her status as UBO of Securinvest, far from showing any commonality of ownership between the two Groups—Rural and Petroforte—rather proved instead that there was no such commonality of ownership as it confirms that only she, a Rabello, and no Petroforte interest, owns Securinvest.

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52 According to para. 11 of the amended defence, the false information about the beneficial ownership of Securinvest through Arnage and Brooklands was submitted to the STJ on October 15th, 2009 and re-submitted on May 11th, 2009, the only change being that the names of the Costa Rican holding companies were switched from Arnage to Brooklands and *vice versa*.

185 If the Securinvest issue was the only concern, there would therefore have been, she asserts, no need to obscure her status as its UBO in the context of the STJ appeal. Her status as UBO should have resulted in Securinvest being released from the Petroforte bankruptcy. This, she argues, should therefore be taken by this court as confirming that her real objective was not to mislead the STJ or defraud Petroforte creditors but to prevent the even more harmful consequences of the disclosure of her status as UBO of Securinvest to the BCB and in the public domain in Brazil.

186 Especially in this regard, she invites this court to consider that by the time of the STJ hearing, the BCB had also embarked upon its own investigation into Banco Rural's involvement in the allegedly fraudulent Sobar transaction, as prompted by Judge Beethoven's judgment of August 24th, 2007.

187 And so, not only were her family and herself at risk of losing Securinvest's Sobar assets, they were (and remain) also at risk of losing all of Securinvest's other assets as well. Further, that they have in fact lost Banco Rural itself which has been compulsorily liquidated by the BCB following a run on the bank caused by the BCB's investigation having become public knowledge. All these events she avers, were triggered or exacerbated by the Cayman disclosure being deployed or publicized against her family in Brazil.

188 The Costa Rican structure is therefore ultimately sought by her to be explained as intended not to deceive the STJ in its determination of Securinvest's appeal but to protect Securinvest from the "confiscation" of its other and more valuable non-Sobar assets, by Dr. Braga.

189 Her family, she asserts, was willing to have the question of the Sobar transaction resolved in the revocation action and this was what would have happened had Securinvest succeeded in its appeal to the STJ. Thus there was no intention to defraud the Petroforte estate of Sobar assets. It is the extension of the Petroforte bankruptcy to all of Securinvest's assets which the plaintiffs regard as confiscatory and which she sought to avoid. And further, for reasons also articulated by Mr. Macaulay in his evidence, the campaign against Securinvest was all part of the incentivized scheme by which Dr. Braga and his advisers, OAR,[53] seek unjustly to enrich themselves at the expense of the Rural Group and the Rabello family.

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53 As mentioned above, it is now acknowledged that Dr. Braga is assisted and advised by OAR (which was appointed by Judge Beethoven to assist in his inquiries). Mr. Macaulay's unchallenged evidence is that both are remunerated by way of commission as a percentage of recoveries made on behalf of the Petroforte estate.

190 These are concerns and explanations upon which Katia Rabello elaborates in her third witness statement[54] and for which she gets support from Mr. Toledo and Mr. Macaulay in their evidence.

191 For reasons which I trust will become apparent from my discussion of the legal principles on liability below, I did not need to reach a conclusion now on the veracity or correctness of these concerns and explanations.

192 Whether or not Katia Rabello's concerns and intentions were as she explains, will be of relevance to the *ex turpi causa* defence raised by the defendant and will be examined further in that context below.

Conclusions on the plaintiffs' loss of opportunity to contest the *Norwich Pharmacal* applications

193 What I was required to conclude upon and which I regard as established for the purposes of summary judgment on liability, is that, at minimum, there was indeed as pleaded a loss of the earliest opportunity for the plaintiffs to defend themselves in the context of the proceedings before this court. Further, that this loss of opportunity arose from the defendant's actions on behalf of Dr. Braga.

194 The defendant relies upon the fact that this court after an *inter partes* hearing approved those parts of the disclosure which revealed the evidence of Katia Rabello's status as UBO of Securinvest.[55] But that cannot in my view be relied upon by the defendant as an answer to liability for the loss of opportunity for the plaintiffs to have challenged the applications for disclosure.

195 I explain my reasons for this conclusion at this juncture, as follows.

196 First, it is notable, as discussed above, that other important aspects of the Cayman disclosure were found by this court to have been unjustified and went well beyond disclosure of the UBO of Securinvest. Given all the other arguments that the plaintiffs would likely have been able to put before this court, they may well therefore have succeeded, either in preventing Dr. Braga's deployment of their confidential information in Brazil altogether or at least in confining the use of it to the singular issue of the identity of UBO, which was pivotal to Securinvest's appeal then before the STJ.

197 The former of those two propositions now finds support in the likelihood that Dr. Braga would have been compelled to explain to this court why, in the absence of risk of dissipation of Sobar assets, he should

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54 See immediately below.
55 Judgment delivered on June 10th, 2011, formal order May 20th, 2011.

not first have been required to prove his allegations of fraud in the revocation action and in so doing also compelled to answer to the concerns over his and/or his advisers' apparent conflicts of interest. These were concerns which could have led this court at first instance, had they been revealed, to question the *bona fides* of his applications especially for the *Bankers Trust* disclosure.

198 The latter proposition now also finds support in the fact that this court would have been inclined, as indeed it showed it was,[56] to impose restrictions to confine the use of the Cayman disclosure to only so much of it as was necessary for answering the specific question raised by the STJ (the subject of its mandate to Dr. Braga for coming to the Cayman Islands), *viz.* the identity of the UBO of Securinvest.

199 It is the denial of the opportunity to establish either of those two propositions that I regard as buttressing the plaintiffs' claims for breach of duty and consequential damages.

200 Ultimately, however, the plaintiffs (Katia Rabello in particular) will also need to establish to the necessary civil standard of proof, the various alleged losses as the result of this averred loss of opportunity. This issue of causation will also necessarily be examined in some detail below for the purposes of summary judgment on liability. The issue arises whether the plaintiffs are entitled to claim equitable compensation for breach of fiduciary duty (as they claim primarily) without proof of causation or must satisfy the "but for" causation test in seeking to recover damages for breaches of the equitable as well as contractual duties.

Katia Rabello's bankruptcy

201 A very obvious consequence of the use of the Cayman disclosure was the reliance on it by Dr. Braga, for petitioning *ex parte* to put Katia Rabello herself into the Petroforte bankruptcy and for persuading Judge Beethoven to hand the Cayman disclosure over to the BCB.[57]

202 It is an irresistible conclusion that these consequences would likely have been avoided had she had the opportunity to oppose the granting of the Cayman disclosure.

203 My reasons specifically for this conclusion will become clearer below after an examination of the Cayman *Norwich Pharmacal* proceedings, including the *inter partes* proceedings in which the plaintiffs were belatedly able to participate before this court, as well as the events which followed in Brazil.

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56 See orders made upon the CR(P)L application.
57 This petition to Judge Beethoven's court will be examined below.

204 I return now to the chronology of events leading to Dr. Braga's applications to this court.

The STJ directions and the *Norwich Pharmacal* applications to this court leading to the Cayman disclosure and Katia Rabello's bankruptcy

205 As mentioned above, Dr. Braga acting through OAR, had made his inquiries in Costa Rica. He concluded that the individuals behind the Costa Rican structure were "straw men for unknown third parties,"[58] a situation which was not consistent with their purported beneficial ownership of a company as valuable as Securinvest. One of them had, moreover, denied having any interest in or knowledge of Arnage and Brooklands.

206 Dr. Braga was therefore able to persuade the STJ that he should be allowed to make further enquiries in the Cayman Islands into the ultimate beneficial (not merely legal) ownership of Securinvest.

207 The STJ, *per* Justice Nancy Andrighi, agreed that he should further his investigation but as a precautionary measure to avoid undue prejudice to Securinvest, she ordered the temporary suspension of the extension of the Petroforte bankruptcy over Securinvest.

208 As expressed by Justice Andrighi in her order of September 22nd, 2009 (translated):

> "Doubt as to the economic group to which SECURINVEST belongs initially suggests that its rights should be protected. Until it is possible to determine which economic group SECURINVEST belongs to, I consider it appropriate to suspend, for the time being, the winding up order before the harm caused to its business becomes irreversible.
>
> However, this measure cannot continue indefinitely. The uncertainty that hangs over this subject must be cleared up.
>
> According to the information contained in this injunction application, SECURINVEST is a company made up of two shareholders: ARNAGE HOLDINGS LTD and BROOKLANDS HOLDINGS LTD (both of which are legal entities based in a foreign country). Documents have been submitted within the proceedings which recount that neither of the two foreign companies have among their shareholders any of the businesses or individuals involved in Grupo Rural or Grupo Petroforte, according to the information checked by the Sao Paulo Public Prosecution Service.

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58 Dr. Braga's first affidavit, dated May 26th, 2010 filed in support of the *Norwich Pharmacal* applications, at para. 12.

> That information however, is not enough to clear up the doubts which these proceedings throw up. SECURINVEST must not just limit itself to saying who does not have a share in its capital. It is possible, for example, that the businesses ARNAGE and BROOKLANDS have among their shareholders other legal entities, and so indirectly it might be possible to identify the two economic groups. Therefore, instead of saying who its shareholders are not, SECURINVEST must indicate who actually has a shareholding in its capital in order to eliminate the impasse over this issue.
>
> For these reasons, I hereby grant this interim injunction and suspend the winding up order against SECURINVEST for a period of 15 (fifteen) days. Within that time limit, the applicant must submit to the High Court of Justice documents which specifically demonstrate who its shareholders are, who the shareholders of the shareholders are, and so on. This must be done in such a way that the corporate chain is unraveled and all the individuals with a direct or indirect share in the company's capital are revealed.
>
> After that information has been submitted, the matter must return for a decision on whether to confirm or revoke the interim injunction hereby granted.
>
> Let the respondent be served so that it may submit a response within the legal time limit."

209 From the foregoing it is clear that the issue before the STJ was two-fold: (i) the identity of the UBO of Securinvest, and (ii) whether Securinvest should remain within the Petroforte bankruptcy by operation of the legal theory of common economic group.

210 There was at that time no question of Katia Rabello herself or her assets being placed into the Petroforte bankruptcy and there is nothing to suggest that the STJ had such a possible outcome in mind.

211 But as was to be soon apparent, Dr. Braga had a different agenda which was not disclosed to this court.

212 Having come to Cayman, Dr. Braga retained the defendant.

213 The first application made by the defendant on his behalf by reliance on the *Norwich Pharmacal* principle[59] sought orders addressed to Equity Trust for disclosure of information held on behalf of Arnage and Brooklands (as the registered owners of Securinvest).

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59 *Norwich Pharmacal Co.* v. *Customs & Excise Commrs.* (52). His affidavit also cited the *Bankers Trust* principle: *Bankers Trust* v. *Shapira* (9).

214 This was on the basis that Equity Trust, in terms of the *Norwich Pharmacal* principle, had become "innocently mixed up" in the fraudulent wrongdoing of Securinvest (and by association Arnage and Brooklands) in its attempts to defraud Petroforte of its assets.

215 This application, made *ex parte* and so without notice to the plaintiffs, resulted in orders made on May 27th, 2010 for the disclosure to Dr. Braga of confidential information which showed not only that Katia Rabello was the UBO of Securinvest through Arnage and Brooklands, but also that on her instructions the registered offices had been changed from CIBC to Equity Trust. It also showed, ultimately to her greatest embarrassment, that also on her instructions to Equity Trust given only some days after Justice Andrighi's order, the Costa Rican structure had been put in place.

216 Recognizing that Equity Trust would have had a fiduciary obligation to inform its clients of the May 27th, 2010 orders ("the Equity Trust orders") and was obliged to bring an application to this court before it could divulge its client's confidential information,[60] the defendant on Dr. Braga's behalf also sought and obtained a "gagging" order, preventing Equity Trust from notifying the plaintiffs of the existence of the proceedings and of the Equity Trust orders.

217 The justification for such orders was said by Dr. Braga to have been to prevent the respondents (first Equity Trust and later CIBC) from "tipping off" their clients "which would likely frustrate and prejudice my investigation. I also seek an injunction which would have the effect of keeping my investigation confidential in Cayman with respect to Brooklands and Arnage."

218 Dr. Braga having thus obtained information from Equity Trust which also showed the earlier involvement of CIBC as service provider to Arnage and Brooklands (and so indirectly to Katia Rabello); a second application[61] was made on his behalf by the defendant resulting in an order of July 1st, 2010 directed to CIBC for disclosure ("the CIBC orders"). Gagging orders were again obtained to prevent CIBC from notifying its former clients.

219 Together, the Equity Trust orders and the CIBC orders are hereinafter referred to as "the *Norwich Pharmacal* orders."

220 As already mentioned, the information sought and ordered to be disclosed extended far beyond that which showed the UBO of Securinvest

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60 Under the law as it then stood, pursuant to the Confidential Relationships (Preservation) Law ("CR(P)L"), s.4.

61 Again relying on the *Norwich Pharmacal* and *Bankers Trust* principles.

and included other information held by the respondents about the financial affairs of the plaintiffs.

221 Of its own motion, this court had, however, required of Dr. Braga certain undertakings to limit the use and disclosure in Brazil and elsewhere of the confidential information obtained by way of the *Norwich Pharmacal* orders. Essentially, the undertakings were that the information not be used or disclosed by him outside of the Petroforte bankruptcy proceedings.

222 Unfortunately, and perhaps inevitably given the entirely *ex parte* nature of the proceedings, those undertakings proved not to have been sufficiently worded to have prevented Dr. Braga from initiating or prompting the dissemination of the Cayman disclosure beyond the STJ, in Brazil.

The *inter partes* review by this court leading to the May 2011 judgment

223 The insufficiency of the undertakings became a subject of concern for the plaintiffs when, on the *inter partes* basis long after Dr. Braga's deployment of the Cayman disclosure in Brazil,[62] they sought a review of the *Norwich Pharmacal* orders and the Cayman disclosure by this court.

224 The unduly extensive nature of the Cayman disclosure and its onward dissemination to the BCB or acquiescence in it by Dr. Braga, were the subjects of deserved criticism by the plaintiffs and this court in its May 2011 judgment.

225 However, no finding of a contemptuous breach of his undertakings was made against Dr. Braga, given the lack of clarity and specificity of the wording. The court expressed its concerns all the same, that the spirit of the undertaking had been violated by him.[63]

Katia Rabello's bankruptcy

226 Dr. Braga's first port of call after obtaining the Cayman disclosure was not the STJ but Judge Beethoven's first instance bankruptcy court.

227 There, he deployed the Cayman disclosure in support of a new (and again) *ex parte* petition for the extension of the Petroforte bankruptcy to Katia Rabello personally, to her lawyer and close associate Flavio Barbosa Do Amaral Jr. and to all other identifiable entities of the Rural Group. This petition appears to have relied upon a different legal theory or premise, *viz.* the "disregarding of legal personality" although apparently to some as

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62 When for the first time, the plaintiffs became aware of the *Norwich Pharmacal* orders and Cayman disclosure having been obtained.

63 See judgment of May 20th, 2011 (extracted below), at para. 265.

had been invoked by Judge Beethoven himself against Securinvest at first instance.

228 Judge Beethoven readily granted the petition, as appears from the strident language of his judgment of October 28th, 2010. It is clear that his judgment was heavily influenced by the Cayman disclosure as it revealed Katia Rabello's lie to the STJ. Relevant passages are excerpted as follows:

> "This matter concerns seeking CIVIL LIABILITY AND THE DISREGARDING OF LEGAL PERSONALITY, along with an application for a freezing order submitted by the LIQUIDATED ESTATE OF PETROFORTE BRASILEIRO DE PETROLEO, and which cites the banker KATIA RABELLO and the lawyer FLAVIO BARBOSA DO AMARAL JUNIONR. The Trustee [illegible] a huge amount of documents.
>
> These documents for the most part were obtained abroad by the Trustee who applied in camera from the courts of those countries at hearings held in camera. This was all done with the authorization of this court and the Office of Counsel for the State consented to this step being taken, as appears in the secret action taken before this court.
>
> . . .
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> Through this brief report I DECIDE AS FOLLOWS.
>
> INITIAL DECLARATION
>
> Even after 32 years of service to the Judiciary of Sao Paulo, this lowly judge is suddenly faced with a truly shocking situation . . . The respondent relied upon LIES and FRAUDULENTLY AVOIDING the Honourable SUPERIOR COURT OF JUSTICE, as represented by the brilliant and esteemed JUSTICE NANCY ANDRIGHI, the greatest judge the JUDICIARY of this country can boast of; it disrespected the moral grandeur of Justice Andrighi, who granted the PETROFORTE GROUP an interlocutory injunction suspending the extension of the effects of the Winding Up Order by way of an interim measure issued by that Honourable Court—as is evidenced by the documents attached to the application by the diligent Receiver, ALVES BRAGA.
>
> UBI GENTIUM SUMUS? As Cicero would say.
>
> The key issue relating to the interlocutory order granted by the aforementioned esteemed Justice lay in unraveling the link which the shareholders in SECURINVEST had with the PETROFORTE ECONOMIC INTEREST GROUP. To put another way, it is alleged that the Court

acted erroneously because, allegedly, no one from SECURINVEST had any relationship with any company in the LIQUIDATED GROUP.[64]

Thus, despite that initial astonishment, the documents attached, and obtained from abroad by the Trustee, demonstrate that the order of the brilliant Justice NANCY ANDRIGHI, Interlocutory Order [which require SECURINVEST] to reveal

> '. . . exactly who the shareholders are, who the shareholders of the shareholders of the shareholders are and so forth . . .'

was responded to by SECURINVEST [by] FALSEHOOD—because, according to documents from the [illegible] country [presumably Cayman Islands], COSTA RICA, the shareholders in SECURINVEST are ARNAGE HOLDINGS in the Cayman Islands—which has one shareholder, DESAROLLO DE PROYECTOS S.A., with only one shareholder, by the name of Jose Ignacio Jenkins Moreno—and BROOKLAND HOLDINGS, also from the Cayman Islands—which has its shareholder the individual Adriana Cordero Ehreberg.

It should be noted that the very clear order of the esteemed Justice revealed that the information provided by SECURINVEST was to the effect that, from among their shareholders, whether individuals or companies, neither ARNAGE HOLDINGS nor BROOKLANDS HOLDINGS had shareholdings in Rural Group or the PETROFORTE GROUP . . . and therein lies the core falsehood used to deceive . . .

The attitude of SECURINVEST is incredible—a thousand times incredible. It is a product and demonstration of the prurient times in which we live that the Superior Court and the meticulous Judge Rapparteur could be FRAUDULENTLY DECEIVED. The rectitude and probity of the Reputable Order were defiled by the action of SECURINVEST which touches on LITIGATION IN BAD FAITH . . . in that way SECURINVEST gambled its defence against an incontrovertible fact, distorting the

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64 It must be noted here that with the Brazilian legal theory framed in those terms, the Cayman disclosure, in revealing the link between Securinvest and Rural Group (through Katia Rabello), did not reveal that anyone from Securinvest had any relationship with any company in the "liquidated group" (*i.e.* Petroforte). This, Katia Rabello argues, was the mistaken "common economic group" basis for the extension of the Petroforte bankruptcy to Securinvest. A different basis was however apparently adopted here against Katia Rabello herself on Dr. Braga's petition by reliance on art. 50 of the Brazilian Civil Code, and so by disregarding her separate legal identity (and that of the other subjects) to treat them as liable for the debts of Petroforte. This emerges more clearly from later passages in Judge Beethoven's judgment below. Despite this change of tack by Dr. Braga deployed *ex parte* against her, Katia Rabello's appeal to the TJSP was refused. She appealed further to the STJ, where her appeal is yet to be concluded.

documented truth after the Court Order was made by creating [illegible] SHAREHOLDER COMPOSITION in order to make believe that there was no connection between RURAL GROUP and the PETROFORTE GROUP, something which was manifestly unfounded, invented and deceitful and which showed disrespect for the Courts and the esteemed Judge Rapporteur. SECURINVEST was oblivious of the fact that these claims did not—nor could they—produce any returns from lies . . .

Even more incredible is the disrespect which SECURINVEST showed to the Courts when it fraudulently altered the shareholder composition of the companies located in tax havens because the documents which the Trustee obtained in Costa Rica, the Cayman Islands and the British Virgin Islands reveal without shadow of doubt that the abovementioned shareholder composition was created after the date when the brilliant Judge Rapporteur made the order requiring clarification as to [ultimate beneficial ownership].

. . . Thus it has been fully established that the ultimate beneficiary of SECURINVEST always was and continues to be KATIA RABELLO . . .

To put it another way; at the time of this Court's decision making SECURINVEST liable for the debts of PETROFORTE in light of clear connections which it has with the liquidated company, Katia was the SECURINVEST shareholder—and FALSE INFORMATION has been supplied to the SUPERIOR COURT OF JUSTICE, because as at 05.11.2009 an email was sent (see page 155) stating that ARNAGE and BROOKLANDS had been incorporated in 2000—it also stated that these companies form part of the structure set up in order to enable Banco Rural to show a better financial balance—so SECURINVEST was set up to in order 'to clean up Banco Rural's balance sheet'[65] . . .

Similarly, it is not possible to say that the owners of SECURINVEST had no relationship with the liquidated company. The dismissal of the director in the Cayman Islands by Katia Rabello and his replacement by the Equity Trust [illegible] intention of misleading JUSTICE NANCY ANDRIGHI. This was untruthful, it created a new circumstance that would frustrate the true situation with regard to the control of SECURINVEST, and it was a manifestly malicious act.

Note must also be taken of the letter from FLAVIO BARBOSA AMARAL giving an account of the creation of Arnage and Brooklands so as to

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65 It is unclear why, in light of this earlier admission by email on November 5th, 2009, it was nonetheless alleged by Dr. Braga (and accepted by Judge Beethoven) that the connection between Securinvest and Rural Group (through Katia Rabello) was sought to be hidden from the Brazilian courts.

'enable Banco Rural to produce better financial statements' and 'to clean up the balance [sheet].'[66] . . .

Similarly, the documents reveal [illegible] that the deceased bankrupt ARI NATALINO was involved with KATIA RABELLO, with River South as intermediary for him and SECURINVEST for her—which by the way was admitted by ARI when he was heard in court. Thus by linking the word of ARI to what FLAVIO AMARAL stated in the letter revealed above, [it can be seen] that SECURINVEST was created to obtain these loans . . .

CONCLUSION

There can be no doubt that hundreds of documents have been omitted, relating to the promiscuity between the companies in the BANCO RURAL [GROUP] and the PETROFORTE GROUP—all in the [illegible] of decisions predating this Judgment and since confirmed by the Court of Justice of SAO PAULO.[67] The true malicious litigation perpetrated, albeit unsuccessfully, by PETROFORTE was revealed, and note should be taken of the judgments of the honourable LABOUR COURT and the Report from the BANCO CENTRAL (CENTRAL BANK OF BRAZIL), all of which have been appended by the Trustee. For that reason, imposition of personal liability on the parties cited in this action must be rigorously enforced, in view of Art 50 of the Civil Code.[68]

OPERATIVE PART

In light of the foregoing, I ALLOW IN FULL the application made by the Trustee. I order that the legal personality of all the companies identified on page 102 be disregarded due to the clearly established

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66 It is worth noting that while this aspect of the evidence as revealed by the Cayman disclosure (as many other aspects) appeared to put the subjects of the petition in a negative light without having given them an opportunity to explain, the obvious explanation was that the use of Securinvest in this way was not in and of itself unlawful but an advisable strategy on which the defendant itself advised, for the recovery of Banco Rural's bad debts and as illustrated by the note purchase transaction.

67 This is a reference to Securinvest's appeal to the TJSP from Judge Beethoven's earlier judgment having been refused—the further appeal then taken to the STJ.

68 Article 50, that which was relied upon here for "the disregarding of legal personality" (as taken from the translation of Dr. Braga's petition) provides:

"If legal personality is abused, through perversion of purpose or by the intermingling of assets, the courts may decide, on application by the party concerned or by the public prosecution service if it joins the proceedings, that the effects of certain given binding relationships extend to the personal assets of directors or members of legal persons."

link with the PETROFORTE GROUP, despite the fact that it has been noted that a number of directors, controllers and managers are declared to be liable for the irregularities found. I impose a freezing order to be placed on the assets of KATIA RABELLO and of FLAVIO BARBOSA DO AMARAL JUNIOR pursuant to Art. 40 Decree Law no. 7.661/45 and an extension of the effects of the Winding up Proceedings to both so that their assets shall be liable to meet the debts of the Liquidated Estate, in light of their attitude to the matters under review. I therefore make the following orders:

1) I order that the bank account of both be blocked and seized ELECTRONICALLY.

2) The application from these individuals for DISMISSAL be dismissed in order to implement this action . . .

7) The BANCO CENTRAL shall be served with a copy of this decision, for the purposes set out in page 104 [of the petition].

8) A copy of this decision shall be sent by official letter to the Honourable JUSTICE NANCY ANDRIGHI, with a direction that the Trustee deliver the appropriate documents.

The Registry Office shall be notified that, due to the fact that the proceedings have been ordered to be heard IN CAMERA in the Cayman Islands, only interested parties shall have sight of and free access to the court papers, along with their legal representatives . . .”

Relevance of Judge Beethoven’s judgment of August 2010 to the plaintiffs’ case

229 I must make a number of relevant findings and observations here about this judgment by way of expansion on conclusions already recorded above.

230 First (and without intending any criticism of the judgment), its obvious far-reaching effects against Katia Rabello, going far beyond anything that this court could have contemplated when granting the *Norwich Pharmacal* orders on the *ex parte* basis on which it did.

231 While Katia Rabello was named as a subject of the second *Norwich Pharmacal* application, no indication was given to this court of Dr. Braga’s intention to press, beyond the remit given him by the STJ in respect of Securinvest, for the extension of the Petroforte bankruptcy to her personally, by reliance upon the Cayman disclosure.

232 Had that intention been disclosed to this court, a different view may well have been taken of the making of the gagging orders which were sought and granted and which resulted in the Cayman disclosure being

released from this jurisdiction to Brazil entirely without notice to her (or to any other plaintiff).

233 Indeed, the specific basis upon which Dr. Braga was granted *Norwich Pharmacal* relief was emphasized by this court in the May 2011 judgment where (at paras. 100–101) is noted the following:

> "In response to those criticisms [as to his lack of standing to bring the applications], Dr. Braga also presented an alternative argument—developed in his third and fourth affidavits—to the effect that he would, in any event, have been entitled as officeholder over the Petroforte Bankruptcy, to investigate the alleged 'economic group' connection with Securinvest and so entitled to Norwich Pharmacal relief in any event in that capacity, whether or not he remained as Administrator over Securinvest.
>
> I am obliged to explain that that is not a premise that I would have accepted given the clearly different basis on which he obtained the Norwich Pharmacal relief in his capacity as office holder over Securinvest."

234 Thus, it was clearly not within the contemplation of this court that Dr. Braga would have been deploying the information against Katia Rabello personally, or against her other interests within the Rural Group apart from against Securinvest itself.

235 Indeed, had such an intention been understood, a different view may well have been taken of the *Norwich Pharmacal* applications being allowed to proceed *ex parte*, in the first instance.

236 The very need for the gagging orders themselves would have been seen in a different light, orders which, in any event, could hardly have been necessary to ensure the compliance of CIBC and Equity Trust. Yet, it ought to have been apparent to the defendant that Katia Rabello was at risk of the actions to be taken in Brazil by Dr. Braga, once armed with the Cayman disclosure. She was in fact specifically named as a subject of the second *Norwich Pharmacal* application addressed to CIBC and which sought the wider disclosure about her financial affairs (including the note transaction involving Arnage and Brooklands on which the defendant itself had advised). This wider disclosure—described by this court as being of the unwarranted *Bankers Trust* type,[69] had not been authorized by

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69 Citing *Bankers Trust* v. *Shapira* (9), the leading case on the principles governing *ex parte* disclosure of financial information which may lead to the location or preservation of assets or where there is a risk of dissipation of assets. The principles are discussed in the May 2011 judgment (2011 (1) CILR 402, at paras. 63–78).

the STJ and was found by this court,[70] upon the eventual review of the *Norwich Pharmacal* orders, to have been improperly obtained.

237 What the defendant ought to have realized then may now be but a secondary consideration—foreseeability not being a requirement for liability for breach of fiduciary duty.[71] Its understanding then of the situation is, however, now relevant (assuming as I have found,[72] that Katia Rabello was a client), to the issue of its actual breach of duty, in acting as it did against her and her interests on behalf of Dr. Braga.

The plaintiffs' loss of opportunity to respond to the *Norwich Pharmacal* applications and the May 2011 judgment

238 The defendant's actions also go to Katia Rabello's loss of opportunity to respond to the *Norwich Pharmacal* and CR(P)L applications, and to do so before the Cayman disclosure was allowed to leave this jurisdiction.

239 Anticipating an adverse conclusion on this aspect of the case—in particular as to the alleged breaches of duty owed to Katia Rabello—the defendant's response, *per* Mr. Simpson, is essentially that there is in any event no proven causation of loss because Katia Rabello would have been (and might yet be),[73] released from the Petroforte bankruptcy if Securinvest itself had been (or is ultimately) released.

240 In other words, that no loss was caused which would not have been caused once her status as UBO became known to the Brazilian courts.

241 But this is hardly an effective response given that, even if the defendant is correct in this supposition, the fiscal harm which will have been caused in the meantime to her interests will be undeniably significant. This fiscal harm would have occurred over many years of litigation, arising from legal costs, as well as the restraint and alienation of her assets. Regard must also be paid to the adverse intervention by the BCB upon Banco Rural, alleged by Katia Rabello to have been also caused by the Cayman disclosure.

242 Regrettably, also now to be factored in, and as is also now apparent from hindsight, Dr. Braga's representations to this court that there was a risk of dissipation of assets as a basis also for the gagging orders and rapid *ex parte* disclosure, were not true.

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70 In its May 2011 judgment (on which in this context, see further below).
71 As will be discussed further below.
72 And as will be more fully explained below.
73 Referring her to Katia Rabello's appeal which is still to be finally resolved by the STJ.

243 This is confirmed, as shown above from Judge Beethoven's judgment of October 28th, 2010, by the earlier appointment of the manager/receiver over all Securinvest assets.

244 And so, by hindsight, it is also now apparent that Dr. Braga's real reason for wanting to shut the plaintiffs out of the Cayman proceedings was to steal a march on those, beyond Securinvest itself, against whom he intended to extend the Petroforte bankruptcy and in so doing seize their assets.

245 Had this court not been misled in relation to the need for secrecy and urgency, again it is highly probable that it would not have proceeded on the entirely *ex parte* basis, nor granted the *Norwich Pharmacal* orders in the terms that it did.

246 Katia Rabello (and, where applicable, other plaintiffs) seek, and are in my view entitled, to rely on this high probability now to ground their claims for breaches of duty and consequential loss.

247 These conclusions, while far-reaching as regards the breach of duties and so potentially detrimental to the defendant's defence on causation, I am satisfied can safely be reached now despite the fact that this court, upon its review of the *Norwich Pharmacal* orders, decided that some of the Cayman disclosure had been properly granted, even while deciding that much of it had not.

248 As explained in the May 2011 judgment, this court was then hearing the matter on the basis of specific criticisms then raised by the plaintiffs in respect of Dr. Braga's conduct in the Cayman proceedings. It then did not have the benefit of hindsight it now has in relation to important aspects of the plaintiffs' case. In summary the concerns which were then addressed were as follows.

1. The first and pivotal question (already touched upon in passing above) was whether Dr. Braga had proper standing for making his applications to this court for any of the Cayman disclosure. As explained at para. 42 (i) of the May 2011 judgment:

> "Dr. Braga's alleged misrepresentation to this Court as to the nature, meaning and effect of the Suspension—that is the Stay Order of the 22 September 2009 of the STJ, as ratified and confirmed by the STJ on 7 May 2010.
>
> As a corollary to this, the alleged misrepresentation by Dr. Braga as to his status as officeholder over Securinvest in light of the suspensive meaning and effect of the Suspension.
>
> And, as a further corollary, Dr. Braga's alleged misrepresentation to this Court as to his authority to act in the Cayman Islands as the

equivalent of trustee in bankruptcy of Securinvest—the basis upon which he obtained the Norwich Pharmacal Orders."

249 On this issue, this court found, in summary, that Dr. Braga did not misrepresent to the court his status as judicial administrator over Securinvest at the time of his applications for *Norwich Pharmacal* relief. It was accepted that he was authorized by the STJ and so had standing to bring the applications.

250 The second issue:

"Dr. Braga's alleged non-disclosure of the Revocation Suit which he had instituted in respect of the SOBAR transaction and which he had failed to pursue; instead seeking to extend the Petroforte Bankruptcy to Securinvest and other Rural Group entities.

Brazilian law. As a further corollary, the alleged failure of Dr. Braga to disclose to this Court, Securinvest's defence to the SOBAR fraud allegations."

251 In essence, Dr. Braga's response to these criticisms was that he was under no obligation to disclose the revocation action and discuss its implications with this court because that was all irrelevant to Securinvest's appeal which was then before the STJ and which was the basis upon which he had been directed to investigate the UBO of Securinvest in this jurisdiction.[74] Further, that Securinvest had been placed into the Petroforte bankruptcy, not on any basis of judicial finding of fraud (the subject-matter of dispute enjoined in the revocation action) but on the basis of findings of fact by the lower courts of a common economic group between Securinvest and Petroforte. And moreover, that these were findings of fact which were not to be reversed on appeal to the STJ, which was concerned only with the *legal basis* for the extension of the bankruptcy.

252 This meant, therefore, that the factual conclusions reached by Judge Beethoven at first instance and affirmed by the TJSP were unassailable. And this was though the implication was that the underlying factual allegations of fraudulent collusion between Sabino Rabello and Ari Natalino must have been accepted and acted upon by those courts, without either the Rabello interests or the Natalino interests having had the opportunity to respond to those allegations.

253 That having been the basis upon which the issue of the revocation action was addressed by Dr. Braga upon the review by this court at paras.

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74 It must be noted that when it suited him, Dr. Braga argued differently to the effect that he was entitled to use the Cayman disclosure to advance the revocation action and for the recovery of assets generally. See the May 2011 judgment.

106–110 of the May 2011 judgment, the following conclusions were reached:

> "If this [the narrow legal basis for appeal to the STJ] is correctly taken as precluding Securinvest's assertion before the STJ that it has a factual defence to the allegations of fraud upon which the extension of bankruptcy has been made to it, then Dr. Braga could have had no obligation to bring such a factual defence to the attention of this Court when making the Norwich Pharmacal application . . .
>
> I do not consider that Dr. Braga had a duty to disclose any more than the fact of the existence of the Suspension and the appeal before the STJ . . .
>
> Whether, as a matter of Brazilian law and procedure, it was permissible and fair for Dr. Braga to have instituted the Revocation Suit in respect of the SOBAR transaction, then elected not to pursue those proceedings, opting instead by ex parte proceedings before the same Court to seek and obtain the extension of the Petroforte Bankruptcy to Securinvest; is not a matter upon which this Court can properly seek to pass judgment. That issue is for the Brazilian Courts to determine. It would therefore have been irrelevant to the question whether the Norwich Pharmacal relief in aid of the Bankruptcy proceedings should have been given by this Court."

254 Those conclusions were reached specifically and only in the context of this court's review of the Cayman disclosure in response to the STJ's mandate to Dr. Braga in relation to Securinvest. Those conclusions in no way anticipated or condoned the use of the Cayman disclosure against Katia Rabello herself or against any other Rabello interest. That was not the subject which was before this court for review.

255 All I think I need repeat for emphasis now with the benefit of hindsight—not only from the point of view of the extension of the Petroforte bankruptcy to Securinvest as considered in the May 2011 judgment but also especially, and differently, as regards its extension to Katia Rabello and her interests—is that it is highly probable that her concerns that the allegations of fraud should first have been resolved in the context of the revocation action before the Cayman disclosure was released for deployment against her in Brazil, would have been regarded by this court as relevant and persuasive. Had she been afforded the opportunity to make that case, it is also highly probable that Dr. Braga would not have been able to force her into the Petroforte bankruptcy without having first resolved the revocation action (which remains unresolved).

256 As already mentioned, this is an important aspect of the loss of opportunity of which she (and by association the other plaintiffs) now complain.

257 In the absence of written reasons from this court for the grant, *ex parte*, of the *Norwich Pharmacal* orders, it must be assumed that the allegations of fraud, albeit then as yet unproven, would have been of central importance to the deliberations of this court when granting those orders.

258 Indeed, at para. 120 of the May 2011 judgment, following the *inter partes* review, the following finding—reflective of the basis for the exercise of the *Norwich Pharmacal* jurisdiction itself—appears:

> "In light of what has been brought to the attention of this Court about the allegations of wrong-doing in Brazil by the use of Securinvest for the fraudulent stripping away of Petroforte Bankruptcy assets, the Defendants [*i.e.* Equity Trust and CIBC] may be regarded as having become innocently 'mixed-up' in those allegations by their arrangements with the Applicants which enabled the impugned transactions to remain concealed."[75]

259 Katia Rabello's inability, for want of notice, to have addressed this issue of fraud in the first instance before this court (and consequently it seems, to address it proactively as it remained to be resolved in the revocation action or in any other forum) in her own defence, is another important aspect of the loss of opportunity of which Katia Rabello now complains and which goes properly, in my judgment, to the issue both of the defendant's breaches of duty as well as to their consequences. These are issues to be more closely examined below.

260 Here I can conclude that had Katia Rabello been given the opportunity to address this court on these matters, it is highly probable that, at the very least, clear and strict orders would have been made to preclude Dr. Braga's deployment of the Cayman disclosure against her personally in the Petroforte bankruptcy, or its disclosure to the BCB to be deployed against Banco Rural—matters which went well beyond the mandate given to Dr. Braga by the STJ.

261 It is safe to arrive at that conclusion now precisely because neither of those uses of the Cayman disclosure was either contemplated or expressly allowed by the *Norwich Pharmacal* orders.

262 For completeness, I will also examine the third, fourth and fifth

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75 See also 2011 (1) CILR 402, at para. 52 (where the analysis proceeded expressly on the basis that the allegations of fraud were as yet unproven but nonetheless sufficed for the grant of *Norwich Pharmacal* relief.

aspects of the plaintiffs' complaints to this court at the time of the *inter partes* review:

2. Dr. Braga's alleged breach of the express *undertakings given to this court upon the grant of the CR(P)L orders for disclosure of the confidential information belonging to Arnage and Brooklands and so relating to or belonging to their ultimate legal and/or beneficial owners. Related to this, Dr. Braga's alleged breaches of the implied undertakings given to this court upon seeking and obtaining the Norwich Pharmacal orders.*

263 In this regard Dr. Braga had indeed given undertakings (both expressed and implied) not to use and file copies of any of the Cayman disclosure for any purpose other than (i) for complying with the order of the STJ; (ii) for the institution and prosecution of any proceedings relating to the Petroforte estate either in Brazil or overseas; or (iii) his investigation regarding the UBO of Securinvest.

264 The evidence reveals that while Dr. Braga did not himself disclose the Cayman disclosure to the BCB, he did persuade Judge Beethoven to direct that that be done for the purpose of expanding the reach of the Petroforte bankruptcy over Banco Rural.[76]

265 It was found by this court from the evidence then available, that his breaches of the undertakings did not rise to the level of proof required for a finding of contempt.[77] However, this court remarked upon his failure to honour the *spirit* of the undertaking in these terms:

> "While the Court must express its disappointment at Dr. Braga's failure to honour the spirit of the Undertakings by taking reasonable measures available to him to protect the confidential information, I am obliged to conclude that he is not shown to have breached the terms—expressed or implied—of the Undertakings.

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76 Dr. Braga's petition to the Bankruptcy Court, dated October 25th, 2010, submitted:
"Petition official letters be addressed to the Central Bank of Brazil for the purposes of acknowledging the transactions of Securinvest Holdings along with the Rural/Petroforte Group, as well as knowing that its actual owner is Katia Rabello. Also, that its shares from Banco Rural and other companies shall be attached and collected by the bankrupt estate. (Law 6.024, on 03/13/74). In the same way, it needs to acknowledge that it is the Rural Group, and personally Ms. Katia Rabello that are behind the companies listed in that evidence."

77 As discussed at paras. 88–136 of the May 2011 judgment (2011 (1) CILR 402).

> In reality, the circumstances of this case emphasize the need for great circumspection (already recognized in the *Codelco* case (above),[78] in the granting, on the ex parte basis, of discovery orders in aid of foreign proceedings; in particular where discovery is to be the consequence of Norwich Pharmacal type applications in aid of foreign proceedings."

266 All the more reason, say the plaintiffs, why it was wrong in all the circumstances then prevailing for the defendant to have acted against them on behalf of Dr. Braga and to have obtained the gagging orders preventing them from making a timely and effective response to his applications.

267 The plaintiffs' case in this regard is firmly grounded in high judicial authority. In *National Comm. Bank of Jamaica Ltd.* v. *Olint* (50) Lord Hoffmann said on behalf of the Privy Council ([2009] 1 W.L.R. 1405, at para. 13):

> ". . . [A] judge should not entertain an application of which no notice has been given unless *either* giving notice would enable the defendant to take steps to defeat the purpose of the injunction (as in the case of a *Mareva* or *Anton Piller* order) or there has been literally no time to give notice before the injunction is required to prevent the threatened wrongful act." [Emphasis in original.]

268 His Lordship went on to say (*ibid.*):

> "Their Lordships would expect cases in the latter category to be rare, because even in cases in which there was no time to give the period of notice required by the rules, there will usually be no reason why the applicant should not have given shorter notice or even made a telephone call. Any notice is better than none."

These standards of care were disregarded by the defendant when it acted for Dr. Braga by proceeding on the *ex parte* basis on which it did, its failings exacerbated in the circumstances then prevailing, by the absence of urgency or any risk of destruction of evidence or dissipation of assets.

3. The question whether or not Dr. Braga was obliged to seek recognition and authorization to act in the Cayman Islands pursuant to Part XVII of the Companies Law (assuming he was properly to be regarded as a foreign representative of a bankrupt estate) instead of bringing an application for Norwich Pharmacal relief as he did.

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78 Reported as *Deutsch-Südamerikanische Bank A.G.* v. *Codelco* (22).

269 Here the argument[79] was that Dr. Braga, acting as a foreign court-appointed trustee as he claimed to be, was obliged to seek recognition and authorization to act in the Cayman Islands pursuant to Part XVII of the Companies Law, instead of bringing an application for *Norwich Pharmacal* relief as he had done.

270 Given the specific and limited mandate of the directions issued to him by the STJ to investigate the UBO of Securinvest, this argument was not accepted by this court in the May 2011 judgment. Rather, it was held that there was no requirement to obtain recognition and enforcement of his appointment generally within the jurisdiction as he was not, for example, required to search for and recover assets.[80] This was notwithstanding that the defendant sought and obtained on his behalf the wider disclosure which could only have been justified on the *Bankers Trust* principles (below) by a mandate of that kind as discussed next below.

4. Other issues of principle relating to the seeking and obtaining of Norwich Pharmacal relief or related Bankers Trust relief[81]—which (further relief by way of disclosure) was also given as part of the Norwich Pharmacal orders.

271 It was here that this court most directly criticized the application for the wider disclosure which had been made by the defendant on behalf of Dr. Braga and which went far beyond the disclosure of Katia Rabello's status as UBO of Securinvest. At paras. 72–74 of the May 2011 judgment, the following conclusions were expressed in this regard:

> ". . . In my view, there simply was no basis for thinking that the information sought by those means could assist with locating and preserving assets which had been fraudulently diverted away from the Petroforte estate.
>
> 73 Any such allegation up to the time of the applications before this court (May 27th, 2010 and July 2nd, 2010) centered around the SOBAR transaction. Yet the assets involved—the ethanol plant and sugar cane plantations—had long since been under the control of Dr. Braga through the extension of the bankruptcy to Securinvest, Turvo, Agroindustrial and Kiaparack in August 2007 (see the first affidavit of Dr. Vasconcellos, para. 77(iv)). No other 'assets' to which a risk of dissipation attends have been identified.
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> 74 The substantive disputes between the parties have been ongoing in open court in Brazil for several years. Accordingly, it cannot

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79 As set out at para. 37(d) of the May 2011 judgment.
80 See paras. 86–87 of the May 2011 judgment.
81 *Bankers Trust* v. *Shapira* (9).

> properly be maintained that there was any urgent need for the *Bankers Trust* type relief here to prevent the dissipation of assets. The fact that there has been no subsequent need for *Mareva* injunctive orders (to freeze assets identified) and no allegedly hidden assets disclosed, is strongly indicative of the fact that the *Bankers Trust* relief was never likely to have achieved its permissible objectives."

272 As already mentioned, the plaintiffs (Katia Rabello in particular) became aware of the Cayman disclosure having been obtained only after it was deployed in Judge Beethoven's court in Brazil against them. This was also after the orders were made placing Katia Rabello's assets into the Petroforte bankruptcy and referring the matter to the BCB for investigation.[82]

273 The Cayman disclosure was also later placed before the STJ by Dr. Braga (he was directed to do so by Judge Beethoven)[83] and the STJ itself—even while making no express reference to the Cayman disclosure but having adjourned for the specific purpose of obtaining it—must have relied upon it to lift the stay ("suspension") of the operation of the Petroforte bankruptcy over Securinvest and to dismiss Securinvest's appeal.

274 This reliance by the STJ will go ultimately to the question of causation of loss and is clear enough from the following analysis.

275 While alluding to and noting the significance of the Cayman disclosure,[84] Justice Andrighi (in her judgment on behalf of the STJ) emphasized that matters of fact were for the courts below, thus:

> "The characterization of a union of companies, in turn, is more than anything else, a factual matter. For that reason, whatever the [Lower] Court decided in that respect cannot be revised in this office [court] by virtue of the obstacle of the Abridgement of Law 7/ Court of Appeals."[85]

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82 See para. 171(vi) of the statement of claim.
83 See "OPERATIVE PART," item 8 at p. 11 of his judgment of October 28th, 2010.
84 Stating at different points for instance that: "It is also asserted [by Dr. Braga] in short, that SECURINVEST itself, whose members/partners/stockholders . . . are two companies with headquarters in a tax haven, would immediately be a member of the Rural Group. It is through that perspective that this appeal shall be judged" and that ". . . the corporate chain described in this process, is not only with regard to the agro-industrial complex SOBAR, but in relation to diverse other assets, shows the existence of a modus operandi which offers evidence of one group of companies (GRUPO SECURINVEST, whether or not it is a member of the more extensive GRUPO RURAL), on the other (PETROFORTE)."
85 *Ibid*.

276 This, as Mr. Simpson, correctly in my view, emphasized on behalf of the defendant, meant that the STJ did not retry the factual issue whether or not there was in existence a common economic group. Instead the STJ deferred to the findings of the lower courts in that regard.

277 But it is clear that it was only after seeing the Cayman disclosure that the STJ was content to defer to the findings of the lower courts (originally by Judge Beethoven but expanded upon by the TJSP by its invocation of the common economic group legal theory).

278 This meant (as Mr. Simpson emphasized throughout the hearing) that the extension of the Petroforte bankruptcy which had been ordered before the Cayman disclosure was obtained, was therefore not a result of the Cayman disclosure obtained by the defendant on behalf of Dr. Braga.

279 If this is correct, then the defendant's actions could not have caused the plaintiffs' losses.

280 A different conclusion is reached, however, on the more likely analysis that the STJ would have released Securinvest from the Petroforte bankruptcy but for the Cayman disclosure, especially the disclosure of Katia Rabello's status as UBO.

281 It is therefore important that I here lay down yet another marker.

282 It is that the question whether the STJ relied upon the Cayman disclosure, and if so to what extent, for the dismissal of Securinvest's appeal remains a disputed question of fact which was not given to determination by me on the basis of this application for summary judgment on liability.

283 Rather, it is a factual dispute which in my view did not have to be resolved now in order to establish liability for breach of duty. However, it still properly remains to be examined and resolved as a question of causation of loss at the next stage.

284 It is a question which will need to be answered in that context but only if Katia Rabello can show that Securinvest would have been released from the Petroforte bankruptcy had it not been for the Cayman disclosure.

285 This will be a difficult hurdle for her to overcome when it is recognized that she was herself under a legal (one might even say moral) obligation to disclose the truth about her status as UBO to the STJ and that status was (on correct *prima facie* analysis in my view) the ultimate reason for the STJ's refusal of Securinvest's appeal.

286 As already mentioned above, it is also in this respect that Mr. Simpson invokes the *ex turpi causa* defence. It goes to the effect that Katia Rabello's case depends upon her having been entitled to mislead the STJ by her lie.

287 Otherwise, she would be required to accept that the extension of the Petroforte bankruptcy to Securinvest (and he also contends ultimately to herself) was the result of her status as UBO being revealed to the Brazilian courts. This, he submits, she was obliged to disclose and so may not claim for damages from the defendant because it brought about the disclosure. Any other competent attorney would have been obliged to take the same actions, said Mr. Simpson. Thus, the same outcome was inevitable.

288 And moreover, the argument goes, Katia Rabello cannot claim to have suffered any loss as the result of the Cayman disclosure, even if it was relied upon by the STJ for dismissing Securinvest's appeal—the loss was the result of her own misconduct in trying to obfuscate the "fraudulent" relationship between Securinvest and Petroforte.

289 While I have rejected the *ex turpi causa* defence as a basis for striking the plaintiffs' claims (especially those of Katia Rabello), I must note that in any event, it could not serve as a defence to *all* of the plaintiffs' claims, some of which—such as the claims for loss of opportunity discussed above—in no sense depend upon Katia Rabello's lie to the STJ or upon any other form of illegality.

290 Given the various and complex bases upon which liability for loss is claimed by the plaintiffs, it sufficed, in my view, for the grant of summary judgment that liability for loss was established in at least some areas.[86] These include, as I will come to discuss further below, the placing of Katia Rabello herself into the Petroforte bankruptcy. I will also consider the provision of the Cayman disclosure to the BCB which is pleaded as resulting in regulatory action against Banco Rural (of which Katia Rabello was a major shareholder) and ultimately its demise.[87]

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86 *Lunnun* v. *Singh* (43) (to be further discussed below).

87 See the statement of claim, para. 15. And, for instance as regards action taken against Banco Rural despite the recall by this court of the Cayman disclosure from the BCB, an English translation of an Attorney General's ruling of March 2012, on the use of the Cayman disclosure by the BCB (submitted with the second affidavit of Nicholas Dunne on behalf of the Defendant) and which confirms that the Cayman disclosure was used as "reputable evidence to support an administrative proceeding for punitive damages against Banco Rural and Ms. Katia Rabello due to violation of the provisions set forth in Article 34, V of Law No. 4595 of 1964."

291 In this regard, the record shows for instance[88] that Katia Rabello was herself the subject of administrative proceedings by subpoena taken by the BCB in relation to Banco Rural's provision of funding to Securinvest. If not exactly the same as by way of the note purchase transaction, these provisions were certainly of that kind. In those proceedings, the BCB sought orders for the recovery of "punitive damages" against Banco Rural and against Katia Rabello, personally.

292 This BCB subpoena went on at length to cite and quote from Judge Beethoven's decision of October 29th, 2010 against Katia Rabello, making it plain that the BCB was relying not only upon his findings but also upon the Cayman disclosure referenced by the judge and sent by him to the BCB at Dr. Braga's behest (and contrary to the spirit of Dr. Braga's undertakings given to this court, as discussed above).

293 It has not yet been established before me what fiscal penalties were imposed upon Katia Rabello arising from this subpoena (or from any other measure taken against her by the BCB) but it is *prima facie* clear that a link between the defendant's breach and the BCB's actions is established and that some loss was caused.

294 This finding too will suffice for summary judgment on liability, as will become clearer from the discussion of the case law below.

295 But I emphasize here again, that the full extent of any loss must be a matter for assessment at the trial of quantum.

Sanction of settlement proposal granted by Judge Beethoven but resisted by Dr. Braga

296 The evidence also reveals that after the case was referred back to Judge Beethoven's court by the STJ,[89] a settlement proposal in relation to Katia Rabello's and Securinvest's bankruptcy (as part of the Petroforte bankruptcy) was propounded before the judge. The judge (after what

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88 That by reliance on the Cayman disclosure, Katia Rabello was subpoenaed, in prosecution of the administrative proceedings for punitive damages by the BCB in respect of "irregularities" committed by her as President of Banco Rural namely,

"Granting prohibited loans to corporations banned from operating with the institution, since the respective corporate control belongs to companies established in tax havens, and of which you are the owner and ultimate beneficiary, while acting as the Director and Board Member of the said financial institution,"the subpoena continued under "Description of events":

"Banco rural S.A granted credit operations to Securinvest Holdings s.a., a company registered with the Brazilian Registry of Legal Entities—a company controlled by two companies incorporated and organized under the laws of the Cayman Islands: Arnage Holdings and Brooklands Holdings . . ."

89 After the rejection of Securinvest's appeal.

seems to be characteristic peroration) approved of the proposal which would have resulted in the release of the non-Sobar assets, referring to the wider effects of the bankruptcy as "offensive" to his court, and as "unjust enrichment" for the Petroforte estate.[90]

297 This judgment of Judge Beethoven's was, however, appealed against by Dr. Braga to the TSPJ and was overturned. Katia Rabello and the other Rural Group interests have appealed further to the STJ, where a final judgment on the settlement proposal is awaited.

Summary of claim

298 In summary, the plaintiffs' claims are as follows:[91]

> 8. Despite the quarter of a century relationship of trust and confidence between the defendant and the Rabello family summarized above (including the specific instruction of the defendant in relation to confidential information relating to Cayman Islands companies being sought by authorities in Brazil), from about May 2010 the defendant betrayed that trust by disloyally acting on behalf of Dr. Braga . . . as judicial administrator over the bankruptcy estate of Petroforte . . . in obtaining extensive disclosure of confidential information relating to the plaintiffs through the *ex parte Norwich Pharmacal* proceedings.
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> 9. The *Norwich Pharmacal* proceedings expressly sought very broad disclosure of documents. At all material times, the defendant knew that Banco Rural and Rural Leasing were directly and/or indirectly owned and controlled by the Rabello family (including Ms. Katia Rabello) and that the material sought was both confidential and sensitive and that the Rabello family would not want such information to be

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90 That

". . . what is certain is that the plea is ready to be accepted. It is offensive to this court that the Bankrupt parties be requested one penny more than what is correctly owed. Continuing in the unlimited accountability of the bankrupt parties, since the main object of the babbling [*sic*] is already in the possession of the Court, is a thesis that does not sail in calm seas. There is a principle that should apply to all human relations: the prohibition of unjust enrichment . . . based on these principles, there is no doubt in the decision for the acceptance of the request . . . the humble magistrate does not have reasons to continue ad infinitum with the persecution of the assets of the bankrupt parties when there is already the main company which was the object of the initiatives from the Public Audit Office . . . [*i.e.* Sobar]."

91 As taken from paras. 8–17 of the statement of claim.

disclosed to the Brazilian authorities which could cause great damage to the plaintiffs.

10. The disclosure obtained by the defendant on behalf of Dr. Braga included numerous confidential documents relating to the defendant's former clients, Arnage, Brooklands and Mr. Sabino Rabello, including both confidential documents created by the defendant and work product produced by the defendant on behalf of those clients.

11. The disclosure also contained numerous confidential documents relating to the defendant's then existing clients, Ms. Katia Rabello and Mr. Fernando Toledo.

12. Furthermore, the disclosure contained numerous confidential documents relating to the ownership and commercial operations of TLB and demonstrating commercial connections between TLB and the Rabello family in circumstances where the defendant was, at the same time, expressly engaged by, *inter alia*, Ms. Katia Rabello in connection with Brazilian criminal proceedings concerning the alleged joint ownership of TLB and Banco Rural by the Rabello family.

13. In summary, the defendant not only acted against its own former and existing clients' interests, it also acted against its existing clients' interests in circumstances where it was simultaneously expressly engaged to seek to protect such confidential information from disclosure to the Brazilian authorities by reason of the great damage which could be caused to the plaintiffs and the Rabello family by . . . such disclosure.

14. Such actions were in serious and flagrant breach of the defendant's fiduciary, contractual and tortious duties to the plaintiffs and were also a gross breach of confidence.

15. The consequences of the defendant's breaches have been catastrophic for the plaintiffs. The disclosure of confidential documents relating to the plaintiffs has in turn led to multiple legal proceedings in various countries, a BCB investigation and extremely harmful publicity in Brazil. In turn, this has:

    (i) severely impaired confidence in the value of Banco Rural, having a devastating impact upon its operations, and has ultimately led to Banco Rural being taken over by the BCB and being placed into compulsory liquidation; and

(ii) resulted in Ms. Katia Rabello's assets being frozen in the Petroforte bankruptcy in Brazil.

16. Further, following the disclosure of the confidential information and documents, the defendant continued to aid and abet Dr. Braga in his improper efforts to pursue alleged offshore assets held by the Rabello family and related entities as well as Brazilian assets which were never part of the Petroforte estate but which are in jeopardy as a result of the defendant's breaches.

17. The defendant's breaches are likely to result in losses of over US$500m. being sustained by the plaintiffs.

Discussion on the four elements to be established for grant of summary judgment

299 Against the background of the foregoing factual explanation of the plaintiffs' case, I will now consider in turn, each of the four elements they must establish, and the applicable legal principles, for the grant of summary judgment.

The existence of the lawyer–client relationship

300 The first, of course, is the existence of the lawyer–client relationship in respect of each plaintiff and the concomitant duties which arose.

301 Both sides agree that the identification of the lawyer–client relationship is an exercise to be undertaken by an examination of all the circumstances of the case.

302 As was stated persuasively by the Ontario Superior Court of Justice in the recent case of *Trillium Motor World Ltd.* v. *General Motors of Canada Ltd.* (72) (2015 ONSC 3824, *per* McEwen J., at para. 417):[92]

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92 In the case, the question was whether the well-known Canadian law firm of Cassels Brock & Blackwell LLP had been retained by the Trillium parties (a group of General Motors car dealerships) and had acted in breach of its fiduciary and contractual duties owed to them by, at the same time, having acted for a Canadian Government entity which regulated the relationship between Trillium and the then distressed General Motors and whose interests were adverse to those of the Trillium parties. The lawyer–client relationship was found to have existed and that Cassells had acted in breach of its duties without having first notified the Trillium parties of its conflict of interests and obtained their consent to act for the Canadian Government (which consent would not have been given). Compensation for the breach of duties in the amount of CA$45m. was awarded to the Trillium parties.

> "The existence of a solicitor–client relationship is a fact-driven and multifaceted analysis. Sometimes, it will be readily apparent that a retainer exists. Other times, a careful examination of the facts must be undertaken. The court must take a holistic approach to the question at hand, considering the evidence in its totality . . ."

303 Earlier in the judgment (at paras. 411–413), the following very helpful *dicta* appear in relation more specifically to the analysis of the issue "Was there a retainer?" This *dicta* was cited and accepted by both sides in the arguments before me as appropriate for adoption and application here. I agree and so set it out fully, as it deserves:

> "[411] The solicitor-client relationship is based on general concepts of contract and the specific contract of a retainer: *Filipovic v. Upshall* (2000), 2000 CanLII 26971 (ON CA), 133 O.A.C. 151 at para. 5 (C.A.). Whether a solicitor-client relationship exists is a question of fact. There is no need for a person to formally retain a lawyer by way of letter or other document. Nor is it necessary that an account be rendered or a bill paid. Rather, a court must look to a number of factors to ascertain whether such a relationship exists.
>
> [412] Justice Hawco helpfully identified twelve relevant indicia in *Jeffers v. Calico Compression Systems*, 2002 ABQB 72, 314 A.R. 294 [*Jeffers*]. Both parties agree that these indicia are accurate and apply to this case. They are as follows:
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> (i) a contract or retainer;
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> (ii) a file opened by the lawyer;
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> (iii) meetings between the lawyer and the party;
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> (iv) correspondence between the lawyer and the party;
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> (v) a bill rendered by the lawyer to the party;
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> (vi) a bill paid by the party;
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> (vii) instructions given by the party to the lawyer;
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> (viii) the lawyer acting on the instructions given;
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> (ix) statements made by the lawyer that the lawyer is acting for the party;
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> (x) a reasonable expectation by the party about the lawyer's role;
>
> (xi) legal advice given; and
>
> (xii) any legal documents created for the party.
>
> [413] Not all indicia need to be present. Rather, as Hawco J. explains at para 8,

> . . . the question appears to be whether a reasonable person in the position of a party with knowledge of all the facts would reasonably form the belief that the lawyer was acting for a particular party.
>
> Further, the twelve indicia are not exhaustive. Depending on the facts of the case, other indicia may be relevant."

304 I think I need only state here what must be obvious from all the circumstances of this case. This is that, when applied to the facts of this case, the *Trillium* indicia serve to identify each of the plaintiffs, including Katia Rabello and Fernando Toledo, as clients of the defendant. I simply make reference here again, by way of illustration, to the discussion of the circumstances pointing to the lawyer–client relationship undertaken above, especially at paras. 134–140.

305 And specifically in relation to "other *indicia*"—these could include, as the case law reveals, a situation where a lawyer acts for a company knowing that its interests are identical to or closely aligned with the interests of its beneficial owners who themselves come to depend upon the lawyer–client relationship. This is, as explained above, the nature of the relationship contended for by the plaintiffs here.

306 This principle is illustrated by the conclusion reached by the Court of Appeal for England and Wales in *Johnson* v. *Gore Wood* (39) ([1999] BCC at 485).[93] There the issue was whether it was an abuse of process to claim that solicitors engaged by a company and who were alleged to have breached their duty of care by giving negligent advice to the company, also had breached a similar duty of care owed to its controlling shareholders (the plaintiffs). Ward, L.J., giving the judgment of the court, approved the reasoning of Staughton, J. (as he then was), where he had decided on a similar issue in favour of the client and against the solicitors in *R.P. Howard Ltd.* v. *Woodman Matthews & Co. (a firm)* (58) ([1999] BCC at 485):

> ". . . [A]rguments of a very similar nature prevailed in the judgment of Staughton J in . . . [*Howard Matthews*] . . . where the solicitor knew that the company was a family company effectively run by Mr Witchell from whom they received instructions. He held at p 121A:
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> > 'In my judgment, in the circumstances of this case, Mr Witchell as well as the company was the client of Mr Mason. That seems to me to reflect the reality of the situation. Mr Mason knew that

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93 [1999] BCC at 485. The case went further on appeal to the House of Lords where the arguments proceeded on the assumption that the duty of care (found by the Court of Appeal on the strike-out application to have been arguable), could be established ([2002] 2 A.C. 1, at 32C–G (*per* Lord Bingham) and 41E–G (*per* Lord Goff)).

> Mr Witchell . . . was the company. He probably knew that Mr Witchell derived his livelihood and some profit from the company, and was vitally concerned in its well-being. Mr Witchell had first been his personal friend, and had then come to him in connection with other matters for legal advice, both as the representative of the company and in a personal capacity. When Mr Witchell sought his advice on . . . [a matter concerning the company] Mr Mason owed a contractual duty of care both to the company and Mr Witchell.'

And in *Ratiu* v. *Conway* (60) ([2005] EWCA Civ 1302, at para. 80):

> "Nor, in my view, should it matter in principle, where a fiduciary duty is engendered by a contractual relationship, whether the client has entered into a direct contractual relationship with the fiduciary or through an agent or, in the case of a corporate client, through the use of a nominee company . . ."

307 Another fundamental issue in *Johnson* v. *Gore Wood* (39) was whether Mr. Johnson should have been allowed to bring claims for losses in his personal capacity as shareholder which were not merely reflective of the losses claimed by his company (which latter claims had been the subject of an earlier settlement between the company and the solicitors).

308 In holding that certain of his claims were not merely reflective of the company's losses and so not prone to being struck out on that basis for being an abuse of process, the Court of Appeal also acknowledged that a separate lawyer–client relationship had developed as between Mr. Johnson and the solicitors.[94] It followed that, subject to Mr. Johnson showing that the damage complained of was caused by the solicitors' breach of duty and was not too remote, he was entitled in principle to recover any damage which he had himself suffered as a personal loss separate and distinct from any loss suffered by the company.[95] Like in this case, the proof of his

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94 Lord Bingham records ([2002] 2 A.C. at 35C), that it was accepted for the purposes of the application to strike out the damages claim that the solicitors Gore Wood & Co., owed a duty to Mr. Johnson personally and was in breach of that duty.

95 The case is a leading authority on the subject of reflective loss. After a compendious review of the earlier case law, Lord Bingham summarized the principle as it applies to circumstances like those claimed in the case by Mr. Johnson and here, by Katia Rabello and Fernando Toledo in respect of Arnage, Brooklands and EFHL ([2002] 2 A.C. at 35H–36A):

> "Where a company suffers loss caused by a breach of duty to it, and a shareholder suffers a loss separate and distinct from that suffered by the company caused by breach of a duty independently owed to the shareholder, each may sue to recover the loss caused to it by breach of the duty owed to it but neither may recover loss caused to the other by breach of the duty owed to the other."

personal loss depended on the facts to be established at trial and could not have been determined simply on the pleadings.

309 *Johnson* v. *Gore Wood* was later reaffirmed and applied by the English Court of Appeal in *Ratiu* v. *Conway* (60). In *Ratiu* v. *Conway*, the court was called upon to decide whether a contractual retainer, engaged between a company and its solicitors, could give rise also to fiduciary obligations of confidence and loyalty owed to the owners of the company who, despite not being privy to the contractual retainer, had nonetheless also reposed trust and confidence in the solicitors not to act in detriment of their interests.

310 In arriving at their affirmative decision, their Lordships necessarily also had to consider whether the separation of legal identity, as between the company and its owners, precluded the extension of the lawyer–client relationship and its attendant fiduciary obligations. In concluding that the relationship could be extended and affirming the approach taken in *Johnson* v. *Gore Wood*, Auld, L.J. on behalf of the court, expressed the reasoning in the following terms ([2005] EWCA Civ 1302, at para. 78):

> "There is, it seems to me, a powerful argument of principle, in this intensely personal context of considerations of trust, confidence and loyalty, for lifting the corporate veil where the facts require it to include those in or behind the company who are in reality the persons whose trust in and reliance upon the fiduciary may be confounded."

311 The solicitors in *Ratiu* v. *Conway* (60) were thus found to be liable, not only to the company for breach of the contractual obligations arising from the retainer, but also to the owners of the company (another company and its individual shareholders) for breach of the implicit fiduciary obligation of loyalty arising from the trust and confidence that they themselves had reposed in the solicitors, not to act against their interests in order to advance their own.[96]

312 These conclusions of principle are very relevant and applicable to the present case where the defendant seeks to rely upon the separation of legal identities as between the incorporated plaintiffs (Arnage, Brooklands and EFHL) and the individual plaintiffs who are their legal and beneficial owners, as a basis for denying the existence of the lawyer–client relationships with the latter and so the fiduciary obligations as well. Like in *Ratiu* v. *Conway*, the circumstances of this case require the lifting of the corporate veil to prevent the defendant from denying the existence of the relationship of trust and confidence which had clearly developed, not merely between the incorporated plaintiffs and the defendant but also

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96 This they had done by bidding for a valuable property in St. John's Wood, London, in competition with those persons who were found to be their clients.

between the individual plaintiffs (Katia Rabello and Fernando Toledo) and the defendant as well.

313 There is further *dicta* from *Ratiu* v. *Conway* which is of instructive application to the present case in this regard.

314 Reflecting on the fiduciary nature of the lawyer–client relationship, Auld, L.J. stated as follows ([2005] EWCA Civ 1302, at paras. 57–58):

> "As to fiduciary obligation, where better to start than the following treatment by Millett LJ (as he then was) in *Bristol & West v Mothew* [1998] Ch 1, at 18A–C:
>
> '. . . A fiduciary is someone who has undertaken to act for or on behalf of another in a particular matter in circumstances which give rise to a relationship of trust and confidence. The distinguishing obligation of a fiduciary is the obligation of loyalty. The principal is entitled to the single-minded loyalty of his fiduciary. The core liability has several facets. A fiduciary must act in good faith; he must not place himself in a position where his duty and his interest may conflict; he may not act for his own benefit or the benefit of a third person without the informed consent[97] of his principal. This is not intended to be an exhaustive list but it is sufficient to indicate the nature of fiduciary obligations. They are the defining characteristics of the fiduciary. As Dr Finn pointed out in his classic work *Fiduciary Obligations* (1977), p 2, he is not subject to fiduciary obligations because he is a fiduciary; it is because he is subject to them that he is a fiduciary.'
>
> 58. In short, as he was later to put it in *Bolkiah v KMPG* [1999] 2 AC 222 at pp 234H–235A, a fiduciary must not put himself in position of actual or potential conflict with his client without the latter's fully informed consent."

315 The foregoing principles have all come to be enshrined in the Code of Conduct for Cayman Islands Attorneys-at-Law:[98]

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97 Defined in *Clark Boyce* v. *Mouat* (18) ([1994] 1 A.C. at 435) as—

"consent given in the knowledge that there is a conflict between the parties and that as a result the solicitor may be disabled from disclosing to each party the full knowledge which he possesses as to the transaction or may be disabled from giving advice to one party which conflicts with the interest of the other."

98 These rules were adopted after the defendant's acceptance of the Braga retainer but the defendant was nonetheless obliged, at the times relevant to the plaintiffs' claims, to comply with the equivalent duties as set out in the English Rules and recognized at common law in place at the time. The English Rules have been deemed by implication to apply in the absence of local rules: see *In re an Attorney-at-Law* (8), written judgment of this court delivered on July 22nd, 1988, *per* Collett, C.J., where disciplinary sanction was imposed on the basis of conduct measured against the long-standing English principle of "conduct unbecoming" an attorney.

(a) "The relationship between practitioner and client is one of confidence and trust which must never be abused" (r.1.02).

(b) "An attorney's primary duty is to his client, to whom he must act in good faith. He must at all times and by all proper and lawful means advance and protect his clients' best interests without fear or regard for self-interest" (r.1.04).

As the commentary states:

(c) ". . . an attorney has a duty to hold in strict confidence all information concerning the business and affairs of the client acquired in the course of the professional relationship, and may not divulge such information except . . ." in certain specified and closely circumscribed circumstances (see r.1.06).

As the commentary records:

> ". . . confidentiality and privilege of client information are among the prime principles of professional practice. Such information belongs to the client and not to the attorney. Generally any request by a third party for client information held by an attorney should be referred to the client or refused . . . An attorney's duty continues even after the client has ceased to be the attorney's client . . ."

(d) "An attorney must not without the informed consent of such person act or continue to act for any person where there is a conflict of interest between the attorney on the one hand and an existing or prospective client on the other hand; nor similarly may the attorney agree to act for such person when, at the time he takes instructions, it is reasonably foreseeable that such conflict may arise during the course of his doing so" (r.1.11).

As the commentary states:

> "This rule is based on the principle that a person who occupies a position of trust must not permit his personal interests to conflict with the interests of those whom it is that person's duty to protect . . . A potential conflict of interest is a situation which, without care, could well lead an attorney into a breach of fiduciary duty."

316 In summary, it is clear from all the foregoing that, as was neatly stated by Ground, J. of the Ontario court in *Drabinsky* v. *KPMG* (24) (41 OR (3D) 565, at 2):

> "I am of the view that the fiduciary relationship between the client and the professional advisor, either a lawyer or accountant, imposes duties on the fiduciary beyond the duty not to disclose confidential information. It includes a duty of loyalty and good faith not to act against the interests of the client."

Actionable breaches of duty

317 The foregoing analysis and findings on the existence of the lawyer–client relationship (and its attendant duties) lead to the second and third elements of the plaintiffs' case—the existence of the duties in this case and the actionable breaches of those duties. These must now also be established beyond reasonable argument, for the grant of summary judgment on liability. They may also be conveniently examined together.

318 Subject to the lawyer–client relationships being established, it is not surprising that the defendant itself would admit to the existence of the duties. At paras. 32 and 34 of the amended defence, the defendant admits to:

> "● Owing a fiduciary duty to existing clients not to prefer the Defendant's own interests over those of existing clients;
>
> ● Owing a fiduciary duty to existing clients not to prefer the interests of one client over another;
>
> ● Owing a fiduciary duty to existing clients not to put itself in a position where its duty to one client might conflict with its duties to another; and
>
> ● That an attorney should not act if it is in possession of '. . . information that might be relevant to a new client.'"

319 Notwithstanding the obvious ways in which the foregoing admissions would also describe the breaches committed by the defendant in this case, it seeks to avoid that conclusion in relation to Katia Rabello and Fernando Toledo by asserting that they were never its clients.

320 As I have found that assertion to be wrong then the defence has no prospect of success as against Katia Rabello's and Fernando Toledo's claims for breaches of duty.

321 This conclusion is unavoidable in light of the continuing nature of the duty of confidence, when the facts of this case are considered in light of the case law.

322 The reason is neatly expressed in the following statement of principle by the Ontario Court of Appeal:[99]

> ". . . that brings me to what appears to be the rationale for the disqualification of a solicitor who owes conflicting duty to two different clients. The most obvious justification for removal of a solicitor is to uphold the public's confidence in the proper administration of justice. A solicitor cannot properly serve clients opposed in interest, and once having chosen to serve a particular client, will not be allowed to advance the cause of that client in a particular matter at the expense of what he has learned in confidence from the other client interested in the same cause . . . Two other justifications are also given. First, the other client feels aggrieved when his or her former solicitor appears for a party opposed to his or her interest. That client feels a sense of exploitation at having confidentiality communicated to that solicitor or his associate certain confidences and later having to answer . . . in cross-examination in the same or related matter. Of course, this situation also diminishes the general public's confidence in the legal profession . . ."

323 That very practical explanation of the importance of the duty of confidence owed by a lawyer to his client underscores the grievances of the plaintiffs in this case. They rightly say that a duty of confidence had arisen when they imparted their confidential information to the defendant such that the defendant was precluded from acting for Dr. Braga against them and from taking steps to disclose their information to him. The obligation to keep matters confidential is one of the defining features of a lawyer–client relationship.

324 That a duty of confidence had arisen as owed by the defendant to the plaintiffs when their confidential information was imparted to the defendant is indisputable. A duty of confidence arises when confidential information comes to the knowledge of a person in circumstances where

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99 From *R.* v. *Speid* (56) ([1983] O.J. No. 2441, at paras. 18–19). The case law is replete with similar denunciations of lawyers acting in conflict of interests for different clients. See for instance, *Al-Sabah* v. *Maples & Calder* (4), where this court injuncted a firm from accepting a brief which would have required it to act against a former client despite the firm's proposal to erect "Chinese walls" to ensure that information belonging to the former client did not inform those acting for the proposed client; and *Bolkiah* v. *KPMG* (10), where Lord Millett explained ([1999] 2 A.C. at 234) that—

> ". . . a fiduciary cannot act at the same time both for and against the same client, and his firm is in no better position . . . his disqualification has nothing to do with the confidentiality of the client information. It is based on that inescapable conflict of interest which is inherent in the situation."

he has notice, or is held to have agreed, that the information is confidential, with the effect that it would be just in all the circumstances that he should be precluded from disclosing the information to others: see *Att.-Gen.* v. *Guardian Newspapers Ltd. (No. 2)* (7) ([1990] 1 A.C. at 281, *per* Lord Goff).

325 Reflecting further on the nature of the fiduciary duties and obligations of a lawyer, their Lordships in *Ratiu* v. *Conway* (60) also emphasized the fact that they will often survive the expiry of the contractual retainer by which they were engendered ([2005] EWCA Civ 1302, at para. 60):

> "As to a solicitor's duty of confidentiality, it can come into its own as a separate obligation from that of a fiduciary when the fiduciary relationship has come to an end with the end of the solicitor/client relationship. Lord Millett, in *Bolkiah v KPMG*, which was a breach of confidence, not a breach of fiduciary duty, case, sought to emphasise this distinction at 235C:
>
> > 'Where the court's intervention is sought by a former client, however, the position is entirely different. The court's jurisdiction cannot be based on any conflict of interest, real or perceived, for there is none. The fiduciary relationship which subsists between solicitor and client comes to an end with the termination of the retainer. Thereafter the solicitor has no obligation to defend and advance the interests of his former client. The only duty to the former client which survives the termination of the client relationship is a continuing duty to preserve the confidentiality of information imparted during its subsistence.'"

326 In the case at bar, the plaintiffs contend for the survival of the ongoing duties of trust and confidence owed to them as arising from each and every one of the distinct retainers discussed above. These surviving duties were, as set out above, belatedly acknowledged by the defendant[100]

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100 This is although at the earlier stages until this hearing began, the defendant had relied upon the defence of "No confidence in iniquity," averring at para. 27 of its amended defence by reliance on the *dictum* of Wood, V.-C. from *Gartside* v. *Outram* (29) (26 L.J. Ch. at 114) that—

"You cannot make me the confidant of a crime or a fraud and be entitled to close up my lips upon nay secret which you have the audacity to disclose to me relating to any fraudulent intention on your part: such a confidence cannot exist."This was explained by the defendant in these terms (at para. 28):

"The documents disclosed by CIBC and Equity Trust in the Cayman Islands (the disclosure of which, on the Plaintiffs' case led to other proceedings in the BVI, Belize and Florida) showed that Katia Rabello had sought to deceive the STJ as to the beneficial ownership of Securinvest in order to cover up a fraud on the creditors of the Petroforte Estate. They were therefore not confidential."The defendant's belated concession in this regard merely reflects the inevitable outcome, as will be more fully explained when dealing with the *ex turpi causa* defence, below.

but it contends, without explanation (at least at this stage), that the duties were never breached. This is contended notwithstanding the defendant's actions on behalf of Dr. Braga, including, as a stark example, the compulsion of disclosure from Equity Trust and CIBC of the records of the note purchase transaction. This was a transaction in respect of which the defendant advised Arnage and Brooklands (and implicitly Katia Rabello on behalf of her own and her family's interests as beneficial owners). Given the defendant's implicit knowledge that the beneficial interests in Arnage, Brooklands, TLB, Securinvest and Banco Rural (the direct or indirect counterparties to the note purchase transaction) all belonged to the Rabellos, it followed that the defendant owed each of those entities and their beneficial owner, the continuing duty of confidence[101] and obligations of trust and loyalty such that the defendant was precluded from acting for Dr. Braga.

327 In light of the existence of the lawyer–client relationship with Arnage and Brooklands (and in my view by extension with the Rabellos) and its patent conflict of interest in acting for Dr. Braga, the defendant's denial of the breach of duty is completely untenable.

328 The plaintiffs also contend that at the time the defendant accepted the Braga retainer, the defendant was still under the contractual (and attendant fiduciary) obligations of trust confidence and loyalty first engendered by the general retainer which began in 1985 and which continued to subsist on behalf of the Rabello family. Its latest iteration was the August 2009 retainer to protect the "Brazilian defendants" and in respect of which, as we have seen, the defendant continued to advise and rendered bills to Mr. Macaulay,[102] even after the acceptance of the Braga retainer.

329 In this regard, further principles from *Ratiu* v. *Conway* are relied upon by the plaintiffs ([2005] EWCA Civ 1302, *per* Auld, L.J., at paras. 71–73):

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101 Here there is no dispute that the continuing duty of confidence was owed at the time of the Braga retainer to those plaintiffs who were admitted to have been or are found by the court to have been clients. The local case law clearly recognizes the continuing nature of this duty of confidence: *Al-Sabah* v. *Maples & Calder* (4).

102 These bills were issued, as we have seen, in the name of EFHL but only as a matter of convenience as Mr. Macaulay explained.

> ". . . it is important to keep in mind that the reason for a solicitor's fiduciary duty to his client, though engendered by the retainer, is distinct from the contractual obligations arising under it. It arises from the relationship of trust and confidence that is an important consequence and feature of the retainer . . .
>
> 73. Where there is a contractual retainer and where it provides expressly or by implication obligations of a fiduciary nature, such obligations must clearly prevail, or 'mould' or 'inform' the fiduciary nature of the contractual relationship. But where there is a relationship involving, say, a transaction or transactions between a solicitor and a person who, having regard to that relationship and the solicitor's profession, reposes trust and confidence in him, a fiduciary duty may arise without a retainer. So much seems to be clear from the historic development and continued separate existence of the notion of a fiduciary relationship and one created purely by contract. It is clearly acknowledged in the following passage from the judgment of Mason J in *Hospital Products Ltd v United States Surgical Corpn* (1984) 156 CLR, 41, at 97, cited with approval by Lord Browne-Wilkinson, giving the judgment of the Privy Council in *Kelly v Cooper* [1993] AC 205, at 215:
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> > 'That contractual and fiduciary relationships may co-exist between the same parties has never been doubted. Indeed, the existence of a basic contractual relationship has in many situations provided a foundation for the erection of a fiduciary relationship. In these situations it is the contractual foundation which is all important because it is the contract that regulates the basic rights and liabilities of the parties. The fiduciary relationship, if it is to exist at all, must accommodate itself to the terms of the contract so that it is consistent with, and conforms to them. The fiduciary relationship cannot be superimposed upon the contract in such a way as to alter the operation which the contract was intended to have according to its construction.'"

330 There then followed some further very pertinent comments from Auld, L.J. (*ibid.*, at paras. 74–75):

> "74. Mason J's approach is instructive in that, whilst it subordinates the effect of a fiduciary relationship to the terms of any concurrent contract, it also acknowledges—depending upon the circumstances—the potential coming into being and continuation of a fiduciary obligation without or regardless of any contract.
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> 75. Illustrative of such an approach is *Longstaff v Birtles* [2002] 1 WLR 470, in which this Court held on the facts, that the defendant's solicitors' fiduciary duty extended beyond the termination of the

retainer. In that case solicitors who had acted for a couple in an abortive negotiation to purchase a public house and whose retainer had been terminated, persuaded the couple to join with them, without advising them to seek independent legal advice, in what turned out to be a disastrous commercial venture. In allowing the couple's appeal against the first instance judge's dismissal because the solicitors' retainer had been terminated before the matters of which the couple complained, Mummery LJ, with whom Laws LJ and Sir Anthony Evans agreed, said at paragraphs 1 and 35 of his judgment:

> '1. . . . The source of the [fiduciary] duty is not the retainer itself, but all the circumstances (including the retainer) creating a relationship of trust and confidence, from which flow obligations of loyalty and transparency. As long as that confidential relationship exists the solicitor must not place himself in a position where his duty to act in the interests of the confiding party and his personal interest may conflict . . .
>
> 35. This case can and, in my judgment, should be decided on the simple ground that there was a relationship of trust and confidence between the Longstaffs and the solicitors; that the relationship did not cease on the termination of the retainer in respect of the intended purchase . . .; that during the course of that relationship a personal business opportunity presented itself to the solicitors; that the solicitors took advantage of that opportunity to propose that the Longstaffs buy into the . . . [solicitors' business venture]; that in the context of the relationship the proposal gave rise to a situation in which the duty of solicitors might conflict with their interest; and that they acted in breach of a fiduciary duty in continuing to deal with Longstaffs, in a situation of a conflict of duty and interest, without insisting they obtain independent advice.'"

331 The importance of the foregoing *dicta* for present purposes is its premise that, irrespective of the existence of a formal or express contractual retainer, a lawyer will owe and continue to owe the fiduciary duties and obligations of trust, confidence and loyalty, if the circumstances of his relationship with his client gave rise to those duties.

332 In this case the evidence has disclosed two express contractual retainers—the May 2007 retainer (to contain the impact of the CIMA disclosure to the BCB) and the August 2009 retainer to protect the Brazilian defendants (in the form of the letter sent by Walkers, *per* Mr. Austin-Smith, to Mr. Macaulay on August 7th, 2009).

333 Nonetheless, the other retainers incontrovertibly existed, as evidenced by their circumstances, including correspondence as between the defendant and Mr. Toledo or Mr. Macaulay.

334 Each retainer gave rise to the lawyer–client relationship and to the attendant duties and obligations of trust, confidence and loyalty. On the basis of the case law discussed above (and indeed the local code of conduct itself),[103] these duties survived the expiry of any retainer which had in fact expired.

335 As I understand his case, the defendant argues for the expiry of all but one of the many retainers, *viz.* the 2000 note purchase retainer. And so, in relation to the TLB retainer in late 1984 (by which TLB was established in 1985), the Arnage and Brooklands retainer (other than for the note purchase transaction in 2000), the May 2006 retainer (re the shareholder certification in respect of EFHL and TLB to the BCB), the May 2007 retainer (re the further BCB investigation aided by CIMA)—that, if they existed, that they had all expired and that the defendant owed no ongoing duties or obligations in relation to them.

336 Moreover, the defendant also denies that there was a "general retainer" on an ongoing basis, to act for the Rabello family.

337 However, as regards the one exception—the August 2009 retainer—the arguments centered around not strictly its expiry but whether it covered only EFHL and/or Mr. Toledo, rather than more widely, the "Brazilian defendants."

338 In light of my conclusions above that the August 2009 retainer obviously covered all those persons known to the defendant to have been in jeopardy in Brazil, especially Katia Rabello and Fernando Toledo (who was also named), and that it continued until well after the Braga retainer, it must also be concluded that the defendant placed itself into an irreconcilable conflict of duty and interest when it accepted the Braga retainer. In so doing, as the case law explains, the defendant acted in breach of its duties owed to Katia Rabello and Fernando Toledo.

339 In light of the case law, it is also clear that the defendant remained throughout under a continuing duty of trust and confidence (in respect of all retainers) not to disclose—nor take steps contrary to its client's interests to disclose—their confidential information. This was a duty owed not only to Arnage and Brooklands in respect of the note purchase transaction in 2000 as the defendant contends, but to all the plaintiffs in respect of all their affairs.

340 It follows that the defendant should not have accepted the Braga retainer, as the defendant has itself come belatedly to acknowledge.[104] In acting for Dr. Braga against the plaintiffs and their interests, the defendant

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103 See the Commentary to r.1.06 (above).
104 *Per* Antonia Hardy, from her affidavits, as explained above.

breached its duties and obligations of trust, confidence and loyalty which it owed to the plaintiffs.

341 While I do not need to find and do not find that the defendant acted knowingly and deliberately in breach, the breaches are nonetheless serious and clear. No explanation has been offered by the defendant. There was, for instance, no explanation whatsoever why Mr. Murray (the managing partner who had direct responsibility for the then still ongoing August 2009 retainer), decided that the defendant could act for Dr. Braga when he was approached by Martin Kenney & Co. to do so on April 28th, 2010. Nor was it explained how it came about that the defendant proceeded to act both for the plaintiffs on the August 2009 retainer and for Dr. Braga, simultaneously acting through the same litigation department which, at that time, comprised a relatively compact team of approximately only ten persons.[105]

The hypothetical "reasonably competent" attorney

342 Given that it is the conduct of the defendant in acting for Dr. Braga that is the subject of the plaintiffs' claim, I do not accept, as the defendant pleaded and argued, that the position of a hypothetical "reasonably competent" attorney is relevant to the outcome. The defendant's proposition—that it must be excused from liability for its own breaches of duty because some other attorney not owing those duties would have achieved the same results for Dr. Braga—is in my view, untenable.

343 Nonetheless, I consider that I should record the reasons for my conclusions on this issue as well.

344 First, the defendant in running this argument also proposes that the effects of the Cayman disclosure should be considered under two separate heads: the *Norwich Pharmacal* disclosure and the *Bankers Trust* disclosure. Thus, as the *Norwich Pharmacal* order—to the extent it allowed the disclosure of Katia Rabello's status as UBO of Securinvest, was upheld by this court—the actions of the defendant could be separated from its actions in obtaining the unwarranted *Bankers Trust* disclosure, for the purposes of assessing what a "reasonably competent hypothetical attorney" would have done. And, that as it was arguably the disclosure of the UBO status that resulted in the losses complained of by Katia Rabello, the defendant should be excused because any other competent attorney would have inevitably obtained that disclosure.

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105 While Antonia Hardy in her first affidavit explains the nature of the conflict searches which were undertaken and their results, she offers no explanation and likely could herself offer no explanation) as to the matters identified by the court in this paragraph.

345 The difficulty for the defendant in running this argument is that the plaintiffs are not suing any other attorneys. They sue the defendant, the firm that had the conflict of interest and which should never have acted against the plaintiffs, its existing and former clients in the circumstances which it did. The basis of the claim is the breach by the defendant of the duties which it, not some other hypothetical set of attorneys, owed.

346 The strictness with which breaches of fiduciary duty by attorneys acting in conflict of interest is regarded by the courts, is illustrated by the House of Lords decision in *Hilton* v. *Barker Booth & Eastwood* (35).

347 In that case, the solicitors had acted for two clients in a commercial transaction in a situation of conflict. They had failed to reveal to client A the fact, of which they were aware because they had acted for him, that client B had convictions for dishonesty, was an undischarged bankrupt and so was unlikely to fulfill his end of the commercial transaction, as he in fact failed to do. His failure resulted in significant financial harm to client A, who sued the solicitors for breach of duty. The trial judge found for the claimant client A but awarded only nominal damages on the basis of what another (hypothetical) solicitor would have done, concluding that if other reasonably competent solicitors had acted the claimant would not have been told about client B's criminal convictions and dubious past (and hence would have proceeded with the transaction in any event).

348 However, the House of Lords looked at what the defendant solicitors should have done (*i.e.* not act in the position of conflict of interest) and found that once they proceeded, they should have disclosed client B's convictions and dubious history (even if that meant they would have been liable to suit by him) and declared that substantial damages for client A should be assessed on that basis.

349 Secondly, the defendant's proposition is unsupported when one considers how a reasonably competent attorney would have been required to meet his or her obligations to the court and to those persons (the plaintiffs) who were properly entitled to notice of the applications for disclosure of their confidential information. The test to be applied being "what the reasonably competent practitioner would do having regard to the standards normally adopted in his profession."[106]

350 I have already considered this issue above in the context of examining the plaintiffs' loss of opportunity. Here, I think it will suffice therefore if I simply set out what I consider to be the factors, correctly identified by counsel for the plaintiffs, which might well have led to a

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106 *Midland Bank* v. *Hett, Stubbs Kemp* (46), approved by the Court of Appeal in *Martin Boston Co.* v. *Roberts* (45) ([1996] P.N.L.R. at 50), and as discussed in *Jackson & Powell*, *op. cit.*, para. 11–086.

different outcome had another "reasonably competent" attorney been engaged by Dr. Braga to act against the interests of the plaintiffs.

351 Having regard to the nature of the duties of full and frank disclosure when making an *ex parte* application of the *Norwich Pharmacal* kind (to be measured also against the duty to give notice as explained by the Privy Council in *Olint* (50)), it is highly probable that another competent attorney would have ascertained and would have disclosed that:

(a) Dr. Braga did not have authority to bring the breadth of claims which he brought for disclosure of the plaintiffs' affairs in Cayman. This is also shown as discussed above by reference to the May 2011 judgment and the order then made for the retrieval of the *Bankers Trust* type of disclosure. The unwarranted disclosure as shown by Schedule 4 of the *Norwich Pharmacal* orders, went so far as to identify *34* allegedly "related entities and individuals" and covered "all" documents relating to Arnage and Brooklands and those 34 other entities and individuals. That breadth of disclosure went far beyond what was necessary to identify Katia Rabello as the UBO of Securinvest through her connection to Arnage and Brooklands.

(b) The statutory fee structure under which Dr. Braga himself stood to be remunerated by way of a percentage of the recoveries on behalf of the Petroforte estate, was, at least, one capable of incentivizing his conduct in a way that could affect his objectivity and credibility as a party and as a witness.[107]

(c) The contingency agreement into which Dr. Braga had entered on behalf of the Petroforte estate with OAR was, at least arguably, champertous. As mentioned above, OAR was a company owned and/or controlled at all material times by Dr. Braga's legal team and was, through the OAR contingency agreement, entitled to a success fee of between 20% and 30% of the value of recoveries by the Petroforte estate (30% being the applicable rate in respect of assets recovered from outside Brazil).

(d) A champertous agreement had also arguably been entered into with BVI solicitors, Martin Kenney & Co.[108] who instructed the defendant on behalf of Dr. Braga and advised him and OAR in respect of actions taken outside Brazil against the plaintiffs.

(e) Thus, OAR and Martin Kenney & Co. both had a significant personal interest in the actions taken against the plaintiffs in Cayman and

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107 He stood to receive at least 6% of recoveries: see decision of the TJSP.

108 As confirmed by them in response to requests for further and better particulars and exhibited at Appendix 1 of the reply to the defence dated April 21st, 2015.

in the other jurisdictions where steps were taken to identify and seize their assets for the Petroforte estate by use of the Cayman disclosure.

(f) Before acting for parties so incentivized under the cloak of champerty, any competent attorney was obliged at least to have ascertained the interests of those instructing him and to inform this court of the arrangement.[109] Champerty was then and still remains an offence in the Cayman Islands. It is therefore probable that this court would not have entertained applications presented on the basis of instructions from parties to such arrangements, at least not without first being satisfied that the arrangements were fair and that it could rely on representations made by or on behalf of parties who were so incentivized; see *Quayum* v. *Hexagon Trust Co. (C.I.) Ltd.* (55) and *In re ICP Strategic Credit Income Fund Ltd.* (40).

352 It would have been a legitimate concern of this court whether Dr. Braga and those advising him were acting in the interest of Petroforte creditors or in their own interests.

353 At the very least, disclosure of the arrangements would likely have led this court to enquiries which would have revealed Dr. Braga's intentions to use the Cayman disclosure more widely than was strictly necessary or permitted to assist the STJ to resolve the Securinvest appeal.

354 At all events, had the defendant not failed in its duty to have notified the plaintiffs of the applications, the plaintiffs would themselves likely have raised these concerns with the court.

355 Further and in any event, it was an abuse of process for the *Norwich Pharmacal* applications to have been made on the misleading bases on which they were, citing the need for urgency and gagging orders which were, in retrospect, clearly unjustified. See again the analysis above from the May 2011 judgment, reflecting on the consequential loss of opportunity.

356 No hypothetical reasonably competent attorney can be assumed to have been willing to act in an abuse of the process of the court, and certainly not without full and frank disclosure being made. It is probable

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109 The flagrant nature of the incentive later became apparent from a *Financial Times* article "Fund sees Brazilian fraud as next big thing in emerging markets," contributed by Joe Leahy from São Paulo, December 8th, 2013. In this article it is revealed that Martin Kenney had entered into a litigation funding deal with an investment fund (Platinum Partners) and in which Jack Simony of Platinum Partners discussed the potentiality of funding for offshore litigation and citing the arrangements with Martin Kenney, opined that while expensive to fund "The rewards of a successful case, however, can be huge. Mr. Kenney said his firm was close to recovering R$900m in a Brazilian fraud case involving the former owner of a local bank, Banco Rural."

that had such disclosure been made, the *Norwich Pharmacal* applications would have been stayed for being champertous (see *Grovewood Holdings plc* v. *James Capel & Co. Ltd.* (32)) or until, at the very least, the plaintiffs had been given the opportunity to respond, that loss of opportunity about which they now complain and are found to have suffered.

357 Finally, on this issue, I considered that if this court were to accept the defendant's proposition, the fiduciary duties which the defendant plainly owed to the plaintiffs would be deprived of any content. It would mean that no duty of loyalty at all would effectively be owed to clients (especially to clients who might most need protection). The fact that documents which should never have been disclosed contain information potentially damaging to the client may not be regarded as meaning that a client should lose its right to argue that the information was confidential and should never have been disclosed in the first place.

358 I am satisfied from the foregoing examination of the plaintiffs' case, that the defendant did owe to each plaintiff respectively, the contractual and fiduciary duties of care, confidence and loyalty and that these duties were breached by the defendant.

359 The breach is for present purposes proven, not just by the obtaining and disclosure of the Cayman disclosure, but also by enabling or facilitating its adverse use against the plaintiffs, in the circumstances to be further examined below.

The defence: no causation of loss

360 The defendant's response to the allegations of causation of loss has been various and complex. They have argued variously that the Cayman disclosure had no character of confidentiality. This argument as I understood it, was a restatement of their "no confidence in inequity" point, which they latterly abandoned.

361 They also argued that it was only the *Norwich Pharmacal* disclosure—that which was obtained by dint of the first order from Equity Trust—that caused the plaintiffs' (in particular Katia Rabello's) losses. And, that in the event, as she was obliged in any event, to disclose the crucial fact that she was the UBO of Securinvest, that crucial element of the *Norwich Pharmacal* disclosure could, for that reason also, have had no quality of confidentiality. This argument, linked to the argument that any other attorney would have obtained this disclosure, means that the defendant should be excused from having obtained the disclosure.

362 Further, that the damage was done by the *Norwich Pharmacal* disclosure and this was inevitable. Moreover, as Katia Rabello was under

a legal obligation to disclose her UBO status to the STJ and maintains[110] that had she done so, Securinvest (and by association herself) ought to have and would have been released from the Petroforte bankruptcy, the losses were caused not by the defendant's actions on behalf of Dr. Braga but by Katia Rabello's lie.

363 This argument is encapsulated in the defendant's written submissions[111] as follows:

> "The Plaintiff's case, as set out in Mr. Macaulay's eighth affidavit and Ms. Rabello's third witness statement, is that if Ms. Rabello had told the truth to the STJ then Securinvest would have been released from the bankruptcy. On that basis the answer to the case is very simple—the Plaintiffs' losses were caused by Ms. Rabello's lie. If Ms. Rabello had told the truth then Securinvest would have been released from the bankruptcy and Ms. Rabello's assets would never have been incorporated in it. Further Dr. Braga, who came to Cayman specifically to ascertain the UBO of Arnage and Brooklands, would not have done so. Thus there would have been no Cayman Disclosure. It is important to note that this causation point does not turn either on the fact that it is a lie, or on the motivation for that lie. It turns on the fact that it is *Ms. Rabello's own actions* which have caused the loss."

364 This in other words, is a defence that whatever breaches the defendant may have committed, there was a break in the chain of causation of loss when Katia Rabello's lie was revealed resulting in the STJ's final dismissal of Securinvest's appeal.[112] Plausible though this argument might at first appear, there are two clear and telling responses from the plaintiffs.

365 First, this argument of the defendant goes only to the question of what was Katia Rabello's duty of disclosure to the STJ and her failure to fulfill that duty. The argument does not address the case against the defendant in relation to the loss of opportunity to appear before this court at first instance and to have prevented the wider abuse, beyond the STJ, of the Cayman disclosure in Brazil against Katia Rabello and Fernando Toledo and the consequences arising from that wider abuse.

366 In other words, this argument of the defendant on causation can be relevant, if at all, only to the loss of Securinvest's assets as that was the

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110 In her explanatory third witness statement, to be considered fully below.
111 For this hearing listed for December 3rd–14th, 2018.
112 The argument was similarly presented on March 3rd, 2016: "It doesn't matter whether the actions of the relevant party were dishonest or fraudulent. What matters is whether it broke the chain of causation. So, it wraps up into the causation point."

issue affected by the duty of disclosure to the STJ. And this must be so also, notwithstanding the defendant's further argument that had Securinvest been released from the Petroforte bankruptcy, so would Katia Rabello have been released. The converse situation must be considered also: had she not been taken into the Petroforte bankruptcy in the first place as a result of the abuse of the Cayman disclosure, she would not have remained in it, whatever the outcome for Securinvest.

367 Moreover, if Securinvest is ultimately released and consequentially Katia Rabello as well, there still will have been significant losses sustained in the meantime such as could be attributed to the defendant's breaches of duty.

368 Secondly, the defendant's response would overlook a very pertinent aspect of Ms. Rabello's explanation, in her third witness statement, for her lie to the STJ:[113]

> "Given the logical consequences in the Petroforte bankruptcy proceeding of my admission to being the UBO of Securinvest [*viz.* that Securinvest would have been shown not to be owned by any Petroforte interest and so entitled to be released from the bankruptcy] this Honourable Court is rightly concerned as to why I chose not to take this course. In essence, as I explain below, the problem was that, had I made the admission, very serious collateral issues would have arisen affecting Banco Rural and me from the perspective of the relevant regulator of the bank; namely the Brazilian Central Bank."

369 It would follow, if this explanation came to be accepted by the court upon an examination of Ms. Rabello's evidence on assessment of quantum of loss, that she was justifiably concerned that disclosing that she was UBO of Securinvest would not only result in the dismissal of Securinvest's appeal[114] and the extension of the Petroforte bankruptcy to herself, but also that it would result in the destruction and loss of Banco Rural.

370 It is already established that the assessment of quantum will proceed on the basis of my conclusion that the Cayman disclosure was, indeed, the cause of losses to be quantified.[115]

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113 As described above and as set out in her own words below in response to the defendant's *ex turpi causa* defence.

114 Although, as set out above at para. 368, she asserts that it ought not to have had that consequence.

115 It was also accepted in the August 2016 judgment, that *all* of the Cayman disclosure was available to the Brazilian courts and would have influenced the outcomes before them.

371 For the present purposes of summary judgment on liability, I will set out briefly below how it is that I find the Cayman disclosure to have had that consequence.

Adverse use of the Cayman disclosure

372 The Cayman disclosure (the confidential nature of which is undeniable and is described in paras. 73–88 of the reply to the defence)[116] related not only to Sabino Rabello and Katia Rabello's ultimate beneficial ownership of Arnage and Brooklands but also contained numerous other documents including:

(a) Documents expressly naming Sabino Rabello, Katia Rabello and Fernando Toledo.

(b) Documents relating to the note purchase transaction (including the defendant's own work product).

(c) Documents concerning both TLB and the Rabello family (the Trade Link Bank documents) which were directly relevant to both the May 2007 and the August 2009 retainers.

(d) Documents relating to Fernando Toledo's personal and business affairs connected to EFHL and TLB.

373 The Cayman disclosure has been heavily relied upon by Dr. Braga in proceedings in Brazil, the United States, the BVI and Belize, contrary to the plaintiffs' interests.

374 The Cayman disclosure has also been relied upon by the Brazilian regulatory authorities in regulatory proceedings unconnected with the Petroforte bankruptcy.

Adverse use of the Cayman disclosure before the Brazilian courts

375 As mentioned above, the Cayman disclosure has been specifically relied upon by Dr. Braga in applications before the Brazilian Bankruptcy Court, the TJSP and the STJ. In particular, it clearly was relied upon for placing Katia Rabello into the Petroforte bankruptcy and, inferentially, by the STJ in refusing Securinvest's appeal.

376 While this was the subject of dispute between the parties before,[117] there really is no longer any doubt about this and it is confirmed by the

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116 Under the heading "The disclosure of documents and information."

117 See, for instance, judgment of August 10th, 2016 (above), where, at paras. 22–24, despite the defendant's argument to the contrary, it is noted that the plaintiffs' case is and always has been that the totality of the Cayman disclosure caused damage.

expert evidence both of Roberto Figueiredo on behalf of the plaintiffs and Roberto Liesegang on behalf of the defendant.

377 Moreover, in his affidavit of February 17th, 2011, Dr. Braga admitted that he had provided the totality of the Equity Trust documents (including *Bankers Trust* documents) to the STJ (Justice Andrighi). Dr. Braga also filed the OAR Report dated June 29th, 2010 on the STJ precautionary measure file (which both summarized and quoted from the Equity Trust disclosure). It is agreed that Dr. Braga filed the totality of the Cayman disclosure on file 1819 (the file of the OAR investigation directed by Judge Beethoven in connection with the Petroforte bankruptcy).[118]

378 The Cayman disclosure was persuasive in the key applications before the Brazilian courts. It was fundamental to the October 28th, 2010 bankruptcy order made by Judge Beethoven against Katia Rabello, the August 9th, 2011 STJ judgment refusing Securinvest's appeal and which, in turn, formed part of the basis for the TJSP's judgment of September 27th, 2011, refusing Katia Rabello's appeal.[119]

379 By the defendant's own admission,[120] the disclosure of the *Norwich Pharmacal* disclosure by Dr. Braga to the Bankruptcy Court resulted in catastrophic consequences for Katia Rabello.

380 The foregoing findings in relation to the deployment of the Cayman disclosure before the Brazilian courts are not, however, to be taken as a conclusion on causation of loss or still less, on quantification of loss. For instance as already explained[121] and will be explained further below,[122] it is part of the defendant's case that, to the extent the revelation of Katia Rabello's status as UBO of Securinvest affected the outcome in Brazil, this was information that she was herself obliged to disclose in any event in the context where Securinvest had already been taken into the Petroforte bankruptcy, before the obtaining of the Cayman disclosure.

Adverse use of the Cayman disclosure by the BCB

381 As also already mentioned, following the October 28th, 2010 bankruptcy order, the Bankruptcy Court also referred the matter to the BCB for investigation with that investigation leading to adverse publicity against Katia Rabello and Banco Rural, and a complaint dated March

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118 As confirmed by defendant's expert Roberto Liesegang in his sixth affidavit.
119 See reply to further request for further and better particulars of the reply to the defence.
120 See for example, para. 17 of its submissions for the March 2016 hearing.
121 At paras. 280–285 above.
122 At paras. 427–428 below.

21st, 2012 ("the BCB 2012 complaint"), specifically based on the Cayman disclosure.[123]

382 Further, as averred in the pleadings,[124] the provision of the Cayman disclosure also led to the BCB intervening in Banco Rural's affairs and the placing of Banco Rural into compulsory liquidation on August 2nd, 2013.

BCB administrative proceedings

383 The adverse use of the Cayman disclosure by the BCB also resulted in formal administrative proceedings against Katia Rabello and Banco Rural in March 2012.[125] By way of the BCB complaint, the BCB alleged (as already mentioned above) that as Katia Rabello is the actual owner of Securinvest, certain credit transactions entered into by Banco Rural in favour of Securinvest were in violation of Brazilian law prohibiting the provision of credit to Securinvest as an "associated" company.

384 The use of the Cayman disclosure by the BCB was in contravention of para. 1(e) of the retrieval order of this court dated July 25th, 2011.

385 The BCB proceeded on the basis of the judgments of the Brazilian courts which had themselves made reference to the wrongfully obtained *Bankers Trust* aspects of the Cayman disclosure; the BCB referring to aspects of it and the information it disclosed as principally set out in Judge Beethoven's decision of October 28th, 2010. Of importance in this regard was an original letter from Judge Beethoven (2892/2010—Docinho) dated November 3rd, 2010, confirming that Katia Rabello was the beneficial owner of Arnage and Brooklands and consequently "controller" of Securinvest.

386 The documents and/or information obtained from the Cayman disclosure and expressly set out in the BCB complaint included:

(i) Arnage and Brooklands subscription documents;

(ii) the 2009 Costa Rican corporate restructuring; and

(iii) correspondence between Katia Rabello and Securinvest.

387 A copy of the regulatory decision imposing a fine of 250,000 Reais upon both Ms. Rabello and Banco Rural is exhibited in evidence. This too expressly referred to and relied upon the Cayman disclosure, referring *inter alia*, to the same subscription documents and to the 2009 Costa Rican restructuring.

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123 All as described at paras. 168–218 of the statement of claim.
124 Statement of claim, para. 192.
125 See plaintiffs' reply to request 2 in replies dated August 21st, 2015 to defendant's further request for further and better particulars.

388 This decision is under appeal and the outcome is still awaited but unless set aside, the fine must be paid.[126] At present the fine is therefore cited by Katia Rabello as being an item of loss and so as an item of the damages she is entitled to recover from the defendant.

Adverse use of the Cayman disclosure in other jurisdictions

389 The Cayman disclosure has repeatedly been used against the plaintiffs in other jurisdictions causing what they allege to be extensive losses and catastrophic damage. For present purposes, it will I think suffice to note that I accept that, at least in relation to the resistance of such proceedings in Florida, the BVI and Belize, the plaintiffs must have incurred significant costs.

The fourth element for summary judgment: proof of causation of "some" loss

390 As already mentioned, even at this summary judgment stage, the plaintiffs must establish beyond argument, that *some* loss was caused by the defendant's breaches of duty. And given the size of the claim, this must be significant in amount. If the plaintiffs can at this stage establish only some *de minimis* amount, it would, in my view, be an abuse of the process of the court to allow this action to proceed any further. This must be correct, although the plaintiffs may not yet be in possession of all material that would be relevant to their pleading out of the issues on causation and loss.

391 I do not understand the plaintiffs to disagree.

392 Instead what they assert through Mr. Akiwumi (also as already mentioned), is that they can indeed show at this stage that significant losses were unarguably incurred both in terms of legal costs and damages and that they are therefore entitled to summary judgment on liability now, with the larger proof of quantum to be established later at the assessment of quantum.

393 The authority cited for this proposition is *Lunnun* v. *Singh* (43), a decision of the Court of Appeal of England and Wales. In that case it was held that the fact that default judgment had been entered in favour of the plaintiff for damage to his property caused by water leakages from the defendant's adjacent property did not absolve the plaintiff from having to prove causation of loss and quantum in respect of each individual head of loss.

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126 *Per* Mr. Akiwumi on Day 7 of the hearing.

394 The principles, as they would also, in my view, apply to a case like the present upon the grant of summary judgment on liability with damages to be assessed, were summarized by Clarke, L.J. (at 7–9):

> "In my judgment the relevant principles can be deduced from *Turner v Toleman* [(73)[127]] and *Maes Finance Limited and Another v A Phillips & Co* [(44)[128]] to both of which my Lord, Mr Justice Jonathan Parker, has referred. They may be summarised as follows:
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> . . .
>
> 4. On the assessment of damages the defendant [in a case like this, following a grant of summary judgment] may not take any point which is inconsistent with the liability alleged in the statement of claim.
>
> 5. Subject to 4 the plaintiff may take any point which is relevant to the assessment of damages.
>
> 6. Such points will include [(where applicable)] the following:
>
> (1) Contributory negligence: see the passage quoted by Mr. Justice Parker from *Maes Finance* [to the effect that contributory negligence could be relevant on an assessment of damages following judgment on liability, but only if the judgment had not settled an issue on which an allegation of contributory negligence would depend];
>
> (2) Failure to take reasonable steps to mitigate (see the same passage in *Maes*).
>
> (3) Subject to (5) below, causation.
>
> (4) Quantum [this is of particular relevance here] [emphasis added].
>
> (5) Causation. As the Vice-Chancellor put it in *Maes*:
>
> 'The defendant cannot thereafter contend that his acts or omissions were not causative of *any* loss to the plaintiff [emphasis in original]. But he may still be able to argue, on the assessment, that they were not causative of any particular items of alleged loss.'
>
> Moreover, he may do so even if the statement of the claim alleges a particular loss was caused by the tort.

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127 Unreported decision of the Court of Appeal, delivered January 15th, 1999, *per* Simon Brown, L.J. and Wilson, J.

128 Unreported decision of the High Court, *per* Sir Richard Scott, V.-C.

In *Turner v Toleman* Lord Justice Simon Brown, with whom Mr. Justice Wilson agreed, as my Lord has indicated, quoted the following statement by Lord Justice Waller in refusing leave to appeal on paper in that case:

> 'What loss and damage was caused by this defendant's negligence must be part of the exercise of assessing damages.'

Lord Justice Simon Brown expressed the view that that was plainly correct and that it accorded with his own experience over many years."

395 Those principles are equally applicable to the present case for the purposes of drawing the appropriate line between the judgment on liability against the defendant for its breaches of duty and the assessment to come of the quantum of loss and/or damages.

Election

396 In this action, each of the plaintiffs claim, in the alternative, (i) damages, (ii) equitable compensation, or (iii) an account of profits received as a consequence of the defendant's breach of fiduciary duty.

397 As regards (ii) and (iii), there is an election to be made by the plaintiffs. The principles, as well as the procedure, were explained by the House of Lords in *Att. Gen.* v. *Blake* (6) as follows *per* Lord Nicholls of Birkenhead ([2001] 1 A.C. at 280):

> "I should refer briefly to breach of trust and breach of fiduciary duty. Equity reinforces the duty of fidelity owed by a trustee or fiduciary by requiring him to account for any profits he derives from his office or position. This ensures that trustees and fiduciaries are financially disinterested in carrying out their duties. They may not put themselves in a position where their duty and interest conflict. To this end they must not make any unauthorised profit. If they do, they are accountable. Whether the beneficiaries or persons to whom the fiduciary duty is owed suffered any loss by the impugned transaction is altogether irrelevant."

398 And by the Privy Council in *Tang Man Sit* v. *Capacious Invs.* (67), *per* Lord Russell, as follows ([1996] A.C. at 521):

> "Faced with alternative and inconsistent remedies a plaintiff must choose, or elect, between them. He cannot have both. The basic principle governing when a plaintiff must make his choice is simple and clear. *He is required to choose when, but not before, judgment is given in his favour and the judge is asked to make orders against the defendant.* A plaintiff is not required to make his choice when he launches his proceedings. He may claim one remedy initially, and

then by amendment claim in favour of the other. *He may claim both remedies, as alternatives. But he must make up his mind when judgment is being entered against the defendant.*" [Emphasis added.]

399 It is accepted that the plaintiffs must elect between remedies but the defendant, through Mr. Simpson, argued that they were bound to do so before obtaining summary judgment on liability.

400 Having regard to the *dictum* above from the Privy Council, this argument is plainly wrong.

401 The defendant proffered an account of the "profits" by way of fees earned from the Braga retainer, for which it says it could only possibly be found accountable. This was done through the affidavit of Neil Sherlock, its Chief Financial Officer. He averred that US$362,117.50 was the amount earned.

402 Notwithstanding that the plaintiffs maintained that they were not obliged to elect until "when judgment is being entered against the Defendant" in keeping with the Privy Council's *dictum*, I was told by Mr. Akiwumi that one of the plaintiffs, EFHL, upon judgment being entered, would elect for an account of profits from the defendant. The other plaintiffs, each of whom would be entitled to do so, would elect instead for the assessment of damages or equitable compensation.

The available remedies

403 It should be helpful for me to express my views at this stage on the nature of the remedies which will be available on the assessment of quantum (apart from an equitable account for profits already mentioned).

404 Given that the defendant has been found liable for breaches of fiduciary as well as contractual duties, the plaintiffs are entitled to claim compensation on two different bases: equitable compensation or damages at common law.

405 The plaintiffs also seek compensation under the supervisory jurisdiction of the court for breaches of professional conduct, citing *Udall (t/a Udall Sheet Metal & Co.)* v. *Capri Lighting Ltd.* (74). I will return to this issue below.

406 As regards the bases for assessment of equitable compensation for breach of fiduciary duty, the case law has been evolving, as very helpfully explained in *Jackson & Powell*.[129]

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129 *Op. cit.*, at paras. 3–013 – 3–017.

407 Equitable compensation is now firmly recognized in English law as a remedy for breaches of fiduciary obligation.

408 There is, however, a clear distinction to be observed between the traditional remedies for breach of fiduciary duty involving non-disclosure by the fiduciary of his interest in a transaction affecting a client[130] or for a fraudulent breach of trust[131] and a claim for damages for breach of fiduciary duty.

409 As was settled by the Privy Council in *London Loan & Savings Co.* v. *Brickenden* (42),[132] in the former set of circumstances, the non-disclosure renders the transaction voidable at the election of the client (as the beneficiary of the fiduciary duty owed) and considerations as to the causative effect of the non-disclosure do not arise.

410 In the latter set of circumstances, the case law now explains the requirement for the showing of a causal link such that it would be inappropriate to regard *Brickenden* as laying down a contrary principle of general application.

411 In *Swindle* v. *Harrison* (66), the Court of Appeal had to consider to what extent proof of a causal link between a breach of fiduciary duty and loss should be established if compensation or damages were to be awarded. The case involved a claim by Mrs. Harrison against her haplessly named solicitor Mr. Swindle, for failure to disclose a small profit he stood to make from an arrangement he made with his bank to provide her with a secured loan for the promotion of her restaurant business. When her restaurant failed, Mrs. Harrison was unable to meet the loan payments and

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130 As classically examined and explained in *Nocton* v. *Lord Ashburton* (51).

131 Where the remedy would be reparative, such as by an account or other form of restitution of a trust fund: see for insightful discussions on the different remedies: M. Hoyle, "'Where there is discord, may we bring harmony': *AIB Group (UK)* v. *Mark Redler* and the Perils Facing Equity," 4 OUULJ 22 (2016) and S. Degeling, "Loss of Chance and Breach of Fiduciary Duty, The Requirement of Certainty of Loss," 28 SAcLJ 825 (2016).

132 [1934] 3 DLR at 469, *per* Lord Thankerton:

"When a party, holding a fiduciary relationship, commits a breach of his duty by non-disclosure of material facts, which his constituent is entitled to know in connection with the transaction, he cannot be heard to maintain that disclosure would not have altered the decision to proceed with the transaction, because the constituent's actions would be solely determined by some other factor, such as the valuation by another party of the property proposed to be mortgaged. Once the Court has determined that the non-disclosed facts were material, speculation as to what course the constituent, on disclosure, would have taken is not relevant."

the charge, secured against her home, was enforced. She lost her home and any equity acquired in the business venture.

412 She counterclaimed against Mr. Swindle for her entire loss, alleging that he was in breach of duty in failing to reveal the profit he stood to make from the loan arrangement, notwithstanding that its terms had been quite reasonable and would in any event have been readily accepted by her, given her then dire need for financing.

413 She relied on the *dictum* of Lord Thankerton in *Brickenden*, arguing that she did not need to prove that the breach of fiduciary duty caused her losses. The argument failed, the Court of Appeal declaring that, as distinct from claims for breach of fiduciary duty involving non-disclosure, considerations of causation applied to claims for compensation for non-fraudulent breaches of fiduciary duty (*per* Evans, L.J. following *Bristol & West Bldg. Socy.* v. *Mothew* (11)) and that it is necessary to satisfy the "but for" test of the common law if damages were to be recovered (*per* Hobhouse, L.J.). Mummery, L.J., the third member of the court, expressly recognized the availability of equitable compensation as a remedy for breach of fiduciary duty. Having observed that common law considerations of remoteness and foreseeability were generally irrelevant to *restitutionary* remedies for breach of trust or fiduciary duty, he held that ([1997] 4 All E.R. at 733):

> "Although equitable compensation, whether awarded in lieu of rescission or specific restitution or whether simply awarded as monetary compensation, is not damages, it is still necessary for Mrs Harrison to show that the loss suffered has been caused by the relevant breach of fiduciary duty. Liability is not unlimited. There is no equitable by-pass of the need to establish causation."

414 In *Target Holdings Ltd.* v. *Redferns* (68), the need to show the connection between the breach of trust and the loss in a claim for equitable compensation was also recognized by the House of Lords, *per* Lord Browne-Wilkinson ([1996] 1 A.C. at 439):[133]

> "Equitable compensation for breach of trust is designed to achieve exactly what the word compensation suggests: to make good a loss in fact suffered by the beneficiaries and which, *using hindsight and common sense*, can be seen to have been caused by the breach." [Emphasis added.]

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133 *Target Holdings* v. *Redferns* has been explained and upheld by the Supreme Court, its widespread academic criticism notwithstanding, in *AIB Group (UK)* v. *Mark Redler & Co.* (2).

415 The words in emphasis, being an adaptation and approval of *dictum* from *Canson Enterprises Ltd.* v. *Boughton & Co.* (13) (85 D.L.R (4th) at 163, *per* McLachlin, J.), will also inform the approach to the exercise of assessment of loss.

416 *Swindle* v. *Harrison* (66), *Target Holdings Ltd.* v. *Redferns* (68) and *Brickenden* (42) have been followed and applied in this jurisdiction in *AB Jnr.* v. *MB* (1).[134] In that case it was found that equitable compensation was an available remedy for the trustees' non-fraudulent breach of trust in failing to disclose information to their beneficiary, information which was relevant to the valuation of the beneficiary's interests in the trust. The appropriate basis for the calculation of equitable compensation was to enquire into whether or not a loss resulted from the failure of the trustees to disclose and to quantify that loss. Thus, by implication, a causation analysis in the context of a non-fraudulent breach of trust.

417 Accordingly, in their claims for compensation for loss caused by the defendant's breaches of fiduciary duty, the plaintiffs must establish causation. However, in assessing compensation, the objective is to compensate for the consequences of the breach of fiduciary duty and in so doing a common-sense view must be taken of what loss occurred from the breach and so falls to be compensated.

418 The remedy is truly compensatory, not punitive,[135] and so there is no power to make an exemplary award (as the plaintiffs also pray).

419 Any claims for compensation for breach of the contractual duties (or in negligence for breach of tortious duties of care if pursued) must, of course, be proven on the usual common law bases.

The supervisory jurisdiction to order compensation

420 As mentioned above, the plaintiffs also claim that the defendant's conduct is such (both in terms of its actions against them on behalf of Dr. Braga and its continuing allegations of misconduct and attacks upon their reputation in the manner of its defence[136]) that the court should exercise

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134 2013 (1) CILR 1, among other cases discussed at 102–114.

135 *Harris* v. *Digital Pulse Pty. Ltd.* (33), cited in *Jackson & Powell*, *op. cit.*, at para. 3–016.

136 These include references to the Mensalao scandal, criticisms of the plaintiffs' honesty and integrity inconsistent with the defendant's duty of loyalty (as explained by Campbell, J. in *Chiefs of Ontario* v. *Ontario* (17)), and their submissions on *ex turpi causa*, to be discussed below. The plaintiffs, through counsel, also submit that the defendant should be estopped from raising such allegations having expressly and/or impliedly represented by its conduct that it would seek to protect the Rabello family and the plaintiffs' interests in relation to the matters alleged.

its supervisory jurisdiction and order compensation for breach of the professional conduct rules, following *Udall* v. *Capri* (74).

421 While these are compelling arguments on which to respond to the allegations in the defence, I am not persuaded that they provide the distinct and separate basis required for the invocation of the court's supervisory jurisdiction leading to the making of an award of compensation or an award of wasted costs, the latter, as I will now explain, being the basis as already applied in this jurisdiction, for the application of the supervisory jurisdiction.[137]

422 The plaintiffs rely upon *dicta* from *Udall* v. *Capri* which suggests that the court has a very wide discretionary jurisdiction ([1988] Q.B. at 916) "to supervise the conduct [of an attorney as its officer] and to visit with penalties any conduct which is of such a nature as to tend to defeat justice in the very cause in which the [attorney] is engaged . . ."[138]

423 That principle was applied in *Udall* v. *Capri* where the professional misconduct involved the failure to honour an undertaking given to the court. The principle was adopted as contained in a passage from the earlier authoritative judgment of Lord Wright delivered on behalf of the House of Lords in *Myers* v. *Elman* (48) by which the jurisdiction of the courts to impose wasted costs orders upon attorneys for gross neglect or inaccuracy in the conduct of a matter, was settled. There the jurisdiction is described ([1940] A.C. at 319) as:

> ". . . not merely punitive but compensatory. The order is for payment of costs thrown away or lost because of the conduct complained of. It is frequently . . . exercised in order to compensate the opposite party in the action."

424 *Myers* v. *Elman* was itself followed and applied by this court in the *Al-Ibraheem* judgments (3) cited above.

425 The jurisdiction is both discretionary and summary in nature. It is *R&T Thew Ltd.* v. *Reeves (No. 2)* (57) ([1982] Q.B. at 1286): "only available where the conduct of the [attorney] is inexcusable and such as to merit reproof" by the court. And, being summary in nature, only where the enquiry to be undertaken will not involve the resolution of extensive factual issues or counter-allegations. Otherwise, the appropriate redress is by way of an action at law for negligence—see *Udall* v. *Capri* (74) (at 917C, quoting from *Myers* v. *Elman* (48)).

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137 As discussed and applied in *Al-Ibraheem* v. *Bank of Butterfield Intl. (Cayman) Ltd.* (3).

138 Citing *Stephens* v. *Hill* (64) (*per* Abinger, C.B.).

426 Given the supervisory and summary[139] nature of the jurisdiction, as well as the debatable question whether it might be used to make an extensive award for unliquidated damages of the sort claimed by the plaintiffs here, I would not consider this a case suitable for its application, egregious though the breaches of duty appear to be.

427 Here, the plaintiffs have open to them the other clear remedies of equitable compensation for breaches of fiduciary duties or damages for breaches of the contractual duties.[140]

Particulars of some loss

428 To the extent that the plaintiffs must now show that they have suffered some loss, I am satisfied that they have met this test. In setting out below the particular heads of pecuniary loss as identified, I do not prejudge the assessment exercise; I simply identify those heads under which I am satisfied the plaintiffs will certainly be able to recover some substantial loss.

429 The other much larger claims, such as for the loss of Securinvest's or Banco Rural's assets,[141] must of course satisfy the causation tests discussed above.

430 In particular, I am satisfied for the purposes of summary judgment on liability (and subject to specific proof at assessment of quantum), that the plaintiffs have suffered the following pecuniary losses, connected to legal fees and disbursements caused by the litigation engendered by the Cayman disclosure (as set out at para. 220 of the statement of claim):

(i) Legal fees and disbursements incurred by Brazilian counsel in respect of (a) the court proceedings in Brazil; (b) the BCB investigation; and (c) proceedings outside Brazil in excess of US$15m.;

(ii) Legal fees and disbursements incurred by Cayman Islands counsel in the Cayman Islands proceedings and assisting in proceedings outside the Cayman Islands in excess of US$850,000;

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139 Albeit the procedural strictures were regarded as not being determinative of whether or not a wasted costs enquiry should be engaged in this jurisdiction: see *Al-Ibraheem* (3) (2000 CILR at 290–300).

140 The latter as based, for instance upon cl. 1 of the August 7th, 2009 terms of engagement letter which states: "We will provide our legal services with reasonable care and skill and in accordance with the professional standards expected of us and in a timely manner."

141 As pleaded at paras. 186 and 187 of the statement of claim.

(iii) Legal fees and disbursements incurred by US counsel in connection with the US proceedings and assisting in proceedings outside the US in excess of US$1m.;

(iv) Legal fees and disbursements incurred by BVI counsel in connection with BVI proceedings and assisting in proceedings outside the BVI in excess of US$100,000;

(v) Legal fees and disbursements incurred in Belize in connection with the Belize proceedings and assisting in proceedings outside Belize in excess of US$25,000.

431 During the hearing, the defendant pressed, through Mr. Simpson, for proof of payment of these fees and disbursements. In response, the plaintiffs were unable to show actual payment of anything like the US$17m. posited above from the statement of claim, instead, at this stage proposing to show that through a company Gladbeck Capital Ltd. owned by Katia Rabello and other companies affiliated with her had in fact paid US$1,875,000 as part of these legal fees.[142] This was money which Mr. Macaulay testified was actually paid to his firm and then paid out, including to Cayman Islands lawyers and counsel. In support of the plaintiffs' case he confirmed that in connection with—

> "taking steps to mitigate their loss and to set aside the orders obtained by the Defendant on behalf of Dr. Braga in the Cayman Islands, the Plaintiffs incurred substantial Cayman Islands legal costs and disbursements in excess of US$850,000 together with substantial further Brazilian and US legal costs and disbursements."[143]

432 I conclude that questions over whether or not Gladbeck Capital Ltd. itself actually made these payments on behalf of the plaintiffs, or from whatever other source they might have been paid, are matters for proof at the assessment hearing, along with other matters for quantification of loss or damage.

433 This is, of course, without prejudice to any proper application the plaintiffs might make for an interim payment on the basis that some quantifiable loss can now be shown beyond argument.

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142 As explained in Mr. Macaulay's tenth affidavit, sworn on December 10th, 2018 (para. 7).

143 As pleaded at para. 173 of the statement of claim.

The defendant's strike-out application

(i) ***The ex turpi causa defence: Katia Rabello's lie to the STJ***

434 It is an inescapable conclusion that the presentation of the Costa Rican structure to the STJ was—as Katia Rabello herself came to admit when pressed by this court in these proceedings for an explanation[144]—an artifice capable of misleading the STJ.

435 She maintains, however, that there was no intention to deceive the STJ so as to defraud the Petroforte estate. Her explanations must also therefore be again considered in the context of her response to the *ex turpi causa* defence of the defendant and this will be done below.

436 The issue to be decided now, therefore, is whether Katia Rabello's lie to the STJ can be invoked in this action by the defendant, in support of its *ex turpi causa* defence, to the extent of striking out the plaintiffs' claims because, in the manner contemplated by GCR O.18, r.19, it fails to disclose a reasonable cause of action or for being an abuse of the process of the court.

437 In this context (as well as in the earlier context discussed above of her (and the other plaintiffs) pleading of the loss of opportunity to limit the harmful deployment of the Cayman disclosure in Brazil), Katia Rabello's explanation for her lie to the STJ is highly relevant.

438 It is therefore convenient to set out here in her own words, her explanations, as taken from her third witness statement filed in this court in these proceedings:

> "In particular, I am responding to the Court's request for clarification as to the motivation relating to Securinvest's deliberate failure to provide the STJ with the UBO information requested in its 22 September 2009 Order.
>
> The STJ Order presented the Rural Group and me with a serious dilemma.
>
> Collectively, we knew that there never was any direct or indirect involvement by Petroforte or any of its affiliates in the ownership or control of Securinvest or the Rural Group and that therefore there was no common economic group between the Rural Group/Securinvest on the one hand and the Petroforte Group on the other. On this basis, as we understood the relevant bankruptcy law to be at that time, we believed that there was no legal basis by which Dr.

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144 In her third witness statement, of November 9th, 2018.

Braga could keep Securinvest within the Petroforte bankruptcy or to pursue any Securinvest asset other than Sobar . . .

A transparent declaration by me, acknowledging my status as UBO of Securinvest, I believe and understand would have fully satisfied the STJ that Petroforte had no ownership or management interest in Securinvest, thereby providing the STJ with the substantive basis for rejecting Dr. Braga's contention of a common economic group. As a result, I believed that had I made the correct UBO declaration, Securinvest would have been excluded from the Petroforte bankruptcy.

I also understood that, if Securinvest and I were successful in the STJ appeal, so as to free Securinvest from the Petroforte bankruptcy, this would not give Securinvest the right to ownership of Sobar, which, logically would remain subject to a resolution on the merits of the revocation action.

Given the logical consequences in the Petroforte bankruptcy proceeding of my admission to being the UBO of Securinvest, this Honourable Court is rightly concerned as to why I chose not to take this course. In essence, as I explain below, the problem was that, had I made this admission, very serious collateral issues would have arisen affecting Banco Rural and me from the perspective of the relevant regulator of the bank, namely the Brazilian Central Bank (BCB).

Under the applicable regulatory regime, common ownership by my family of Securinvest (100% through the First and Second Plaintiffs) and Banco Rural (54%) meant that transactions between Securinvest and Banco Rural should have been classified and disclosed as related party transactions and subject to the BCB's rigorous restrictions on related party transactions. Had the true nature of the relationship between Securinvest and Banco Rural been disclosed to the BCB, given the extensive transactions between Banco Rural and Securinvest, Banco Rural (the main asset of the RURAL Group) and I would have been exposed to severe legal and administrative sanctions.

Regrettably, it is against this background that I made the choice not to make a full and frank disclosure to the STJ that I was the UBO of Securinvest. Paradoxically, it was clearly in my interest to declare my UBO status for the purposes of the Petroforte litigation; however, for reasons I have stated in this Statement, namely protection from the significant risk of legal and/or regulatory proceedings against Banco Rural and me for the breach of the relevant banking laws and regulations, I elected not to declare this status.

At the time of my decision not to disclose Securinvest's UBO to the STJ, I knew that proceedings had already commenced against me and other Banco Rural affiliates in 2008 as a result of disclosure of UBO information as to TLB, which had been provided by CIMA to the BCB in 2006.[145]

In summary therefore, at the time of Securinvest's response to the STJ's Order regarding UBO disclosure, I knew that the Rural Group was the victim of an attempt by Dr. Braga to misappropriate hundreds of millions of dollars worth of non-Sobar assets based on the Rural Group's vulnerability to the BCB arising from the irregular nature of the Securinvest/Banco Rural relationship.

The cost of declaring my status as UBO of Securinvest would have been very high given the risks relating to the BCB and Brazilian banking law. Consequently, given the dilemma we faced, I decided not to disclose myself as Securinvest's UBO and instead disclose only the Costa Rican nominees while truthfully emphasizing to the STJ the key legal point that there was no connection between Securinvest's owners and Petroforte and that therefore no basis existed for any Securinvest assets to be subjected to the Petroforte bankruptcy, save for Sobar, which remained subject to the outcome of the revocation action:

> 'We would stress that what is important for the purposes of the law upheld by these interim remedy proceedings and according to the esteemed court ruling which granted an interim injunction, is that the Petitioner's shareholders, and the natural persons who are partners of those shareholders, do not have any relationship with the bankrupt party's group of companies.'[146]

My lack of candor with the STJ regarding the UBO of Securinvest had nothing to do with either the merits of Securinvest's appeal to the STJ or the Sobar property, which would have remained subject to Dr. Braga's revocation action following Securinvest's exclusion from the Petroforte bankruptcy. I and the Rural Group simply sought to vindicate our legitimate rights to the non-Sobar assets which Dr. Braga was trying to misappropriate, while at the same time avoiding

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145 I note in parenthesis here that this is implicitly a reference to herself as an interested party behind the note purchase transaction and a subject of the August 2009 retainer.

146 From the closing paragraph of Securinvest's submissions to the STJ (submissions to Justice Andrighi) of November 5th, 2009, exhibited to Katia Rabello's third witness statement.

> the very serious collateral regulatory and legal problems for Banco Rural (the main asset of the Rural Group) and me, which could arise from the BCB receiving proof that Securinvest was not independent, in terms of its ultimate beneficial ownership, from Banco Rural.
>
> In the absence of this huge legal and regulatory risk having nothing to do with Petroforte, I would have gladly disclosed my beneficial ownership of Securinvest to the STJ. Of course, in the absence of that risk, which I believe Dr. Braga knew I faced, I strongly doubt that he would have tried to misappropriate Securinvest's non-Sobar assets. Indeed, the existence of this overarching concern was subsequently validated by Dr. Braga's actions after obtaining the Cayman Disclosure in ex parte proceedings before this Court in May and July 2010, with the Defendant acting as his counsel in breach of the Defendant's duties to me. My fears were realized when I learned that Dr. Braga had requested Judge Beethoven to deliver to the BCB the confidential documents concerning my ownership of Securinvest, an action which was entirely irrelevant to the limited basis upon which he claimed to have been authorized by the STJ to seek cross border assistance from this Honourable Court."

439 The first point to note for present purposes is Ms. Rabello's response to the allegation of her intent fraudulently to mislead the STJ.

440 In summary, her response as I understand it (and as already briefly discussed above in the context of the plaintiffs' summary judgment application), is that her lie had no fraudulent intent primarily because, had the STJ been misled, the result would not have been the successful extraction of the contentious Sobar assets from Petroforte. Instead, had the STJ acted on her misrepresentations, allowed Securinvest's appeal and reversed the extension of the Petroforte bankruptcy over it, the validity of the Sobar transaction would have remained to be resolved in the context of the revocation action.

441 Further, that Dr. Braga would then have been obliged not merely to allege fraud, as he was able to in support of the bankruptcy proceedings, but instead to prove it in the revocation action. Securinvest's non-Sobar assets, to which he could have had no entitlement to claim, would very likely therefore have remained where they belonged, with Securinvest, because he would not have been able to prove the alleged fraudulent intermeddling in the Petroforte estate.

442 This explanation of Katia Rabello's intent was of course, not something given to resolution on the summary basis so as to afford her (or the other plaintiffs through her) a final answer to the defendant's strike-out

application. But conversely, neither was the defendant's strike-out application which must also be taken summarily,[147] a proper basis for rejecting it.

443 In short, the *bona fides* of her explanation is a matter of fact which could not be resolved without a trial, including cross-examination as to her intentions. The plaintiffs' case was therefore not amenable to being struck simply because (on the defendant's view of it) it depends on Katia Rabello's intention to deceive the STJ.

444 Her explanation also gives rise to the question whether, if accepted by the court, it might afford her a *locus poenitentiae*[148] from which she might urge this court to uphold her claims, her lie to the STJ notwithstanding. If so, it would provide a definitive answer to the defendant's strike-out application which, again, must show that the plaintiffs' case reveals no reasonable cause of action. The case law on this issue will be examined immediately below.

445 In light of her explanation, the defendant could not have succeeded with its strike-out application on the summary basis relying solely on its interpretation of her intentions in lying to the STJ. In this context, the defendant needed to show that her explanation was not an arguable or plausible response to its allegations of illegality. The onus was on the defendant to do so and, given her untested and therefore as yet unrefuted explanations, the onus was not discharged.

446 The principle of illegality (as a defence to a claim) was recently and authoritatively considered and restated by the UK Supreme Court in the case of *Patel* v. *Mirza* (54).

447 The facts were that Mr. Patel, the plaintiff, had transferred £620,000 to the defendant Mr. Mirza for him to bet on the price of shares in the Royal Bank of Scotland (RBS). Their agreement was based on the expectation that Mr. Mirza had access to inside information from his RBS

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147 See GCR O.18, r.19 (at fn 4 above). As the Notes to RSC explain at 18/19/6: "It is only in plain and obvious cases that recourse should be had to the summary process under this rule." And at 18/19/10: "[A] 'reasonable cause of action' [such as should survive a strike-out application] means a cause of action with some chance of success when . . . only the allegations in the pleadings are considered" (*per* Lord Pearson in *Drummond-Jackson* v. *B.M.A.* (25) ([1970] 1 W.L.R. at 696)). So long as the statement of claim or the particulars (*Davey* v. *Bentinck* (20)) disclose some cause of action, or raise some question fit to be decided by a judge or a jury, the mere fact that the case is weak and not likely to succeed is no ground for striking it out (*Moore* v. *Lawson* (47); *Wenlock* v. *Maloney* (75)).

148 Within the meaning of the case law as recently discussed by the Court of Appeal in *Patel* v. *Mirza* (54), although now to be regarded as but a factor for consideration and subsumed within the proportionality principle recognized by the Supreme Court in the majority decision delivered by Lord Toulson to be considered below.

contacts which would enable him to predict or anticipate movements in the market price of the shares. This agreement was illegal—it was a conspiracy to commit an offence of insider trading contrary to s.52 of the Criminal Justice Act 1993. But the inside information, which would have moved the market, never arrived. The bid for shares was not placed and although Mr. Mirza said he would return the money, he decided to keep it. When he was sued by Mr. Patel for its return he pleaded illegality as the defence, invoking the time honoured legal maxims: *ex turpi causa non oritur actio* (from a dishonourable cause an action may not arise) and in *pari delicto potior est conditio defendentis* (where fault is equal, the condition of the possessor is better)—in other words, where the parties are equally to blame, the position of the defendant is to be preferred, *i.e.* "let the loss lie where it falls."

448 The nine justices were unanimous that Mr. Patel should be entitled to recover his money and, which came to the same thing, that Mr. Mirza should not be permitted to keep the money because he would thereby have been unjustly enriched. The reasoning also was that Mr. Mirza was able to make full restitution of the money and Mr. Patel would neither be profiting from his admitted complicity in the illegal agreement, nor did he need to invoke the process of the court by way of reliance on it to prove his claim. In essence his claim was for his money handed over to Mr. Mirza, money by which Mr. Mirza would be unjustly enriched if it was not returned.

449 In his judgment on behalf of the majority, Lord Toulson identified tripartite policy considerations and adopted a "range of factors" approach that a court should take when deciding on a defence to a claim on the basis that the claim should fail on account of some illegality by the plaintiff. He explained that ([2016] UKSC 42, at para. 120):

> "*The essential rationale of the illegality doctrine is that it would be contrary to the public interest to enforce a claim if to do so would be harmful to the integrity of the legal system* . . . In assessing whether the public interest would be harmed in that way, it is necessary a) to consider the underlying purpose of the prohibition which has been transgressed and whether that purpose will be enhanced by denial of the claim, b) to consider any other relevant public policy on which the denial of the claim may have an impact and c) to consider whether denial of the claim would be a proportionate response to the illegality, bearing in mind that punishment is a matter for the criminal courts." [Emphasis added.]

450 In assessing whether it would be disproportionate to refuse relief to which the plaintiff was otherwise entitled (consideration (c) above), Lord Toulson explained (at para. 107) that "various factors may be relevant." In a claim where a party was attempting to enforce a contract, he explained

that these factors could include how central to the contract or its performance the relevant conduct was, how serious a sanction the denial of the enforcement would be for the party seeking enforcement, whether denying enforcement of the claim would further the purpose of the rule which the conduct had infringed, and whether denying enforcement would act as a deterrent to conduct that was illegal or contrary to public policy.

Impact of Patel v. Mirza in this case

451 In seeking to strike out the plaintiffs' claims on the ground of their illegality, the defendant made no effective attempt to engage with the impact of *Patel* v. *Mirza* (54).

452 Instead, the defendant has throughout repeated the refrain that if the claims succeed, then the plaintiffs, and Katia Rabello in particular, would have profited from her own dishonest wrongdoing. As Mr. Simpson put it during the final days of the hearing, asserting her reliance on illegality: "giving back to Katia Rabello by way of damages against her attorney that which was correctly taken by the Brazilian courts" and that she is guilty of "a massive fraud on Petroforte."

453 Yet, even a cursory reading of *Patel* v. *Mirza* explains that a claim can no longer be dismissed[149] simply by reliance on the doctrine of *ex turpi causa.* The mere assertion that Ms. Rabello would be profiting from her wrongdoing as an automatic bar to the plaintiffs' claims, fails to engage with the principles from *Patel* v. *Mirza.* As Lord Toulson explained ([2016] UKSC 42, at paras. 100–101):

> "100. Lord Goff observed in the Spycatcher case, *Attorney General v Guardian Newspapers Ltd (No 2)* [1990 1 AC 109], 286, that the '*statement that a man shall not be allowed to profit from his own wrong is in very general terms, and does not of itself provide any sure guidance to the solution of a problem in any particular case*'. In *Hall v Hebert* [1993] 2 SCR 159 McLachlin J favoured giving a narrow meaning to profit but, more fundamentally, she expressed the view (at 175–176) that, as a rationale, *the statement that a plaintiff will not be allowed to profit from his or her own wrongdoing does not fully explain why particular claims have been rejected, and that it may have the undesirable effect of tempting judges to focus on whether the plaintiff is 'getting something' out of the wrongdoing, rather than on the question whether allowing recovery for something which was illegal would produce inconsistency and disharmony in the law, and so cause damage to the integrity of the legal system.*

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149 As it was sometimes liable to be under the old rule in *Tinsley* v. *Milligan* (71) which was overruled by *Patel* v. *Mirza* (54).

101. *That is a valuable insight, with which I agree.*" [Emphasis added.]

454 With those principles in mind, it readily became apparent why the defendant's strike-out application based on *ex turpi causa* was bound to fail.

455 In the first place, even if the approach to the issue of illegality approved in *Patel* v. *Mirza* could be applied here (about which I make no finding because the allegation in this case of illegal conduct is entirely moot) then clearly, the burden of making out this defence rests upon the defendant. Yet the defendant has not even attempted to say why the defence of illegality should apply to bar each and every one of the plaintiffs' claims.

456 Moreover, there are no allegations of illegality on the part of EFHL and Mr. Toledo. Accordingly, to the extent that those plaintiffs can show loss or damage caused by the Cayman disclosure, the defendant may not argue that their claims are unsustainable or an abuse of process.

457 Secondly, so far as Katia Rabello herself is concerned, she makes no admission of illegal conduct nor has she been convicted of any in relation to the pivotal issue of the extension of the Petroforte bankruptcy. Her transgression, at least from the point of view of Judge Beethoven's extension of the bankruptcy to her, appears to have been the fact of her beneficial ownership of Securinvest and her lie to the STJ about that fact.

458 There is no reliance in her pleaded case, in order to claim loss against the defendant, upon any illegality as between herself and anyone (including the defendant as the counterparty for that matter). Her case is that the defendant breached its duties and obligations owed to her and that these breaches resulted in loss and damage, in turn the result of court and regulatory actions in Brazil.

459 In no sense does she rely upon her own impugned conduct. As already mentioned, this is in two respects. First her lie to the STJ. While she offers an explanation, she does not suggest that her lie should be accepted as the truth by this court in order to establish her claims. Acknowledging that she lied to the STJ, she explains that she had no fraudulent intent and no such intent could have prevailed in any event because the Sobar assets claimed by Petroforte would not have been released to her even if she had succeeded in Securinvest's appeal. And so, in light of the proportionality exercise advised by *Patel* v. *Mirza*, it would be disproportionate to reject her claims against the defendant on account of her lie, which would result only in an unjustified windfall for the defendant.

460 Moreover, again when considering proportionality, it must be remembered that the alleged fraudulent misappropriation of Petroforte

assets, allegations relating to events which preceded her time as head of the Rural Group—are, as yet, strictly to be regarded as unproven.

461 And so, even assuming the applicability of the *Patel* v. *Mirza* principles, in order to invoke them to block the plaintiffs' claims, the defendant must explain but has failed to even attempt to do so:[150]

(i) which acts it relies upon as constituting the relevant transgressions which would engage the illegality principle. Even if (in the continuing irresolution of the revocation action and despite also the absence of any criminal charges), the plaintiffs were to be regarded as guilty of the alleged "fraud" against Petroforte, the plaintiffs have not sought to rely upon that fraud for recovery in this action. Their claim, primarily, is for recovery of the value of Securinvest's and Katia Rabello's non-Sobar assets which were lost as a result of the defendant's actions which enabled the extension of the Petroforte bankruptcy to them by dint of civil,[151] not criminal, legal measures;

(ii) what effect the enforcement of the claims would have upon the public interest (in Cayman or in Brazil, assuming without acknowledging, the relevance of the latter) and conversely, their denial would have upon the plaintiffs. In the absence of proven illegality on the part of Katia Rabello in particular (and hence Arnage and Brooklands against whom the defendant makes such assertions) it is difficult to see how the public interests in the Cayman Islands (or in Brazil for that matter) would be harmed by allowing the enforcement of her and Arnage's and Brooklands' claims. Conversely, denying these claims would allow the defendant to escape from the consequences of its numerous and serious breaches of

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150 Instead, in its written submissions seeking to invoke public policy as a bar to the plaintiffs' claims on the basis that they sought to pervert the course of justice in Brazil by Katia Rabello's lie to the STJ. See defendant's skeleton arguments for hearing December 3rd–14th, 2018, paras. 172–175. And by a bold reliance on allegations of illegal conduct at written submissions for May 2018 hearing, paras. 110–111.

151 Recognizing that in *Laboratoires Servier* v. *Apotex* (41), in the context of a claim for infringement of pharmological patents, the Supreme Court held, *inter alia* (while finding on the facts of the case that the public interest was not sufficiently engaged to invoke the *ex turpi causa* rule) that:

"acts which constituted 'turpitude' for the purposes of the ex turpi causa rule were not confined to criminal acts but extended to acts which were quasi-criminal in that they were contrary to the public law of the state and engaged the public interest, which was the foundation of the illegality defence; that non-criminal acts which engaged the public interest included dishonesty or corruption even in the context of purely civil disputes, and the infringement of rules which were enacted for the protection of the public interest and which attracted civil sanctions of a penal character . . ."And see *Safeway* v. *Twigger* (63) (breaches of competition law) cited by the defendant.

duty owed to the plaintiffs because, entirely separately, unproven allegations by the defendant itself of illegal conduct in Brazil have been made against one (but not others) of the plaintiffs;

(iii) whether the denial of the claims would be a proportionate response to the (alleged) illegality. The defendant has not sought to explain why denial of these claims would be a proportionate response despite the apparent harm suffered by the plaintiffs. Let alone why denial of the claims would be proportionate to the undermining of the public interests which also demand (and would be in this case denied) the preservation and observance of the lawyer–client duties of confidentiality, loyalty and trust. Moreover, given Katia Rabello's explanation for her lie to the STJ, why it would be a proportionate response to block her claims entirely by way of strike-out, instead of affording her a *locus poenitentiae* (as discussed above), on the basis of her stated intention not to defraud the Petroforte estate of any of its assets.

462 Put shortly, the defendant has failed to explain why the plaintiffs' claims, or any of them, should be barred on the basis of the modern restatement of the illegality principle.

463 When properly understood and applied, the modern restatement of the principles present no clear basis for the denial of the plaintiffs' claims. In particular, the plaintiffs do not plead any reliance upon any illegal activity as between themselves and anyone else including, in particular, Securinvest. Their claims seek no recovery in respect of the Sobar assets and so, in that respect, any allegations of fraud (illegality), as yet unproven and yet to be resolved in the revocation action, are irrelevant to this action. Here I emphasize the difference, as I understand it, between the extension of the Petroforte bankruptcy on the civil (*i.e.* non-criminal) bases cited in the Brazilian judgments,[152] and any *proven* criminal allegation of fraud.[153]

464 Nor do the modern principles provide a proper basis upon which the defendant might seek to strike out the plaintiffs' claims on the summary basis upon which the defendant proposes.

465 Any fraudulent intent behind Katia Rabello's "lie" to the STJ is a matter to be cross-examined upon at the assessment of loss stage and can

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152 *Viz.* "common economic group" or "lifting of the corporate veil" to extend the bankruptcy respectively to Securinvest and Katia Rabello.

153 To the extent any such allegation ought now to be regarded as proven at this stage, the defendant, in any event, would be precluded from relying upon such allegation against its former clients in order to bar an otherwise proper claim. See *In re Thomas* (69), where the English Court of Appeal roundly rejected such a pleading by solicitors against their former client.

go only to the question of causation of loss,[154] not, in my view, to the question of the defendant's liability for breaches of duty. These are important observations to be expanded upon below, in the context of addressing the defendant's abuse of process "collateral attack" arguments.

(ii) ***Abuse of process: collateral attack upon the Brazilian judgments***

466 The court has a well-settled jurisdiction—both as a matter of its inherent powers and expressly from GCR O.18, r.19—to strike out claims which amount to an abuse of its process.

467 The categories of conduct which might render a claim liable to strike out for being frivolous, vexatious or otherwise an abuse of process are not closed but depend on all the relevant circumstances and, for this purpose, considerations of public policy and the interests of justice may be very material.[155]

468 The term "abuse of process of the court" connotes that the process of the court must be used *bona fide* and properly and must not be abused. The court will prevent the improper use of its machinery, and will, in a proper case, summarily prevent its machinery from being used as a means of vexation and oppression in the process of litigation by striking out the offending pleading. See Notes to the RSC, citing *Castro* v. *Murray* (16) and *Dawkins* v. *Prince Edward of Saxe Weimar*, *Willis* v. *Earl Beauchamp* (21) (11 P. at 63, *per* Bowen, L.J.).

469 The further manner in which the defendant says that the plaintiffs' claims are an abuse of process is that they are a collateral attack upon the Brazilian judgments and that in effect, the plaintiffs seek to re-litigate the consequences of those judgments by challenging both the correctness of the judgments under Brazilian law, as well as the integrity of the judges who decided them. Further, that in so doing submits the defendant, the plaintiffs question the very integrity of the Brazilian judicial system itself.

470 The defendant relies upon the statement of the law on collateral attack from Lord Diplock in *Hunter* v. *Chief Const. (West Midlands)* (38) ([1982] A.C. at 541). In that case there was an attempt by Hunter, one of the hapless Birmingham Six,[156] to challenge his criminal convictions for 21 murders by way of a civil claim in damages against the West Midlands

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154 That is, whether she should be regarded as having been obliged to tell the truth and so whether, had she told the truth as she was obliged to do, the outcome for Securinvest would have been the same as that which resulted from the defendant's breaches of duty.

155 See Notes to the RSC (*op. cit.*)—18/19/18, at 352.

156 As shown by their exoneration many years later when it was revealed that their confessions had indeed been fabricated by the police.

Police. In doing so he had to impugn in his civil action, the admissibility and authenticity of his confession upon which he had been convicted by the jury in the criminal case. This he sought to do by alleging that his confession to having planted the devastating bomb had been fabricated, following beatings at the hands of the police. Lord Diplock declared on behalf of the House of Lords that ([1982] A.C. at 541):

> "The abuse of process which the instant case exemplifies is the initiation of proceedings in a court of justice for the purpose of mounting a collateral attack upon a final decision against the intending plaintiff which has been made by another court of competent jurisdiction in previous proceedings in which the intending plaintiff had a full opportunity of contesting the decision in the court by which it was made."

471 While the House of Lords was there concerned with precluding the potential abuse of process which would have been inherent in allowing a challenge to the integrity of a *criminal conviction* by way of re-litigation in subsequent *civil proceedings*, it is clear from the discussion of the older cases that the collateral attack principle is meant to be of wider application. And so, that it could apply as regards a challenge in later civil proceedings to the outcome in earlier civil proceedings.

472 Lord Diplock stated (*ibid.*, at 541–542):

> "My Lords, collateral attack upon a final decision of a court of competent jurisdiction may take a variety of forms. It is not surprising that no reported case is to be found in which the facts present a precise parallel with those of the instant case. But the principle applicable is, in my view, simply and clearly stated in those passages from the judgment of A.L. Smith L.J. in *Stephenson v. Garnett* [1898] 1 Q.B. 677, 680–681 and the speech of Lord Halsbury L.C. in *Reichel v. Magrath* (1899) 14 App. Cas. 665, 668 which are cited by Goff L.J in his judgment in the instant case. I need only repeat an extract from the passage which he cites from the judgment of A. L.Smith L.J:
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> > '. . . the court ought to be slow to strike out a statement of claim or defence, and to dismiss an action as frivolous and vexatious, yet it ought to do so when, as here, it has been shewn that the identical question sought to be raised has been already decided by a competent court.'
>
> The passage from Lord Halsbury's speech deserves repetition here in full:
>
> > '. . . I think it would be a scandal to the administration of justice if, the same question having been disposed of by one case, the

> litigant were to be permitted by changing the form of the proceedings to set up the same case again.'"

473 Despite the many criticisms in their pleadings and written submissions of the Brazilian judgments,[157] the plaintiffs, *in arguendo* through Mr. Akiwumi, have disavowed any reliance on an invitation to this court to conclude that those judgments were wrong.

474 Instead, as I understand their argument, while the plaintiffs protest what they regard as injustice at the hands of the Brazilian judges, it is the consequence of their judgments which forms the basis of their claims against the defendant. Accordingly, the plaintiffs' position is that they do not need to invite this court to re-litigate the outcome or second-guess the correctness of the Brazilian judgments, a proposition which, as I already noted earlier in this judgment, it would have been inappropriate for this court to entertain in any event.[158]

475 So for instance, while they regard the *ex parte* and summary manner of Judge Beethoven's extension of the Petroforte bankruptcy to Katia Rabello as unjust, their claim against the defendant in that regard is for having, in breach of duty, obtained for Dr. Braga Katia Rabello's confidential information upon which Judge Beethoven relied in coming to his decision.

476 And that while Judge Beethoven's judgment may have been the most proximate cause of her loss, she does not need to challenge its correctness in order to hold the defendant liable for its breaches of duty which also caused her loss.

477 In other words, the plaintiffs say that it is not a challenge to the validity of the Brazilian judgments to seek to recover from the defendant the losses which were incurred as the result of the defendant's actions resulting in those judgments. Indeed, the opposite would be the case advanced, the losses being but the manifestation of the effectiveness of the judgments.

478 And moreover, that where the defendant may not show that recovery should be barred on grounds of the illegality principle,[159] there can be

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157 See as summarized in paras. 164–171 of the defendant's written submissions for hearing on December 3rd–14th, 2018.

158 In light of the settled principle that the decision of a foreign court taken in accordance with its own law is binding, notwithstanding that an English (Cayman) court would have decided the matter differently according to English law: *Goddard* v. *Gray* (30) (L.R. 6 Q.B. at 149 and *Castrique* v. *Imrie* (15).

159 Discussed above.

no abuse of process in seeking to recover the losses resulting from the defendant's breaches of duty.

479 Understood as set out in those terms, it is difficult to see why the plaintiffs' claims should be struck for being an abuse of process either by exercise of the O.18, r.19 power or the inherent jurisdiction of the court. And this is so notwithstanding that, in the latter context, the cases suggest that a wider discretionary power to strike out exists.[160]

480 Simply put—despite the critical tenor of much of their pleadings and arguments—as the plaintiffs' case does not depend upon this court having to conclude in any way contrary to the Brazilian judgments, there can be no finding of a collateral attack upon those judgments. For that reason, say the plaintiffs, the defendant's strike-out application for abuse of process must be dismissed.

481 There is, however, a further point of principle which has arisen and which I think should be recognized, if only in passing.

482 The point arises because what is by no means clear from the case law is the extent to which the collateral attack principle may be invoked for the preclusion of an action which seeks to challenge an earlier *foreign* judgment.

483 In light of my understanding of the plaintiffs' case as set out above, I do not need to resolve this question raised by the defendant as relating to the plaintiffs' pleadings *vis-à-vis* the Brazilian judgments. In the absence of any collateral attack upon them, those judgments will be relevant but only to the issue of causation in the context of the assessment of loss or damages to come, and that exercise will in no manner involve a scrutiny or criticism of the correctness of those judgments.

484 Following, therefore, is but a brief examination of the case law relating to the question of collateral attack upon foreign judgments. This is for the sake of explaining why, in any event, I would not have considered it appropriate to strike out the plaintiffs' claims on that basis.

485 There is a longstanding rule first settled in *Henderson* v. *Henderson* (34), that it is an abuse of the process of the court to raise in subsequent proceedings matters which could and should have been litigated in earlier proceedings.

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160 See Notes to RSC (*op. cit.*) 18/19/26–18/19/38, where it is explained among other things, that resort to the inherent jurisdiction allows the court to conduct a full factual enquiry based upon evidence (unlike the guidance given in relation to the O.18, r.19 route).

486 The abuse of process arises from the fact that in such circumstances, *res judicata* in the wider sense is deemed to have been established as between the disputing parties even though, in the strict, narrower sense, the matters raised had not actually been joined or adjudicated in an earlier action between them. The principle was explained by the Privy Council in *Yat Tung Inv. Co. Ltd.* v. *Duo Heng Bank* (76) ([1975] A.C. at 590):

> "But there is a wider sense in which the doctrine may be appealed to, so that it becomes an abuse of process to raise in subsequent proceedings matters which could and therefore should have been litigated in earlier proceedings. The locus classicus of that aspect of res judicata is the judgment of Wigram V-C in *Henderson v. Henderson* (1843) 3 Hare 100, 115, where the judge says:
>
> '. . . where a given matter becomes the subject of litigation in, and of adjudication by, a court of competent jurisdiction, the court requires the parties to that litigation to bring forward their whole case, and will not (except under special circumstances) permit the same parties to open the same subject of litigation in respect of matter which might have been brought forward as part of the subject in contest, but which was not brought forward, only because they have from negligence, inadvertence, or even accident, omitted part of their case. The plea of res judicata applies, except in special cases, not only to points upon which the court was actually required by the parties to form an opinion and pronounce a judgment, but to every point which the parties, exercising reasonable diligence, might have brought forward at the time.'"

487 This principle ("the *Henderson* principle") has been applied to preclude actions[161] being taken in England for the determination of matters which could and should have been determined not only in

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161 In cases which have been the subject of strong criticism because of the assumption on which they proceeded that the *Henderson* rule should operate to preclude action in England in deference to action taken in foreign courts. See for instance Briggs, "Foreign judgments and res judicata," 68 BYBIL 355, at 357 (1997), extensively discussed with approval by 2001, and Beckwith, "Res Judicata and Foreign Judgments: The Indian Grace," 43(1) *Int. & Comp. L.Q.* 185–193 (1994). These critiques, which also identify (Briggs, "Foreign judgments and res judicata: Desert Sun Loan Corp v. Hill," 67 BYBIL 596, at 599 (1996)) the danger of giving ready preclusive effect to foreign judgments which have not otherwise satisfied the standards for recognition and enforcement, draw support from the cautionary words of the House of Lords in *Carl Zeiss Stiftung* v. *Rayner & Keeler Ltd. (No. 2)* (14), albeit relating to the preclusive effect of issue estoppel rather than to the abuse of process *Henderson* rule: "Issue estoppel can be based on a foreign judgment, although in such a case the doctrine should be applied with caution because of the uncertainties arising from the differences of procedure in foreign countries" (as taken from the headnote ([1967] 1 A.C. 853)).

domestic but also in earlier foreign proceedings between the same parties.[162]

488 However, as is trite law, the preclusive effect of a foreign judgment *in personam*[163] in subsequent proceedings in England is limited according to the doctrines of privity and mutuality; *i.e.* the parties or privies to the earlier foreign proceedings must be the same as those to the subsequent English proceedings and must have been mutually bound by the outcome in the foreign proceedings. In other words, each party in the subsequent proceedings must have been party or privy to the earlier proceedings, and must claim or defend in the subsequent proceedings in the same right as they, or those to whom they are privy, claimed or defended in the earlier. Thus:

> ". . . [I]t unquestionably is not the general rule of law that a judgment obtained by *A.* against *B.* is conclusive in an action by *B.* against *C.* On the contrary, the rule of law is otherwise. . . . [A] judgment *inter partes* is conclusive only between the parties and those claiming under them."[164]

489 There is no privity of parties or mutuality of outcome as between the defendant and the plaintiffs in relation to the Brazilian judgments and the case at bar and the defendant clearly may not and does not contend otherwise.

490 The defendant's strike-out application, based as it also is upon the *Henderson* principle (or for that matter upon *Hunter* v. *Chief Constable of West Midlands* (38)) is therefore misconceived.

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162 See, for instance, *House of Spring Gardens Ltd.* v. *Waite* (36), where it was found to be an abuse of the process of the court in England and contrary to justice and public policy for a party to re-litigate the issue of fraud after the selfsame issue had been tried and decided by the Irish court. In *Fennoscandia Ltd.* v. *Clarke* (28), where the claimant, C, was precluded from bringing proceedings in England against F Ltd. to claim breach of a legal duty allegedly owed by F Ltd. to C, C having already brought and lost proceedings against F Ltd. in Delaware. F Ltd. defended the English action by arguing (successfully) that C's claim did not identify a legal duty known to English law but, also, by arguing that (in any case) this was a claim which could and should have been raised in Delaware. These decisions are themselves the subject of convincing criticism because of their confusing interpolation of issue estoppel and the preclusive *Henderson* principle on abuse of process. See again *Briggs* (*op. cit.*).

163 Such as, for instance here, the judgment of Judge Beethoven which rendered Katia Rabello bankrupt.

164 *Gray* v. *Lewis*, *Parker* v. *Lewis* (31) (8 Ch. App. at 1059–1060), *per* Mellish, L.J. See, as these cases are discussed also by Barnett, *Res Judicata, Estoppel & Foreign Judgments*, *op. cit.*, at 62–74.

491 For the reasons explained above, so is its application as it is based upon the illegality principle.

492 The defendant's strike-out application for abuse of process is, for those reasons, dismissed.

493 The plaintiffs are granted summary judgment on liability with loss/damages to be assessed.

494 The plaintiffs are of course entitled as they seek at para. 4 of their summons, to their costs.

495 I will accept submissions in writing as to the terms of the order to be made for the costs of these proceedings. Written submissions are to be exchanged between the parties within four days and submitted to the court within seven days.

Orders accordingly.

Stuarts for the plaintiffs; *Appleby* for the defendant.

ITEM NO. 169

JA-55

[2020 (2) CILR 787]

IN THE MATTER OF LATAM FINANCE LIMITED

IN THE MATTER OF PEUCO FINANCE LIMITED

IN THE MATTER OF PIQUERO LEASING LIMITED

GRAND CT. (Kawaley, J.) August 24th, 2020

Conflict of Laws — companies — cross-border insolvency — approval of court-to-court communication protocol — common law duty to assist foreign insolvency courts

The court was asked to approve a court-to-court communications protocol.

Joint provisional liquidators (the JPLs) were appointed with "light-touch" powers to supervise a restructuring on the application of each of three companies. It was anticipated that the companies would seek relief under Chapter 11 of the US Bankruptcy Code. There were also proceedings in Chile and Colombia.

The JPLs applied for orders for directions that a cross-border court-to-court communications protocol be approved subject to the approval of the same by the relevant courts in the United States, Chile and Colombia. The JPLs relied on O.21 of the Companies Winding Up Rules 2018, Practice Direction No. 1 of 2018 (Court-to-court Communications and cooperation in cross-border insolvency and restructuring cases) and the court's practice of promoting cross-border cooperation in insolvency cases.

Held, granting the orders sought approving the protocol:

(1) The principal foundation of the court's jurisdiction to approve the protocol was the common law duty to assist foreign insolvency courts in service of the goal of a universal application of the regime for dealing with creditors' claims being applied in the main insolvency proceeding (modified universalism). The principle of comity had been identified as underpinning the common law assistance power. Subsidiary sources of jurisdictional rules included the court's inherent jurisdiction to manage its own processes. The JPLs had rightly identified as important Practice Direction No. 1 of 2018, which approved the American Law Institute/ International Insolvency Institute Guidelines Applicable to Court-to-Court Communications in Cross-Border Cases (the ALI/III Guidelines) and the Judicial Insolvency Network Guidelines for Communication and

Cooperation between Courts in Cross-Border Insolvency Matters (the JIN Guidelines). The Practice Direction and the Guidelines could be viewed as emerging sources of law which provided a jurisdictional basis for approving the protocol (paras. 17–26).

(2) The main governing principles applicable to an application for the court's approval of a court-to-court communication protocol were that (a) the court was under a positive duty to assist the primary foreign main insolvency or restructuring proceedings unless there were good reasons not to do so; (b) there was a starting assumption that a clear framework for communication between the court and any relevant foreign courts in cross-border insolvency cases would enhance the efficiency of the cross-border case; and (c) there was a starting assumption that the ALI/III Guidelines and the JIN Guidelines (approved in the Practice Direction) were suitable guidelines to adopt and apply in cross-border cases. It was consistent with constitutional principles of judicial independence, the more pragmatic principles of modified universalism and the inherent powers of the court to protect the efficiency and integrity of its processes that the particularities of how to advance the efficiency of cross-border insolvency proceedings at the operational case management level should predominantly be grounded in such soft law instruments, which could be viewed as a form of extra-judicial judge-made transnational procedural law. There was a long and substantial history of the court coordinating its hearings with parallel insolvency and restructuring proceedings in foreign courts and commun-icating indirectly with such courts. The cooperation and coordination between the court and foreign insolvency courts in past cases had been grounded in the court's common law duty to assist foreign courts and to promote the most economically efficient administration of transnational insolvency estates (paras. 26–32).

(3) In light of the clarity and depth of the common law principles commending judicial coordination and communication in cross-border insolvency cases, combined with the recent promulgation of the Practice Direction, it was obvious that the protocol could only properly be approved. The protocol merely sought formal approval of the already administratively pre-approved ALI/III Guidelines Applicable to Court-to-Court Communications in Cross-Border Cases. The judicial approval sought also implicitly required the court to recognize the Chapter 11 proceeding as a foreign main proceeding which the court, in conjunction with the courts in Chile and Colombia, was willing to assist. This was also uncontroversial. The requisite recognition had already effectively been granted by the court's initial appointment of the JPLs for the explicit purpose of pursuing a restructuring. It was explicitly contemplated that such restructuring would take place primarily through Chapter 11 proceedings before the US Bankruptcy Court (paras. 33–34).

Cases cited:

(1) *BCCI (Overseas) Ltd., In re*, 2009 CILR 373, considered.

(2) *CW Group Holdings Ltd.*, *Re*, FSD 113 and 122 of 2018, Grand Ct., August 3rd, 2018, unreported, considered.
(3) *Cambridge Gas Transport Corp.* v. *Creditors' Cttee. (Navigator Holdings plc)*, [2006] UKPC 26; [2007] 1 A.C. 508; [2006] 3 W.L.R. 689; 2005–06 MLR 297; [2006] 3 All E.R. 829; [2007] 2 BCLC 141; [2006] BCC 962, considered.
(4) *China Agrotech Holdings Ltd., In re*, 2019 (2) CILR 356, considered.
(5) *Da Yu Fin. Holdings Ltd.*, *Re*, [2019] HKCFI 2531; October 17th, 2019, considered.
(6) *Impex Servs. Worldwide Ltd.*, *In re*, 2003–05 MLR 115; [2004] BPIR 564, *dicta* of Deemster Doyle considered.
(7) *Lancelot Investors Fund Ltd., In re*, 2009 CILR 7, considered.
(8) *Nanfong Intl. Invs. Ltd., In re*, 2018 (2) CILR 321, considered.
(9) *Singularis Holdings Ltd.* v. *PricewaterhouseCoopers*, [2014] UKPC 36; [2015] A.C. 1675; [2015] 2 W.L.R. 971; [2014] 2 BCLC 597; [2015] BCC 66, considered.

Legislation construed:
Grand Court Law (2015 Revision), s.11: The relevant terms of this section are set out at para. 18.
M. Hecht and *Z. Nolan* for the joint provisional liquidators.

1 **KAWALEY, J.:**

Background

The JPLs were appointed with "light-touch" powers to supervise a restructuring on the application of each of the companies on May 28th, 2020 (LATAM Finance Ltd. ("LTM") and Peuco Finance Ltd. ("PF")) and on July 10th, 2020 (Piquero Leasing Ltd. ("PL")), respectively. It was anticipated by each petition that the companies would seek relief under Chapter 11 of the US Bankruptcy Code.

2 By *ex parte* summonses each dated July 22nd, 2020, the JPLs applied for orders for directions that:

> "1. The certain cross-border court-to-court communications protocol be approved subject to the approval of the same by each of the United States Bankruptcy Court for the Southern District of New York, the 2nd Civil Court of Santiago, Chile and the Superintendencia de Sociedades in Colombia."

3 The applications were supported by the first affidavit of Jeffrey Stower which explained how the protocol idea had developed (prompted by the suggestion of the Chilean court) and placed the proposed form of protocol before the court. Counsel for the JPLs addressed the court's jurisdiction to grant the applications, albeit by reference to general principles being

unable to identify any directly applicable previous published decision of this court. At the end of the hearing I granted the applications and made orders, *inter alia*, that:

> "1. The cross-border court-to-court communications protocol as appended hereto (the 'Cross-Border Protocol'), as it may be amended or supplemented by further order of this Honourable Court, be approved in all respects subject to approval of the same by each of the United States Bankruptcy Court for the Southern District of New York (the 'U.S. Court'), the 2nd Civil Court of Santiago, Chile and the Superintendencia de Sociedades in Colombia (the 'Courts')."

4 As this appears to be the first time that this court has approved a "court-to-court communications" protocol, and the jurisdictional basis for this decision was somewhat unclear, I now give reasons for this decision.

The JPLs' submissions

5 In the JPLs' skeleton argument, it was first submitted that the "law applicable to the presentation and consideration of international protocols is contained in Order 21 of the Companies Winding Up Rules, 2018 (the 'CWR')" (para. 10). It was further submitted that the scope of the proposed protocol was consistent with the requirements of CWR, O.21, r.3. As I observed in the course of hearing, this was a difficult basis to rely upon given the apparent non-alignment between the types of protocols contemplated by O.21 and the narrow scope of the proposed "cross-border protocol" ("the protocol").

6 It was then submitted as follows:

> "17. Importantly, Practice Direction No. 1 of 2018 ('PD') stipulates that consideration should be given by provisional liquidators to the incorporation of the certain guidelines into international protocols and that the protocol may, subject to the approval of the Court; cover other matters including court-to-court communications and cooperation as provided for in the Guidelines.
>
> 18. It is noted that the Cross-Border Protocol is a distilled version of the ALI/ABA/III Guidelines, which are expressly referred to in the PD as being appropriate to the jurisdiction of the Cayman Islands."

7 Footnote 36 pointed out:

> "There are two main sets of guidelines (the 'Guidelines') for court-to-court communications and cooperation which might be adopted in this jurisdiction, with appropriate modifications. These are the American Law Institute/International Insolvency Institute Guidelines Applicable to Court-to-Court Communications in Cross-Border Cases (the 'ALI/ABA/III Guidelines') and The Judicial Insolvency

Network Guidelines for Communication and Cooperation between Courts in Cross-Border Insolvency Matters."

8 In the course of the hearing, Mr. Hecht sensibly accepted that Practice Direction No. 1 of 2018 ("the practice direction") addressed the protocol more directly than any other source of jurisdiction advanced.

9 Reliance was also placed on the fact that the JPLs had been empowered by para. 5(h) of the order appointing them in respect of each of the companies—

"to enter into such protocol or other agreement as the JPLs deem appropriate for the co-ordination of these proceedings, the proceedings that have been commenced by the Company and other entities within the LATAM group of companies under Chapter 11 of Title 11 of the U.S. Bankruptcy Code and any other like proceedings for the winding up, restructuring and/or reorganisation of the Company and other companies within the LATAM group of companies, subject to the approval of this Court and the U.S. Bankruptcy Court for the Southern District of New York in the United States of America."

10 This power was potentially relevant because it contemplated protocols dealing with cross-border "co-ordination of . . . proceedings," but the present application related to a protocol to be entered into, on its face, between the respective courts, and the JPLs appeared to be acting as facilitators of the protocol rather than intending to actually enter into it.

11 Finally, most pertinently, reliance was placed on this court's established practice of promoting cross-border cooperation in insolvency cases. It was submitted by Mr. Hecht and Ms. Nolan in their skeleton:

"21. This Honourable Court has demonstrated its willingness, on various occasions, to cooperate with foreign Courts to ensure the efficient management of cross-border insolvency proceedings, including, by approving the entry into international protocols.

22. Indeed, this Honourable Court in the Matter of Lancelot Investors Fund Limited [2009 CILR 7], adopted the language of Lord Denning, who, when sitting in the Court of Appeal in Rio Tinto Zinc Corp. v. Westinghouse Elec. Corp. (7) ([1978] A.C. at 560) stated that:

'It is our duty and our pleasure to do all we can to assist [the foreign] court, just as [the English court] would expect the [foreign] court to help us in like circumstances.'"

Legal findings: the jurisdictional basis for entering into a court-to-court communications protocol

Sources of jurisdiction

12 The Cayman Islands, so far as cross-border insolvency law is concerned, remains to a significant extent a "traditional" common law jurisdiction. The rules of private international law, or the conflict of laws, have not been codified and cannot be discerned in single set of statutory rules. The importance of international financial centres actively utilizing common law powers in the absence of comprehensive statutory international cooperation codes has long been recognized. As Deemster David Doyle opined in *Re Impex Services Worldwide Ltd.* (6) (2003–05 MLR 115, at para. 52):

> "52 Here on the Isle of Man, we are all citizens of the Island but we are also citizens of the global community in which we live, work and contribute. We need to recognize our international as well as our local responsibilities. If the English High Court requires assistance then the Manx High Court, if it has jurisdiction and subject to any necessary safeguards, should not, in a proper case, be slow to provide such assistance."

13 England and Wales was also primarily reliant on common law cross-border insolvency rules of private international law for many years. Then, partly under European Union influences, the ambit of the common law was narrowed in England and Wales by increased reliance on statutory rules. As Lord Hoffmann observed, dealing with a Privy Council appeal from the Isle of Man in *Cambridge Gas Transport Corp.* v. *Creditors' Cttee. (Navigator Holdings plc)* (3) ([2007] 1 A.C. 508, at paras. 16–22):

> "16 The English common law has traditionally taken the view that fairness between creditors requires that, ideally, bankruptcy proceedings should have universal application. There should be a single bankruptcy in which all creditors are entitled and required to prove. No one should have an advantage because he happens to live in a jurisdiction where more of the assets or fewer of the creditors are situated. For example, in *Solomons* v. *Ross* . . . a firm in Amsterdam was declared bankrupt and assignees were appointed. An English creditor brought garnishee proceedings in London to attach £1,200 owing to the Dutch firm but Bathurst, J., sitting for the Lord Chancellor, decreed that the bankruptcy had vested all the firm's movable assets, including debts owed by English debtors, in the Dutch assignees. The English creditor had to surrender the fruits of the garnishee proceedings and prove in the Dutch bankruptcy.
>
> 17 This doctrine may owe something to the fact that 18th and 19th century Britain was an imperial power, trading and financing

development all over the world. It was often the case that the principal creditors were in Britain but many of the debtor's assets were in foreign jurisdictions. Universality of bankruptcy protected the position of British creditors. Not all countries took the same view. Countries less engaged in international commerce and finance did not always see it as being in their interest to allow foreign creditors to share equally with domestic creditors. But universality of bankruptcy has long been an aspiration, if not always fully achieved, of United Kingdom law. And with increasing world trade and globalisation, many other countries have come round to the same view.

18 As Professor Fletcher points out (*Insolvency in Private International Law*, 1st ed (1999), p 93), the common law on cross-border insolvency has for some time been 'in a state of arrested development', partly, no doubt, because in England a good deal of the ground has been occupied by statutory provisions such as section 426 of the Insolvency Act 1986, the European Council Regulation (EC) No 1346/2000 and the Cross-Border Insolvency Regulations 2006 (S.I. 2006/1030), giving effect to the UNCITRAL Model Law. In the present case, however, we are concerned solely with the common law.

. . .

21 Their Lordships consider that these principles are sufficient to confer upon the Manx court jurisdiction to assist the committee of creditors, as appointed representatives under the Chapter 11 order, to give effect to the plan. As there is no suggestion of prejudice to any creditor in the Isle of Man or local law which might be infringed, there can be no discretionary reason for withholding such assistance.

22 What are the limits of the assistance which the court can give? In cases in which there is statutory authority for providing assistance, the statute specifies what the court may do. For example, s.426(5) of the Insolvency Act 1986 provides that a request from a foreign court shall be authority for an English court to apply 'the insolvency law which is applicable by either court in relation to comparable matters falling within its jurisdiction.' At common law, their Lordships think it is doubtful whether assistance could take the form of applying provisions of the foreign insolvency law which form no part of the domestic system. But the domestic court must at least be able to provide assistance by doing whatever it could have done in the case of a domestic insolvency. The purpose of recognition is to enable the foreign office holder or the creditors to avoid having to start parallel insolvency proceedings and to give them the remedies to which they would have been entitled if the equivalent proceedings had taken place in the domestic forum."

14 The following principles which are still largely uncontroversial can be extracted from the quoted extracts from *Cambridge Gas*:

(a) there is a common law rule of private international law which affirms the desirability that an insolvency proceeding which crosses jurisdictional borders should, so far as is practically possible, be administered on a global (or universal) basis within a single "main proceeding";

(b) where a single proceeding is not possible and the courts in an ancillary proceeding are requested to assist the foreign main proceeding, the ancillary court is under a common law duty to assist the foreign court, unless there are discretionary or mandatory statutory grounds for refusing relief; and

(c) the combination of these two common law rules is known as "modified universalism."

15 In the post-*Cambridge Gas* era, Anthony Smellie, C.J. identified the deeper underpinnings of the common law assistance power as being the wider, and older, principle of "comity." Writing extra-judicially in "A Cayman Islands Perspective on Transborder Insolvencies and Bankruptcies: The Case for Judicial Co-Operation," 2(4) *Beijing Law Review* 145 (2011), he opined as follows (at 147):

> "The over-arching principle is, of course, Comity—that civilized notion that requires reciprocity of co-operation and assistance between the courts of different countries, classically described by Lord Denning in the Westinghouse case in relation to a request by the United States Federal Court in this way:
>
> > 'It is our duty and pleasure to do all we can to assist that court, just as we would expect the United States Court to help us in like circumstances. Do unto others as you would be done by.'"

16 In *Singularis Holdings Ltd.* v. *PricewaterhouseCoopers* (9), in which actual decision in *Cambridge Gas* was disapproved, Lord Sumption described the sources of the modified universalism principle as follows ([2015] 1 A.C. 1675, at para. 19):

> "In the Board's opinion, the principle of modified universalism is part of the common law, but it is necessary to bear in mind, first, that it is subject to local law and local public policy and, secondly, that the court can only ever act within the limits of its own statutory and common law powers. What are those limits? *In the absence of a relevant statutory power, they must depend on the common law, including any proper development of the common law.*" [Emphasis added.]

17 It is this common law duty to assist foreign insolvency courts in service of the goal of a universal application of the regime for dealing with creditors' claims being applied in the main insolvency proceeding, which is the principal foundation of this court's jurisdiction to approve the protocol in the present case.

18 However, it is important to acknowledge the relevance of other subsidiary sources of jurisdictional rules which are built on top of the foundations of comity and the common law duty to assist foreign insolvency courts. The next most important, in my judgment, is the inherent jurisdiction of the Grand Court to manage its own processes (*i.e.*, its procedures). Section 11 of the Grand Court Law (2015 Revision) provides:

> "11. (1) The Court shall be a superior court of record and, in addition to any jurisdiction heretofore exercised by the Court or conferred by this or any other law for the time being in force in the Islands, shall possess and exercise, subject to this and any other law, the like jurisdiction within the Islands which is vested in or capable of being exercised in England by—
>
> (a) Her Majesty's High Court of Justice; and
>
> (b) the Divisional Courts of that Court,
>
> as constituted by the Senior Courts Act, 1981, and any Act of the Parliament of the United Kingdom amending or replacing that Act."

19 This statutory provision incorporates into Cayman Islands law the common law rules of practice under which English superior courts of record have the right to manage their own procedures to prevent the court's processes being misused. Those inherent powers based almost entirely on judge-made law are supplemented by rules of court which are in substance made not by the executive or legislative branches of Government, by the judiciary itself.

20 Where a case management power is not found in legislation or, for present purposes, in the CWR, the gap may generally be filled by the court's inherent jurisdiction. In some contexts, an inherent common law power may overlap with or be supplemented by a rule of court. A helpful example is the case management stay in ordinary civil litigation. In *In re Nanfong Intl. Invs. Ltd. (8)*, Moses, J.A. stated (2018 (2) CILR 321, at para. 42):

> "42 There is no specific power contained within Cayman Islands legislation for the imposition of a case management stay. The courts invoke their inherent jurisdiction and their general case management powers derived from the preamble to the Grand Court Rules 1995 (Revised) and the *Financial Services Division Guide*, 2nd ed., s.A4,

at 9–10 (2015), which reproduces the same text (see *CIGNA Worldwide* v. *ACE Ltd.* . . . (2012 (1) CILR 55, at paras. 55–57)).”

21 This passage illustrates, first, that case management powers as significant as the power to grant a stay of proceedings are derived from the court’s inherent jurisdiction. But, further, the passage demonstrates that the exercise of the power may be derived not just from formally promulgated rules of court, but also from practice directions such as the Financial Services Division Guide which, incidentally, reproduces the overriding objective from the Preamble to the Grand Court Rules. It is this inherent jurisdiction, fortified it might be said by the constitutional protections for judicial independence,[1] which may be viewed as the source of the power to issue practice directions to signify the court’s general view of the procedural approach to various types of cases and matters. In the present case, the JPLs’ counsel rightly identified as important Practice Direction No. 1 of 2018, “Court-to-court Communication and cooperation in cross-border insolvency and restructuring cases,” issued by Anthony Smellie, C.J. on May 31st, 2018 (“the practice direction”).

22 The first section of the practice direction merits reproduction in full:

“The Guidelines—what they cover and when they should be used.

1. This practice direction deals with the use and adoption in cases pending before the Grand Court of the Cayman Islands (Court) of published guidelines relating to court-to-court communications and cooperation in cross-border insolvency and restructuring proceedings.

2. *There are two main sets of guidelines (Guidelines) for court-to-court communications and co-operation which might be adopted in this jurisdiction, with appropriate modifications. These are the American Law Institute/International Insolvency Institute Guidelines Applicable to Court-to-Court Communications in Cross-Border Cases and The Judicial Insolvency Network Guidelines for Communication and Cooperation between Courts in Cross-Border Insolvency Matters.* Copies of the current versions of both sets of Guidelines are attached to this Practice Direction.

3. *The Guidelines primarily cover the procedural rules that may be adopted and applied in particular cross-border cases for regulating the manner of communications between the courts involved, the appearance of counsel in each court, notification to parties in parallel proceedings, the acceptance as authentic of official documents or orders made in the foreign jurisdiction or court and joint hearings.* They are to be applied either by being incorporated in a protocol between the respective officeholders which protocol is then approved

by the Court (and other courts involved as required) or by a separate order of the Court without a protocol (and orders of the other courts involved as required), in each case subject to such modifications as may be required in the circumstances.

4. *The Guidelines are relevant where the insolvency or restructuring proceedings are being supervised by, or involve related applications to, courts in more than one jurisdiction. Such proceedings will include liquidation (including provisional and voluntary liquidation) and other insolvency or restructuring proceedings involving applications to court.* Accordingly, the Guidelines will be relevant to schemes of arrangement relating to a company being supervised by the Court which also involve a parallel scheme (or debt adjustment proceeding) or ancillary proceedings in another jurisdiction (and may also be relevant in cases in which the Court has appointed a receiver or other officer of the Court and where the Cayman Islands Monetary Authority has appointed a controller pursuant to the Cayman Islands regulatory laws). The Guidelines can apply whether the officeholder is appointed by the Court or is appointed out of Court and whether the person is appointed in respect of a company (incorporated in the Cayman Islands or abroad) other legal entity (established in the Cayman Islands or abroad) or an individual.

5. *Officeholders appointed in the Cayman Islands, companies subject to restructuring proceedings supervised by the Court and other interested parties involved in cross-border insolvency cases should consider, at the earliest opportunity, whether to incorporate some or all of the Guidelines with suitable modifications either into an international protocol to be approved by the Court or an order of the Court adopting the Guidelines.*" [Emphasis added.]

23 The practice direction appears designed to achieve the following objectives:

(a) it informally and administratively approves the ALI/III Guidelines and the JIN Guidelines as suitable for use in cross-border insolvency cases;

(b) it explains that these Guidelines are relevant "where the insolvency or restructuring proceedings are being supervised by, or involve related applications to, courts in more than one jurisdiction"; and

(c) it recommends that Cayman Islands office-holders "consider, at the earliest opportunity, whether to incorporate some or all of the Guidelines with suitable modifications either into an international protocol to be approved by the Court or an order of the Court adopting the Guidelines."

24 It may immediately be seen that the practice direction, probably like all practice directions, does not seek to promulgate new law. It seeks to

nudge, rather than push, office holders towards considering in suitable cases inviting the court to adopt either one of the two annexed sets of guidelines. The practice direction approves the respective guidelines in principle as being in general terms "fit for purpose" for use in cross-border insolvency cases. The recommended guidelines are themselves international practice directions which various other courts pre-approved. The guidelines bear the *imprimatur* of distinguished sitting and former judges, not just from the United States, Canada and England and Wales, but from countries in Africa, Asia, Australasia and Eastern Europe as well. The introduction to the ALI/III Guidelines ("the guidelines") concludes as follows:

> "The Guidelines are not meant to be static, but are meant to be adapted and modified to fit the circumstances of individual cases and to change and evolve as the international insolvency community gains experience from working with them. They are to apply only in a manner that is consistent with local procedures and local ethical requirements. They do not address the details of notice and procedure that depend upon the law and practice in each jurisdiction.
>
> However, the Guidelines represent approaches that are likely to be highly useful in achieving efficient and just resolutions of cross-border insolvency issues. Their use, with such modifications and under such circumstances as may be appropriate in a particular case, is therefore recommended."

25 The guidelines then set out a series of practical operational principles, essentially different forms of communications, such as exchanging copies of court filings, communications between judges (on notice to the parties limited to logistical matters) and joint hearings. The overarching guiding principle is best encapsulated in Guideline 2:

> "A Court may communicate with another Court in connection with matters relating to proceedings before it for the purposes of coordinating and harmonizing proceedings before it with those in the other jurisdiction."

26 The practice direction and the ALI/III and JIN Guidelines may be viewed as emerging sources of law which have been described as "soft law instruments" (Gert-Jan Boon and Bob Wessels, "Soft Law Instruments on Restructuring and Insolvency Law: Why They Matter (or Not)").[2] It is these instruments that most directly provide a jurisdictional basis for approving the protocol, building on the more substantive common law principle mandating assisting foreign insolvency courts as far as possible and the inherent jurisdiction of the Grand Court to manage its own

processes. The main governing principles applicable to an application for this court to approve a court-to-court communication may be summarized as follows:

(a) the court is under a positive duty to assist the primary foreign main insolvency or restructuring proceeding unless there are good reasons not to do so;

(b) there is a starting assumption that a clear framework for communication between this court and any relevant foreign courts in cross-border insolvency cases will enhance the efficiency of the cross-border case; and

(c) there is a starting assumption that the ALI/III and/or the JIN Guidelines are suitable guides to adopt and apply in cross-border case.

27 In my judgment, it is consistent with both elevated constitutional principles of judicial independence, the more pragmatic principles of modified universalism and the even more functional inherent powers of this court to protect the efficiency and integrity of its processes, that the particularities of how to advance the efficiency of cross-border insolvency proceedings at the operational case management level should be predominantly grounded in such "soft law instruments." These instruments may be viewed as a form of extra-judicial "judge-made" transnational procedural law. As Lord Dyson has noted in "The Globalisation of Law":[3]

> "41. We are living in an increasingly interdependent world. Jurists read each other's judgments with ease on the internet. They meet at international conferences to discuss issues of common interest. The good sense of learning from each other and taking the best that each of us has to offer is now well appreciated . . ."

Past practice of the Grand Court

28 There is a long and substantial history of this court coordinating its hearings with parallel insolvency and restructuring proceedings in foreign courts and, in the process, communicating indirectly with such courts. The co-operation and coordination which occurs may usually be too uncontroversial to be formally addressed in published judgments, but notable judicial statements have occasionally been made. The JPLs' counsel aptly cited *In Lancelot Investment Fund Ltd.* (7), where Quin, J. held as follows (2009 CILR 7, at para. 71): "the Grand Court embraces the concept of facilitation of co-operation and co-ordination in cross-border insolvency proceedings."

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1 Cayman Islands Constitution Order 2009, ss. 7(1) and 107.
2 law.ox.ac.uk/business-law-blog/blog/2018/07.
3 Pilgrim Fathers Lecture, November 6th, 2015, cited in Doyle, "International Judicial Cooperation," Notes in Respect of Talks to Trainee Manx Advocates, at para. 57.

29 The same volume of the Cayman Islands Law Reports contains a report on one of the later of the various decisions relating to the huge BCCI liquidation, *In re BCCI (Overseas) Ltd.*, where Anthony Smellie, C.J. stated (2009 CILR 373, at para. 1):

> "The worldwide liquidation of the BCCI companies is now in its final stages. The bleak prospect of recoveries at the date of liquidation has since been transformed into the reality of actual dividends paid to creditors in the global liquidation of 86.5% to date. *A major reason for this level of success has been the close co-operation between the global liquidators of the principal BCCI companies.*" [Emphasis added.]

30 The commercially driven rationale of the doctrine of modified universalism underpins the instinctive assumption by this court that it should manage insolvency cases with a cross-border element in way which fosters cooperation with overseas courts. In *Re CW Group Holdings Ltd.* (2), Raj Parker, J. (dealing with a dispute as to the identity of provisional liquidators) held (FSD 113 and 122 of 2018, at para. 67):

> "67. *It makes sense to use entities from the same group to allow for better coordination and communication between Singapore and Hong Kong which is likely to be of value to the company as they further engage with creditors and seek to propose and implement a restructuring.* Following the approach of Hoffmann J in *Re Maxwell Communications Corp plc* [1992] BCC 372 it also seems to me that it makes sense to choose a firm which is already in possession of a great deal of information with which to carry on acting in the interests of efficiency and economy." [Emphasis added.]

31 An even more recent illustration of robust judicial support for the general desirability of coordination in cross-border insolvency cases may be found in Segal, J.'s remarks in *In re China Agrotech Holdings Ltd.* (4) (2019 (2) CILR 356, at para. 37). In the parallel Hong Kong proceedings, Segal, J.'s remarks on behalf of this court were echoed by William Wong, S.C., Deputy High Court Judge,[4] who reproduced those remarks in his own judgment:

> "*Cross-border coordination*
>
> 46. Finally, I like to say a few words about cross-border coordination. In the Cayman Scheme Judgment, Mr Justice Segal made some apt and important remarks about the need for cross-border coordination (at §37):

4 *Re Da Yu Fin. Holdings Ltd.* (formerly known as China Agrotech Holdings Ltd.) (5).

> '*Throughout this case I have reminded the liquidators (and Perfect Gate) of the need to consider the coordination of the applications made in this Court and the Hong Kong court (and the possible benefit of and need for common directions regarding the filing of evidence and submissions in both courts and even of court to court communication and simultaneous hearings).* For reasons of which I am not aware this has not proved to be possible in this case. I do not intend to be critical. There may be good reasons why these steps were considered to be inappropriate or unavailable in this case (and I would note with gratitude that Mr. Justice Harris in the Hong Kong court very helpfully sent me a copy of his Decision of 9 July). *But I would remind parties for the future to keep the need for such coordination firmly in mind.*'
>
> 47. I would respectfully echo Mr Justice Segal's remarks . . ." [Emphasis added.]

32 The cooperation and coordination between this court and foreign insolvency cases that has taken place in past cases has, even if only tacitly, been grounded in this court's common law duty to assist foreign courts and to promote the most economically efficient administration of transnational insolvency estates. Writing extra-judicially almost 10 years ago, Anthony Smellie, C.J. concluded a comprehensive review of early 21st century local case law with the following propitious remarks (*op. cit.*, at 154):

> "In the light of such decisions emanating from the early exercise of the statutory jurisdiction under Part XVII of the Companies Law, there is every reason to believe that the strong tradition of co-operation in trans-national insolvency and bankruptcy matters at common law will continue by the Cayman Islands Courts.
>
> Considerations such as whether the foreign court presides at the 'centre of main interests' of the debtor entity or whether the foreign proceedings are 'main' or 'non-main proceedings' or whether in that regard the debtor entity had an 'establishment' in the foreign jurisdiction—all matters of import under the UNCITRAL Model Law—can all be accorded due if not exclusive weight by the Cayman Courts in deciding whether or not to grant recognition to foreign proceedings and foreign representatives. *This ability to co-operate can, in large measure, be attributed to the flexibility provided by the wide discretion vested in the Court in exercise of the jurisdiction under Cayman Islands law.*
>
> *Accordingly, the Cayman Islands jurisprudence can be expected to develop well in pace with the development of the common law principles of comity, in keeping with the principles of the UNCITRAL*

Model Law and in keeping with the legitimate demands of the international financial markets within the wider global economy." [Emphasis added.]

Findings: merits of application for approval of the protocol

33 In light of the clarity and depth of the common law principles commending judicial coordination and communication in cross-border insolvency cases, combined with the recent promulgation of the practice direction, it was obvious that the protocol could only properly be approved. The protocol merely sought formal approval of the already administratively pre-approved ALI/III "Guidelines Applicable to Court-to-Court Commun-ications in Cross-Border Cases."

34 The judicial approval sought also implicitly required the court to recognize the Chapter 11 proceeding as a foreign main proceeding which this court, in conjunction with the courts in Chile and Colombia, was willing to assist. This was also an entirely uncontroversial matter. The requisite recognition had already effectively been granted by this court's initial appointment of the JPLs in relation to the companies for the explicit purpose of pursuing a restructuring. It was explicitly contemplated that such restructuring would take place primarily through Chapter 11 proceedings before the US Bankruptcy Court.

Conclusion

35 For these reasons, on July 29th, 2020, I granted the JPLs the orders which they sought approving the protocol between each of the four courts concerned with the companies' restructuring under the primary supervision of the US Bankruptcy Court for the Southern District of New York, subject to approval of the three other courts.

Orders accordingly.

Attorneys: *Walkers* for the JPLs.

ITEM NO. 170

JA-56

[2020 (2) CILR 390]

IN THE MATTER OF DUET REAL ESTATE PARTNERS 1 LP

GRAND CT. (Kawaley, J.) June 9th, 2020

Partnership — exempted limited partnership — winding up — expiry of term — petitioner to establish (a) duration of respondent fund expired; and (b) petitioner is contributory with contractual right to voluntary winding up — petitioner also to show tangible and practical need for winding up and no more appropriate alternative remedies

The petitioner sought the winding up of an exempted limited partnership. The petitioner had invested some US$4.5m. in the fund and become a limited partner in 2007. Thereafter it received no return on its investment. It petitioned for the winding up of the fund on the expiry of term ground.

The petitioner also sought a declaration as to the date on which the winding up should be deemed to have commenced, which it contended was March 30th, 2012. The limited partnership agreement provided that the fund would continue until the fifth anniversary of the final closing date (*i.e.* March 30th, 2012) but that date could be extended, the final closing date being defined as March 30th, 2007 or such earlier or later date as determined by the general partner. The petitioner submitted that, as far as it was aware, the final closing date had not been varied by the general partner, nor had the life of the fund been extended. The winding up process contemplated by the limited partnership agreement had not taken place and for several years the petitioner had pursued the fund's management for information about its investment. It had effectively been told that its investment had been lost but it had not been supplied with sufficient information to reach an informed view as to whether it was entitled to a recovery.

Section 92(c) of the Companies Law (2020 Revision) provided:

"92. A company may be wound up by the Court if—

. . .

(c) the period, if any, fixed for the duration of the company by the articles of association expires, or whenever the event, if any, occurs, upon the occurrence of which it is provided by the articles of association that the company is to be wound up . . ."

The petitioner's counsel addressed the tangible interest that had to be established to justify a winding up on the expiry of term. It was initially submitted that the test applicable to just and equitable petitions under s.92(e) applied but that the petition fell within an exception to that test that a petitioner could not be required to establish the solvency of a fund in circumstances where its management was depriving it of relevant information. Alternatively, the petitioner submitted that a more flexible test applied.

Held, ordering that the fund be wound up:

(1) The winding up of the fund was deemed to commence on March 30th, 2012. The uncontroversial evidence supporting the March 30th, 2012 date was more probative than evidence supporting a later date. On balance, it appeared that the fund was at least informally in winding up mode by the end of 2012 and that there had been no formal decision to extend the duration of the fund (para. 12).

(2) On a petition to wind up an exempted limited partnership, the provisions of Part V of the Companies Law (2020 Revision) applied unless there were conflicting provisions of the Exempted Limited Partnership Law (2018 Revision). The provisions of Part V applicable to contributories applied to petitions presented by partners and the regime applicable to creditors of companies applied to petitions presented by creditors of exempted limited partnerships (para. 15).

(3) The court considered what sufficient or tangible interest a petitioner had to establish to justify a winding up order on the expiry of term ground in s.92(c). If the requirement to show that it was likely that the fund was solvent applied, the facts of the present case brought the petitioner within the ambit of the exception. However, the court preferred the petitioner's bolder submission that a more flexible test applied to the s.92(c) ground, which was connected with the statutory function of s.92(c).The grounds on which a winding up was sought must logically inform the standing requirements. The main purpose of s.92(c) was to provide a statutory alternative to a contractual "automatic" right to a voluntary winding up when the duration of a company had come to an end. The most essential jurisdictional conditions which the petitioner had to meet (and had met to the court's satisfaction) required it to establish that (a) the respondent had a fixed duration which had expired and/or that an event had occurred which triggered the contractual entitlement to a voluntary winding up; and (b) the petitioner was a contributory with a crystallized or vested contractual right to a voluntary winding up (or, possibly, had some other leave basis contemplated by s.92(c) for invoking the statutory remedy) (paras. 18–24; para. 29).

(4) Once a petitioner under s.92(c) established that (a) the duration of the respondent had expired or some other contractual right it held to a voluntary winding up had occurred; and (b) the petitioner was *prima facie* qualified to enforce that right, the following additional standing

requirements would usually have to be met: (i) to show that there was a tangible and practical need for a winding up; and (ii) to show that there were no more appropriate remedies that the petitioner should be left to pursue as an alternative to a winding up order under s.92(c). Most winding up proceedings were driven by commercial logic but the jurisdiction was only available to achieve legitimate aims. If a winding up petition were filed under s.92(c) by a contributory who had been fully paid, the lack of any commercial interest in a winding up despite possessing an abstract commercial right to one would likely be grounds for refusing the relief sought. The same would probably apply if it were obvious that the respondent to the petition was insolvent and creditors wished to pursue some other course. In addition, it might be held that jurisdiction to wind up did not exist if, as soon as the right to a contractual voluntary liquidation crystallized, the petitioner came straight to court. It might be said that the more appropriate remedy was to afford the management of the respondent a reasonable opportunity to conduct the voluntary liquidation. The practical need for a winding up would usually mean that the petitioner had no available and more suitable alternative remedies. Where, as in the present case, the limited partner/shareholder had invested with no return in a fixed term investment vehicle the duration of which had expired and which had not been voluntarily wound up, these standing requirements were easily met (paras. 35–38).

Cases cited:
(1) *BDO Cayman Ltd.* v. *Governor in Cabinet*, 2018 (1) CILR 457, considered.
(2) *Chesterfield Catering Co. Ltd., Re*, [1976] 3 All E.R. 294, considered.
(3) *Deloitte & Touche* v. *Johnson*, 1999 CILR 297, considered.
(4) *Rhone Holdings, In re*, 2016 (1) CILR 46, considered.
(5) *Westminster City Council* v. *National Asylum Support Serv.*, [2002] UKHL 38; [2002] 1 W.L.R. 2956; [2002] 4 All E.R. 654, considered.
(6) *XiO Diamond LP, In re*, 2020 (2) CILR 270, considered.

Legislation construed:
Companies Law (2020 Revision), s.92(c): The relevant terms of this subsection are set out at para. 25.
s.100(1)(b): The relevant terms of this provision are set out at para. 45.

Exempted Limited Partnership Law (2018 Revision), s.36(10): The relevant terms of this subsection are set out at para. 46.

Companies Act 1948 (11 & 12 Geo. VI, c.38), s.222: The relevant terms of this section are set out at para. 40.
A. Park and *K. Pearson* for Colville LLC ("the petitioner");
The respondent ("the fund") did not appear.

1 **KAWALEY, J.:**

Introductory

The petition was presented by the petitioner as a limited partner of the fund on February 12th, 2020. The petition was served at the fund's registered office on February 12th, 2020.

2 The summons for directions was heard on March 25th, 2020 (via Zoom) and the fund did not appear. Directions ordered included the following:

> "1. The Fund is properly able to participate in the proceeding.
>
> 2. The proceeding is treated as a proceeding against the Fund.
>
> 3. The Petitioner shall, by 4pm on 9 April 2020, cause an advertisement of the Petition to be placed in a newspaper having circulation in the Cayman Islands, and newspapers having circulation in the United Kingdom, Switzerland, and St Barthelemy.
>
> 4. The following directions are given in relation to Ground 1 only:
>
> . . .
>
> (c) The Petitioner shall file and serve any affidavit evidence in reply to the evidence filed and served by the Fund by 4pm on 24 April 2020. The Petitioner shall also place before the Court any further information or documentation which either supports or undermines Ground 1 of the Petition by 24 April 2019 . . .
>
> (g) The trial of Ground 1 shall be listed to be heard on the first available date after 1 May 2020, with an estimate of two hours . . ."

3 The affidavit of Moesha Ramsay-Howell sworn on April 29th, 2020 established that Harneys by email dated March 25th, 2020 (a) notified a representative of the fund that the petition was listed for hearing on May 7th, 2020, and (b) provided a copy of the approved directions order made on that date. The same affidavit also deposed to advertisement of the petition in early April 2020 and

a reminder letter about the May 7th, 2020 hearing being sent by email on April 24th, 2020 to the person who had previously communicated with the petitioner on behalf of the fund.

4 At the hearing of the petition the fund again did not appear. The petitioner had sensibly sought to convince the court to grant the relief sought based on the potentially more evidentially straightforward and therefore more economical expiry of term ground (Ground 1), reserving the right to pursue the more evidentially elaborate, and therefore less economical, just and equitable ground if necessary at a subsequent hearing.

5 Because Ground 1 of the petition involved a ground not seemingly considered before by this court, and in light of the direction given requesting the petitioner's counsel to put before the court any material which might undermine the case for a winding up order, the petitioner's counsel gave a helpfully full and nuanced presentation on both the facts and, in particular, the law. At the conclusion of the hearing, I ordered, *inter alia*, that:

> "1. The Fund be wound up in accordance with section 92(c) of the Companies Law and section 36(3) of the ELP Law.
>
> 2. The winding up of the Fund is deemed to commence on 30 March 2012 pursuant to section 36(10) (c) of the ELP Law.
>
> 3. Michael Pearson and Richard Murphy of FFP Limited, 2nd Floor, Harbour Centre, 42 North Church Street, George Town, Grand Cayman, Cayman Islands, be appointed as joint official liquidators of the Fund (the Liquidators) . . ."

6 These are the reasons for that decision.

The factual matrix

7 There was no reason to doubt that the petitioner had invested some US$4.5m. and become a limited partner of the fund in 2007, and thereafter received no return on its investment. The critical area of factual inquiry was the documents constituting the fund and the contractual provisions relating to the fund's intended duration. The petitioner's counsel was able to clearly identify what might be described as the "primary" termination date, but that date was subject to extension depending on what subsequent events occurred. Two alternative later dates, both now long past, were also readily identified. Subject to jurisdictional questions of law, the case for a winding up on Ground 1 was evidentially supported.

8 The petitioner also sought a declaration as to the date on which the winding up should be deemed to have commenced. For these purposes, it was necessary for the court to decide whether the evidence supported the petitioner's case that the "primary" termination date, March 30th, 2012, applied. Because of the fund's non-participation, I was anxious about the possibility that crucially relevant material might not be before the court. My initial inclination was to adopt a precautionary approach and conclude that the latest possible date was most clearly supported by the evidence. However, Ms. Park's careful dissection of the evidence at the hearing ultimately persuaded me that it was appropriate to infer from the proven facts that, on a balance of probabilities, no extension of the termination date had occurred.

9 It was submitted in the petitioner's skeleton argument that:

> "12. Clause 2.4 of the Limited Partnership Agreement dated 15 December 2006 (LPA) provided that (page 17 of exhibit AM-1):
>
> 'The life of the Fund shall continue until the fifth anniversary of the final closing date, unless:
>
> (a) Extended at the discretion of the general partner or it's [*sic*] duly authorised delegates for up to two consecutive additional one year periods from and after such date; or
>
> (b) Terminated in accordance with the terms of this Agreement.'
>
> 13. The final closing date is defined as '30 March 2007 or such earlier or later date as determined by the general partner.' So far as the Petitioner is aware, the final closing date has not been varied by the general partner, nor has the life of the Fund been extended. Accordingly, pursuant to the LPA the term of the Fund expired on 30 March 2012 . . .
>
> 15. The LPA further provided that the Fund shall be dissolved upon the earliest to occur of certain events, including the 'end of the term of the [fund], as provided in clause 2.4' (clause 9.1(a) (ii))."

10 It was properly disclosed that because the LPA (cl. 8.1(a)(i) also provided that a capital contribution could not be made after the final closing date), and the petitioner had made a second capital contribution on or about November 1st, 2007, it could be argued that the general partner must have extended the final closing date until at least then. On that basis, the general partner might potentially have extended the final closing date until November 1st, 2014 at the latest. The possibility of commitments by existing or additional limited partners after November 1st, 2007 was refuted by reference to accounts sent out by the general partner in 2012, after which there were no audited accounts. These did not reveal any further capital commitments. And it was broadly consistent with the proposition that the final closing date was indeed viewed by those managing the fund as being March 30th, 2012 that no audited accounts were prepared for any subsequent year. That said, nothing in the financial statements for the year ending 2012 was said to provide positive support for the date contended for and investor reports were prepared in subsequent years before the fund was struck off the register on December 31st, 2016.

11 The petitioner fairly acknowledged that it was theoretically possible that without its knowledge the final closing date could have been expressly extended by the general partner. However, counsel pointed, in particular, to three factors supporting a contrary inference:

(a) after resolving a dispute with one of the fund's principals in relation to a separate investment between 2011–2016, the petitioner began to make

inquiries about its investment with the fund. During these exchanges the fund did not reveal any extension of the final closing date;

(b) on September 3rd, 2018, Harneys wrote, *inter alia*, to the general partner foreshadowing an application to reinstate the fund (which had by that date been struck off the register of exempted limited partnerships[1]) and wind it up. It was asserted that the final closing date appeared to be March 30th, 2012 and an express request was made for any documents indicating an extension of life beyond that date. The letter was responded to but the request for any documents indicating an extension was ignored;

(c) an opportunity had been given to those who managed the fund in the prelude to the hearing of the petition to advance a contrary case but that opportunity had also been spurned.

12 I concluded that the uncontroversial evidence supporting the March 30th, 2012 final closing date was more probative than the evidence supporting a later date, taking the surrounding legal context provided by the LPA into account. On balance, it appeared that the fund was at least informally in winding up mode by the end of 2012 and that no formal decision to extend the duration of the fund was ever taken.

13 The evidence also showed that the winding up process contemplated by the LPA had not taken place and that the petitioner had for several years been pursuing the fund's management for information about the state of its investment. The petitioner was effectively being told that its investment had been lost, had not been supplied with sufficient information to be able reach an informed view as to whether it was entitled to a recovery or not.

Legal findings: jurisdiction to make a winding up order on a contributory's petition on the ground that the duration of the fund is at an end

Statutory basis for winding up: which statute?

14 The petitioner's counsel addressed the interaction between the Companies Law (2020 Revision) ("the Law") and the Exempted Limited Partnership Law (2018 Revision) ("the ELP Law") in her skeleton argument as follows:

> "52. The Cayman Island Court of Appeal (CICA) held in In the matter of Rhone Holdings LP [2016 (1) CILR 46], in an application to extend

the time for seeking leave to appeal where the CICA considered the merits of the proposed appeal, that (per Rix JA at paragraph 20):

> '. . . Mr Asif was bound to concede, as he did, that the power to wind up on the just and equitable ground, or indeed on any ground, is to be found not in the Exempted Limited Partnership Law, but in the underlying provisions of Part V of the Companies Law, to which of course s.36(3) of the Exempted Limited Partnership Law makes express reference, and that there is no language, express or necessarily to be implied, in the Exempted Limited Partnership Law which is inconsistent with provisions for winding up to be found in Part V of the Companies law . . . This may be contrasted with certain provis-ions of s.36 (3) of the Exempted Limited Partnership Law which plainly are inconsistent with certain provisions of Part V of the Companies Law, for instance s.36(3)(b) and (d) of the Exempted Limited Partnership Law . . .'"

15 As I noted in the course of the hearing, the quoted passage does not strictly reflect a holding by the Court of Appeal as Sir Bernard Rix was only agreeing with the soundness of a point which was conceded. It is nonetheless the most authoritative appellate statement on the fact that if one seeks to wind up an exempted limited partnership, it is the provisions of Part V of the Law which apply unless there are conflicting provisions of the ELP Law. This point was actually decided in *In re XiO Diamond LP* (6) and the significance of *In re Rhone Holdings LP* (4) as providing valuable *obiter dicta* was not acknowledged. In short, the provisions of Part V of the Law applicable to contributories apply to petitions presented by partners and the regime which was applicable to creditors of companies apply to petitions presented by creditors of an exempted limited partnership.

Standing: could the petitioner demonstrate a sufficient or tangible interest in a winding up?

16 In the present case, therefore, no dispute arose about whether the winding up order should be made under the Law or the ELP Law. Instead, the "new point" which the petitioner's counsel addressed was what tangible interest had to be established to justify a winding up order on the expiry of term (as opposed to just and equitable ground). If the same test applied in both cases, there was room for evidential doubt as to whether the fund was solvent and the petitioner had any tangible interest in a winding up. If a more fluid test applied, the petitioner's standing was not in doubt.

17 Ms. Park initially adopted the more conservative stance that the more stringent tangible interest test applicable to just and equitable petitions applied but that the petition fell within an exception to that test. However,

at the hearing she adopted the bolder primary submission that a more flexible standing test applied to the s.92(c) ground.

18 The standard sufficient or tangible interest test (based on just and equitable petition case law) was summarized in the petitioner's skeleton argument as follows:

> "29. A contributory must normally establish that it has a 'sufficient interest' in the winding up.
>
> 30. The English High Court noted in Re C & MB Holdings Ltd [2017] 1 BCLC 269 held that a 'sufficient interest' can be established 'by proving on the balance of probability that a winding up will result in a distribution to creditors provided the distribution will be more than negligible' but that 'solvency' is only an example of the application of the sufficient interest rule."

19 Various judicial articulations of an exception to the general rule were cited which it was contended the petitioner was entitled to rely upon. In essence, the petitioner could not be required to establish the solvency of the fund in circumstances where its management was depriving it of relevant information. One authority cited was the following:

> "35. In Re Commercial and Industrial Insulations Ltd [1986] BCLC 191, Hoffmann J (as he then was) referred to the exception to the sufficient interest rule and noted (at page 193):
>
> 'This, if I may say so, seems to me to be common sense, because it would obviously be unjust to the petitioner to have his petition struck out in limine because he was unable to allege a surplus on a winding up on account of wrongfully being deprived of access to the necessary documents.'"

20 Accordingly, the petitioner concluded by submitting, *inter alia*:

> "39. . . . the Petitioner considers that the financial position of the Fund is not clear, the amounts of assets and liabilities in the accounts which the petitioner has seen are disputed on the basis that they contain material inconsistencies and/or are not properly explained, and the financial position of the Fund therefore requires further inves-tigation."

21 I had little difficulty in accepting that if the requirement to show that it was likely that the fund was solvent *did* apply to Ground 1 of the petition, there being no doubt that it applied to the just and equitable ground (Ground 2), the facts of the present case brought the petitioner within the ambit of the exception. Counsel also aptly relied upon *Re Chesterfield Catering Co.* (2) and the following observation of Oliver, J. as he then was ([1976] 3 All E.R. at 298):

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1 The Registrar of Companies is also the Registrar of Exempted Limited Partnerships: s.8. Section 9 of the ELP Law requires the Registrar of Companies to maintain a record of exempted limited partnerships. Section 37(1) empowers the Registrar to strike a partnership off the register if it appears to have ceased conducting business. Section 37(5) permits, *inter alia*, a limited partner to apply to the court to restore the exempted limited partnership to the register.

> ". . . I do not think that as the law now stands the exception goes beyond this: that a petition will not be regarded as demurrable on the ground of the petitioner's lack of locus standi if his inability to prove his locus standi is due to the company's own default in providing him with information to which, as a member, he is entitled."

22 The petitioner (I found) had an entitlement to a winding up at the end of the duration of the fund under LPA. No winding up had occurred and the petitioner had no reliable basis upon which to determine whether or not the fund was solvent.

23 The petitioner's alternative argument was that if it had to prove the likelihood of solvency and its entitlement to a distribution, the evidence did support such finding in any event. This argument was inconsistent with the primary position that an investigation was at least required and was based on a "to wish is to hope, to hope is to expect" view of the evidence. Had it been necessary for me to consider this fall-back submission, I would have found that the petitioner had failed to establish sufficient interest.

24 I preferred the bolder submission that a somewhat flexible test applied to Ground 1 of the petition which was broadly analogous to the exception to the usual sufficient interest rule upon which the petitioner relied. That test is closely connected with a proper analysis of the statutory function of s.92(c) of the Law and will be considered along with the analysis of the relevant jurisdiction below.

The statutory function of s.92(c) and what interest must the applicant for a winding up order possess?

25 Section 92(c) of the Law provides as follows:

> "92. A company may be wound up by the Court if—
>
> . . .
>
> (c) the period, if any, fixed for the duration of the company by the articles of association expires, or whenever the event, if any, occurs, upon the occurrence of which it is provided by the articles of association that the company is to be wound up . . ."

26 The petitioner advanced the following main submissions on the function or purpose of this statutory provision:

> "54. There appear to be no reported cases on the application of section 92(c) of the Companies Law.
>
> 55. Section 92(c) was proposed by the Companies (Amendment) Bill 2007.

Page 4 provides:

'4. Section 92 widens the circumstances in which a company may be wound up by the Court. Section 92(c) provides that a company may be wound up by the Court if the period, if any, fixed for the duration of the company by the articles of association expires . . . This is a basis up on which a company may be put into voluntary liquidation automatically. It is also intended to be a ground upon which a contributory (or conceivably a creditor) should be able to present a petition. *For example, if the directors of a company which has gone into liquidation automatically are failing to wind up its affairs, a contributory should be entitled to present a petition on this ground.*' (Emphasis added)

56. The Petitioner submits this explanatory memorandum suggests that the purpose of section 92(c) is to expedite the automatic winding up of a company (or fund) at the instance of a shareholder, where the automatic voluntary winding up is not progressing as it should."

27 There is no ambiguity about the words of the new subsection in taking into account the wider context of s.92 and Part V of the Law as a whole. But the "Memorandum of Objects and Reasons" found in the 2007 Bill does provide helpful confirmation of what the language of the statutory provision suggests its legislative purpose was. As Mangatal, J. observed in *BDO Cayman Ltd.* v. *Governor in Cabinet* (1) (2018 (1) CILR 457, at para. 125), even where the meaning of words is clear external aid can be used, as it were, as a cross-check to verify the reasonableness of the primary statutory meaning. She then noted (*ibid.*, at para. 126):

"126 On an 'informed interpretation' the court considers the wider context including internal aids, such as other provisions in the same statute, and it may include external aids, such as the legislative history and other materials *in pari materia* which may provide guidance as to the underlying legislative intention. It is in my view not necessary (as the applicants contend) for there to be some 'ambiguity' before those aids to construction may be considered. Thus, the court can consider these aids to construction even where the grammatical or legal meaning of a provision is clear."

28 However, the court has even broader scope to consider explanatory memoranda with a view to understanding what the legislative object of a provision actually is. As Lord Steyn opined in *Westminster City Council* v. *National Asylum Support Serv.* (5) ([2002] 1 W.L.R. 2956, at para. 5):

"5. The question is whether in aid of the interpretation of a statute the court may take into account the Explanatory Notes and, if so, to what extent. The starting point is that language in all legal texts conveys meaning according to the circumstances in which it was used. It

follows that the context must always be identified and considered before the process of construction or during it. It is therefore wrong to say that the court may only resort to evidence of the contextual scene when an ambiguity has arisen. In regard to contractual interpretation this was made clear by Lord Wilberforce in *Prenn v Simmonds* [1971] 1 WLR 1381, 1384–1386, and in *Reardon Smith Line Ltd v Yngvar Hansen-Tangen* [1976] 1 WLR 989, 995–996. Moreover, in his important judgment in *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896, 912–913, Lord Hoffmann made crystal clear that an ambiguity need not be established before the surrounding circumstances may be taken into account. The same applies to statutory construction. In *River Wear Commissioners v Adamson* (1877) 2 App Cas 743, 763, Lord Blackburn explained the position as follows:

> 'I shall . . . state, as precisely as I can, what I understand from the decided cases to be the principles on which the courts of law act in construing instruments in writing; and a statute is an instrument in writing. In all cases the object is to see what is the intention expressed by the words used. But, from the imperfection of language, it is impossible to know what that intention is without inquiring farther, and seeing what the circumstances were with reference to which the words were used, and what was the object, appearing from those circumstances, which the person using them had in view; for the meaning of words varies according to the circumstances with respect to which they were used.'

Again, there is no need to establish an ambiguity before taking into account the objective circumstances to which the language relates. Applied to the subject under consideration the result is as follows. Insofar as the Explanatory Notes cast light on the objective setting or contextual scene of the statute, and the mischief at which it is aimed, such materials are therefore always admissible aids to construction. They may be admitted for what logical value they have. Used for this purpose Explanatory Notes will sometimes be more informative and valuable than reports of the Law Commission or advisory committees, Government green or white papers, and the like. After all, the connection of Explanatory Notes with the shape of the proposed legislation is closer than pre-parliamentary aids which in principle are already treated as admissible: see Cross, *Statutory Interpretation*, 3rd ed (1995), pp 160–161. If used for this purpose the recent reservations in dicta in the House of Lords about the use of Hansard materials in aid of construction are not engaged: see *R v Secretary of State for the Environment, Transport and the Regions, Ex p Spath Holme Ltd* [2001] 2 AC 349, 407; *Robinson v Secretary*

> *of State for Northern Ireland* [2002] UKHL 32, The Times, 26 July 2002, in particular per Lord Hoffmann, at paragraph 40. On this basis the constitutional arguments which I put forward extra-judicially are also not engaged: 'Pepper v Hart: A Re-examination' (2001) 21 Oxford Journal of Legal Studies 59." [Emphasis added.]

29 So Ms. Park's submissions established that one express purpose of the new subsection was to provide a remedy to a contributory to seek a winding up order from this court when the duration of a company had come to an end and the contributory's contractual right to an "automatic" voluntary winding up (using the language of the Bill) had been denied.[2] The suggestion conveyed by the language of s.92(c) that its main purpose is to provide a statutory alternative to a contractual "automatic" right to a voluntary winding up is confirmed by the "Memorandum of Objects and Reasons" which introduced the Bill to the legislature. I inferred from the literal meaning of s.92(c) of the Law as confirmed by the Bill which preceded its enactment that the most essential jurisdictional conditions which the petitioner had to meet (and had met to my satisfaction) required it to establish:

(a) that the respondent had a fixed duration which had expired and/or that an event had occurred which triggered the contractual entitlement to a voluntary winding up;

(b) that the [petitioner] was a contributory with a crystallized or vested contractual right to a voluntary winding up (or, possibly, had some other legal basis contemplated by s.92(c) for invoking the statutory remedy).

30 The policy underpinning s.92(c) was also explained in the petitioner's skeleton argument as follows:

> "57. It is further submitted that there is a point of principle to consider, in that a shareholder should not be locked into a company or fund for a period longer than that for which the shareholder signed up."

31 That submission in my judgment understated the present position. Where a winding up order is sought under s.92(c) on the grounds that the duration of the relevant investment vehicle has come to an end, as in the present case, the *only* point of principle which is engaged is that the investor "should not be locked into a company or fund for a period longer than that for which the shareholder signed up." Here the expiry of the term of the fund was itself one of various events which gave rise to a contractual right to a voluntary winding up. The difference between seeking a winding

up order under s.92(c) and s.92(e) on the just and equitable ground is quite distinct, in legal context terms.

32 Although prior to the enactment of s.92(c) shareholders with a contractual right to a voluntary winding up which had been thwarted presumably had no choice but to rely upon s.92(e), the just and equitable jurisdiction was created in the 19th century before modern bespoke investment vehicles like the fund had been invented. It is reasonable to assume that the overwhelming majority of just and equitable petitions which generated the early case law in England which helped to define the jurisdiction involved unlimited duration companies where only a majority of shareholders had a contractual right to obtain a voluntary winding up.

33 The "Memorandum of Objects and Reasons" in the 2007 Bill suggested that "conceivably" a creditor could invoke the new winding up jurisdiction. I assumed for the purposes of the present proceedings that s.92(c) is primarily designed for use by shareholders as that view finds support both in the statutory language and wider context, including the express terms of the Bill. No need to consider the position of creditors arose.

34 It is only in light of this understanding of the statutory object of the 2007 vintage s.92(c) jurisdiction that one can properly analyse the appropriate sufficient or tangible interest requirements which a petitioner relying on this winding up ground should be required to meet.

Standing: sufficient interest in the s.92(c) context

35 Based on the statutory construction of s.92(c) set out above, I found that once a petitioner under s.92(c) establishes that (a) the duration of the respondent has expired or some other contractual right it holds to a voluntary winding up has occurred, and that (b) the petitioner is *prima facie* qualified to enforce that right, the following additional standing requirements it will usually have to be met:

(1) showing that there is a tangible and practical need for a winding up; and

(2) showing that there are no more appropriate remedies that the petitioner should be left to pursue as an alternative to a winding up order under s.92(c).

36 Most winding up proceedings are driven by commercial logic. But the jurisdiction is only available to achieve legitimate aims. If a winding up petition was filed under s.92(c) by a contributory who had been fully paid, the lack of any commercial interest in a winding up despite possessing an abstract contractual right to one would likely be grounds for refusing the relief sought. The same would probably apply if it was obvious that the

respondent to the petition was insolvent and creditors wished to pursue some other course.

37 Again, it might be held that jurisdiction to wind up did not exist if as soon as the right to a contractual voluntary liquidation crystallized, the petitioner came straight to court. It might be said that the more appropriate remedy was to afford the management of the respondent a reasonable opportunity to conduct the voluntary liquidation. The practical need for a winding up will usually mean that the petitioner has no available and more suitable alternative remedies.

38 Where, as here, the limited partner/shareholder had invested with no return in a fixed term investment vehicle the duration of which had expired and which had not been voluntarily wound up, these standing requirements were easily met. The legal underpinnings for these conclusions are elaborated upon below.

39 I found important judicial support for the ultimately elementary proposition that the content of the standing requirements must be informed by the winding up ground which a petitioner invokes in *Re Chesterfield* (2), upon which the petitioner relied. Oliver, J. (as he then was) held that a fully paid contributory presenting a just and equitable petition had to show a likelihood of a surplus available on a winding up. However, in discussing the sufficient interest test, he observed ([1976] 3 All E.R. at 298):

> "I think that what counsel for the petitioners says is right, but I do not think that as the law now stands the exception goes beyond this: that a petition will not be regarded as demurrable on the ground of the petitioner's lack of locus standi if his inability to prove his locus standi is due to the company's own default in providing him with information to which, as a member, he is entitled. Thus, *for instance, I cannot think that a petition presented by a fully paid shareholder on ground (b) of s 222 of the 1948 Act could be treated as demurrable because he was unable to allege that there would be a surplus of assets.*" [Emphasis added.]

40 Section 222 of the Companies Act 1948 provided that:

> "A company may be wound up by the court if—
>
> . . .
>
> (b) default is made in delivering the statutory report to the registrar or in holding the statutory meeting . . ."

41 Although only *obiter dicta*, I found these observations, and those set out below, quite compelling. The ground on which a winding up is sought must logically inform what the standing requirements are. This is why, even on a just and equitable petition where the established general rule is

that a shareholder must prove that he is likely to be entitled to recover from a surplus, exceptions to that general rule have been developed as the specific factual grounds upon which reliance is placed may vary from case to case. As Oliver, J. went on to say in *Re Chesterfield* (*ibid.*, at 299):

> "I also think, if I may say so respectfully, that the references to 'a surplus' or to 'assets for distribution amongst the shareholders', which appear in some of the cases, are to some extent an unnecessarily restrictive gloss on what was said in *Re Rica Gold Washing Co*. What was required for a fully paid shareholder to petition was, Jessel MR said, 'a sufficient interest to entitle him to ask for the winding-up of the company'. 'He must shew', he said, 'what I may call a tangible interest'. He then went on to stress that he was not going to lay down any rule as to what that tangible interest must be, and gave as an example of what was not a sufficient interest a negligible surplus on the distribution.
>
> I do not, however, think that it can be quite accurate to say that the tangible interest of the fully paid shareholder must necessarily and in all cases be restricted to the existence or the prospective existence of a surplus. Indeed, Jessel MR himself in *Re Rica Gold Washing Co* [(1879), 11 Ch D 36, at 43], in the opening words of the paragraph which I have read, seems to suggest that the potential liability of a shareholder can constitute an interest for this purpose. *And, for instance, a fully paid shareholder who petitions to wind up a company on ground (d) of s 222 of the 1948 Act, i e that the number of members has been reduced below the requisite minimum, has the strongest possible interest in seeing that the company's business is brought to an end, for otherwise he may find himself personally liable for the company's debts under s 31; and I cannot conceive, if the company were insolvent and his peril thus increased, that the court would tell him that the petition was incompetent on this ground.* Furthermore, it must be recalled that the fasciculus of sections dealing with winding-up applies to unlimited companies as well as to limited companies, and a shareholder, albeit his shares were fully paid in such a company, might have a very strong interest in the liquidation of the company which was totally insolvent simply from the point of view of terminating his liability as a member.
>
> . . .
>
> *The reported cases in which, in recent years, the question has arisen, have all been cases of petitions either under s 210 of the Companies Act 1948*[3] *or on the just and equitable ground, and no doubt it is true that in such cases the test of a sufficient interest will*

> *be the existence or probable existence of a surplus. It seems clear, however, that the same or similar principles apply in other cases:* see, for instance, *Re London Suburban Bank*, where a shareholder's petition on the ground of insolvency was dismissed by reason of the paucity of his interest, and *Re New Gas Generator Co*, where a subscriber's petition based on the failure of the company to commence business within a year of its incorporation was dismissed. But I have not been referred to any case in which so amorphous an interest as that alleged in the present petition has been held to be sufficient to support a petition by a fully paid shareholder, and it seems to me to be contrary to the principle of all the cases to suggest that, even allowing that there may be exceptions to the general rule, a petitioner can demonstrate his locus standi by pointing to some private advantage which he may derive from the winding-up and which is unconnected with his membership of the company." [Emphasis added.]

42 These observations support the conclusion that no matter what winding up ground is relied upon, the petitioner must have a sufficient interest to justify obtaining the relief sought. What that interest must be is a question which will ultimately be shaped by the specific winding up ground relied upon in each case.

43 Indeed, there appears to be a broader rule of practice to the effect that the applicant for any statutory relief in relation to a winding up must have sufficient interest to make the relevant application. *Deloitte & Touche* v. *Johnson* (3) was placed before the court. That case concerned an application to remove official liquidators under s.106(1) of the Companies Law (1995 Revision). Section 106(1), somewhat like s.92(c), creates a power to grant relief without conferring an express broad statutory discretion as does s.92(e) of the Law. The Privy Council characterized the determination of what the standing requirements for obtaining such statutory relief as a doctrine of "judicial restraint." This was to be contrasted with both (a) determining who was jurisdictionally qualified to make an application, and (b) determining the purpose and scope of the jurisdiction created by the Legislative Assembly, which were exercises in statutory interpretation.

44 As Lord Millett opined (1999 CILR at 304–305, delivering the advice of the Board):

> "*In their Lordships' opinion two different kinds of case must be distinguished when considering the question of a party's standing to make an application to the court. The first occurs when the court is asked to exercise a power conferred on it by statute. In such a case the court must examine the statute to see whether it identifies the category of person who may make the application. This goes to the*

jurisdiction of the court, for the court has no jurisdiction to exercise a statutory power except on the application of a person qualified by statute to make it. The second is more general. Where the court is asked to exercise a statutory power or its inherent jurisdiction, it will act only on the application of a party with a sufficient interest to make it. This is not a matter of jurisdiction; it is a matter of judicial restraint. Orders made by the court are coercive. Every order of the court affects the freedom of action of the party against whom it is made and sometimes (as in the present case) of other parties as well. It is therefore incumbent on the court to consider not only whether it has jurisdiction to make the order but whether the applicant is a proper person to invoke the jurisdiction.

Where the court is asked to exercise a statutory power, therefore, the applicant must show that he is a person qualified to make the application. But this does not conclude the question. He must also show that he is a proper person to make the application. This does not mean, as the appellant submits, that he 'has an interest in making the application or may be affected by its outcome.' It means that he has a legitimate interest in the relief sought. Thus, even though the statute does not limit the category of person who may make the application, the court will not remove a liquidator of an insolvent company on the application of a contributory who is not also a creditor: see *In re Corbenstoke Ltd. (No. 2)* [(1989), 5 BCC 767]. This case was criticized by the appellant. Their Lordships consider that it was correctly decided." [Emphasis added.]

Date of commencement of winding up

45 The petitioner's counsel also referred to the statutory provisions governing the commencement of the winding up. Section 100(b) of the Law provides that where before a petition is presented:

"(b) the period, if any, fixed for the duration of the company by the articles of association has expired . . .

the winding up of the company is deemed to have commenced at the time of passing of the resolution or the expiry of the relevant period."

46 Section 36(10) of the ELP Law provides that:

"(10) The winding up of an exempted limited partnership shall be deemed to commence upon the earlier to occur of any of the following—

. . .

(c) the expiry of the period fixed for the duration of the exempted limited partnership by the partnership agreement . . ."

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2 Section 36(9) of the ELP Law has a special definition of "automatic winding up" which was not engaged by the facts of the present case. The terms of LPA provided that a winding up should occur upon the expiry of the fund's fixed term, so an automatic right to a voluntary liquidation clearly existed in the broader sense used in the 2007 Bill.

3 A minority shareholder oppression provision.

47 The ELP is entirely consistent with the Law in this regard so the provisions of the Law could clearly be applied.

Conclusion

48 For the above reasons, on May 7th, 2020 I ordered that the fund should be wound up under s.92(c) of the Companies Law.

Order accordingly.

Attorneys: *Harneys* for Colville LLC.

ITEM NO. 171

JA-57

[2020 (1) CILR 417]

TIANRUI (INTERNATIONAL) HOLDING COMPANY LIMITED v. CHINA SHANSHUI CEMENT GROUP LIMITED

C.A. (Rix, Field and Moses, JJ.A.) February 18th, 2020

Companies — compulsory winding up — dispositions and transfers during winding up — validation by court — Companies Law (2018 Revision), s.99 preserves status quo pending resolution of petition — validation order must not impede, undermine or preclude preservation of status quo

The appellant sought the winding up of the respondent.

China Shanshui Cement Group Ltd. ("the company") was a Cayman Islands company listed on the Hong Kong Stock Exchange ("SEHK"). The company's major shareholders were the appellant, Tianrui (International) Holding Co. Ltd. ("Tianrui"); Asia Cement Corporation ("ACC"); and China National Building Material Holding Co. ("CNBM"). They were involved in what Tianrui described as a bitter take-over battle for the company. Tianrui presented a petition to wind up the company on the just and equitable ground, alleging that ACC had been acting improperly in concert with CNBM to dilute Tianrui's shareholding and squeeze it out of the company. It was alleged that the dilution had been achieved by an improper exercise by the directors of their powers to issue securities, through successive issues of bonds to bondholders with whom ACC and CNBM were associated or connected, which bonds were subsequently converted into shares. The company sought validation of proposed transfers of shares to the Hong Kong Securities Clearing Co. Nominees Ltd. ("HKSCC") to facilitate the trading of those shares through the CCASS. A validation order would have the effect that those transactions could not be unwound under s.99 of the Companies Law in the event of the petition being successful.

Section 99 provided:

"When a winding up order has been made, any disposition of the company's property and any transfer of shares or alteration in the status of the company's members made after the commencement of the winding up is, unless the Court otherwise orders, void."

The Grand Court (Mangatal, J.) made a validation order that any transfers of the shares in the company to HKSCC should not be avoided by the provisions of s.99 in the event of an order being made on Tianrui's petition for the winding up of the company (that decision is reported, *sub*

nom. In re China Shanshui Cement Group Ltd., at 2019 (2) CILR 734). The judge accepted the company's case for validation, that it was a response to CCASS's request and that it wished to reduce the illiquidity of its shares, which reasons an intelligent and honest director could reasonably hold in good faith and had a clear commercial basis. She accepted the company's argument that the share transfer did not "run afoul of the rationale of s.99" to prevent the shareholders of partly paid up shares to evade liability by transferring their shares to men of straw after the commencement of the winding up.

The appellant appealed, submitting that the judge misunderstood the purpose of s.99 and failed to identify the correct approach to validation.

Held, allowing the appeal:

(1) The purpose of s.99 of the Companies Law was to preserve the status quo. Its retrospective effect derived from the legislative scheme for insolvency which treated the commencement of a winding up as the date when the winding up was initiated, normally the date of the presentation of the petition, rather than the date when a winding-up order was made and the winding up began. During the period between the presentation of a petition and its resolution, any transaction such as the proposed transfer of shares to HKSCC or alteration in the status of the company's members would be avoided if the winding-up order was made, unless the court exercised its discretionary power under s.99 to validate the transaction. The avoidance effect of s.99 enabled the liquidator to unwind any transactions which might have taken place during this period and return the assets and circumstances of the company and its contributors to those which were in place at the time the winding up commenced. The ability to validate transactions during the period between presentation and the hearing of the petition enabled companies to continue to operate in the ordinary course of their business prior to the hearing. The purpose and importance of validation could most clearly be seen in relation to trading companies. They were not prevented from continuing to trade once a winding-up petition was presented: a validation order provided commercial certainty for those trading with the company, and for the company, that their transactions would not be avoided. The power to make a validation order must not be exercised in a way that undermined the essential purpose of s.99, namely to preserve the status quo pending resolution of the petition. Any assessment of an application for a validation order must have, at the forefront of consideration, the need not to impede, undermine or preclude fulfilment of that purpose (paras. 13–20).

(2) The judge had been led into a fundamental error in relation to the purpose of s.99. She had been led by the company to take a limited view of s.99, namely that it was to prevent shareholders from evading liability by transferring their shares to a straw man after winding up had commenced. The transfer of legal title from a shareholder to HKSCC fell squarely within s.99. A validation order in respect of such a transaction

ought only to be made in circumstances which assisted in preserving the status quo and which did not frustrate the purpose of s.99 (paras. 21–23).

(3) When considering whether to exercise the power to make a validation order under s.99, as a matter of principle a court must satisfy itself that any order it might make would not undermine or frustrate the maintenance of the status quo pending resolution of the winding-up petition; the order should be made in furtherance of that objective. This underlying principle should not alter according to the particular circumstances of a case, although its application would of course vary from case to case. The court's assessment as to whether a proposal would advance or undermine the purpose for which the power was conferred would vary according to whether or not it was sought in relation to the ordinary course of business. It would be dangerous to assume that a court might be relieved of the responsibility of careful scrutiny and caution merely because a company was solvent. In every case, those seeking a validation order must be able to satisfy the court that what was proposed would not undermine the avoidance function of s.99, that it would not impede or frustrate the unwinding of transactions after the presentation of the petition but would maintain the status quo. That was so whether the company was solvent or insolvent, and whether or not the proposal was made in the ordinary course of business. Where a proposal was made for the purposes of the ordinary course of business, the court would more readily take the view that there was no unacceptable risk to the maintenance of the status quo. In such a case the views of the directors as to whether the proposals were for the benefit of the company would plainly be relevant even though not dispositive. The court adopted the appellant's submission that just as in the case of a creditors' petition validation would not be allowed to undermine the purpose of a winding up, in a just and equitable petition a validation order should not undermine the objective of stopping or reversing oppressive conduct. Careful scrutiny was needed not just to protect creditors in an insolvency petition but also contributories at a stage when no one could say whether the petition in respect of a solvent company would succeed. Validation orders should only be made if they were consistent with the purposes of s.99 and of the power to make such orders (paras. 40–47).

(4) As the judge had not scrutinized the company's proposal, the court would do so. The deposit of shares to CCASS was alleged by the appellant to be an important further stage in the process of diluting its shareholding and the conspiracy to cause it damage. It should not have been forgotten that the proposed transactions in respect of which validation was sought were themselves the subject matter of the petition. Validation would make it impossible to reverse the issue of the shares and risk stymying what a court, liquidator or the appellant might legitimately do. There appeared to be no reasonable explanation other than that proffered by the appellant, namely that the deposit was intended to prevent the unwinding of the transactions should the petition be successful. The transactions were not

made in the ordinary course of business; the company's business was in holding interests in subsidiaries, not trading in its own shares. The judge made material errors of law leading her to a failure to consider relevant evidence and to make the necessary assessments of it. Her exercise of evaluative judgment could not stand. The court would reverse the order and refuse to make a validation order in respect of the proposed CCASS deposit (paras. 60–61; paras. 66–72).

Cases cited:

(1) *A.I. Levy (Holdings) Ltd.*, *In re*, [1964] Ch. 19, considered.
(2) *Burton & Deakin Ltd.*, *In re*, [1977] 1 W.L.R. 390; [1977] 1 All E.R. 631, considered.
(3) *Charterbridge Corp. Ltd.* v. *Lloyds Bank*, [1970] 1 Ch. 62, considered.
(4) *Company (007130 of 1988)*, *In re a*, [2000] 1 BCLC 582, considered.
(5) *Cybervest Fund, In re*, 2006 CILR 80, considered.
(6) *Fortuna Dev. Corp., In re*, 2004–05 CILR 533, considered.
(7) *Henderson* v. *Foxworth Invs. Ltd.*, [2014] UKSC 41; [2014] 1 W.L.R. 2600; 2014 SCLR 692; 2014 SLT 775, referred to.
(8) *Howard Smith Ltd.* v. *Ampol Petroleum Ltd.*, [1974] A.C. 821; [1974] 2 W.L.R. 689; [1974] 1 All E.R. 1126, considered.
(9) *Park Ward & Co. Ltd.*, *Re*, [1926] Ch. 828, referred to.
(10) *Rudge* v. *Bowman* (1868), L.R. 3 Q.B. 689, referred to.
(11) *Torchlight Fund LP, In re*, 2018 (1) CILR 290, referred to.
(12) *Wiltshire Iron Co.*, *Re* (1868), L.R. 3 Ch. App. 443, considered.

Legislation construed:

Companies Law (2018 Revision), s.99: The relevant terms of this section are set out at para. 13.
s.100(2): The relevant terms of this sub-section are set out at para. 14.

T. Lowe, *Q.C.* and *G. Lardner* for the appellant;
V. Flynn, *Q.C.*, *J. Eldridge* and *A. Davey* for the respondent.

1 **MOSES, J.A.:**

Background

This is an appeal against a validation order made by Mangatal, J. dated September 12th, 2019 (reported at 2019 (2) CILR 734) in which she ordered, *inter alia*, that any transfers of the shares in China Shanshui Cement Group Ltd. ("the company/respondent") to HKSCC Nominees Ltd. ("HKSCC") should not be avoided by the provisions of s.99 of the Companies Law (2018 Revision) in the event of an order being made on a petition by Tianrui International Holding Co. Ltd. ("Tianrui") for the winding up of the company.

2 The company is a holding company whose subsidiary is amongst the largest of the cement producers in the People's Republic of China. Its major shareholders, Tianrui, Asia Cement Corporation ("ACC") and China National Building Material Holding Co. ("CNBM"), have been involved in what Tianrui describes as a bitter take-over battle for the company. Tianrui alleges in its petition, brought on the just and equitable ground, that ACC has been acting improperly in concert with CNBM to dilute Tianrui's shareholding and squeeze it out of the company.

3 The petition has already been fully analysed and explained in the decision ("the CICA decision") of this court (CICA (Civil) 26 of 2018 (Martin, Newman and Moses JJ.A.), January 16th 2019, reasons given April 5th, 2019 (reported at 2019 (1) CILR 481)) in which it overturned a decision of the Grand Court to strike out the petition.

4 The relevant part of the validation order concerns share issues which the appellant Tianrui seeks to impugn as part of the conspiracy to dilute Tianrui's own shareholding.

5 It is alleged that this dilution was achieved by an improper exercise by the directors of their powers to issue securities, through successive issues of bonds in August and September 2018 to bondholders with whom ACC and CNBM were associated or connected. The convertible bonds were subsequently converted into shares. This is described more fully in the CICA decision (2019 (1) CILR 481, at paras. 5–7):

> "5 . . . In August and September 2018 . . . when nominees of CNBM and ACC were on the board, the company made two issues of convertible bonds. The first issue, made on August 8th, 2018, was in consideration of a payment of US$210.9m. at an interest rate of 20%; and on conversion the bondholders would receive shares in the company, resulting in the dilution of the shareholdings of all the then current shareholders. In Tianrui's case, the effect of conversion would be that its percentage of shares would drop from 28.16% to 26.13%. The second issue of convertible bonds was made on September 3rd, 2018, in consideration of payments totalling US$320.7m., again at an interest rate of 20%; and the effect of conversion into shares in the company would be that the percentage of shares held by Tianrui would fall from 26.13% to 23.56%.
>
> 6 On October 7th, 2018, after service of the petition on September 4th, 2018, the company announced that it had agreed with some of the bondholders to vary the terms so that conversion would occur immediately at a lower price in return for more shares. The effect of conversion into shares would be that Tianrui's shareholding would fall to 21.40%.

> 7 On October 30th, 2018, an EGM of the company was held at which the shareholders voted by a majority to authorize the issue of new shares to the bondholders on conversion . . . The shares were issued on the same day. The issue of the shares allowed the company to represent to the Hong Kong stock exchange that there were enough public investors to satisfy the listing requirements, with the result that the suspension of the company's listing was revoked and trading in its shares resumed on October 31st, 2018."

6 These successive steps taken, as Tianrui asserts, to dilute its shareholding were the latest stage in an alleged conspiracy to cause it damage (CICA decision, 2019 (1) CILR 481, at para. 33). Both by means of its petition and by a separate action to reverse the convertible bond and share issues, Tianrui is seeking to unwind the allegedly improper steps taken to achieve this dilution of its shareholding. The shares into which the bonds were converted were the subject-matter of the validation order. Tianrui contends that the application for the validation order was part of the means by which ACC and CNBM, through the company, sought to safeguard the impugned share issues and baulk any future restoration of the status quo, should the petition be successful.

7 The company sought validation of a proposed transfer of shares in the company, held by eighteen shareholders known as the "definitive shareholders" (defined by the company as those who held their shares by direct entry on the register of members). It was proposed that the shares should be transferred to the Hong Kong Securities Clearing Co. Nominees Ltd. ("HKSCC") to facilitate the trading of those shares through the central clearing and settlement system ("CCASS"). CCASS is an electronic book-entry clearing and settlement system for the public stock market in Hong Kong. In order to trade using CCASS, shareholders must transfer their legal title to HKSCC, acting as common nominee for shares held in CCASS, prior to depositing their shares into CCASS. The transfer of legal title would involve the company issuing the necessary share certificates for deposit with CCASS, delivering the certificates to CCASS on behalf of the shareholders and confirming that henceforth legal title in the shares was held by HKSCC rather than the individual shareholders to whom the share certificates had been issued.

8 CCASS had indicated that, before it would accept the deposit of shares, it required that the Cayman court should validate the transfer of legal title to HKSCC (see the exchange of emails referred to by Mangatal, J. in her judgment, 2019 (2) CILR 734, at para. 47). The eighteen definitive shareholders had informed the company that they wished to have their physical shares, representing 43.96% of the company's issued share capital, deposited into CCASS.

9 A validation order made in respect of the transfer of legal title in the shares to HKSCC and their subsequent deposit into CCASS would have the effect that those transactions could not be unwound under s.99 in the event of the petition being successful.

10 The judge accepted the company's case for validation, that it was a response to CCASS's request and that it wished to reduce the illiquidity of its shares. She was sedulous in her application of what she concluded, at the invitation of the company, to be the applicable test to be found in *Burton* v. *Deakin Ltd.* (2): the postulated reasons were those which an intelligent and honest director could reasonably hold in good faith and had a clear commercial basis.

11 Further, she accepted the company's argument that the transfer of legal title in the shares did "not run afoul of the rationale of s.99" (2019 (2) CILR 734, at para. 129). That rationale was said by the company to be to prevent the shareholders of partly paid shares to evade liability by transferring their shares to men of straw after the commencement of the winding up. The company's entire share capital was fully paid up.

12 This appeal is focused on Tianrui's contention that the judge misunderstood the purpose of s.99 and failed to identify the correct approach to validation under that section. Had she considered the application in a manner consistent with the purpose of s.99 she would have appreciated that the consequence of validation of the proposed transactions was, by virtue of ss. 45 and 54 of the Hong Kong Securities and Futures Ordinance, to make it impossible to unwind those transactions should the petition be successful.

Section 99

13 Section 99 of the Companies Law (2018 Revision), which, for relevant purposes, replicates s.127 of the UK Insolvency Act 1986, provides:

> "When a winding up order has been made, any disposition of the company's property and any transfer of shares or alteration in the status of the company's members made after the commencement of the winding up is, unless the Court otherwise orders, void."

14 It is fundamental to this appeal to identify the purpose of this section. Its purpose is to preserve the status quo; it has what *Palmer's Company Law*, vol. 4, at 15.526 describes as a "conservational" function. The retrospective effect of s.99 derives from the legislative scheme for insolvency which treats the commencement of a winding up as the date when the winding up was initiated, normally the date when the petition was presented, rather than the date when a winding-up order is made and the real winding up begins (see s.100(2) Companies Law (2018 Revision)

which provides that the winding up "is deemed to commence at the time of the presentation of the petition for winding up").

15 Accordingly, once a petition has been presented, during the "twilight period" between presentation of the petition and its resolution, any transaction such as the proposed transfer of shares to HKSCC or alteration in the status of the company's members will be avoided if the winding-up order is made, unless the court exercises its discretionary power under s.99 to validate the transaction. The avoidance effect of s.99 enables the liquidator to unwind any transactions which may have taken place during this twilight period and return the assets and circumstances of the company and its contributors to those which were in place at the time the winding up commenced.

16 However, during this twilight period, it is important that the deleterious effect of the very fact of the presentation of the petition, possibly long before its merits are determined, may be ameliorated by the process of validation. Validation may prevent the risk of paralysis once a petition is presented. All companies are vulnerable to the damaging effect the presentation of a petition may have; the ability to validate transactions during the period between presentation and the hearing of the petition enables companies to continue to operate in the ordinary course of their business prior to the hearing. As the editors of *Palmer* put it (*op. cit.*, at 15.527):

> "A company is not by law required to cease trading merely because a winding-up petition is presented against it. Pending the determination of the petition it is permissible for the company to continue to trade, provided that it does so in a bona fide and regular manner and with necessary regard to the implications for all interested parties (including the potential liability of the directors) if a winding up order is made by the court when the petition is heard."

17 The purpose and importance of validation may most clearly be seen in relation to trading companies. They are not prevented from continuing to trade once a winding-up petition is presented; a validation order provides commercial certainty for those trading with the company, and for the company, that their transactions will not be avoided.

18 The rationale for validation of transactions by a trading company in the ordinary course of business was explained by Lord Cairns in *Re Wiltshire Iron Co.* (12) in relation to a predecessor of s.127, s.153 of the Companies Act 1862 (3 Ch. App. at 446):

> "The 153rd section no doubt provides that all dispositions of the property and effects of the company made between the commencement of the winding up (that is the presentation of the petition) and the order for winding up, shall, unless the court otherwise orders, be

> void. This is a wholesome and necessary provision, to prevent, during the period which must elapse before a petition can be heard, the improper alienation and dissipation of the property of a company in extremis. But where a company actually trading, which it is the interest of everyone to preserve, and ultimately to sell, as a going concern, is made the object of a winding-up petition, which may fail or may succeed, if it were to be supposed that transactions in the ordinary course of its current trade, bona fide entered into and completed, would be avoided, and would not, in the discretion given to the court, be maintained, the result would be that the presentation of a petition, groundless or well-founded, would, ipso facto, paralyse the trade of the company, and great injury, without any counter-balance of advantage, would be done to those interested in the assets of the company."

See also Romer, J. in *Re Park Ward & Co. Ltd.* (9).

19 Thus validation itself may be seen as preserving the status quo by permitting a company to conduct its business in a manner which enables it to survive notwithstanding the depressing effects which flow from the presentation of a petition. It enables the company to keep "ticking over."

20 It ought hardly to need emphasis that the power of the court to make a validation order must not be exercised in a way which undermines the essential purpose of s.99, namely to preserve the status quo pending resolution of the petition. Any assessment of an application for a validation order must always have, at the forefront of consideration, the need not to impede, undermine or preclude fulfilment of that purpose.

21 The judge was led by the company to take a far more limited view of the purpose of s.99. It had submitted that the purpose of s.99 was to prevent shareholders from evading liability by transferring their shares to a man of straw after winding up has commenced. The judge appeared to accept that submission. The company has persisted in that submission in this appeal. The judge said (2019 (2) CILR 734, at para. 129):

> "I also accept the company's submission that the transfer of legal title from a shareholder to HKSCC is as nominee and does not run afoul of the rationale of s.99, since the shares of the definitive shareholders are fully paid-up."

22 Undoubtedly, there is authority that s.99 did have that purpose in relation to calls on a shareholder in respect of partly paid up shares (see *e.g. Rudge* v. *Bowman* (10)). But the days of partly paid up shares are long gone. The purpose of s.99 cannot be so confined. The statutory analogue in the United Kingdom has been re-enacted many times (in 1908, 1929, 1984 and 1985), into a period long after the days of partly paid up shares. Moreover, the section has application to all kinds of compulsory winding

up whether on the grounds of insolvency or on just and equitable grounds, and, accordingly, whether the company is solvent or not.

23 The judge was led into a fundamental error in relation to the purpose of s.99. The transfer of legal title from a shareholder to HKSCC fell squarely within s.99; a court ought only to have made a validation order in respect of such a transaction in circumstances which assisted in preserving the status quo and which did not frustrate the purpose of s.99. The question then arises as to the principles the judge ought to have applied, consistent with that purpose.

The principles applicable to a validation order

24 The principles which apply were disputed by the parties to the instant appeal. The judge based her decision on what Slade, J. himself called "broad guidelines" in *In re Burton & Deakin Ltd.* (2). In that case, the company was trading in the business of buying and selling new and second hand cars. Faced with the reluctance of its finance company to continue to finance the supply of new cars, the company sought an alternative source of borrowing and to obtain a validation order to protect itself from the operation of s.227 in respect of a proposed deed of assignment in favour of the new finance company and the discharge of the remaining indebtedness to the former finance company. It asserted that the payments were to be made in the ordinary course of business ([1977] 1 W.L.R. at 393–394). To this proposal objection was made on the basis that it was a radical change in the company's course of business which would have a deleterious effect (*ibid.*, at 395). The precise reasons for this challenge need not detain us, but it led to an argument relating to the burden of proof in circumstances where Slade, J. thought the evidence was such that he could not decide the case "firmly" either way (*ibid.*, at 395).

25 Slade, J. accepted that where a company was insolvent, in order to protect the creditors, careful scrutiny of the proposed disposition was needed (*ibid.*, at 396), following the approach of Buckley, J. in *In re A.I. Levy (Holdings) Ltd.* (1) ([1964] Ch. at 24). But he drew a significant distinction between an insolvent and a solvent company. Where the company was solvent, he said there was no onus on the directors to justify the proposed transactions; on the contrary, the onus was on those who opposed validation: a court would normally sanction the disposition unless "compelling evidence" was adduced by the contributory who opposed the proposal. Mangatal, J. relied on the following passage (quoted at 2019 (2) CILR 734, at para. 121):

> "As Mr. Stubbs pointed out, the responsibility of managing the business of the company is entrusted in its articles of association to its directors. At least so long as a winding up petition has not been presented, the court will not generally, save in the case of proven bad

faith or other exceptional circumstances, interfere with the exercise of the discretion conferred on the directors by a company's articles of association at the instance of a shareholder. Thus, if before the presentation of a petition a shareholder were to come to the court in an attempt to restrain a particular disposition of the company's property contemplated by the board of directors and falling within their powers, he would not generally succeed, unless he could prove bad faith or other exceptional circumstances. He would not be able, merely by adducing prima facie grounds for criticizing the wisdom or beneficial nature of a particular transaction, to place upon the company or its board of directors the onus of justifying the proposed disposition by detailed evidence.

I can see no good reason why the rights of interference by a shareholder vis-à-vis the company or its directors should, in this kind of situation, for practical purposes be drastically improved during the interim period, merely because he happens to have presented a winding up petition which is not demurrable and which has not yet been heard. The interim period may be quite a long one. In the present case, from what I have been told, it looks like between three and six months. In a case such as the present, the court, at the time when the application under section 227 comes before it generally has not sufficient evidential material to enable it properly to form even a prima facie view as to whether the petition itself is ultimately likely to succeed or fail. It must therefore necessarily assume that the petition is at least as likely to fail as it is to succeed. Indeed, in the case of many contributories' petitions—of which this is one—the primary relief sought by the petitioners is an order under section 210 that other persons be ordered to purchase their shares at a stated price, a winding up order being sought only as a second alternative—so that, if the primary relief were granted, the petitioner would in any event have had no interest in the intended dispositions at all.

Taking all these considerations into account and in the absence of any authority demonstrating the contrary, I thus reach these conclusions on the question of principle raised by the present application. If on an application under section 227 relating to a solvent company, (a) evidence is placed before the court showing that the directors consider that a particular disposition, falling within their powers under the company's constitution, is necessary or expedient in the interests of the company, and (b) the reasons given for this opinion are reasons which the court considers that an intelligent and honest man could reasonably hold, it will in the exercise of its discretion normally sanction the disposition, notwithstanding the opposition of a contributory, unless the contributory adduces compelling evidence

proving that the disposition is in fact likely to injure the company. A fortiori in my judgment the court will be inclined to exercise its discretion in this manner in a case such as the present, where the primary relief sought by the petition is an order under section 210 that the other shareholders be ordered to purchase the shares at a stated price.

While I have attempted to formulate these statements of principle so as to explain the basis upon which I decide this particular case, I should nevertheless make it clear that they are intended merely as broad guidelines. No limits are placed by the sections on the court's discretion to grant or refuse an application under section 227, and such a discretion will of course be exercised in every instance having regard to the particular circumstances of the case."

26 Mangatal, J. (*ibid.*, at paras. 123–124) then invoked the decision of Henderson, J. in the Grand Court in *In re Fortuna Dev. Corp.* (6), which followed *In re Burton* (2). In that case the company sought a validation order permitting it to engage in a major refinancing to relieve its principal of his obligations under a personal guarantee. Henderson, J., at the first hearing, adopted Slade, J.'s distinction between an insolvent and solvent company (2004–05 CILR 533, at para. 3) and stated that the passage cited above accurately stated the law in the Cayman Islands (*ibid.*, at para. 4). Henderson, J. continued, in passages cited by Mangatal, J. (*ibid.*, at para. 5):

"5 Thus, there are four elements which must be established before an applicant is entitled to a validation order. First, the proposed disposition must appear to be within the powers of the directors. There is no dispute about that here. Secondly, the evidence must show that the directors believe the disposition is necessary or expedient in the interests of the company. There is no dispute here that the directors do have that belief. Thirdly, it must appear that in reaching the decision the directors have acted in good faith. The burden of establishing bad faith is on the party opposing the application. Fourthly, the reasons for the disposition must be shown to be ones which an intelligent and honest director could reasonably hold."

After considering further evidence at a later hearing, Henderson, J. continued (*ibid.*, at para. 16):

"16 I am not called upon here to answer the question 'Is this in the best interests of the company?' or even 'Is this a reasonable decision?' The question is a narrow one. Might an intelligent and honest director acting reasonably come to such a conclusion? I find for the reasons given in Ms. Tsien's affidavit that he or she might. The

decision has been demonstrated to fall within the realm of reasonableness. The applicant will therefore be granted a validation order."

27 In two further passages, Mangatal, J. emphasized the approach she adopted in reliance on those two cases (2019 (2) CILR 734, at para. 126):

"One of the principles that I derive from the decision in *Fortuna* . . . is that the type of solid evidence that the court needs to see must depend upon the nature and type of transaction in respect of which validation is sought. As *Burton & Deakin* . . . reminds, the articles of association of a company entrust the management of the business of a company to its directors. Thus, upon a winding-up petition being filed in relation to a solvent company—

'it is not only normal but necessary for a company to obtain a validation order and that it would only be if the shareholder has specific concerns which he can support by credible evidence that he should actively contest any part of the application.'

See the statement of Harris, J. in the *Emagist* Hong Kong decision referred to in para. 107 above ([2012] 5 HKLRD 703, at para. 7)."

She continued later (*ibid.*, at paras. 130–131):

"130 As *Burton & Deakin* reminds, in the case of a solvent company, a shareholder should not, merely because he happens to have presented a winding-up petition which is not demurrable and which has not yet been heard, get some greatly improved position from which to attack the decisions taken by the directors of the company which they say are taken in good faith and in the best interests of the company. The consideration discussed in *Cybervest* . . . does not arise here, or at least at this stage since the court is not in a position at this stage to say and has not sufficient evidential material to enable it properly to form even a *prima facie* view as to whether the petition itself is ultimately likely to succeed or fail. I must therefore necessarily assume that the petition is at least as likely to fail as it is to succeed—*Burton & Deakin.* In *Cybervest*, the facts were, in my view, distinguishable—see paras. 32–34 of the judgment. In the instant case, I am not, on the state of the evidence before me, able to say that irregularities in the conduct of the company have been 'shown.'

131 Also as contemplated in *Burton & Deakin*, the interim period may be quite a long one. Between the different interlocutory applications that are pending in the Financial Services Division and the pending application to the Privy Council for special leave, this petition is likely to take a long time to come on for hearing."

28 The judge's reference to *Re Cybervest Fund* (5) was to observations made by Smellie, C.J. in a case where a winding up had been sought on just and equitable grounds because there was alleged to have been convoluted dealings with the assets of the fund about which the manager had failed to consult the shareholders. The Chief Justice refused to validate management fees said to be paid in the ordinary course of business. After citing Henderson, J. in *Fortuna* (6) (2004–05 CILR 533, at para. 5), he continued (2006 CILR 80, at para. 29):

> "There is another consideration to add to this list, in light of the concerns raised in this matter, although arguably it is subsumed within the third and fourth elements. This would be whether irregularities in the conduct of the affairs of the company can be shown, even if the company is clearly solvent, as is alleged here."

29 The Chief Justice then referred to *In re a Company (007130 of 1998*) (4) in support of the proposition that even in the case of a solvent company the conduct of the company's business should not be at the expense of its members (2006 CILR 80, at para. 30). But his approach was strongly influenced by Henderson, J.'s fourth principle. He did not consider that "the directors could properly hold" that the opposed payment of fees was "necessary or expedient in the interests of the company at that time" and rejected the validation order (*ibid.*, at para. 33).

30 *In re a Company (No. 007130 of 1998)* (4) provides, as you would expect, an important explanation of the approach adopted by Slade, J. in *Burton* (2) but also sounds a significant note of caution in cases where the opposed transactions were not in the ordinary course of business. Mervyn Davies, J. drew attention to Buckley, J.'s identification in *Re A.I. Levy (Holdings) Ltd.* (1) ([1964] Ch. at 24) of the purpose of validation orders, founded on Lord Cairns' judgment in *In re Wiltshire* (12) (at 59):

> "[they are] designed to preserve the value of the assets of a company for the people interested in the assets notwithstanding the pendency of winding up proceedings in order that the company might not be unduly hampered in carrying out transactions which might be for the benefit of those interested in the value of its assets."

31 Mervyn Davies, J. pointed out that in the case of solvent companies, when both petitioner and respondent are anxious to preserve the worth of their shares, the application for a validation order is usually unopposed (*ibid.*, at 59). He cited Slade, J. in *Re Burton* and continued (*ibid.*, at 60):

> "As I see it, that case brings out the point that on a s.522 application of that kind, great weight is to be attached to the wishes of the directors of the company since the mere presentation of a petition should not have the effect of allowing a shareholder to interfere with the directors' management of the company's business. But beyond

> that I do not see that the Burton case affords much guidance here. I say that because in Burton (i) there was no objection to an order validating transactions in the ordinary course of business; (ii) the application (as opposed) concerned specific transactions and (iii) the company was plainly solvent . . . None of those three features appears in the case before me."

32 Mervyn Davies, J. then commented (*ibid.*, at 61) that "s.522 consents are in all cases to be given with some caution" and concluded that continued trading would not be for the benefit of the shareholders and might well work to their detriment.

33 *In re a Company* (4) is of importance in the instant appeal in three respects. First, in the distinction drawn between cases where it is plain that the proposed dispositions sought to be validated are in the ordinary course of business. It was beyond question that *Burton* (2) concerned a disposition proposed for the purposes of the ordinary course of business of that motor trader. No other justification had been advanced. That the proposal was to enable the company to continue in business during the twilight period was not disputed by the opposition.

34 The second significant feature of Mervyn Davies, J.'s judgment lies in his reminder that the beliefs and wishes of the directors, even if advanced in good faith and without improper motives, and even if the proposal is made for the purposes of the ordinary course of business, although to be given great weight are not dispositive.

35 Third, all applications need to be approached with some caution, whether in the ordinary course of business or not and whether the company is solvent or not.

36 Slade, J.'s guidelines in *Burton* paraphrase the test adopted, in the alternative, by Pennycuick, J. in *Charterbridge Corp. Ltd.* v. *Lloyds Bank* (3), in which it was alleged that a legal charge had been created for purposes outside the scope of the company's business, and was *ultra vires.* The state of mind of the directors was, so Pennycuick, J. held, irrelevant on the issue of *ultra vires* ([1970] 1 Ch. at 74). But he took an alternative approach in case he was wrong in his view of the law (*ibid.*, at 74):

> "The proper test, I think, in the absence of actual separate consideration, must be whether an intelligent and honest man in the position of a director of the company concerned could, in the whole of the existing circumstances, have reasonably believed that the transactions were for the benefit of the company."

37 That Pennycuick, J. was not wrong as to the irrelevance of the directors' state of mind, where a transaction is said to be *ultra vires*, is confirmed by Lord Wilberforce in *Howard Smith Ltd.* v. *Ampol Petroleum* (8). A shareholder company challenged the issue of shares to a rival in a

takeover battle on the basis that the issue was to reduce the proportion of its shareholding. The directors contended they were acting in good faith for the purposes of raising capital in the target company. The Board decided that it was unconstitutional for directors to use their fiduciary powers over the shares in a company purely for the purpose of destroying an existing majority, or creating a new majority which did not exist ([1974] A.C. at 837). Lord Wilberforce continued (*ibid.*, at 838):

> "That this is the position in law was in effect recognised by the majority directors themselves when they attempted to justify the issue as made primarily in order to obtain much needed capital for the company. And once this primary purpose was rejected, as it was by Street, J., there is nothing legitimate left as a basis for their action, except honest behaviour. That is, in itself, not enough."

38 Both *Charterbridge* and *Howard Smith*, in admittedly different contexts, although the latter may subsequently be relevant to issues in the petition, provide an important reminder that there will be cases where the honest belief of the directors is irrelevant to the propriety of a transaction. In an application for a validation order, where the purpose of the proposed transaction is impugned, the motive of the directors is far from determinative. If the proposed transaction undermines the purposes of s.99 and of the power to make validation orders, then the directors' belief or good faith may be irrelevant.

39 Before analysing the principles which may be drawn from these authorities, I should mention one further Cayman Islands authority to which attention was drawn: *In re Torchlight Fund LP* (11). In that case, a validation order was sought in respect of payments in the ordinary course of the business of a partnership. This court (Martin, Newman and Morrison, JJ.A.) adopted *Burton* (2), *Fortuna* (6) and *Cybervest* (5) (2018 (1) CILR 290, at paras. 16–22), but there was no dispute as to the test (at para. 16) either in this court or below and the judge's exercise of his discretion to make the order was not challenged on the basis that he had applied the incorrect legal test (at para. 68). The opposition was not on the basis that the payments were outside the ordinary course of business but that they were inadequately explained or not legally due (at para. 70).

Principles to be drawn from the authorities

40 The starting point for the identification of the principles a court should apply in considering whether to exercise its power to make a validation order must be the legal source of that power, s.99. Two features are fundamental. First, that the power to make such an order is contained within that section itself. It is, therefore, part and parcel of the means by which the purpose of the section is to be achieved. That purpose is, as I have already identified, the maintenance of the status quo between

presentation and resolution of the winding-up petition, so as to render effective the section's retrospective avoidance function. Second, the section applies to all companies, the subject of a compulsory winding up, whether the company is solvent or not, whether it is a trading company or undertakes some other business, and whether the winding up is on the grounds of insolvency or on just and equitable grounds.

41 It follows, in my view, that as a matter of principle, a court, in every case, must satisfy itself that any order it makes does not undermine or frustrate the maintenance of the status quo pending resolution of the petition and that, on the contrary, the order should be made in furtherance of that objective. This principle should not alter according to the particular circumstance of the case. Of course, its application will vary from case to case.

42 I stress what might be called this underlying principle because there was considerable debate as to whether the approach identified in cases such as *Burton* (2) and *Fortuna* (6) was, as submitted by the appellant, to be confined to cases where the proposals were advanced as being to maintain the ordinary course of the company's business. The respondent contended they were not to be so limited. I suggest it is better to regard the underlying principle as applicable to all cases. But, the court's assessment as to whether the proposal will advance or undermine the purpose for which the power is conferred will vary according to whether it is sought in relation to the ordinary course of business or not.

43 Thus, in cases such as *Burton*, *Fortuna* and *Torchlight* (11), where there can have been no doubt that the proposals were to further the ordinary course of business, the court might need little persuasion that they assisted in maintaining the business pending resolution of the winding up, provided the interests of those concerned with the assets of the company were considered. Such proposals were consistent with s.99. But that is not to recognize a distinction in principle between solvent and insolvent companies. It is, rather, that the application of the underlying principle I have sought to identify will vary according to the relevant circumstances of the company and the nature of its proposed transactions, as Slade, J. himself seems to have acknowledged.

44 It is dangerous to assume that a court may be relieved of the responsibility of careful scrutiny and caution merely because the company is solvent. It may be disputed whether what is proposed is in the ordinary course of business or is in the best interests of the company during the period between presentation and resolution of the petition. It may be contended that the directors themselves are making the proposals out of dishonest or improper motives or that the proposals themselves will run the risk of undermining or frustrating the purpose of the section. In such cases, a court can make no assumptions as to the propriety of the

proposals and will need to be satisfied that they are consistent with the purposes of the section and for the benefit of the company and those interested in the value of its assets.

45 The real danger I detect in the approach in *Burton* (2) and *Fortuna* (6) is that it focuses on the burden of proof and creates a presumption in favour of the belief of the directors as to the propriety of their proposals. Cases will rarely turn on the burden of proof; there is no presumption. In every case, those seeking a validation order must be able to satisfy the court that what is proposed will not undermine the avoidance function of s.99, that it will not impede or frustrate the unwinding of transactions after the presentation of the petition but will maintain the status quo. This is so whether the company is solvent or insolvent, and whether the proposal is made in the ordinary course of business or not. Where the proposal is made for the purposes of the ordinary course of business, the court will more readily take the view that there is no unacceptable risk to the maintenance of the status quo. In such a case the views of the directors as to whether the proposals are for the benefit of the company will plainly be relevant even though not dispositive.

46 For these reasons I adopt the submission of Mr. Lowe, Q.C. in his written argument:

> "Just as in the case of a creditors' petition validation will not be allowed to undermine the purpose of a winding up (i.e. *pari passu* distribution), in a just and equitable petition a validation order should not undermine the objective of stopping or reversing oppressive conduct."

47 Careful scrutiny is needed not just to protect creditors in an insolvency petition but also contributories at a stage when no one can say whether the petition in respect of a solvent company will succeed or not. Validation orders should only be made if they are consistent with the purposes of s.99 and of the power to make such orders.

The judge's approach

48 The foundations of the judge's conclusion are (2019 (2) CILR 723, at paras. 127–129):

> "127 In my judgment, it is quite important that it is the SEHK that has sought for the company to make this application. This is one of the reasons that the company advanced for making this application, along with requests from the definitive shareholders regarding the deposit of their physical shares in CCASS. The company just as recently as October 31st, 2018 was able to have trading in its shares resumed on the SEHK, which both the company and Tianrui consider

a positive development. The company also advanced that the illiquidity of the company's shares has had a significant adverse effect on the company. This is because the illiquidity affects the company's share price adversely. In addition, it maintains that the illiquidity will make it difficult for the company to raise significant capital from the equity markets in the future.

128 In my judgment there is an abundance of evidence and reasons (para. 127 above) that the company has provided, which, viewed objectively, indicate that the directors consider that it is necessary and expedient to seek the validation order. In my judgment, the reasons are reasons which an intelligent and honest director could reasonably hold in good faith and obviously have a clear commercial basis. It is rational as well as reasonable that the company would wish to bring down the illiquidity of its shares, and the company being a holding company, would have good reasons in wanting to reduce difficulties, such as illiquidity, lying in the way of its raising required capital in the equity markets in the future. In my view, it is not possible or necessary for the court at this stage to delve deeper into what are complicated questions as to precisely what are the causes of this illiquidity; the fact of the matter is that the directors have approached the court to validate a type of transaction which in my view clears the bar and ought to be validated.

129 The evidence of Tianrui, including Mr. Birkett, is as to the facility with which changes in beneficial ownership of the shares can be effected and the anonymity of the new shareholders and 'the cloak which CCASS validation would give to future collusive dealings in the shares.' However, it is common ground by the experts on both sides that CCASS is a computerized system, which handles the process of matching buyers and sellers, and the definitive shareholders cannot choose who their shares are sold to. It is also common ground that s.99 does not affect the ability of shareholders to deal with the beneficial interest in their shares. The shareholders could therefore deal with the beneficial interest off market. As a matter of law, shareholders who have not deposited their shares in CCASS may still sell the beneficial interest in their shares off market. I also accept the company's submission that the transfer of legal title from a shareholder to HKSCC is as nominee and does not run afoul of the rationale of s.99, since the shares of the definitive shareholders are fully paid-up. The burden is on Tianrui to demonstrate and unless it adduces 'compelling evidence proving that the disposition is in fact likely to injure the *company*' [Emphasis added.] (*Burton & Deakin* . . . ([1977] 1 W.L.R. at 397)), the court will be inclined to exercise its discretion provided the evidence from the company fulfills the

> requirements (the bar not being a high one). Tianrui has not discharged the burden. Its allegations about being unable to trace beneficial ownership relate to its alleged claim which of course, at this point, remains a matter of assertions. In my judgment, Tianrui has not provided any compelling evidence that the transfers to allow for trading on CCASS is detrimental to the company as a whole."

49 In reliance on *Burton* (2) and *Fortuna* (6), the judge was led to regard herself as free from any requirement to subject the application to close scrutiny, whilst imposing the burden on the appellant to adduce compelling evidence. This approach dictated her view of the evidence and arguments advanced by the appellants and led to her adopting, rather than questioning, the case advanced by the respondent. In addition, by virtue of her incorrect identification of the purpose of s.99, she never even considered whether the proposal to deposit shares with the HKSCC would impede or undermine the purposes of the section.

Tianrui's challenge to validation: the effect of s.45 of the Hong Kong Securities and Futures Ordinance

50 As I have previously indicated, the respondent's case for validation was that the share transfers to HKSCC, as nominees, for depositing into CCASS was to remedy the illiquidity of its shares. The eighteen definitive shareholders had informed the company that they wished to do so to counter the adverse effects of illiquidity (see the company's argument recorded at 2019 (2) CILR 734, paras. 48–57, and paras. 127–128 cited above). The argument as to the ill effects on illiquidity was based on the evidence of an expert, Philippe Espinasse. He described the average daily trading volume in proportion to the company's market capitalization as unreasonably illiquid; this had an adverse effect on share price and made it difficult for the company to raise significant capital.

51 The application was supported by an affirmation from Wu Ling-Ling ("Ms. Wu") (the fourth affirmation). She asserts that the definitive shareholders are at a disadvantage to those who have deposited their shares prior to the presentation of the petition because they cannot trade through the Exchange (*ibid.*, at para. 93), and are left with dealing in the beneficial interests in their shares off-market (para. 95). She records that the company announced on the Hong Kong Exchange that they were applying for a validation order to sanction the deposit of share certificates into CCASS and invited applications from shareholders (para. 102). In the six days following, the eighteen definitive shareholders informed the company they wished to do so and, for that purpose, to transfer the legal title to HKSCC Nominees Ltd. Their shares represent 1,870,323,160 shares being 42.69% of the company's share capital (para. 104). She identifies those shareholders and their holdings in Schedule 1.

52 As is apparent from the passages in the judgment I have cited above, the judge thought it was reasonable for the company to wish to reduce the illiquidity of its shares should they wish to raise capital in the future (*ibid.*, at para. 128). She took the view that it was neither possible nor necessary to delve deeper into the causes of illiquidity. In short, she accepted the evidence of Ms. Wu without any critical analysis, in the absence of compelling evidence from Tianrui.

53 By adopting that approach, it seems to me that the judge wrongly overlooked one of the essential features of Tianrui's opposition. The opposition was based on two distinct arguments. One of the arguments was that validation would enable CNBM and ACC and their related parties to play a "shell game" with beneficial ownership of their shares and cloak future collusive dealings, an argument recorded at para. 94. The judge answered that argument by concluding that under the CCASS system the definitive shareholders could not choose to whom the shares were sold and, in any event, they could deal with the beneficial interest in their shares off market (para. 129). Tianrui contends that investigation of the true beneficial ownership of the shares will be impeded, but that is not material to the nub of this appeal. For the purposes of this appeal, it is unnecessary to consider this aspect of the dispute. The argument relating to the shell game was by no means the only argument.

54 This appeal is concerned with the distinct argument relating to s.99. As the judge herself had earlier recorded, Tianrui contended that the transfer of shares to the CCASS system would cause "serious and irreversible consequences" and would prejudice the outcome of the petition because it would be impossible to unwind the "improper and dilutive share issue if the petition is upheld" (*ibid.*, at paras. 85–86). This argument had been based, as the judge recorded, on the evidence of an expert, Mr. Birkett, adduced on behalf of Tianrui and set out in the judgment (at para. 93). Section 45 of the Securities and Futures Ordinance provides (quoted at para. 93):

"45. Proceedings of recognized clearing house take precedence over law of insolvency:

(1) None of the following shall be regarded as to any extent invalid at law on the ground of inconsistency with the law relating to distribution of the assets of a person on insolvency, bankruptcy or winding up, or on the appointment of a receiver over any assets of a person—

(a) a market contract;

(b) the rules of a recognized clearing house relating to the settlement of a market contract;

(c) any proceedings or other action taken under the rules of

a recognized clearing house relating to the settlement of a market contract;

(d) a market change;

(e) the provision of market capital;

(f) the default rules of a recognized clearing house, or

(g) any default proceedings.

(2) The powers of a relevant office-holder in his capacity as such, and the powers of a court acting under the law of insolvency, shall not be exercised in such a way as to prevent or interfere with—

(a) the settlement in accordance with the rules of a recognized clearing house of a market contract; or

(b) any default proceedings.

(3) Subsection (2) shall not operate to prevent a relevant office-holder from recovering an amount under section 51 after the completion of a matter referred to in paragraph (a) or (b) of that subsection."

55 Mr. Birkett took the view that this section, through the operation of s.54 of the SFO, removed the proposed transactions from the scope of s.99 of the Cayman Companies Law and would place the proposed deposits into CCASS outside the power of a liquidator. Mr. Birkett was of the opinion that the effect of s.45 was to override the Hong Kong law of winding up and insolvency in relation to certain transactions on a recognized clearing house such as HKSCC and by virtue of s.54 of the Ordinance this applied to non-Hong Kong winding up and insolvency statutes (see his evidence recorded, *ibid.*, at para. 93). He concluded:

"51. There are strong statutory finality protections in place for settlement of trades in CCASS. This structure has been established to provide certainty and reduce risk for market participants, and is based on the fungibility of an issuer's securities of the same class, and the interposition of a central counterparty in the clearing mechanics. Together, these elements do appear to be effective in preventing a Participant or issuer, or a liquidator or either of them, from reopening or reversing a sale or purchase of the issuer's shares through CCASS once it has been settled."

56 On the basis of this evidence, Tianrui contended that the CCASS share deposits would be irreversible; the transactions would be beyond the reach of the liquidators, in the event of a winding up (arguments recorded, *ibid.*, at paras. 88–89).

57 The company disputes that interpretation of the Hong Kong Ordinance but produced no expert evidence to the contrary. Although the judge, in her "Discussion and analysis," referred to the "shell game" argument and to Mr. Birkett's evidence in relation to changes in beneficial ownership, she made no reference to this second argument at all. The respondent contended that it was a new argument. But it is plain from both written and oral arguments before the judge, and the argument recorded by the judge, that that is not so. It was a crucial argument in relation to the compatibility of the respondent's application for validation with the purposes of s.99. The consequence of her mistaken view of the purposes of s.99 was that this vital argument received no consideration by the judge.

58 Further, led as she was to the view that the bar which the respondent had to clear "was not a high one" (*ibid.*, at paras. 128–129), and that it was for Tianrui to provide compelling evidence, she neither questioned nor scrutinized the respondent's case for validation.

59 Yet that case required careful analysis as to the reason why the respondent was seeking to deposit the definitive shareholders' shares into CCASS and, above all, consideration as to whether validating such a transaction would impede or frustrate the purpose of s.99, as Tianrui contended.

Examination of the company's proposal

60 Since the judge was deflected from the necessity to scrutinize the company's proposal, this court should undertake that task. The judge did not have the good fortune of the Hon. John Martin, J.A.'s appraisal of the petition and the nature of case advanced by Tianrui, to which I have referred above.

61 The deposit of shares to CCASS was alleged by the appellant to be an important further stage in the process of diluting its shareholding and the conspiracy to cause it damage. It should never have been forgotten that the proposed transactions in respect of which validation was sought were themselves the subject matter of the petition. Validation would have the effect of preventing the successive conversion of the bonds into shares, which took place after presentation of the petition, being unwound. It would make it impossible to reverse the issue of shares and, as Tianrui put it, "risk stymying what a Court, the liquidator or the appellant might legitimately do."

62 Faced with that opposition, the obvious question which arises is as to why the company sought, for its benefit, to deposit the definitive shareholders' shares identified by Ms. Wu. Ms. Wu's schedule identifies four shareholders who had been holders of the convertible bonds. The shares had been issued following an EGM on October 30th, 2018 (CICA

decision, 2019 (1) CILR 481, at para. 7). The names of eleven others on the list speak of a relationship with ACC. No explanation has been given as to why any of those shareholders wanted to deposit their shares into CCASS. It seems unlikely they would wish to sell those shares, the acquisition of which was an integral part of the process whereby Tianrui's percentage was diminished and ACC and CNBM sought to gain control, and of the alleged conspiracy.

63 Moreover, Ms. Wu is not only director of the company but executive vice president and chief financial officer of ACC. She would have been in a position to explain the reason why those shareholders on her list which bore names suggesting association with ACC were concerned with illiquidity at that time when, as I have said, it seems so unlikely that they would want to divest themselves of the shares.

64 Nor does the suggestion that illiquidity would cause problems, should the company wish to raise capital, bear examination. There was no evidence as to why the company which is a holding company, the parent of operating subsidiaries, wanted to raise finance. In any event raising finance would itself need validation to avoid the risk of being unwound.

65 Further, the timing of the request appears of significance. Before the suspension of listing most of the company's shares had not been deposited on CCASS. ACC and CNBM, who became shareholders before the listing was suspended, had not, at that time, sought to deposit all their shares. They could have done so during the period after Mangatal, J. struck out the petition on October 19th, 2018 and before the Court of Appeal's decision was given on January 16th, 2019 restoring the petition. Their asserted concerns as to illiquidity did not prompt them to do so.

66 In the absence of any response, I am driven to the conclusion that there was no reasonable explanation other than that proffered by Tianrui, namely that the deposit was intended to have the effect described by Mr. Birkett and to baulk the unwinding of those transactions should the petition be successful.

67 The fact that prior to deposit CCASS required validation of the transfer of legal title to HKSCC was regarded by the judge as "quite important" and a reason for making the application. On the contrary, it does not seem to me to provide any explanation for the shareholders' wish to deposit the shares. If there was a reasonable explanation for such deposits, then it was true that validation was needed, but that has no bearing on examination of the logically prior question as to why the deposit was requested or needed.

68 There was a dispute between the parties as to whether the deposit was in the ordinary course of the company's business. Whether it was or was not did not preclude the need for acceptable answers to the obvious

questions I have posed nor as to why the transactions should be validated, notwithstanding the effect they would have in frustrating the avoidance provision on s.99.

69 I should, however, record my view that, though it does not appear to have been argued to the contrary below, as the judge noted when giving leave to appeal, the transactions proposed were not made in the ordinary course of business: the company's business is in holding interests in subsidiaries, it is not in the business of trading in its own shares.

70 Nor do I accept the company's repeated complaint that Tianrui is seeking to impose an injunction on the deposit without fulfilling the stringent requirements that would be necessary for such an application, particularly a cross-undertaking in damages. Section 99 and the power to make a validation order have the purpose and effect I have identified. Tianrui had the right to oppose the making of the order and s.99 requires the respondent to make its application good. Tianrui had no obligation or need to seek an injunction, when the merits of the application were to be considered under s.99.

71 For those reasons, I conclude that the judge made material errors of law leading her to a failure to consider relevant evidence and to make necessary assessments of that evidence. Accordingly, her exercise of evaluative judgment cannot stand (see *e.g. Henderson* v. *Foxworth Invs. Ltd.* (7) ([2014] 1 W.L.R. 2600, at para. 67)).

72 At the end of yet another stage in this bitterly fought dispute, there remains the fact that no answer has been advanced as to why the court, in response to the application, should make an order which runs the risk of impeding or obstructing the unwinding effect of s.99, in relation to transactions which are the subject-matter of the petition. In those circumstances I would reverse the order made by the judge and refuse to make a validation order in respect of the proposed CCASS deposit.

73 **FIELD, J.A.:** I agree.

74 **RIX, J.A.:** I also agree.

Order accordingly.

Attorneys: *Ogier* for the appellant; *Maples* for the respondent.

ITEM NO. 172

JA-58

[2021 (2) CILR 556]

IN THE MATTER OF PADMA FUND L.P.

GRAND CT. (Parker, J.) October 8th, 2021

Partnership — exempted limited partnership — winding up — no jurisdiction to make winding up order against exempted limited partnership on creditor's winding up petition — creditor may commence proceedings against general partner

The petitioners sought the winding up of a partnership.

The partnership (acting by its general partner) was a minority shareholder of Atlantic Aurum Invs. B.V. ("AAIBV"). San Miguel Holdings Corp. ("SMHC") was the only other shareholder in AAIBV, which was a joint venture vehicle. Disputes had arisen in respect of the joint ventures, which were the subject of ongoing arbitration proceedings.

The petitioners (SMHC and AAIBV) sought an order that the partnership be wound up pursuant to s.92(d) of the Companies Act (2021 Revision), as applied by s.36(3) of the Exempted Limited Partnership Act (2021 Revision), on the basis that the partnership was unable to pay its debts in respect of a costs award arising out of one of the arbitrations.

The partnership, acting by its general partner, opposed the petition on the grounds *inter alia* that it was procedurally defective and the court had no jurisdiction to make the orders sought. Section 91 of the Companies Act did not apply to exempted limited partnerships and the remedy of a creditor of an exempted limited partnership, such as the petitioners, was to commence proceedings against the general partner. The wrong procedure had been used and the court therefore had no jurisdiction to make the orders sought.

The petitioners submitted *inter alia* that the practice of attorneys in the Cayman Islands who were experts in "funds work" which involved exempted limited partnerships was that s.91 of the Companies Act applied to exempted limited partnerships by virtue of s.36(3) of the Exempted Limited Partnership Act.

Held, dismissing the petition:

There was no jurisdiction for the court to make a winding up order against an exempted limited partnership on a creditor's winding up petition. The prefatory words of s.36(3) of the Exempted Limited Partnership Act ("Except to the extent that the provisions are not consistent with this Act, and in the event of any inconsistencies, this Act shall prevail, and subject to any express provisions of this Act to the contrary …") made clear that Part V of the Companies Act only applied to an exempted limited

partnership if and to the extent that the provisions were not inconsistent with the Exempted Limited Partnership Act. The presentation of a creditor's petition against an exempted limited partnership was inconsistent with (and contrary to) the provisions of s.33(1) of the Exempted Limited Partnership Act, which provided that "legal proceedings by or against an exempted limited partnership may be instituted by or against any one or more of the general partners only …" The legislative purpose of s.36(3) of the Exempted Limited Partnership Act was to apply the applicable provisions of Part V of the Companies Act and the Companies Winding Up Rules following the commencement of a winding up in order to facilitate an orderly winding up of a partnership's affairs. The remedy of any creditor of an exempted limited partnership was to commence proceedings against the general partner (paras. 46–52; paras. 65–66; para. 72; paras. 89–94).

Cases cited:
(1) *China Shanshui Cement Group Ltd., In re*, 2015 (2) CILR 255, referred to.
(2) *Maso Capital Invs. Ltd.* v. *Shanda Games Ltd.*, 2020 (1) CILR 293, referred to.
(3) *Rhone Holdings L.P., In re*, Cause No. FSD 119 of 2015, Grand Ct., September 29th, 2015, unreported, considered.
(4) *Simamba* v. *Health Servs. Auth.*, 2019 (2) CILR 213, referred to.
(5) *XiO Diamond LP, In re*, 2020 (2) CILR 270, not followed.

Legislation construed:
Companies Act (2021 Revision), s.91: The relevant terms of this section are set out at para. 41.
s.92: "A company may be wound up by the Court if—

…
(d) the company is unable to pay its debts …"

Exempted Limited Partnership Act (2021 Revision), s.2: The relevant terms of this section are set out at para. 30.
s.33(1): The relevant terms of this subsection are set out at para. 32.
s.36(3): The relevant terms of this subsection are set out at para. 47.

Grand Court Act (2015 Revision), s.18(1): The relevant terms of this subsection are set out at para. 14.

Partnership Act (2013 Revision), s.3: The relevant terms of this section are set out at para. 21.
s.10: The relevant terms of this section are set out at para. 23.
s.13: The relevant terms of this section are set out at para. 24.

Insolvency Act 1986 (c.45), s.220: The relevant terms of this section are set out at para. 74.

L. Faulkner for Padma Fund L.P.;
P. Sherwood and *T. Baildam* for the petitioners;
T. Heaver-Wren for CCP Henderson Capital Ltd.

1 **PARKER, J.:**

Introduction

The petition of San Miguel Holdings Corp. ("SMHC") and Atlantic Aurum Invs. B.V. ("AAIBV") (together, "the petitioners") presented on July 19th, 2021 seeks orders for the winding up of Padma Fund L.P. ("the partnership").

2 The petitioners seek an order that the partnership be wound up pursuant to s.92(d) of the Companies Act (2021 Revision) ("the Companies Act"), as applied by s.36(3) of the Exempted Limited Partnership Act (2021 Revision) ("the ELP Act"), on the basis that the partnership is unable to pay its debts.

3 Parallax Capital Management ("the general partner") acts on behalf of the partnership. The general partner is the sole general partner of the partnership.

4 The partnership, acting by its general partner, opposes the petition on the following grounds:

(1) the petition is procedurally defective and the court has no jurisdiction to make the orders sought by the petition;

(2) the statutory demand relied upon to evidence insolvency is defective and invalid;

(3) the petition debt is disputed bona fide on substantial grounds;

(4) the partnership (acting by its general partner) has a cross-claim exceeding the amount of the alleged petition debt; and

(5) the petition has been presented for a collateral and improper purpose and is an abuse of process.

5 Mr. Liam Faulkner, who appeared on behalf of the partnership, argues that if he succeeds on the jurisdiction argument (ground (1) above) then the petition must be dismissed. Mr. Peter Sherwood, who appeared on behalf of the petitioners, did not dispute this, but argued that all five arguments in opposition were each without merit. Mr. Tony Heaver-Wren, who appeared for CCP Henderson Capital Ltd., opposes the making of the winding up order, but took no position on the jurisdiction argument.

Background

6 In summary, the partnership (acting by its general partner) is a minority shareholder of AAIBV. SMHC is the only other shareholder in AAIBV, which is a joint venture vehicle. Disputes have arisen in respect of the joint ventures which are the subject of ongoing arbitration proceedings. The petitioners have presented a winding up petition in respect of a costs award arising out of one of the arbitrations. The partnership says its assets exceed its liabilities and it has a cross-claim against the petitioners in the arbitration which exceeds the petition debt.

7 The partnership says the petition has been presented for a collateral and improper purpose and for strategic reasons in the ongoing arbitration. It says that the intention and effect of the petition, if a winding up order is made, would be to displace the general partner, who has the institutional knowledge

and expertise concerning the partnership's affairs and the ongoing litigation against the petitioners, and put the conduct of the litigation in the hands of court appointed liquidators nominated by the petitioners who have none of that institutional knowledge and expertise.

The jurisdiction argument

8 Mr. Faulkner submits that the petition is procedurally defective and the court has no jurisdiction to make the orders sought by the petition. He relies on the statutory framework applicable to an exempted limited partnership. He also argues that s.91 of the Companies Act does not apply to exempted limited partnerships.

9 This leads to the result that the remedy of a creditor of an exempted limited partnership, such as the petitioners, is to commence proceedings against the general partner. It is the general partner who (a) has the authority to enter into agreements and contracts on behalf of the partnership; (b) holds the assets of the partnership on a statutory trust; and (c) has unlimited liability in respect of the partnership's liabilities.

10 A petition presented against the general partner would need to be served on the general partner and advertised in accordance with the Companies Winding Up Rules 2018. Essentially, in Mr. Faulkner's submission, the wrong procedure has been used and the court therefore has no jurisdiction to make the orders sought. The correct course of action, where adequate grounds exist, is for a creditor to present a winding up petition against the general partner.

11 Mr. Sherwood for the petitioners submits that the decision of Kawaley, J. in *In re XiO Diamond* (5) would have to be departed from for this argument to succeed. This is a high bar. In any event the court would have to reach a tortured and a wrong construction of s.36(3) of the ELP Act so as to conclude that it does not mean what Kawaley, J. said it did.

12 He added that the practice of attorneys in the Cayman Islands who are experts in "Funds work," which involves Cayman Islands exempted limited partnerships, is that s.91 of the Companies Act applies to exempted limited partnerships by virtue of s.36(3) of the ELP Act. He provided an annex to his written submissions listing the cases decided in the Grand Court pursuant to winding up petitions issued against the exempted limited partnership, not the general partner. He argued that the partnership's argument was novel and without merit.

Decision on jurisdiction

Approach

13 The petitioners have presented the winding up petition against the partnership. The onus is on the petitioners to satisfy the court that it has the jurisdiction to make the orders sought by the petition.

14 Section 18(1) of the Grand Court Act (2015 Revision) provides that: "Subject to this or any other law, the jurisdiction of the Court shall be exercised in accordance with any Rules made under this Law."

15 The court's jurisdiction is to be exercised in accordance with the Rules, with the corollary that English practice may apply where no other provision is made.

16 Both Mr. Faulkner and Mr. Sherwood agreed that the scope of the court's jurisdiction under s.91 of the Companies Act and s.36 of the ELP Act is a matter of statutory interpretation.

17 The principles of statutory interpretation are well established and were succinctly summarized by the Privy Council in *Maso Capital Invs. Ltd.* v. *Shanda Games Ltd.* (2) where Lady Arden said (2020 (1) CILR 293, at para. 27):

> "the court has to ascertain the intention of the legislature from the words it has used in their context, and also in the light of any material which demonstrates the mischief that it was concerned to redress by the statutory provision."

Analysis

18 The partnership is an exempted limited partnership which was registered in the Cayman Islands on September 8th, 2008.

19 Section 2 of the ELP Act in material part defines an "exempted limited partnership" as a partnership formed and registered under s.9(1) of the ELP Act.

20 The formation, operation and termination of exempted limited partnerships in the Cayman Islands is governed by the ELP Act and by certain provisions of the Partnership Act (2013 Revision) ("the Partnership Act"), as well as by certain principles of common law and the provisions of the limited partnership agreement entered into between the parties.

21 Section 3 of the Partnership Act states that a partnership is "the relation which subsists between persons carrying on a business in common with a view to profit." This concept survives from English law dating back to the late 19th century.

22 Section 4(2) of the ELP Act provides that to be an exempted limited partnership, the partnership must consist of:

(i) at least one person, called the general partner, who, in the event that the assets of the exempted limited partnership are inadequate, is liable for all of the debts and obligations of the exempted limited partnership; and

(ii) at least one person, called the limited partner, who shall not be liable for the debts or obligations of the exempted limited partnership in excess of the capital contributed by that person to the exempted limited partnership, save as provided for in the partnership agreement or otherwise in the limited circumstances specified in s.20(1) and s.34(1) of the ELP Act.

23 This is a modification of s.10 of the Partnership Act which provides that: "Every partner in a firm is liable jointly with the other partners for all debts and obligations of the firm incurred while he is a partner …"

24 It is also a modification of s.13 of the Partnership Act which provides:

> "Every partner of a general partnership is liable jointly with this co-partners and also severally for everything for which the firm while he is

a partner therein becomes liable under section 11 [liability of the firm for wrongs] or 12 [misapplication of money or property]."

25 An exempted limited partnership is not an entity with separate legal personality and cannot own property in its own right.

26 Pursuant to s.16(1) of the ELP Act, any rights or property of every description of an exempted limited partnership shall be held or deemed to be held by the general partner upon trust as an asset of the exempted limited partnership in accordance with the terms of the partnership agreement.

27 The business carried on by an exempted limited partnership is conducted by its general partner who has the authority to enter into all letters, contracts, deeds, instruments or documents whatsoever on behalf of the exempted limited partnership: s.14(2) of the ELP Act.

28 By contrast, s.14(1) of the ELP Act prohibits a limited partner from conducting business on behalf of the exempted limited partnership in its capacity as a limited partner.

29 The key and controlling role the general partner plays in an exempted limited partnership is therefore made clear by the ELP Act.

30 That role extends to insolvency situations. Section 2 of the ELP Act provides that in the ELP Act:

"'**insolvency of the exempted limited partnership**' means that the general partner is unable to pay the debts and obligations of the exempted limited partnership, otherwise than in respect of liabilities to partners on account of their partnership interests, in the ordinary course of business as they fall due out of the assets of the exempted limited partnership, without recourse to the separate assets of the general partner not contributed or committed to the exempted limited partnership and '**insolvent**' shall be construed accordingly …"

31 The defined term "insolvency of the exempted limited partnership" is used in s.20(1) and 34(1)(b) of the ELP Act only and the defined term "insolvent" used in s.34(1)(a) and s.43(2)(g) only. There is therefore a distinct definition of insolvency applicable to exempted limited partnerships.

32 Against that backdrop s.33(1) of the ELP Act states that:

"**Proceedings**

33. (1) Subject to subsection (3), *legal proceedings by or against an exempted limited partnership may be instituted by or against any one or more of the general partners only*, and a limited partner shall not be a party to or named in the proceedings. …

(3) A limited partner may bring an action on behalf of an exempted limited partnership if any one or more of the general partners with authority to do so have, without cause, failed or refused to institute proceedings …" [Emphasis added.]

33 I reject Mr. Sherwood's submission that because the clause does not say in terms one cannot issue proceedings against an exempted limited partnership that the petitioners are permitted to do so.

34 As to interpretation Mr. Sherwood submitted that the clause would have to say: "You may not issue proceedings against an exempted limited partnership or against a limited partner. You may only commence them against the general partner."

35 There is however no provision within the ELP Act or the Partnership Act which provides that legal proceedings may be instituted against an exempted limited partnership in the name of the partnership. This is because it is through the general partner that its debts and obligations are enforced. Section 33(1) of the ELP Act says in terms proceedings may be instituted against the general partner(s) only.

36 Mr. Sherwood relied on O.81, r.12 of the Grand Court Rules 1995 (Revised Edition) which provides that any action by or against an exempted limited partnership may be commenced in the name of the firm. However in my view that does not assist Mr. Sherwood because the applicable statutes must take precedence over procedural rules, and the particular rule does not in my view deal with the court's winding up jurisdiction.

37 Section 2 of the Companies Act defines a "company" as, except where the context excludes exempted companies, a company formed and registered under the Companies Act or an existing company.

38 Section 89 provides that in Part V of the Companies Act: a "company" includes a foreign company in respect of which the court has made a winding up order.

39 Neither of these two definitions include an exempted limited partnership because it is not a company.

40 Section 89 provides that in Part V of the Companies Act: a "limited partnership" means an ordinary limited partnership registered in accordance with s.49 of the Partnership Act (2013 Revision) or an exempted limited partnership registered in accordance with s.9 of the ELP Act (2021 Revision).

41 Section 91 of the Companies Act provides:

"**Jurisdiction of the Court**

91. The Court has jurisdiction to make winding up orders in respect of—

(a) an existing company;

(b) a company incorporated and registered under this Act;

(c) a body incorporated under any other law; and

(d) a foreign company which …

(iii) is the general partner of a limited partnership …"

42 The defined term "limited partnership" is used only once in Part V of the Companies Act—in s.91(d)(iii) which gives the court jurisdiction to wind up a

foreign company which acts as the general partner of a limited partnership. It is therefore clear that the court has jurisdiction to make a winding up order in respect of a general partner of the limited partnership.

43 I accept Mr. Faulkner's submission, having set out these provisions, that if the intention of the legislature were for the court to have jurisdiction to wind up an exempted limited partnership under s.91 of the Companies Act then this would have been expressly provided for in s.91. The entities over which the court has jurisdiction were clearly delineated in s.91.

44 However, Mr. Sherwood relies on s.36(3)(a) of the ELP Act to argue that reference in s.91 of the Companies Act to a company is deemed to be a reference to an exempted limited partnership. By the petition, the petitioners plead that s.92(d) of the Companies Act applies to an exempted limited partnership by virtue of s.36(3) of the ELP Act.

45 This is an important point which has not, I am informed by Mr. Faulkner, been fully considered by this court in light of all the relevant statutory provisions.

46 Section 36 of the ELP Act was introduced into Cayman law when the Exempted Limited Partnership (Amendment) Law, 2009 came into force on May 11th, 2009, as s.15(3) of the Exempted Limited Partnership Law (2007 Revision). I am informed by Mr. Faulkner that there was no equivalent provision in the repealed Exempted Limited Partnership Law (2007 Revision) prior to that amendment.

47 Section 36(3) of the ELP Act states:

> "*Except to the extent that the provisions are not consistent with this Act, and in the event of any inconsistencies, this Act shall prevail, and subject to any express provisions of this Act to the contrary*, the provisions of Part V of the Companies Act (2021 Revision) and the Companies Winding Up Rules, 2018 shall apply to the winding up of an exempted limited partnership and for this purpose …" [Emphasis added.]

48 It seems to me that this provision does not give a freestanding right for a creditor to present a winding-up petition against an exempted limited partnership (*XiO Diamond* (5)).

49 I also find that there is no jurisdiction for the court to make a winding-up order against an exempted limited partnership on a creditor's winding-up petition. I have reached this conclusion for the following reasons.

50 The prefatory words of s.36(3) are clear that Part V of the Companies Act only applies to an exempted limited partnership if and to the extent that the provisions are not inconsistent with the ELP Act, and in the event of any inconsistencies, the ELP Act is to prevail, and Part V is subject to any express provisions of the ELP Act to the contrary.

51 The presentation of a creditor's petition against an exempted limited partnership seems to me to be inconsistent with (and is contrary to) the provisions of s.33(1) of the ELP Act.

52 An exempted limited partnership can be wound up and the partnership dissolved in one of two scenarios:

(1) voluntarily in accordance with the provisions of the partnership agreement pursuant to s.36(1) of the ELP Act; or

(2) by the court pursuant to s.35 of the Partnership Act, which applies by virtue of s.3 of the ELP Act (see below).

53 Section 36(1) of the ELP Act contains provisions for the voluntary winding up and dissolution of an exempted limited partnership upon the occurrence of two events: (a) at the time or upon the occurrence of any event specified in the partnership agreement; or (b) unless otherwise specified in the partnership agreement, upon the passing of a resolution of all the general partners and a two-thirds majority of limited partners.

54 Section 3 of the ELP Act provides that the rules of equity and of common law applicable to partnerships as modified by the Partnership Act (but excluding ss. 31, 45–54 and 56–57) shall apply to an exempted limited partnership, except where they are inconsistent with the express provisions of the ELP Act.

55 Section 35 of the Partnership Act contains five grounds on which a court may order the dissolution of a partnership on application by a partner and includes, at s.35(d), when the business of the partnership can only be carried on at a loss and, by s.35(e), whenever in any case circumstances have arisen which, in the opinion of the court, render it just and equitable that the partnership be dissolved.

56 Section 35 of the Partnership Act is in substantially the same terms as s.35 of the English Partnership Act 1890. It was introduced into Cayman Islands law by s.36 of the Partnership Law 1983.

57 From this chronology, at the time of introducing the ELP Act into law, it is to be reasonably inferred that the legislature chose not to disapply or modify s.35 of the Partnership Act.

Application

58 When considering s.36(3) of the ELP Act, following the Privy Council in *Shanda* (2), the court is required to identify (2020 (1) CILR 293, at para. 27): "the mischief that it was concerned to redress by the statutory provision."

59 I accept Mr. Faulkner's submission that the intention of the legislature could not have been to enable a partner of an exempted limited partnership to apply to wind up and dissolve an exempted limited partnership on just and equitable grounds pursuant to s.92(e) of the Companies Act as the jurisdiction to do so already existed under s.35(e) of the Partnership Act.

60 As the remedy already existed, there was no "mischief" to redress. Indeed, I accept Mr. Faulkner's submission that the court's jurisdiction to dissolve an exempted limited partnership on the application of a partner under s.3 of the ELP Act and s.35 of the Partnership Act appears to be broader than under s.92 of the Companies Act. I accept his submission that it could not have been the

intention of the legislature to narrow the court's jurisdiction by replacing s.35 of the Partnership Act (which specifically applies to partnerships) with s.92 of the Companies Act.

61 I seems to me that from a proper analysis of the above statutory provisions that the court's jurisdiction to wind up an exempted limited partnership on the application of a partner on the grounds that it is just and equitable to do so arises by virtue of s.3 of the ELP Act and s.35(e) of the Partnership Act only.

62 This is relevant for when one examines the decision in *XiO Diamond LP* (5) below as, unlike the present case, it concerned an analysis of the situation which applied on the application to wind up by a limited partner.

63 I have considered whether there was "mischief" which the legislature sought to address by introducing s.36(3) of the ELP Act to enable a creditor to present a winding up petition against an exempted limited partnership, as in the present case.

64 I have concluded that no mischief existed as the creditor was (and remains) entitled to enforce any debt against the general partner which, unlike the exempted limited partnership, has a legal personality.

65 In any event, the provisions of Part V of the Companies Act referenced in s.36(3) of the ELP Act are subject to s.33(1) of the ELP Act which expressly states that legal proceedings against an exempted limited partnership may be instituted against a general partner only.

66 It seems to me therefore that the legislative purpose of introducing s.36(3) was to apply the applicable provisions of Part V of the Companies Act and the Companies Winding Up Rules, 2018 *following* the commencement of the winding up in order to facilitate the orderly winding up of the partnership's affairs.

67 This analysis accords with the commercial position and the legal liabilities which arise on the insolvency of a partnership where the business of the partnership is conducted by the general partner, the assets of the partnership are held by the general partner on a statutory trust and the general partner is personally liable for the debts of the partnership.

68 Pursuant to s.2 of the ELP Act, the partnership is deemed to be insolvent when the general partner is unable to pay the debts and obligations of the exempted limited partnership in the ordinary course of business as they fall due out of the assets of the exempted limited partnership, without recourse to the separate assets of the general partner not contributed or committed to the exempted limited partnership.

69 In that scenario the general partner remains personally liable for the partnership's debts and therefore the remedy of any creditor when the partnership is insolvent is to commence proceedings against the general partner. This is consistent with s.33(1) of the ELP Act.

70 The winding up procedure as it relates to exempted limited partnerships also fits with this analysis. When an exempted limited partnership is being

wound up, either voluntarily under s.36(1) of the ELP Act or by order of the court pursuant to s.35 of the Partnership Act, the general partner is deemed to be the liquidating trustee of the partnership unless the court orders otherwise.

71 The role of the liquidating trustee is to conduct the orderly winding up of the partnership's affairs by collecting in and realising its assets, paying its liabilities, and distributing any surplus to the partners in accordance with their contractual rights under the limited partnership agreement. In the event of a shortfall, the general partner remains personally liable for the shortfall.

72 I accept Mr. Faulkner's analysis that it follows that the remedy of any creditor of an exempted limited partnership is to commence proceedings against the general partner. In the event that a winding up order is made against the general partner, any liquidator appointed will continue to hold the assets of the exempted limited partnership on a statutory trust to be distributed to the creditors of the exempted limited partnership in accordance with the statutory scheme. In the event of a shortfall in the partnership assets, the liquidating trustee has a claim against the separate assets (if any) of the general partner and such claim would constitute an unsecured claim in any liquidation of the general partner which ranks *pari passu* with the claims of other creditors of the same class who have an unsecured claim against the general assets of the general partner.

73 It is also illustrative to look at the position in England. There is no statutory equivalent in the Cayman Islands to Part IV of the Insolvent Partnerships Order 1994 ("the IPO") which is in force in England.

74 The IPO modifies Part V of the Insolvency Act 1986 to extend the jurisdiction of the English court to wind up a partnership as an unregistered company in certain scenarios. An "unregistered company" is defined by the Insolvency Act 1986, s.220 to include: "any association and any company, with the exception of a company registered under the Companies Act 2006 in any part of the United Kingdom."

75 Pursuant to s.7 and s.8 of the IPO, the procedure for a creditor to petition for the winding up of a limited partnership can be implemented either with concurrent actions against one or more current or former partners or against the partnership alone. The English court's jurisdiction to make the winding up order arises under the IPO. I note that a statutory equivalent has not been introduced in the Cayman Islands.

The decision of the court in *XiO Diamond* (5)

76 It is necessary to examine this case in a little detail. It concerned a just and equitable winding up petition presented by the sole limited partner against the exempted limited partnership.

77 Kawaley, J. held (2020 (2) CILR 270, at para. 23) that s.36 of the ELP Act applies to voluntary liquidations *after* their commencement and (*ibid.*, at para. 26) that s.36(3) of the ELP Act does not confer a freestanding judicial power to make a winding up order. I respectfully agree.

78 However the learned judge made certain other findings ("the other findings") which Mr. Sherwood relies upon:

(1) At para. 28 he held that Part V of the Companies Act applies to exempted limited partnerships where an official liquidation is sought by a limited partner;

(2) At para. 30 he held that:

(i) s.94 of the Companies Act applies to exempted limited partnerships, and expressly confers the right to petition for a winding up on the grounds set out in s.92 of the Companies Act; and

(ii) s.95 of the Companies Act applies to exempted limited partnerships and expressly empowers the court to appoint official liquidators.

(3) At para. 31 he held that s.36(3) of the ELP Act provides access to the winding up jurisdiction of Part V of the Companies Act.

79 It is important to note that it appears that Kawaley, J. was not taken to and did not consider s.33(1) of the ELP Act or s.3 of the ELP Act and s.35 of the Partnership Act. No inconsistency seems to have been pointed out or raised.

80 The parties proceeded on the basis that there was an agreed basis for the limited partner to petition to wind the partnership up on just and equitable grounds. Indeed Mr. Faulkner who was counsel in the case submitted that a winding up order would have been made in any event, but the jurisdictional gateway should have been s.3 of the ELP Act and s.35 of the Partnership Act. Mr. Faulkner submitted that it was wrong to interpret the decision to mean that a creditor can use Part V of the Companies Act in relation to an exempted limited partnership to present a petition to wind it up.

81 Mr. Faulkner informed me that none of the decisions concerning the application of s.36(3) of the ELP Act, since it came into force on May 11th, 2009, have considered s.33(1) or s.3 of the ELP Act and s.35 of the Partnership Act, including in the case of *In re Rhone Holdings LP* (3), which also concerned an application by a limited partner to wind up an exempted limited partnership on just and equitable grounds. It was common ground in that case that the Part V jurisdiction existed to properly bring a winding up petition against the exempted limited partnership.

82 It is to be noted that the applicable provisions of s.3 of the ELP Act and s.35(e) of the Partnership Act expressly gives the court jurisdiction to dissolve an exempted limited partnership on the application of a limited partner where it is just and equitable to do so. Section 36(3) is expressly subject to s.3 of the ELP Act.

83 Upon a winding up order being made pursuant to those provisions, the commencement date of the winding up would be the presentation of the petition by the limited partner pursuant to s.36(10)(e) of the ELP Act and, following such commencement, the court may make any order and give directions for the winding up and dissolution of the exempted limited partnership as may be just and equitable under s.36(3)(g) of the ELP Act. Section 36(2) of the ELP Act governs the winding up regime of an exempted limited partnership that is being

wound up pursuant to either s.36(1) of the ELP Act or s.35 of the Partnership Act.

84 I respectfully differ from Kawaley, J.'s "other findings." I bear in mind that a decision of another judge of this court should be followed unless I am convinced it is wrong (*In re China Shanshui Cement Group Ltd.* (1) (2015 (2) CILR 255, at para. 64)) and special care must be taken in circumstances where the judge heard argument by experienced lawyers and wrote a fully reasoned judgment (*Simamba* v. *Health Servs. Auth.* (4) (2019 (2) CILR 213, at paras. 68–71)). I would add that I hesitate long and hard before differing from a judge so eminent and experienced in this field.

85 However, having been taken to the statutory framework in some detail by Mr. Faulkner, I am regrettably bound to do so. I note in this context that not only was Kawaley, J. not taken to the relevant provisions of the ELP Act and the Partnership Act set out above but also, in *XiO Diamond* (5), the general partner did not oppose a winding up order being made on the just and equitable ground of loss of substratum (but opposed the loss of trust and confidence ground) and in that sense the petition was unopposed in substance.

86 His decision is also distinguishable (as is the *Rhone* case (3)) on the basis that the position of a limited partner to dissolve a partnership is distinct from those of a creditor, like the petitioners in this case, who are outsiders to the partnership.

87 I have concluded that the court in *XiO Diamond* was in error to state that the jurisdictional basis for winding up the exempted limited partnership was s.36(3) of the ELP Act and Part V of the Companies Act.

88 Mr. Faulkner accepted the line of authority relating to the jurisdiction by which the court can order the winding up of an exempted limited partnership on the application of a partner. He accepted that the court has jurisdiction, but submitted that that jurisdiction arises by virtue of s.3 of the ELP Act and s.35 of the Partnership Act (which is broader in scope than s.92 of the Companies Act). I agree with this analysis. The proper jurisdictional basis was s.3 of the ELP Act and s.35(e) of the Partnership Act, which it appears the court was not referred to.

Summary

89 It is clear in my view from a review of the statutory provisions engaged, that the Companies Act is not of general application to an exempted limited partnership. To the extent that its provisions apply, they apply (i) only to the extent that the provisions are not inconsistent with the ELP Act and in the event of any inconsistencies the ELP Act is to prevail, and (ii) subject to any express provisions of the ELP Act to the contrary.

90 The scope of the court's jurisdiction to make a winding up order under the Companies Act is set out in s.91, and this provision does not on its terms expressly extend to an exempted limited partnership.

91 This seems to me to be consistent with an exempted limited partnership not being an entity with separate legal personality; the partnership is simply

the relation which subsists between the general partner(s) and the limited partner(s) by virtue of s.3 of the Partnership Act.

92 My conclusion is that the court has no jurisdiction over a creditor's winding up petition against an exempted limited partnership.

93 The creditor has an available statutory alternative remedy which is to commence proceedings against the general partner, which accords with the commercial and legal position.

94 It follows that the petition is dismissed.

Ruling accordingly.

Attorneys: *Campbells LLP* for the Padma Fund; *Carey Olsen* for the petitioners; *Appleby* for CCP Henderson Capital Ltd.

ITEM NO. 173

JA-59

IN THE GRAND COURT OF THE CAYMAN ISLANDS
FINANCIAL SERVICES DIVISION

CAUSE NO: FSD 230 OF 2022 (RPJ)

IN THE MATTER OF THE EXEMPTED LIMITED PARTNERSHIPS ACT (2021 REVISION)
AND IN THE MATTER OF ECM STRAITS FUND I, LP

MALAYSIA VENTURE CAPITAL MANAGEMENT BERHAD

Plaintiff

-and-

(1) ECM STRAITS FUND I, LP

(2) ECM STRAITS FUND GP I, LP

(3) ECM STRAITS FUND UGP I, LTD

Respondents

Appearances:	Peter Sherwood of Carey Olsen on behalf of the Applicant
Before:	The Hon. Raj Parker
Heard:	24 November 2022
Date of decision:	24 November 2022
Draft Reasons circulated:	19 December 2022
Judgment delivered:	20 December 2022

JA-59

Headnote

ss.9,36 Exempted Limited Partnerships Act (2021)-voluntary winding up-s.11(2) Grand Court Act (2015)-GCRO.15r6 -Part V Companies Act -Companies Winding Up Rules 2018-disapplication of ss.124,131-133 Companies Act by s.36 ELPA

Introduction

1. On 24 November 2022 I granted the following relief:

   (a) a declaration that ECM Straits Fund I, LP (the "Partnership") entered voluntary winding up on 25 November 2021 in accordance with the terms of the Amended and Restated Exempted Limited Partnership dated 25 November 2013 and pursuant to section 36(1)(a) of the Exempted Limited Partnership Act (2021 Revision) (the "ELP Act");

   (b) Orders pursuant to sections 36(3)(g) and 36(13) of the ELP Act appointing Mr Michael Penner and Mr Michael Green of Deloitte & Touche LLP and Mr. Matthew Becker of Deloitte LLP (Singapore) to conduct the winding up of the Partnership in place of ECM Straits Fund GP I, LP (the "General Partner");

   (c) Orders as to the Liquidator's powers.

2. This Judgment gives reasons for that decision which traverse a new area of law in relation to liquidators powers under a voluntary liquidation in respect of an exempted limited partnership.

Background

3. Malaysia Venture Capital Management Berhad (the "Applicant") is a subsidiary of the Malaysian government and is the only known Limited Partner of the Partnership.

4. The Partnership is a Cayman Islands exempted limited partnership ("ELP") registered on 6 November 2013 pursuant to Section 9(1) of the ELP Act. The purpose of the Partnership was to

make venture capital investments in tech-enabled growth companies located primarily in Malaysia, Indonesia and Southeast Asia.

5. The Partnership is governed by the terms of the Amended and Restated Exempted Limited Partnership dated 25 November 2013 (the "LPA").

6. The general partner of the Partnership is ECM Straits Fund GP I, LP (the "General Partner"). It is also a Cayman Islands exempted limited partnership registered on 6 November 2013 pursuant to the ELP Act (but has since been struck off the register). The general partner of the General Partner is ECM Straits Fund UGP I, Ltd (the "UGP").

7. The Partnership's assets are primarily shareholding interests in entities which the Partnership has, indirectly or directly, invested (the "Portfolio Entities").

Expiry of the term of the Partnership

8. Clause 9.1 of the LPA provides that the Partnership "*shall be dissolved on the eighth anniversary of the Final Closing Date"* unless extended in accordance with the provisions of that clause.

9. It has not been possible to determine the "*Final Closing Date*" from the LPA alone.

10. However, on 1 April 2021, the General Partner informed the Applicant that the term of the Partnership would expire on 25 November 2021 and would not be extended. The letter stated that the General Partner "*is working aggressively to liquidate its portfolio holdings and provide the LP's exits prior to wrapping up the Fund*."

11. Consistent with section 36(13) of the ELP Act clause 9.4 of the LPA provides that the General Partner shall be the liquidator of the Partnership upon the commencement of the winding up and the General Partner's letter stated that it "*is working aggressively to liquidate its portfolio holdings and provide the LP's exits prior to wrapping up the Fund*."

12. Clause 9.4(b) of the LPA provides a scheme for the winding up of the Partnership and the distribution of surplus assets to the limited partner(s).

13. The following facts appear from the Applicant's evidence and documents submitted[1].

Failure to wind up the Partnership's affairs and strike-off of the General Partner

14. Since the Partnership's term expired, little progress has been made and it now appears that the Partnership has effectively been abandoned by the General Partner and the individuals with authority to act on the General Partner's behalf:

(a) responsibility for managing the Portfolio Entities was apparently split between three individuals, Mr Ahmed, Mr Azahar and Mr Hussain, the managing directors of the UGP. However, only Mr Ahmed has remained in communication with the Applicant**.** Mr Ahmed explained in an email on 22 June 2022 that the three individuals have "*gone their separate ways*", and that he would only be able to assist with the distribution of the five Portfolio Entities which he purportedly manages (out of the 12 Portfolio Entities under the Partnership);

(b) on 27 April 2022, Mr Ahmed issued an invoice to the Applicant for US$125,000 for what was described as "*de facto management fees since fund termination"*. There is no contractual basis for these fees, or for Mr Ahmed in his personal capacity to charge any fees to the Applicant;

(c) the registered office provider for the Partnership, the General Partner and the UGP has resigned (which is usually indicative of a failure to pay registered office fees and/or to comply with statutory filing obligations);

[1] First Affidavit of Shahril Anas Bin Hasan Aziz dated 19 October 2022, the Second Affidavit of Shahril Anas Bin Hasan Aziz dated 19 October 2022

(d) both the General Partner and the UGP were ultimately struck off the register on 29 July 2022; and

(e) the Partnership was designated "*pending strike off*" by the Registry but the Applicant wrote to the Registrar to explain the situation and request that the Partnership is not struck off pending the outcome of the present application. The Registrar has helpfully returned the status of the Partnership to "*active*".

15. In addition, on 14 June 2022, the Applicant raised concerns with the General Partner that Mr Ahmed has instructed Portfolio Companies to transfer shares in those companies held on behalf of the Partnership to entities related to him. No substantive response to this allegation has apparently been received.

16. As the General Partner is no longer acting, the Applicant seeks the appointment of independent liquidators to wind up the Partnership's affairs and to conduct such investigations into the Partnership's affairs as the liquidators consider appropriate.

The Law

Commencement of the voluntary winding up of the Partnership

17. Section 36(1)(a) of the ELP Act provides that:

> "*An exempted limited partnership shall be voluntarily wound up in accordance with the provisions of the partnership agreement –*
>
> *(a) at the time or upon the occurrence of any event specified in the partnership agreement; or […]* "

Section 36(10) provides that the winding up of an exempted limited partnership "*shall be deemed to commence upon the earlier of*:

(a) *the expiry of the period fixed for the duration of the exempted limited partnership;*

(c) *the occurrence of an event provided by the partnership upon which the exempted limited partnership is to be wound up;"*

[…]

18. A number of recent decisions of the Grand Court have considered the jurisdiction of the Court (or lack of jurisdiction) to order the winding up of an exempted limited partnership on the petition of a creditor or limited partner. While the reasoning in these decisions differed to a certain extent, there does not appear to be any controversy surrounding the route into *voluntary* winding up via section 36(1)(a) in those decisions[2].

19. In *In Re Duet Real Estate Partners 1 LP* (unreported, FSD 22 of 2020, 9 June 2020) a limited partner successfully petitioned for a winding up order under the Companies Act despite the fact that the term of the exempted limited partnership had already expired (and therefore pursuant to section 36(1)(a) of the ELP Act the voluntary liquidation had already commenced). It is not clear why the petitioner in that case sought a winding up order under the Companies Act rather than relying on section 36(1)(a) (which does not appear to have been considered) and the question of whether a winding up order can be made in respect of an exempted limited partnership that is already in voluntary liquidation is not discussed in the judgment. I accept Mr Sherwood's submission that it may be that an application under the Companies Act is not the proper route as, with very limited savings, it would seem to have no application to voluntary liquidations-see 36(3)(d) of the ELP Act.

[2] See references to the voluntary route in eg *In Re Xio Diamond Ltd* (unreported, FSD 256 of 2019, 30 April 2020) at §20(a) and *In Re Padma Fund LP* (unreported, FSD 201 of 2021, 8 October 2021) at § 52

Jurisdiction of the Court to grant declaratory relief

20. The wide jurisdiction of the Court to grant declaratory relief in relation to the commencement of a voluntary winding up is derived from section 11(2) of the Grand Court Act (2015 Revision) which provides that:

> "*Without prejudice to subsection (1), the Court shall have and shall be deemed always to have had power to make binding declarations of right in any matter whether any consequential relief is or could be claimed or not.*"

21. Also relevant is Order 15 rule 16 of the Grand Court Rules which provides that "*the Court may make binding declarations of right whether or not any consequential relief is or could be claimed*".

22. The jurisdiction to grant declaratory relief was recently exercised by the Grand Court in the context of a voluntary winding up of an ELP in *In the matter of Kuwait LBO Fund L.P.* (unreported, FSD 273 of 2021, 9 November 2021).

23. In that case, Justice Doyle referred to the judgment of Justice Mangatal in *Woods v. Thompson and Saxon Motor and General Insurance Company Limited* [2016 (2) CILR 1] and derived the following principles from the English authorities:

(a) per Neuberger J's (as he then was) judgment in *Financial Services Authority v. Rourke (trading as J E Rourke & Co)* [2002] CP Rep 14:

> "*…when considering whether to grant a declaration, the Court should take into account what was just for both parties, whether the declaration would serve a useful purpose and whether there were special reasons why the Court should not grant a declaration.*"

(b) per Aikens LJ in *Rolls-Royce plc v. Unite the Union* [2010] 1 WLR 318:

> *"(1) The power of the court to grant declaratory relief is discretionary.*

> *(2) There must, in general, be a real and present dispute between the parties before the court as to the existence or extent of a legal right between them. However, the claimant does not need to have a present cause of action against the defendant.*
>
> *(3) Each party must, in general, be affected by the court's determination of the issues concerning the legal right in question.*"

24. With these principles in mind, the Court considered that a declaration affirming the validity of a resolution appointing voluntary liquidators of the ELP would serve a "*useful purpose*", by bringing clarity to their appointments.

25. Whilst in the *Kuwait LBO* case the voluntary liquidators were appointed by resolution pursuant to the Limited Partnership Agreement, and in the present case the appointment would be made by the Court, nevertheless, as Mr Sherwood submitted, it would be useful to have a declaration as to the commencement of the voluntary liquidation, as this engages the Court's jurisdiction to make the orders under section 36(3)(g). That date is 25 November 2021.

26. A declaration that the Partnership entered voluntary winding up would serve to confirm the same to any interested parties (such as the Registrar, which was not aware that the Partnership was being wound up).

Jurisdiction of the Court to appoint liquidators in place of the General Partner

27. Section 36(13) of the ELP Act provides:

> "*Following the commencement of the winding up of an exempted limited partnership its affairs shall be wound up by the general partner or other person appointed pursuant to the partnership agreement unless the court otherwise orders on the application of any partner, creditor or liquidator of the exempted limited partnership pursuant to subsection (3)(g).*"

28. Accordingly, if the winding up of the Partnership has commenced under section 36(1)(a), the Applicant has standing to apply under section 36(3)(g) for an Order that the Partnership is wound up by persons other than the General Partner.

29. Upon a section 36(3)(g) application, the Court may make such orders "*as may be just and equitable*". The extent of the Court's jurisdiction under this provision is discussed further below, but it evidently extends to the appointment of replacement liquidators under section 36(13).

30. The Applicant submits that it would plainly be "*just*" for the Court to appoint alternative liquidators in circumstances where the incumbent liquidator is not performing the role and has been struck off.

31. In *Kuwait LBO* [§52], Doyle J took the view that in a situation where there was an absent General Partner and the liquidation was not progressing, it was clearly just and equitable that the liquidators be replaced.

The powers of the incoming liquidators

32. While acknowledging that this is a novel area of law Mr Sherwood submitted that the Court's discretionary powers under section 36(3)(g) extend to granting orders and directions that have the equivalent effect to the making of a supervision order under the Companies Act (2022 Revision) (the "Companies Act").

33. Section 36(3) provides that certain provisions of the Part V of the Companies Act and the Companies Winding Up Rules, 2018 apply, except to the extent of any inconsistencies, to the winding up of an exempted limited partnership.

34. However, section 36(3)(d) disapplies the majority of Part V to voluntary liquidations, with limited savings. The provisions disapplied include the entire scheme for applications to being a voluntary liquidation of a company under the supervision of the Court (sections 124, 131, 132 and 133 of the Companies Act).

35. Consequently, there is no express mechanism for bringing a voluntary liquidation of an exempted limited partnership under the supervision of the Court so that it may proceed as an official liquidation (other than, as Mr Sherwood submitted, section 36(3)(g)).

36. Section 36(3)(g) was considered by Kawaley J in *Xio Diamond* (*ibid)* a case in which a limited partner had sought to bring a winding up petition under that section and section 36(13). The Court found that those provisions do not create a freestanding jurisdiction to wind up an exempted limited partnership, but are only engaged once a voluntary liquidation was already on foot:

> *"25. The general rule created by section 36(13) logically applies in all instances when a voluntary winding-up has commenced on a date specified in any of subsections (a) to (d) of section 36(10). Where no voluntary winding-up has commenced independently of the making of a winding-up order, it is not easy to see how the question of appointing someone in place of the general partner arises. Section 36(3)(g) itself, carefully read, is not expressed in terms suggesting that a freestanding jurisdiction to present a winding- up petition is being created. Rather, as Mr Faulkner rightly submitted, subsection (3)(g) is expressed (read in the wider context of section 36 as a whole) in terms consistent with creating a supervisory jurisdiction over voluntary winding-ups".*

Justice Kawaley went on to state:

> *"29. In my judgment, section 36(3)(g) of the ELP Law is analogous to the following provision applicable to voluntary liquidation under Part V of the [Companies Act] which does not apply to section 36(1) winding-ups:*
>
> *"References of questions to Court*
>
> *129(1) The voluntary liquidator or any contributory may apply to the Court to determine any question arising in the voluntary winding up of a company or to exercise, as respects the enforcing of calls or any other matter, all or any of the powers which the Court might exercise if the company were being wound up under the supervision of the Court.*

(2) The Court, if satisfied that the determination of the question or the required exercise of power will be just and beneficial, may accede wholly or partly to the application on such terms and conditions as it thinks fit, or make such other order on the application as it thinks just."

37. While *Xio Diamond* was not followed in all respects in subsequent decisions (most notably in *Padma*), the suggestion that section 36(3)(g) represents an avenue for parties to seek directions concerning an existing liquidation has not been challenged (and was expressly supported in *Padma*[3]).

38. Mr Sherwood submitted that the broad jurisdiction envisaged by Justice Kawaley in *Xio Diamond* is correct, and that the jurisdiction extends to making directions akin to a supervision order, for the following reasons:

(a) Section 36(3)(g) is drafted in the broadest terms, allowing the Court to make whatever directions and orders it considers are just and equitable;

(b) The need for a broad mechanism in this regard is plain. In contrast to the position for companies, there are no rules for exempted limited partnership voluntary liquidations equivalent to the Companies Winding Up Rules or schedules of powers equivalent to Schedule 3 of the Companies Act (except insofar as the Companies Act and Companies Winding Up Rules may apply);

(c) After lodging the skeleton argument, immediately before the hearing, the Applicant lodged some further materials including an Annexure to the skeleton argument addressing the legislative history of section 36 of the ELP Act, the relevant Explanatory Memorandum to the bill that brought in (what is now) section 36 and the relevant extracts from Hansard.

39. It is clear from those materials that section 36 was enacted because "*the existing section 15 fell far short of a meaningful dissolution framework for exempted limited partnerships*" and that "*clause*

[3] Ibid §83

10 is a significant and necessary improvement that addresses a current gap in the Law in the immediate term" (Official Hansard Report, pp1050 per Hon. G. Kenneth Jefferson

40. At the hearing, Mr Sherwood submitted that the Court has been given a broad discretion *precisely because* of the lack of meaningful framework and the need to "fill in the gaps":

(a) there is a clear need for a mechanism for a voluntary liquidation to be brought under the supervision of the Court in cases where it is discovered that there is a need for independent, qualified Court-appointed liquidators to take control (such as in cases of insolvency, malfeasance, or where it is otherwise more effective or efficient);

(b) applying the principles of statutory interpretation summarised by the Privy Council in *Shanda Games Ltd v Maso Capital*[4], the mischief that section 36(3)(g) is concerned to redress is that the provision must be sufficient to allow the Court to perform a "*supervisory role*" in the absence of the statutory scheme and guidance that exists for companies;

(c) further, the need for the Court to be permitted to make orders as to the liquidators' powers is clear from the nature of exempted limited partnerships, which do not have legal personality or the ability to hold assets. In contrast to the position for company voluntary liquidations, therefore, in which the company's corporate state and powers are unaffected[5], an incoming liquidator of an exempted limited partnership must be empowered to take control of and deal with the partnership's assets from the general partner, and to take such other steps as are necessary in the winding up.

41. Mr Sherwood further submitted that in contrast to liquidators appointed pursuant to the terms of a partnership's LPA, liquidators appointed by the Court under sections 36(3)(g) and (13) derive their power from the Court. Therefore, if the Court has jurisdiction to appoint or replace liquidators, it follows that it must have jurisdiction to grant those liquidators the necessary powers to conduct the liquidation.

[4] As applied in *Padma* at §17
[5] See section 118(2) of the Companies Act

42. The Court accepts Mr Sherwood's submissions

Conclusion

43. The Court accepts that the partnership entered voluntary winding up on 25 November 2021.

44. The Court accepts that it is necessary to replace the General Partner with Messrs Penner Green and Becker of Deloitte and they are suitable replacements.

45. As to the powers the incoming liquidators should have, the Court has been considerably assisted by Mr Sherwood's researches and submissions in this new area of law as it relates exempted limited partnerships, by analogy with the Court's powers to make orders and directions in making supervision orders in respect of companies in voluntary liquidation, and makes the Orders sought.



THE HON. MR JUSTICE RAJ PARKER
JUDGE OF THE GRAND COURT

ITEM NO. 174

JA-60

IN THE GRAND COURT OF THE CAYMAN ISLANDS
FINANCIAL SERVICES DIVISION

CAUSE NO. FSD 23 of 2022 (DDJ)

IN THE MATTER OF THE COMPANIES ACT (2022 REVISION)
AND IN THE MATTER OF SEAHAWK CHINA DYNAMIC FUND

Appearances:	Sebastian Said, Andrew Jackson and Ryan Kuss of Appleby (Cayman) Ltd on behalf of the Petitioner Lau Chun Shun Tom Smith QC instructed by Paul Smith and Caitlin Murdock of Harneys on behalf of Hao Liang Tom Lowe QC instructed by Jamie McGee of Bedell Cristin on behalf of fourteen minority shareholders namely Jin Cheng, Qianyi Zhang, Junchen Feng, Min Zhao, Wentian Wu, Ming Hu, Yulin Deng, Chun-Hsia Chiang, Lingxiao Li, Long Chen, Po Yee Rosa Au-Yeung, Yong Yu, Yulu Mo and Qian Luo
Before:	The Hon. Justice David Doyle
Heard:	21- 29 June, 29 July 2022
Draft Judgment circulated:	3 August 2022
Judgment delivered:	9 August 2022

HEADNOTE

Dismissal of winding up petition based on the just and equitable ground – assessment of the oral and documentary evidence – consideration of whether there was a quasi-partnership – whether there was justifiable and irretrievable loss of trust and confidence – whether there was serious lack of probity, dishonesty and oppression – whether there was a need for an urgent investigation – whether the Petitioner had a legitimate expectation of participating in the management of the company - whether the Petitioner was unreasonably failing to pursue alternative remedies including the redemption of his shares

JUDGMENT

Introduction

1. It is a very serious step to make an order winding up a solvent company. In the particular circumstances of this case I have not been persuaded that it is just and equitable to make such an order and I therefore dismiss the winding up petition.

2. The two main protagonists in this case are Lau Chun Shun ("Mr Lau") and Hao Liang ("Mr Liang").

3. Mr Lau is stated to be part of the well known "Nine Dragons" family in the People's Republic of China ("PRC"). He is the son of Madam Cheung Yan who is the founder of Nine Dragons Paper (Holdings) Limited which is listed on the Hong Kong Stock Exchange. Mr Lau's wife is Chen Li ("Ms Lau") and she is also engaged in the family business.

4. Mr Liang was born in China and has been interested in the financial markets since the age of 13. He is the son of He Hui. Various internet articles feature him as an investment prodigy and he appears to be well known as an investment manager. Mr Liang's wife is April Li ("Ms Liang"). Ms Liang is described as an expert in primary market private equity investment.

5. The paths of Mr Lau and Mr Liang appear to have first crossed in September 2017 when they were introduced through a relative of Mr Lau and a former schoolmate of Mr Liang. Mr Liang had set up Seahawk China Dynamic Fund (the "Company" or the "Fund") in the Cayman Islands in August 2017 and was on the look out for investors. Mr Lau seemed interested. Mr Lau had a family investment management company, incorporated under the laws of Hong Kong, called Gold Dragon Worldwide Asset Management Limited ("Gold Dragon" or the "Manager"). Both Mr Lau and Mr Liang saw good potential for cooperation with Mr Lau becoming a significant investor and Mr Liang being key in respect of investment management and producing significant financial returns. At a meeting in November 2017 in Hong Kong, Mr Lau met Ms Liang and Mr Liang met Ms Lau. Mr Lau became a significant investor in the Company. Mr Liang directed management of the investments and produced very significant financial returns and was described by Mr Lau as "awesome". Sadly however the relationship between Mr Lau and Mr Liang deteriorated culminating in Mr Lau presenting a petition for the winding up of the Company.

Mr Lau's case

6. Mr Lau says that he has justifiably and irretrievably lost all confidence in the Company's management because of the clear lack of probity of Mr Liang, the Company's sole voting

member. Mr Lau says that Mr Liang has abused and misused his power and authority in connection with his control and management of the Company and has acted in a manner that favours his own interests to the detriment of the interests of the Company, Mr Lau and other investors.

7. In particular Mr Lau complains about two specific issues, which he describes as (1) the Unauthorised Scheme and (2) the Late Trade Allocations.

8. In respect of the Unauthorised Scheme, Mr Lau says that Mr Liang "attempted to secretly strip approximately US$19,997,219.62 for his own benefit from the Company" (paragraph 11 (a) i. of the petition).

9. In respect of the Late Trade Allocations, Mr Lau says that Mr Liang "has orchestrated a deliberate and cynical system to siphon moneys to the Hover4pi Funds (controlled by Mr Liang and his wife) while simultaneously causing significant losses to the Company". Mr Lau adds that "In doing so [Mr Liang] deliberately preferred the interests of the Hover4pi Funds, and ultimately himself, and has deliberately caused the Fund to suffer losses of approximately USD 8,073,918.07" (paragraph 11 (a) ii. of the petition).

10. Mr Lau complains about significant amendments to the Company's constitutional documents and the Investment Management Agreement (the "IMA") between the Manager and the Company without formal notice to him. Mr Lau alleges that Mr Liang convened board meetings "without providing the requisite notice to [him], who was entitled to such notice as a director, despite dishonestly recording the contrary in relevant minutes" (paragraph 11 (a) iv of the petition).

11. Mr Lau makes the general complaint that Mr Liang "sought to conceal his illegitimate actions and acted with a complete lack of transparency by failing to inform investors and the Manager of his conduct" (paragraph 11 (a) vi of the petition).

12. Mr Lau complains that Mr Liang created a new class of shares which he allocated to himself and that Mr Lau was removed from the board of the Company.

13. Mr Lau alleges that the Company was operated by Mr Lau and Mr Liang "akin to a quasi-partnership and the personal relationship involving mutual trust and confidence on which it was founded and operated (as part of an effective 'consolidation' of [Mr Lau's] business through the Manager) has irretrievably broken down. The legitimate expectations that had arisen on account of that relationship and the understanding between Mr Liang and [Mr Lau], have been disregarded by Mr Liang. Accordingly, there is no or no reasonable hope of reconciliation between Mr Liang and [Mr Lau]." (paragraph 11 (b) of the petition).

14. Mr Lau further alleges that Mr Liang has used his voting power to cause "oppression and prejudice to Mr Lau's interests as a shareholder, exclude him from the Fund's management as a director and to further his own personal interests." (paragraph 11 (c) of the petition).

15. Mr Lau also says that there is an urgent need for an investigation into Mr Liang's actions explaining that the Late Trade Allocations have been reported to the regulator in Hong Kong and the Unauthorised Scheme is the subject of civil proceedings brought by the Manager in Hong Kong (paragraph 11 (d) of the petition).

16. Mr Lau says that he seeks a winding up of the Company "as, in the circumstances, there is no other more suitable remedy to pursue." (paragraph 13 of the petition).

17. Mr Lau at paragraph 21 of his petition says that the following matters are demonstrative of a relationship of trust and confidence between Mr Lau and Mr Liang "similar to that obtaining between partners":

(a) each became a director of the other's entity: Mr Liang a director and CEO of the Manager an entity owned and run by Mr Lau and his family, and Mr Lau became a director of the Company which had been founded by Mr Liang;

(b) Mr Lau agreed to manifestly uncommercial terms, pursuant to which the substantial majority of the fees normally payable to the Manager would be paid to Mr Liang as a bonus (as to 80%);

(c) Mr Lau settled Mr Liang's bonus entitlements for 2018 and 2020 in the manner requested by Mr Liang, contrary to the General Terms, and personally ensured Mr Liang was paid a bonus for 2019 notwithstanding Mr Liang's lack of entitlement to the same (paragraph 21 of the petition).

18. Mr Lau at paragraph 77 of his written closing submissions submits that the Fund should be wound up for the following reasons:

"(1) *First*, the Fund was a quasi-partnership and the relationship of mutual trust and confidence which previously existed between [Mr Lau] and Mr Liang as quasi-partners has irretrievably broken down on account of:

(a) The Late Trade Allocations; and/or

(b) The Unauthorised Scheme; and/or

(c) Mr Liang's removal of [Mr Lau] as a director of the Fund.

(2) *Second*, [Mr Lau] held a legitimate expectation that he would remain a director of the Fund and, in breach of that legitimate expectation, Mr Liang unjustifiably removed [Mr Lau] as a director of the Fund and, thus, excluded him from its management.

(3) *Third*, [Mr Lau] has lost confidence in Mr Liang managing the Fund due to a serious lack of probity of the part of Mr Liang in his conduct of the Fund's affairs, and in particular on account of his dishonesty in respect of:

(a) The Late Trade Allocations; and

(b) The Unauthorised Scheme.

(4) *Fourth*, [Mr Lau] has been oppressed on account of [Mr Liang's] actions as part of the implementation of the Unauthorised Scheme, where his complete voting control of the Fund was used to e.g. create the new class of Performance Allocation Shares.

(5) *Fifth*, given *inter alia*, the seriousness of the matters which have been the subject of the Petition, their recent discovery, and concerning aspects of the evidence in respect of the approach to the corporate governance of the Fund, there is clearly an urgent need for an investigation into the affairs of this CIMA-regulated Fund."

19. At paragraph 1 of his written closing submissions Mr Lau says that he applies for a winding up order on the just and equitable basis "primarily as a result of two courses of dishonest

conduct: the Late Trade Allocations and the Unauthorised Scheme." These serious allegations of dishonesty are at the core of Mr Lau's case.

20. Paragraph 356 on page 155 of Mr Lau's written closing submissions reads as follows:

> "356. For all the foregoing reasons, [Mr Lau] seeks the winding-up of the Fund, on the just and equitable basis, in light of [Mr Lau's] loss of confidence in Mr Liang arising from his dishonest misconduct relating to the Late Trade Allocations, and the Unauthorised Scheme; and because of: (i) the justifiable and irretrievable breakdown of the quasi-partnership relationship between [Mr Lau] and Mr Liang as a result of that dishonesty; (ii) Mr Liang's disregard of [Mr Lau's] legitimate expectations of being a director of the Fund, by removing him as such in December 2021, and (iii) the clear need for a thorough independent investigation of the Fund's affairs, based on what the Court has heard and seen at trial, both in the *private interests of all stake-holders* of this Fund, but also in the *wider public interest* of these Islands, given the seriousness of much of the misconduct that has been ventilated on this Petition, in respect of a CIMA-regulated fund, which (absent a winding up order) will then be seeking further investment from the public."

Mr Liang's case

21. Mr Liang denies that he has been dishonest and denies that it is just and equitable for the Company, a solvent and highly profitable company, to be wound up. Mr Liang says that Mr Lau could request redemption of his shareholding in the Company "which would be a

far more appropriate and less destructive remedy than liquidation, especially given that it would also be a very profitable remedy for [Mr Lau] considering how much profit the Company has generated with the efforts of Mr Liang" (paragraph 51 of the amended defence).

22. Mr Liang openly admits that he convened board meetings on 11 August 2021 and 16 November 2021 without providing prior notice to Mr Lau but says that Mr Lau was unable to dictate or alter the outcome of any board meetings on his own (paragraph 11 a i. and ii. of the amended defence).

23. Mr Liang also openly admits that the effect of the resolutions passed was, among other things, to create a new class of shares known as Performance Allocation Shares by way of resolution of the board of directors dated 11 August 2021 which were allocated to him on 16 August 2021 (paragraph 11 a. iii of the amended defence). Mr Liang admits that there was a resolution to remove Mr Lau as a director of the Company in December 2021 (paragraph 11 a. iv of amended defence).

24. Mr Liang says that any rights that Mr Lau has are in his capacity as an investor in the Company and such rights are limited to those rights of an investor as set out in the relevant documents including the subscription agreements, a side letter dated August 2018, and the offering Memorandum and Articles (paragraph 11 b. iii of amended defence).

25. Mr Liang denies that (1) the Company was operated by Mr Lau and Mr Liang akin to a quasi-partnership; (2) there was a personal relationship of mutual trust and confidence on the basis of which the parties agreed to operate the Company (3) there has been an irretrievable breakdown of trust and confidence (paragraph 11 b viii to x of the amended

defence). Mr Liang says that "Mr Lau has admitted that the Company has been extremely successful and that he has enjoyed enormous profit through his investment." Mr Liang adds that to the extent that Mr Lau alleges that there is no reasonable hope of reconciliation Mr Lau could request a redemption of his shareholding in the Company so as to withdraw his investment per the terms of his investment (paragraph 11.b.xi of the amended defence).

26. Mr Liang denies that Mr Lau could have had any legitimate expectation to participate in the management of the Company or of the Manager given that Mr Lau had no relevant investment or fund management qualifications or experience and was not licensed by the Hong Kong Securities and Futures Commission (paragraph 11.b.xiv of the amended defence).

27. Mr Liang avers that the Manager is simply a "figurative corporate vehicle" and that he was in effect the investment manager and that "all performance fees and management fees after deduction of costs were paid and are payable to Mr Liang" (paragraph 11.b.xv of the amended defence).

28. Mr Liang says that Mr Lau subscribed for his investment to the Company in full knowledge that Mr Liang held all Management Shares and that the Participating Shares enjoyed no voting rights and accordingly there has been and can be no oppression or prejudice caused to Mr Lau or any other investor (paragraph 11.c.i. of the amended defence).

29. Mr Liang avers that Mr Lau may redeem his investment in the Company which is very successful and other than Mr Lau (and according to Mr Lau some of his family members) no other investor has come forward in support of the petition. Mr Liang says that Mr Lau

has available alternative remedies which are more appropriate than a winding up of the Company but has failed to pursue them.

30. Mr Liang avers that the appointment of Mr Lau as a director of the Company was done to assist him "as he wished to be seen to hold a position of importance in addition to his investment, and to give him a veneer of legitimacy in the Company, even though he performed no actual functions" (paragraph 14 k. of the amended defence).

31. Mr Liang denies that the matters pleaded at paragraph 21 of the petition demonstrate any relationship of trust and confidence similar to that pertaining between partners as alleged "rather they reflect the industry practice and terms of a commercial transaction" and denies that he lacked entitlement to the bonus for 2019 (paragraph 21 of the amended defence).

32. Mr Liang denies that he sought to divert the performance fee payable to the Manager to himself. Mr Liang avers that he was in fact, at all material times, entitled to the surplus of the performance fees and management fees as his bonus. Mr Liang develops this averment by descending into the following detail:

(1) the General Terms dated 11 July 2018 entered into between Mr Liang and Mr Lau (on his own behalf and on behalf of the Manager) stipulated that the bonus of Mr Liang shall not be less than "80% of the performance fee plus management fees less costs" in any event;

(2) the General Terms were subject to a common understanding (the "Common Understanding") between Mr Liang and Mr Lau (on his own behalf and on behalf of the Manager) that:

(a) Mr Liang would have full autonomy and power to manage and operate the Company as he had always done, including but not limited to making all investment decisions as its portfolio manager, selecting the team members for operating and investing on behalf of the Company, and deciding on the remuneration and bonuses of those team members; and

(b) Mr Liang would be entitled to receive all the performance fees and management fees after deduction of costs from the Company;

(3) the General Terms were also subject to Mr Lau's express assurance, made to Mr Liang prior to the execution of the General Terms and on the morning of 9 July 2018, whereby Mr Lau (on his own behalf and on behalf of the Manager) promised Mr Liang that matters relating to distributions of all the Company's staff's salaries and bonuses would and should be wholly decided by Mr Liang, given that the surplus was ultimately "Mr Liang's fees", so it should be up to Mr Liang (rather than Mr Lau) to decide how to distribute the same, irrespective of the provisions in the General Terms (the "Promise");

(4) it is expressly provided under the section "Allocation Method" of the General Terms that all the profits of the Manager shall belong to the Company's team and shall be distributed to the team members in the form of bonuses;

(5) the provision under "Profit Distribution" of the General Terms that (a) Mr Lau has the final decision on the team salary and bonus; but that (b) Mr Liang's bonus is protected at no less than 80% of the Company's performance fees plus management fees less costs, unless agreed by both parties, was added so that Mr Lau could appear as "the boss" in front of his family, albeit he did not (and could not) actually participate in the

daily management and operation of the Manager, the Company, or any related investment activities. Such provisions were purely in order to make Mr Lau look good in the eyes of the Nine Dragon Group's matriarch, and were at all material times subject to the Common Understanding and the Promise;

(6) pursuant to the Common Understanding and the Promise (a) Mr Lau (on behalf of himself and the Manager) allowed Mr Liang to decide on the salary and bonuses of the staff of the Company for the years 2018, 2019 and 2020; and (b) Mr Liang was paid all performance fees plus the management fees surplus as his bonuses for the years 2018, 2019 and 2020; and

(7) by reason of the dispute no performance fees nor management fees surplus have been paid for 2021 (paragraph 24 a. (i) to (vi) of the amended defence).

33. Mr Liang denies that he failed to act in good faith for the benefit of the Company as a whole when passing on 12 August 2021 the Management Shareholder Resolutions (paragraph 24 b. of the amended defence). Mr Liang says that the amendments were made (a) as a means to obtain tax savings in respect of Mr Liang's bonus distribution in accordance with the Common Understanding and the Promise; and (b) in order to obviate the need to take out cash from the Company thus preserving its liquidity (at a time when Mr Lau was seeking early redemption to which he had no contractual entitlement). The effect of the amendments was such that instead of the Company distributing to the Manager performance fees in cash and the Manager then distributing to Mr Liang his bonus allocation in cash (which would attract substantial tax liability in Hong Kong), pursuant to the Common Understanding and the Promise, the Company would instead issue

Performance Allocation Shares direct to Mr Liang at the Fund level (paragraph 24 c. of the amended defence).

34. Mr Liang says that Rachel Kong Wai Nga ("Ms Kong") and Lee Wing Lam ("Ms Lee"), both employed by the Manager, were aware of the issue of the performance allocation shares and the conversion of the crystallised performance fees which was reflected in the relevant NAVs for the Company issued from October 2021 onwards (paragraph 24 ci. of the amended defence).

35. Mr Liang says that he had various discussions with Mr Lau's wife (who often acted as Mr Lau's representative and channel for communication with Mr Liang) and Ms Kong about his intention to change the method of payment of the performance fees to allotment of shares at the Company level in order to obtain tax savings, so they were well aware of the same (paragraph 25 e. of the amended defence).

36. Mr Liang admits that on 16 November 2021 resolutions of the board of directors of the Company were passed and a supplemental agreement was entered into approving and providing for the full conversion of the outstanding crystallised performance fee in the sum of US$19,997,216.62 as of 31 October 2021 to the Performance Allocation Shares and that the supplemental agreement was provided to the Administrator (paragraph 29 and 30 a. of the amended defence).

37. Mr Liang denies that he acted dishonestly by not giving Mr Lau notice of the 11 August and 16 November 2021 board meetings of the Company (paragraph 35 of the amended defence).

38. In relation to the alleged dishonest Late Trade Allocations Mr Liang says that during the period June to December 2021 the Manager's management of the investment activities of the Company and the Hover4pi Funds, including the placement and allocation of trades, involved (a) Mr Liang (in his capacity as an employee of the Manager and authorised trader for the Company) and members of the investment team of the Manager, (b) Ms Lee (who was stated by Mr Liang to be the settlement officer responsible for the operation of the broker of the accounts of the Manager), and (c) Ms Kong (who, among other responsibilities, was said by Mr Liang to have supervised Ms Lee and was responsible for the Manager's compliance and internal controls). Mr Liang adds that Ms Lee and Ms Kong, who supervised all works of Ms Lee, were responsible for the settlement of all the relevant trade orders (paragraph 37 a.i of the amended defence).

39. Mr Liang openly says that there were occasions after June 2021 where the Manager allocated trades to the Company or to the Hover4pi Funds after the relevant trade orders were placed (paragraph 37 b. of the amended defence).

40. Mr Liang says that all trades made by the Manager were placed in the expectation of generating profit over the term of the holding of the trade, and therefore trades that were not immediately profitable (or appeared not to be immediately profitable) were still expected to be profitable over a longer time frame (paragraph 37 b. of the amended defence).

41. Mr Liang says that he discussed with Mr Lau and his wife in July 2021 the fact that the Manager needed to take some actions in compensating certain losses, arising from a specific trading activity, to Hover4pi Funds, and in doing so the Company might need to endure some temporary loss as a result. Given that the estimated amount of the temporary

loss was relatively small compared to the Company's profit made in 2021 and that Ms Liang had generated substantial returns for Mr Lau's family by her investment advice throughout the previous few years, Mr Lau raised no objection and did not voice any concerns about doing so. Mr Liang denies the allegations of dishonesty (paragraph 37 d. of the amended defence).

42. Mr Liang denies that the Company has suffered the US$8 million loss alleged and that Mr Liang had intended to act in a manner that favoured his own interests to the detriment of the interests of the Company.

The position of certain minority shareholders

43. The fourteen minority shareholders represented by Mr Tom Lowe QC say that to whatever extent Mr Lau's allegations succeed they do not merit winding up and Mr Lau has an alternative remedy. Their position is developed as follows:

(1) it is unheard of for a solvent open ended investment company with active redemption rights to be wound up. This is because redemption according to the Fund's redemption terms is always an alternative remedy. That remedy is equivalent to an automatic buyout right;

(2) in respect of the Unauthorised Scheme allegations, Mr Liang has not in fact stripped the Fund of performance fees. Mr Liang is entitled to at least 80% of the performance fee in the sum of US$62.3 million for 2021 which has not been paid to him and which exceeds the US$20 million. Even if the creation of the Performance Fee Allocation Shares was wrongful this is not a wrong done to the Fund who had no entitlement to

the performance fee. Mr Lau has an obvious alternative remedy to seek cancellation of the share class and have the amendments to the IMA declared invalid;

(3) the Late Trade Allocations need to be put into perspective. They amount to a miniscule percentage of gains made by Mr Liang for the Fund. This is not the type of misconduct which justifies winding up of the Fund on the just and equitable basis. This might have justified a claim for compensation, apart from the obvious course of referring the conduct to the Hong Kong Securities and Futures Commission;

(4) the alleged misconduct needs to be placed into perspective and falls a long way short of the degree of seriousness required for winding up. The quasi-partnership complaint that Mr Lau was excluded from management is unsustainable. There is no need for investigation even if this was a ground for winding up (which it is not);

(5) Mr Lau plainly has an alternative remedy in this case. Mr Lau has a contractual right to exit by redemption at an agreed fair value and by way of an agreed fair procedure;

(6) even if the court is minded to conclude that it would be just and equitable to wind up the Company at most what are needed are relatively modest orders with respect to the conduct of the Company under section 95(3) of the Companies Act.

Submissions

44. I take account of all the written and oral submissions placed before the court. I do not refer to all of them in this judgment. They form part of the court record and I have regard to them all. The parties will be able to glean from the determination section of this judgment

which submissions I have accepted, which submissions I have rejected and those that I considered immaterial to the determination of the relevant issues in the case.

45. As much as I enjoy reading them, skeleton arguments are getting too long and attorneys must exercise more discipline and focus on making skeleton arguments shorter.

46. In this case the written opening submissions ran to 237 pages:

129 pages (including its Schedules) with 568 footnotes for Mr Lau
90 pages with 11 footnotes for Mr Liang; and
18 pages for fourteen minority shareholders which in the main argued in favour of an alternative remedy.

47. The closing written submissions ran to 244 pages:

156 pages with 711 footnotes for Mr Lau (with the authors having the gall at paragraph 339 on page 150 to refer to "the interests of brevity");
75 pages with 389 footnotes for Mr Liang; and
13 pages for fourteen minority shareholders which in the main attacked Ms Kong.

48. A grand total of nearly 500 pages with 1679 footnotes of written submissions for what should have been a relatively simple case. Over 30 volumes of documentation were placed before the court with some filled to bursting with too many pages (volume 2 had some 1,582 pages but was beaten to the top spot by volume 3 which had some 1626 pages and volume 8 part of 1 of 3 had some 1401 pages to give just a few examples of the mass of material this case has generated). The court also scheduled a hearing at 8am on 29 July

2022 to accommodate counsel for oral closing submissions. The parties had suggested that the court dispense with oral closing submissions. The court however insisted upon them. I find that there is still value in oral advocacy.

49. In view of the increasing length of written submissions and the mass of material being put before the courts these days it is no wonder that judgments are getting so long. Lady Arden who recently visited these islands to deliver this year's Annual Guest Lecture some ten years earlier had argued for consideration to be given to, where possible and appropriate, more concise judgments (M Arden "*Judgment Writing: Are Shorter Judgments Achievable?*" (2012) 128 LQR 515; see also P Butt *Judgment Writing: an Antipodean Response* (2013) 129 LQR 7). More recently Lord Burrows in *Judgment – Writing: A Personal Perspective* (20 May 2021) stressed the importance of the 3Cs (clarity, coherence and conciseness).

50. Judges at first instance must, where appropriate, make findings of fact and give adequate reasons for their decisions. Appellate courts sometimes criticise judges for the length of their judgments, the time taken to deliver them and their failure to make all necessary findings of fact and to give all necessary reasons. Remarkably in one case counsel had the temerity to criticise a judge for delivering a judgment too concisely and too quickly. Fortunately the Judicial Committee of the Privy Council in *Byers v Chen Ningning* [2021] UKPC 4 robustly and properly rejected the misconceived criticism that the judgment itself was "so concise and that it was produced with such speed that it may be inferred that the judge did not consider all of the relevant evidence before him or the submissions he heard" as follows at paragraph 37:

> "The Board has no hesitation in rejecting this contention. As a general matter, the expeditious production and delivery of a judgment is to be applauded, not criticised; and concision in a judgment is a quality, not a defect. That is not to say that expedition and concision are a justification for a failure by a judge to address material submissions; for making errors of law or findings of fact which cannot be supported or which are plainly wrong; or for failing adequately to explain the reasons for his or her decision. Of course, they are not."

51. I will continue to endeavour to ensure that my judgments address material submissions, contain any necessary findings of fact and adequate reasons and that they are delivered within a reasonable time. I think most busy first instance judges will appreciate that the worthy aspiration for concise judgments is a lot easier said in theory than implemented in reality. Lord Burrows at page 5 of the lecture referred to above stated:

> "My overall point here, therefore, is that judgment-writing is a particularly difficult exercise; and that applying the three Cs – being clear, coherent and concise – is, in the context of judgments, easier said than done."

Lord Burrows at page 6 added:

> "The old adage that it is harder to write a short judgment than a long judgment is true; but from the perspective of the reader the time and effort needed to produce a short judgment is well worth it."

I also note Lord Bingham's comment in his much read book *The Rule of Law* (2010) at pages 42 – 43:

> "The length, elaboration and prolixity of some common law judgments … can in themselves have the effect of making the law to some extent inaccessible."

Law

52. The well-established and well-known law is common ground (with the exception of the need for an investigation ground which I will come to shortly). I think I can properly deal with the relevant law briefly. What is in dispute in this case is the application of the relevant law to the particular circumstances of this case and I will turn to that further in due course.

Section 92(e) – the just and equitable ground

53. Under section 92(e) of the Companies Act (2022 Revision) (the "Companies Act") a company may be wound up by the Court if "the Court is of the opinion that it is just and equitable that the company should be wound up".

54. There is no doubt that Mr Lau is a contributory and has standing to present a petition pursuant to section 94(1)(c) of the Companies Act.

55. Under section 95(3) of the Companies Act where a petition is presented by a contributory on the just and equitable ground the court has the jurisdiction to make various orders, as an

alternative to a winding up order including an order regulating the conduct of the company's affairs in the future.

Lack of confidence in management

56. It is well settled that a company may be wound up on the just and equitable ground if it is established that there has been a justifiable loss of confidence in management, for example on account of serious misconduct or serious mismanagement of the affairs of the company by the directors or the majority shareholders (paragraph 22 of Martin JA's judgment in *Tianrui (International) Holding Company Limited v China Shanshui Cement Group Limited* 2019 (1) CILR 481).

Lack of probity

57. Lack of probity in the conduct of a company's affairs is a well-established basis for a just and equitable winding up. Lack of probity complaints can be based on allegations of breaches of fiduciary duties (see paragraph 10 (11) of my judgment in *Aquapoint L.P.* delivered on 23 November 2021). Lack of probity is not limited to quasi-partnership cases. Where a lack of confidence is rested on a lack of probity in the conduct of the company's affairs this may justify a winding up order. A winding up order can be sought on the ground that the shareholder petitioner has lost confidence in the probity of the directors (paragraph 24 of the judgment of the Judicial Committee of the Privy Council in *Lau v Chu* [2020] 1 WLR 4656).

Equitable considerations

58. At paragraphs 158 – 162 of my judgment in *Fan v AquaPoint* (FSD; unreported 10 June 2022) I briefly referred to equitable considerations and made reference to the various leading authorities including Lord Wilberforce's judgment in *Ebrahimi v Westbourne Galleries Ltd* [1973] AC 360, the judgment of Ma CJ and Lord Millett NPJ in *Re Yung Kee Holdings Ltd* [2015] 6 HKC 644 and the judgment of the Judicial Committee of the Privy Council in *Lau v Chu* [2020] 1 WLR 4656.

59. Where the company is a corporate quasi-partnership, an irretrievable breakdown in trust and confidence between the participating members may justify a just and equitable winding up, essentially on the same grounds as would justify the dissolution of a true partnership (paragraph 15 of the judgment of the Judicial Committee of the Privy Council in *Lau v Chu* [2020] 1 WLR 4656).

Ratification

60. It is well established that a shareholders' meeting is capable of ratifying an unauthorised act of the directors (paragraph 52 of *Tianrui*). In the *Byers* appeal referred to above the Privy Council also considered the application of the *Duomatic* principle, named after the case of *In re Duomatic Ltd* [1969] 2 Ch 365, which it had considered in some detail in *Ciban Management Corpn. Citco (BVI) Ltd* [2020] 3 WLR 705 at paragraphs 31 to 47.

Alternative remedies

61. It is also well settled that a winding up petition will not succeed if there exists an adequate alternative remedy which the petitioner has unreasonably failed to pursue (paragraph 23 of *Tianrui*). Winding up is a shareholders' remedy of last resort. But this does not mean that winding up is unavailable to members if they have any other remedy. The member retains a significant element of choice in the remedy to be sought, even though the court has the last word (paragraph 20 of the judgment of the Judicial Committee of the Privy Council in *Lau v Chu* [2020] 1 WLR 4656). An unreasonable refusal to accept a fair offer for the applicant's shares might bar relief by way of winding up (paragraph 21 of *Lau v Chu*). It may be expected that a respondent (especially if represented by an experienced legal team) should put forward one or more remedies which it is alleged were both available and sufficiently attractive as an alternative to make it unreasonable to continue to seek a winding up. It is not for a judge to imagine every potential alternative remedy and deal with it, in the absence of a properly formulated invitation to do so (paragraph 52 of *Lau v Chu*).

62. If the actions of the directors have resulted in a justifiable loss of confidence in the management of a company, an aggrieved contributory has a statutory right to petition for the winding up of the company on the just and equitable ground. It cannot be deprived of that right merely because the company can point to other remedies which, alone or in combination, might arguably go all or some way to obtaining compensation for what has occurred. A petitioning contributory may legitimately take the view that it prefers the company to be wound up to having to pursue piecemeal a series of actions, by litigation or otherwise, or by a combination of litigation and other steps, that might be capable of redressing some, or even all, of its concerns (paragraph 37 of *Tianrui*).

Is the need for an investigation a self-standing sole ground for a winding up order?

63. There was a brief debate in these proceedings as to whether the need for an investigation can be a self-standing sole ground for a winding up order.

64. Chief Justice Smellie in *GFN Corporation Limited* 2009 CILR 135 at paragraph 37 stated:

> "… the authorities have also clearly established that the court has jurisdiction, in the exercise of its statutory jurisdiction … to wind up a company on the basis that an investigation into its affairs is necessary and justified."

65. Chief Justice Smellie applied to *Bell Group Fin. (Pty) Ltd v Bell Group (UK) Holdings Ltd* [1996] BCC 505 at 512 (Chadwick J) and *In re Krasnapolsky Restaurant & Winter Garden Co* [1892] 3 Ch 174 at 178 (Vaughan Williams J) and at paragraph 42 added:

> "This principle – that the need for an investigation into the affairs of a company can be a free-standing basis for the making of a winding-up order on the just and equitable ground – is already recognised in Cayman law: see *In re Parmalat Capital Fin. Ltd* 2006 CILR 171, at para 18 [on appeal 2006 CILR 480 on further appeal 2008 CILR 202]".

66. Mr Lowe submitted that the Chief Justice's decision in *GFN* was overturned in the Court of Appeal on the law in respect of the petitioner's claim to be a creditor (2009 CILR 650). I note from the law report that the headnote confirms that the appeal was dismissed and the winding up order affirmed, although an error was specified in relation to the approach of failing to determine that the petitioner was on the balance of probabilities a creditor before

making the winding-up order. Notwithstanding this, the Court of Appeal was satisfied on the basis of evidence before it that the petitioner was a creditor of the appellant in respect of at least a substantial part of the petition and therefore since it was a creditor in respect of an undisputed debt it had sufficient standing to petition for the winding-up order.

67. In *Parmalat* 2006 CILR 171 Henderson J at paragraph 18 stated:

> "The circumstances surrounding its downfall need continuing investigation, and that is a free standing ground for making a winding up order: *Re Gordon & Breach Science Publishers* [1995] 2 BCLC 189; *In re Pantmaenog Timber Co Ltd* [2004] 1 AC 158 (HL); *Bell Group Fin. (Pty) Ltd v Bell Group (UK) Holdings Ltd* [1996] BCC 505 …"

68. Henderson J in *Paradigm Holdings* 2004-05 CILR 542 at paragraph 35 stated:

> "These are matters which require a full investigation. That is one of the traditional reasons for making a winding-up order under the just and equitable ground: see 1 *Palmer's Company Law*, 22nd ed., para 81-08, at 887 (1976); and *Re Peruvian Amazon Co. Ltd* (1913), 29 T.L.R. 384 …"

69. More recently Cheryll Richards J in *Madera Technology Fund (CI), Ltd* (FSD unreported judgment 3 November 2021) at paragraph 76, praying in aid *Paradigm* and *GFN*, felt able to say:

> "It is accepted that the need for an investigation can be a free-standing basis for the making of a winding up order on the just and equitable ground."

70. Andrew Jones J in a 6 page judgment in *ICP Strategic Credit Income Fund Ltd* (FSD unreported judgment 10 August 2010) at paragraph 8 stated:

> "In the circumstances of this case, I also accept that the need for such an investigation is a sufficient justification for making a winding up order."

71. Peter Cresswell J in an 80 page judgment in *Fortune Nest Corporation* (FSD unreported judgment 5 February 2013) dealt with a winding up petition based on three grounds: (1) lack of probity; (2) oppression; and (3) need for an investigation. When dealing with the relevant law at paragraphs 30 to 33 Cresswell J referred to *Paradigm* (at paragraph 30), *GFN* (at paragraph 31) and *ICP* (at paragraph 32). The Respondent in *Fortune* submitted that these cases all involved a company rendered insolvent due to fraud or serious wrongdoing and where such allegations had been made outside of the winding up process and that the court would be taking a novel step in ordering a winding up on the ground of a need for an investigation in circumstances where serious factors, external to the winding up process, were not present. The Petitioner's case in *Fortune* was that such factors were not necessary in order for it to be just and equitable to wind up a company on the basis that an investigation is necessary, and that it was wrong to trammel the court's jurisdiction in this manner. Cresswell J dealt with the issue as follows at paragraph 33 of his judgment:

> "It is unnecessary to address these competing submissions because in this case I consider that there is no need to go beyond consideration of loss of confidence caused by a lack of probity and oppression."

72. Three years later, Ingrid Mangatal J in a 78 page judgment in *Washington Special Opportunity Fund, Inc* (FSD unreported judgment 1 March 2016) at paragraph 122 referred to *Parmalat*, *GFN* and *ICP* as "leading Cayman cases on this area" adding:

> "These, and other cases, demonstrate that it has been accepted in this jurisdiction that the need for an investigation into the affairs of a company can be a free-standing basis for the making of a winding-up order on the just and equitable ground. For a contrary view, see the Second Edition of Derek French's work *Applications to Wind Up Companies*, paragraph 7.7.6.2."

73. In French's Fourth Edition at paragraph 8.179 the following is stated:

> "A need to investigate a company's affairs does not in itself justify winding up on a contributory's petition… A need to investigate a company may be a sufficient reason for ordering a winding up by the court on a public interest petition."

74. Mr Lowe courageously submitted that Mangatal J's decision in *Washington Special Opportunity Fund Inc* was *per incuriam* as she followed the Chief Justice without noticing the differing reasons in the Cayman Islands Court of Appeal and neither she nor the Chief Justice grappled with the contrary English case law on the subject. Mr Lowe boldly submitted that there was no authority in the Cayman Islands in which the court has reached

a reasoned conclusion that a need for investigation is an independent ground for winding up.

75. For my part I note the local authorities (see for examples Parker J in *Padma Fund*, FSD unreported judgment 8 October 2021 at paragraph 84 and *Alibaba.com Limited* 2012 (1) CILR 272 Cresswell J) to the effect that a decision of another judge of the FSD should be followed unless the subsequent judge is convinced it is wrong.

76. I also note that the Cayman Islands Court of Appeal in *GFN* 2009 CILR 650 did not comment adversely on the comments of the Chief Justice at paragraphs 37 and 42 of his judgment reported at 2009 CILR 135. Indeed they expressly left the point open for further consideration when the need arises. Chadwick P at paragraph 32 stating:

> "It is unnecessary also to decide whether the Chief Justice was wrong to hold that a creditor could obtain a winding-up order on the just and equitable ground on the sole basis that an investigation into the company's affairs was necessary. We heard no argument on that question. It can await further consideration by this court when the need arises."

77. In *GFN* the petitioner petitioned on the basis it was a creditor. Mr Lau in the case presently before me petitioned on the basis he was a contributory and that was not in dispute.

78. *In Re Asia Private Credit Fund* 2020 (1) CILR 134 concerned the jurisdiction of the courts in respect of supervision orders. *GFN* was referred to in a footnote. Field JA at footnote 9 to paragraph 103 commented:

> "… the petitioner threatened to apply to wind up APCF on the just and equitable ground if the manager did not appoint the FTI liquidators as the voluntary liquidators, this being a ground that can be relied on where there is the need for an investigation into the affairs of a company, see *In re GFN Corp Ltd* … per Smellie, CJ."

79. This was not an issue that had to be determined by the Court of Appeal and consequently there appears to have been no consideration of the authorities other than *GFN* which, I accept, the Court of Appeal appears to have referred to as the existing law of the Cayman Islands.

80. It will be seen from the determination section of this judgment that I do not, in the circumstances of this case, need to resolve the issue as to whether the need for an investigation is a free-standing basis for a winding up order and I leave it open for determination by wiser heads than mine in another case should the need arise. Suffice for me to say at first instance that I am not presently convinced that my fellow first instance judges in *GFN*, *Paramalat*, *Paradigm*, *Madera*, *ICP* and *Washington* were plainly wrong on this point.

Dishonesty

81. Mr Lau's case is based on serious allegations of dishonesty in respect of the Unauthorised Scheme and the Late Trade Allocations. Counsel were agreed that in respect of the allegations of dishonesty the court should be guided by the test laid down by the Supreme

Court of the United Kingdom in *Ivey v Genting Casinos (UK) Ltd* [2018] AC 391. Lord Hughes JSC set out the relevant test at paragraph 74 as follows:

> "When dishonesty is in question the fact-finding tribunal must first ascertain (subjectively) the actual state of the individual's knowledge or belief as to the facts. The reasonableness or otherwise of his belief is a matter of evidence (often in practice determinative) going to whether he held the belief, but it is not an additional requirement that his belief must be reasonable; the question is whether it is genuinely held. When once his actual state of mind as to knowledge or belief as to facts is established, the question whether his conduct was honest or dishonest is to be determined by the fact-finder by applying the (objective) standards of ordinary decent people. There is no requirement that the defendant must appreciate that what he has done is, by those standards, dishonest."

The assessment of the witnesses

82. I now turn to the assessment of the witnesses who gave live evidence in this case and were subject to cross-examination.

Mr Lau

83. It is probably an understatement to say that I did not find Mr Lau an impressive witness. His evidence and recollections were extremely vague and it was plain that he had relied on others to deal with the detail. He frequently responded "I don't recall"; "I don't remember"; and on one occasion "I just don't remember any more … it's a few months ago". He frequently failed to answer questions directly, but, in fairness, he was not alone

in that failing. His reliability and credibility were badly damaged in respect of his lack of recollection and detail and in respect of certain non-disclosure issues. It would appear, based on his response to the questions put to him on the non-disclosure issues, that his main focus at the *ex parte* stage was in getting the Order rather than complying with his disclosure duties (but a determination in that respect may, if matters are not settled, be for another day so at this stage I say no more about it).

84. In addition to leaving the detail to others it cannot be said that he had a handle on the overall situation or on the main issues in this case. He sought refuge in the General Terms but did not seem to fully understand them or be fully on top of the evidence provided in his affirmations. It appeared that these had been drafted by others (as is often the case) and he had simply signed them largely relying on others involved in the drafting process. Mr Lau did appear to find it difficult to answer simple questions in a straight forward way and tried on occasions to pre-empt any perceived damage to his case by long-winded self-serving explanations. He could not resist trying to get in, whenever he felt he could, something which he thought would be prejudicial to Mr Liang.

85. Mr Lau struck me as an individual who did not dirty his hands with the detail and was content to leave persons he described as his "co-workers" and his in-house lawyer "Alan" (whose surname he did not mention) to do the running in this respect. Mr Lau's admission that he was not aware of the precise terms on which he was investing, to most people, a significant amount of money was somewhat startling. It appeared that provided the General Terms were largely complied with and money was made for his family, Mr Lau was not too concerned about the detail or corporate governance. He was content to leave (in his word) the "awesome" Mr Liang to it in the expectation that healthy returns would be produced.

86. Mr Lau's stubborn persistence in his exaggerated allegations of dishonesty and secret asset stripping by Mr Liang appeared to be fuelled by his subjective feeling that he had been wronged or slighted in some way. I did not find his overstated protestations that he had been wronged and that Mr Liang must pay for it impressive. I also gained the impression that Mr Lau's wife heavily influenced his thinking in this regard and indeed generally. At perhaps his wife's instigation it appears that Mr Lau really wanted to teach Mr Liang a "lesson" so that he would "remember the pain" and was content to launch these misconceived and ill founded proceedings in an attempt to advance that unfortunate and unjustified agenda.

87. I take into account Mr Lau's very limited role in respect of the Company, his lack of grasp of the detail and the language difficulties and that this was, on his evidence, the first time he had been involved in litigation. Having said all that, I did not find him a convincing witness. His claims were overstated and at times grossly exaggerated. They appear to have been constructed after he had decided to part ways with Mr Liang and in an attempt to justify putting an end to the Company and adversely impacting Mr Liang's reputation as an extremely successful investment manager. His evidence was insufficient to justify this court making a winding up order.

88. Even Mr Lau's own attorneys, who tried to leave no stone unturned in advancing serious allegations against Mr Liang, had to reluctantly but inevitably accept that:

> "… his recollection of matters and documents at trial was such that careful assessment, and corroboration as against other evidence is clearly going to be

required in respect of the evidence he has given" (paragraph 71 of their written closing submissions).

Ms Kong

89. Ms Kong plainly understood the questions put to her and was not an unintelligent witness. Again her credibility was impacted by her responses to questions put to her in respect of alleged non-disclosure at the *ex parte* stage. She seems to have accepted that certain documents could have been disclosed especially in respect of the Unauthorised Scheme/Performance Allocation Share issue but were not, as admittedly her main focus was on Mr Liang's alleged wrongdoing and concealment. Counsel referred various documents to her where Mr Liang did not conceal the Performance Allocation Share issue and she had no real answers to these questions. She also had no real answer to questions to the effect that the practice was not to have formal board meetings but to use pro forma board minutes. Ms Kong says this practice was not disclosed at the *ex parte* hearing as she did not think it relevant and they were focused on the alleged wrongdoing of Mr Liang. Ms Kong's loyalty was to her "boss" Mr Lau. She was plainly on the side of Mr Lau. Ms Kong accepted that others had placed some of the "late" trades but said that Mr Liang could still allocate them to Hover4pi or the Company. Ms Kong was the COO but says she worked in the back office not the front office and had no hands-on supervision of Ms Lee. Ms Kong also could not resist frequently trying to get in as much prejudice against Mr Liang, as she felt was possible. I have concluded that there was some substance in the criticisms against Ms Kong advanced by Mr Liang represented by Mr Smith QC and the minority shareholders represented by Mr Lowe QC.

Ms Lau

90. Ms Lau endeavoured most of the time to give concise and direct answers to the questions. She did however sometimes not give a direct answer and instead used the opportunity to create prejudice against Mr Liang; for example when asked whether Mr Liang received all the management fee surplus for 2019 her answer started with a criticism of Mr Liang's "bad performance in the year of 2019". She did however accept that Mr Liang was paid a bonus based on the Fund's performance in 2020 "including by a transfer of shares". She maintained that Mr Liang had inflated the value of ByteDance. Ms Lau maintained that she "reiterated multiple times to Mr Liang that … we need to do his bonuses with very normal procedures."

91. Ms Lau was not cross-examined at length and her evidence was of limited relevance to the main issues which were before the court for determination.

Mr Liang

92. Mr Liang was well able to protect and advance his own case. He seemed almost relaxed in his exchanges with counsel during cross-examination. He was an engaging individual and I must guard against being overly influenced by the positive and confident way in which he delivered his evidence. On occasions during his cross-examination he was disarmingly frank. He remained calm and controlled throughout a lengthy cross-examination.

93. I entirely accept that an individual who comes across as an engaging and confident witness may not always be a truthful witness but on the whole I was much more impressed with

Mr Liang's evidence than Mr Lau's evidence. I do not however fully accept the pleaded case on the alleged Common Understanding and the Promise for reasons which I will come to. Moreover I was not impressed with the fact that Mr Liang took legal advice on the notice of a directors' meeting point and subsequently failed to follow it. Neither was I impressed with Mr Liang's conduct in respect of the Late Trade Allocations. Furthermore, Mr Liang was wrong to attempt to belittle the role of non-executive directors of funds. I was not however persuaded that Mr Liang dishonestly attempted to secretly strip out the assets of the Company or that he acted dishonestly in respect of the Late Trade Allocations.

94. Mr Liang made errors and with the benefit of hindsight he accepted these. It is plain to me, having observed the open way in which he gave his evidence, that he has learnt important lessons from his dealings with Mr and Ms Lau and his involvement in these legal proceedings which must have been a painful and distracting process for him. Suffice to say I do not think these errors will be committed in the future. Mr Liang gave me the impression that he now realised the importance of corporate governance and of conducting board business properly and following all relevant regulatory guidance to the letter. I am not persuaded that there is any significant risk of any serious mismanagement in the future.

Fei Qin

95. Fei Qin had worked with Mr Liang since the creation of the Company and gave her limited evidence in a very straightforward way but was plainly loyal to Mr Liang and wished to assist his case.

Wang Ning

96. Wang Ning was called by Mr Lowe and is a trader having joined the Manager on 30 March 2021. He was cross-examined in respect of various trades and the Late Trades Allocation allegations. He accepted that there was a flaw in the procedure relating to the allocation and settlement of some of the trades. My impression of him was that he was a bright and intelligent young man who gave his evidence honestly and to the best of his ability.

The expert witnesses

97. I accept the credibility and integrity of the expert witnesses (William Wong SC, Nathan Paul Wilmor Dentice and Norman Nip SC). I am grateful to them for their assistance to the court on the specific and limited issues referred to them for their opinions.

General law on assessment of evidence

98. Deemster Hodge Malek QC in *UK Secured Finance Fund plc (in liquidation) v UKSFF Subsidiary Limited* (unreported judgment 28 March 2022; Isle of Man High Court) at paragraphs 19-20 helpfully set out some of the factors to consider when assessing evidence from witnesses stating:

> "witness recollection can be fallible and memory is often unreliable" (paragraph 19).

> "It is important to bear in mind the distinction between reliability and credibility. A witnesses account may be tainted by unreliability for a number of reasons: inability to remember, filling in gaps, wishful thinking, the way statements are prepared by lawyers as part of the adversarial process, to name a few. Credibility relates to the honesty and truthfulness of an account, i.e, is a witness lying …." (paragraph 20).

Deemster Malek at paragraph 20 of his judgment quoted from the leading book he edits namely *Phipson on Evidence* (20th edn, 2022) at paragraphs 45-18:

> "The principal tests or factors to take into account in determining whether a witness is lying more or less overlap with those which apply in assessing the reliability of a witnesses account. These are:
>
> (1) the consistency or otherwise of the witness's evidence with what is agreed or clearly shown by other evidence, to have occurred;
>
> (2) the internal consistency of the witness's evidence;
>
> (3) consistency with what the witness has said or deposed on other occasions;
>
> (4) the credit of the witness in relation to matters not germane to the litigation;
>
> (5) lies established in evidence or in the context of the proceedings;
>
> (6) the demeanour of the witness;
>
> (7) the inherent probabilities of the witness's account being true.
>
> All these matters can be explored and tested in cross-examination, a key part of the process in getting to the truth of a witness's account."

Deemster Malek commented that he was not assisted by demeanour quoting from Atkin LJ in 1924 "….I think that an ounce of intrinsic merit or demerit in the evidence, that is to say, the value of the comparison of evidence with known facts, is worth pounds of demeanour." (paragraph 21).

99. Our very own Justice Kawaley has recently reminded us of the issues to be considered when assessing evidence. Sitting in the Supreme Court of Bermuda in *Wong v Grand View Private Trust Company and others* [2022] SC (Bda) 44 Com (22 June 2022) Assistant Justice Kawaley at paragraph 21 of his 471 page judgment, in respect of a trial which took place largely remotely over many months, quoted from Leggatt J in an English case from 2013 to the effect that a trial judge in a commercial case should place little if any reliance at all on witnesses' recollections of what was said in meetings and conversations and base factual findings on inferences drawn from the documentary and known or probable facts. Cross-examination affords the opportunity to subject the documentary record to critical scrutiny and to gauge the personality, motivations and working practices of a witness recalls of particular conversations and events. Above all, it is important to avoid the fallacy of supposing that, because a witness has confidence in his or her recollection and is honest, evidence based on that recollection provides any reliable guide to the truth. Justice Kawaley at paragraph 22 also quoted from Lord Bingham's helpful cautionary extra-judicial words from 20 years ago: "… however little insight a judge may gain from the demeanour of a witness of his own nationality when giving evidence, he must gain even less when (as happens in almost every commercial action and many other actions only) the witness belongs to some other nationality and is giving evidence either in English as his second or third language, or through an interpreter."

100. Judges in other cases have also stressed the obvious importance of contemporaneous documentary evidence. Lord Pearce in an English case in 1968 commented that witnesses who think they are morally in the right tend very easily and unconsciously to conjure up a legal right that did not exist. A witness, however honest, rarely persuades a judge that his present recollection is preferable to that which was taken down in writing immediately after the incident occurred. Lord Pearce stressed: "… contemporary documents are always of the utmost importance."

101. Males LJ in *Simetra Global Assets Ltd v Ikon Finance Ltd* [2019] 4 WLR 112 at [48] also stressed "the importance of contemporary documents as a means of getting at the truth, not only of what was going on, but also as to the motivation and state of mind of those concerned. That applies to documents passing between the parties, but with even greater force to a party's internal documents including emails and instant messaging. Those tend to be the documents where a witness's guard is down and their true thoughts are plain to see."

102. All these statements are generalisations and, of course, the proper assessment of the evidence in each case must be decided in the context of the particular issues, facts and circumstances of that specific case.

103. In view of the evidence put before this court I need to make a general point. I accept that in the world of money and investment business wealthy people do not always bother themselves with what they may describe as "boring lawyer's detail" but when individuals choose to make serious allegations of dishonesty without cogent evidence to support them

they should not be surprised when their claims are dismissed with adverse judicial comment against them.

Determination

104. The attorneys helpfully agreed a list of issues and I refer below to the main issues I consider necessary to determine in order to come to a conclusion as to whether Mr Lau is entitled to a winding up order on the just and equitable ground. I deal with the following main issues:

(1) the alleged quasi-partnership;
(2) the alleged Common Understanding and Promise;
(3) the alleged lack of probity and loss of confidence: the Unauthorised Scheme, the Late Trade Allocations and the removal of Mr Lau as a director;
(4) the alleged oppression;
(5) the alleged need for an investigation; and
(6) alternative remedies.

Alleged quasi-partnership

105. I am not satisfied that this is a quasi-partnership case. I am not persuaded that there should be any superimposition of equitable considerations in this case in *Ebrahimi* terms. There

was "nothing more" in *Ebrahimi* terms. The association between Mr Lau and Mr Liang was not on the basis of a personal relationship and there was no mutual confidence over and above the usual confidence between an investor and investment manager. There was no agreement or understanding that Mr Lau would significantly participate in the conduct or oversight of the business of the Company. In Mr Smith's blunt but justifiable expression "All Mr Lau brought to the party was money". There was no undue restriction of the transfer of Mr Lau's interest in the Company. Mr Lau can in *Ebrahimi* terms "take out his stake and go elsewhere."

106. I would not describe the relationship between Mr Lau and Mr Liang as a close personal relationship or as a "quasi-partnership". Despite casual phrases in the messages between Mr Lau and Mr Liang and wedding ceremony invites and attendance at dinner it was plain that the foundation and core of their relationship was strictly business. The General Terms were not indicative of a personal relationship or something equating to the quasi-partnership cases. Mr Lau, although a very significant investor and by far the largest, was not the only investor. First names terms or informal personal references do not amount to a relationship tantamount to a quasi-partnership. Moreover the involvement of Ms Lau and Ms Liang does not transform the relationship between Mr Lau and Mr Liang to one tantamount to a quasi-partnership no matter how hard Mr Said may attempt to persuade me otherwise and neither does Mr Liang's meetings with other members of Mr Lau's family. The fact that Mr Lau and Mr Liang introduced their wives to one another is not indicative of a quasi-partnership relationship. It is a common feature of many business relationships. I do not accept that the business and personal lives of Mr Lau and Mr Liang were "interwoven" as suggested by Mr Said on Mr Lau's behalf. Moreover I do not think Mr Lau's personal congratulations to Mr Liang on the birth of his son assists Mr Said in his attempts to portray the relationship as a close personal relationship and neither does the

fact that Mr Liang obtained some information about Mr Lau's family wealth. Furthermore the bonus payments were a commercial business matter and there is nothing in Mr Lau's consolidation and mutual directorship points that lead me to conclude that the relationship was tantamount to a quasi-partnership. I agree with Mr Smith when he says that mutual benefit, trust and polite communications are basic aspects of modern business relationships. None of these, whether alone or together, are sufficient to persuade me that the business relationship between Mr Lau and Mr Liang amounted to a quasi-partnership.

107. Frankly, I do not think that Mr Lau had any real interest in the overall management of the Company. I note the evidence in respect of Mr Lau's request for meetings to discuss investment strategy and Mr Lau imparting information in respect of the policies of the PRC and comments on certain specific investments but this goes nowhere near evidencing serious involvement in the management or oversight of the Company. Frankly I gained the impression that Mr Lau was just "playing at it" when it suited him and was not in a position to make any real significant contribution to the management or oversight of the Company. Being named as a director may have offered him some status and the perception of some credibility within his family but it was apparent that Mr Lau had very little appreciation of the duties of directors.

108. Of course there was some "trust" between Mr Lau and Mr Liang. Mr Liang "trusted" Mr Lau to come up with the money to invest and Mr Lau "trusted" Mr Liang to make a significant financial return for his family.

109. I have gained the impression that Mr Liang saw in Mr Lau a wonderful opportunity to secure significant funds to manage. I have also gained the impression that Mr Lau saw in Mr Liang a successful investment manager who could make his family a lot of money and

increase his reputation within his family. There can be no doubt that Mr Lau's family invested hundreds of millions of US dollars into the Company and that, in return, Mr Liang produced a lot of money for them. For example Mr Liang generated a US$380 million profit for the Fund in 2021. Mr Liang also made a lot of money for himself along the way.

110. Commissioner Jonathan Sumption sitting as a judge on the Channel Island of Jersey, in *Syvret v Chief Minister and Others* [2011] JLR 343 at paragraph 38 stated: "… official entertaining does not bring together companies of choice. Such entertaining is simply part of the courtesies of office on both sides." In a similar way, I am sure, that the "social engagements" of Mr Lau and Mr Liang had their foundations in business rather than in personal choice. Without Mr Liang's desire for money to invest and without Mr Lau's desire to obtain a good financial return for his family, their paths would not have crossed, or if they did they would not have continued to walk the same path together for more than one brief moment. They lived in different worlds. Without the business of money being on the agenda they would have had no time for each other and would not have walked the same path together. I accept that the dividing line in Hong Kong and the PRC between business and pleasure may not be as distinct as it is in other parts of the world but I am convinced that it would be wrong to describe the relationship between Mr Lau and Mr Liang as tantamount to a quasi-partnership. Mr Lau was an investor. Mr Liang was an investment manager. The commercial relationship, at its core, was as simple as that. I agree with Mr Smith that "This was a pure investor-manager relationship."

Alleged Common Understanding and Promise

111. I do not accept that there was a Common Understanding and Promise precisely in the lawyers' terms pleaded on behalf of Mr Liang. There is no contemporaneous evidence or corroboration to support Mr Liang's pleaded case in this respect. The Common Understanding and Promise may have reflected Mr Liang's perception and the reality on the ground but there is no evidence that Mr Lau signed up to the Common Understanding or the Promise. Moreover, I found parts of Mr Liang's version as to what transpired at the 15 July 2021 meeting mere "wishful thinking". I find on the evidence that Mr Lau did not give his informed consent to the alleged Unauthorised Scheme or the alleged Late Trade Allocations. I do however also find on the evidence that Mr Lau was not overly concerned as to the mechanisms or amount of the payment of the bonuses as long as there was a healthy financial return for his family from their significant investments. If matters had otherwise progressed smoothly, I doubt that Mr Lau would have had any issues in respect of the trades he now complains of. In the grand scale of this matter they were relatively insignificant, but Mr Lau has blown them out of all reasonable proportion in his attempt to obtain a winding up order.

Alleged Lack of Probity and Loss of Confidence

Unauthorised Scheme

112. In respect of the Unauthorised Scheme I am not persuaded on the evidence and arguments presented that Mr Liang has "attempted to secretly strip approximately US$19,997,219.62 for his own benefit from the Company" (paragraph 11 (a) i. of the petition). In any event

any loss suffered would be a loss of the Manager not the Company. Mr Lau accepted that the Company itself was not entitled to any part of the performance fees or the management fees. Mr Lau also accepted that the Company was always liable to pay the full amount of the management and performance fees to the Manager.

113. Mr Lau's complaints about lack of notice of a directors' meeting ring somewhat hollow in the circumstances of this case. The evidence indicates that this is not how the Company worked. I do not find any dishonesty whatsoever in Mr Liang's production of the board minutes. He was simply using a pro forma, which had been used by others many times before, which recorded that "requisite notice" had been given when it had not been. This was entirely consistent with how the Company had previously been run, with Mr Lau's blessing or at least lack of objection. I was however concerned to note that having taken the trouble to take legal advice in respect of the meeting Mr Liang appears not to have followed it. Mr Liang was conscious that with 3 directors he did not require Mr Lau's vote. Mr Lau had not played an active role as a director. Mr Liang raised the majority vote point in his email dated 10 August 2021 to Ogier. Ogier responded promptly on 11 August 2021 confirming in effect that a majority vote was sufficient but they also stated that if all directors were not agreeable then an actual meeting must be called with due notice. Mr Liang acknowledges receiving the legal advice but thought there must be a reason as to why Ms Kong never gave notice in the past "good or bad, I just didn't take it as serious … It might seem questionable corporate governance, but this is the practice. We never had any issue, so I didn't think this is necessary … I definitely failed to appreciate the seriousness of this procedure phase and I do accept that on corporate governance perspective, it might look a bit imperfect." The failure to give notice was not ideal but I

have not been persuaded to grant a winding up order on this ground alone or taken together with the other grounds Mr Lau relies upon.

114. It is common ground that Mr Liang produced board minutes dated 11 August and 16 November 2021 and the business was conducted without providing prior notice to Mr Lau, who was a director at the material times. The failure to give notice was not the correct way to proceed but was entirely consistent with the previous way in which directors' "meetings" had been conducted in the past with, I find, Mr Lau's knowledge and acquiescence or at least lack of objection. The failure to give notice was wrong but it was not dishonest. It is wrong to refer to the minutes produced as "forged". Any procedural irregularity was, in any event, capable of being ratified by Mr Liang as the holder of the management shares in the Company. I find that Mr Liang genuinely believed that the amendments reflected what he understood was justified and proceeded in the way he did because he did not think, based on previous practice, that the giving of notice was necessary and he wished to avoid any unnecessary confrontations or further disagreements with Mr Lau.

115. I accept that it is clear from the WeChat messages on 30 April 2021 that Mrs Lau wanted to follow the "normal procedure" in respect of the fees but was also keen to get the redemptions. Mr Liang was also keen to obtain any legitimate tax savings. The exchanges finished by Mr Liang saying he would "think of another solution" but the redemptions could "still go on as planned." I believe Mr Liang in part when he says that the amendments were effected in order (a) for Mr Liang to obtain tax savings in respect of his bonus distribution and (b) to preserve the liquidity of the Fund. They were also effected by Mr Liang in an attempt to prevent Mr Lau trying to delay the payment of the bonus in future years until Mr Lau's requests for early redemption were satisfied. Mr Liang wanted to remove any areas of unnecessary and distracting conflict with Mr Lau.

116. Furthermore I find that the Company has not suffered any detriment as a result of the amendments. The Manager can pursue any remedies it believes it is entitled to against Mr Liang if these cannot be settled by agreement. I find, on the evidence, that the Manager was aware of Performance Allocation Shares issue. Mr Liang did not deliberately hide it from the Manager. For example, on 2 April 2021 Mr Liang sent a WeChat message to Ms Kong asking her to discuss with "fund admin" whether the crystalised performance fees can be paid "directly to Liang Hao and converted into fund shares. Because Liang Hao owns 100% of the fund's management shares, it should be okay to do so." Ms Kong sent an email to Apex on 3 May 2021 subject: Performance Fee Queries "Could Hao LIANG subscribe the shares with the accrued performance fee … we just wonder if he can directly subscribe the fund with the accrued performance fee in the year end". On 2 May 2021 Ms Kong had sent an email to Apex stating: "The amount depends on the total performance fee accrued at the year end. For example, if the Dec 2021 NAV is confirmed, the total performance fee is USD 50mn, then we would like to subscribe the Seahawk Fund with USD 50mn by Hao Liang. It means the Manager would not receive any fee income from the Fund." Ms Kong said that she mentioned to Mr Lau towards the end of July 2021, Mr Liang's intention to change the mechanism for the payment of performance fees. Moreover Ms Kong admitted to introducing the concept of Performance Allocation Shares to Mr Liang in 2019 in the context of the economic substance requirements in the Cayman Islands.

117. There was no improper attempt at the "secret stripping" of nearly US$20 million. Mr Liang's actions in respect of the Performance Allocation Shares were not dishonest or seriously lacking in probity in the overall context of the relationship between Mr Lau and himself and in all the circumstances of this case. Mr Lau accepted that Mr Liang, as the

holder of all the voting shares of the Company, was entitled to pass a resolution creating a new class of Performance Allocation Shares. Mr Lau also inevitably accepted that Mr Liang was entitled on Mr Lau's own case to a bonus of approximately US$50 million in performance fees, way in excess of the US$20 million which Mr Lau has accused him of dishonestly attempting to "secretly strip" out of the Company. I find that there was no dishonesty or "secret stripping" out of assets.

Late Trade Allocations

118. In respect of the Late Trade Allocations or "rat" trades I accept the expert evidence that such are against the regulatory guidance in Hong Kong but even if these trades could be properly categorised as late or "rat" trades it would not be sufficient to justify a winding up order in the grand scale of the overall context. I do not belittle the importance of complying with the law and regulatory guidance but the allegations in this case need to be considered in their proper context and they are insufficient to justify taking the draconian step of placing this solvent company into liquidation. Moreover the late or "rat" trades have been referred to the appropriate regulatory body in Hong Kong for investigation and if anyone genuinely believes that they have suffered a loss then legal action may be pursued in respect of any wrongdoing. I am not persuaded that Mr Liang acted dishonestly (in the *Ivey v Genting Casinos (UK) Ltd*) [2018] AC 391 at paragraph 74 sense) in respect of the Late Trade Allocations.

119. I accept that Mr Liang and others have acknowledged that the Late Trade Allocations were not the proper way to proceed. For example Ms Lee in a WeChat on 7 July 2021 suggested

that these allocations should stop when a new employee was due to start as "I don't know how to explain it."

120. In a useful document entitled "Note on 32 Alleged Late Trade Allocations" Mr Liang has helpfully provided his detailed comments in respect of the trades. Mr Said in his closing submissions focused on trades 26 and 27 and Mr Liang's comments:

> "Seahawk Fund sustained a loss of US$1.9 million from Trades 26 and 27 combined. As detailed in my Affidavit, the funds would split the loss on a pro rata basis. Accordingly, Hover4pi Funds would bear approximately US$180,000 loss from this trade."

121. Mr Said submitted that the loss suffered by the Company was therefore admitted by Mr Liang at US$1.9 million in respect of these trades. Mr Smith refers to Mr Liang's evidence which he says was not seriously challenged on this point to the effect that Hover4pi Funds should have had the loss of US$180,000 allocated to them so the figure of loss to the Company is just US$180,000 and not US$1.9 million. Moreover all the trades were entered into because they were believed to be good profitable trades. There was no dishonesty but it is accepted that there were some regulatory breaches of the code of conduct namely best execution practice. I accept Mr Smith's submission that they fall "way short of the sort of conduct that might justify winding-up of an investment fund."

122. I do not find that in making the Late Trade Allocations, Mr Liang intended to improperly favour (a) the interests of the Hover4pi Funds; and/or (b) his own and his wife's interests to the detriment of the interests of the Fund. I accept that the trades made by the Manager

were placed in the expectation of generating profit over the term of the holding of the trade. I find that the serious allegations pleaded at paragraph 11 (a) ii of Mr Lau's petition namely that through the Late Trade Allocations Mr Liang "has orchestrated a deliberate and cynical system to siphon moneys to the Hover4pi Funds (controlled by him and his wife) while simultaneously causing significant losses to the Company. In doing so he deliberately preferred the interests of the Hover4pi Funds, and ultimately himself, and has deliberately caused the Fund to suffer losses of approximately USD 8,073,918.07" not proved. During his closing submissions I asked Mr Said if there was evidence before the court as to what loss the Fund had suffered in respect of the trades as at the date of the hearing. Mr Said responded in the negative and stressed that the loss of confidence of Mr Lau was based on the grounds of dishonesty or lack of probity in respect of Mr Liang's conduct.

123. I find that Mr Liang genuinely believed that Mr Lau would have no objection to Mr Liang's attempts to help Mr Liang's wife out in respect of Hover4pi Funds. Applying the objective standards of ordinary decent people I find no dishonesty. Certainly Mr Liang's activities in this respect do not justify making a winding up order in respect of the Company. I do not, however, accept that there was any positive fully informed agreement from Mr Lau in respect of the trades and in my judgment Mr Laing's evidence in respect of the 15 July 2021 meeting on this point is simply wishful thinking. Mr Liang may have mentioned the issue in very general terms but there was no positive fully informed agreement from Mr Lau to the trades.

124. I find that the plan to make up the loss was, however, known about in the office of the Manager. Mr Wang referred to the strategy in his evidence. Ms Lee also had responsibility of settling the trades and Ms Kong as COO was ultimately responsible. The brokers sent queries in relation to the settlement of trades to an email address to which Ms Kong and

Ms Lee had access. Mr Liang did not try to dishonestly hide any of the trades. They were conducted openly in the office of the Manager. I find that Mr Liang's subjectively held genuine belief was that Mr Lau would not object to the strategy. In his own mind it would appear that he had genuinely convinced himself that Mr Lau had agreed to the strategy or at the very least would not object to it. I agree with Mr Smith that in the context of this case and given the vast sums Mr and Ms Liang had generated for Mr Lau and his family this was a genuine and reasonable belief. Viewed objectively Mr Liang's conduct could not properly be regarded as dishonest, in the particular circumstances of this case.

125. I am also persuaded that the "investigation" undertaken by Ms Kong was not an independently, fairly, competently and comprehensively undertaken investigation. Again there is much to be said for the submission that she had an axe to grind. She wanted to encourage Mr Lau to develop a business relationship with her husband and to use his fund. It was in her best interests and the best interests of her husband to "rubbish" Mr Liang and find fault. Her "investigation" was not a professionally undertaken investigation. She did not even ask Mr Liang for an explanation of his position. I accept the submission of Mr Lowe on behalf of certain minority shareholders that: "There was no sense of proportion to the criticisms of Mr Liang." The partisan "investigation" was in effect akin to a witch hunt with a foregone conclusion in mind, on the basis of "I must find serious wrongdoing against Mr Liang as that will be to my benefit." I do not believe that the work of the JPLs on this issue salvages the difficulties created by Ms Kong's flawed and tainted investigation. Mr Smith referred the court to a 6 page letter from Harneys to the JPLs dated 8 June 2022 in which various concerns are raised by Mr Liang in respect of this issue. I also take into account the persuasive criticisms raised under the heading "The analysis is inherently flawed" at paragraphs 153 to 164 of Mr Liang's closing written submissions.

126. I do not find that the Late Trade Allocations were dishonest or significantly lacking in probity in the circumstances of this case.

127. Mr Lau's exaggerated pleaded allegations are in respect of "dishonest breaches of Mr Liang's fiduciary duty as a director of the Company to avoid placing himself in a conflict of interests and to not make a personal profit at the expense of the Company" (paragraph 38 of the petition) and that "Mr Liang acted dishonestly: (a) Mr Liang consciously and deliberately placed himself in a conflict of interest by making the Late Trade Allocations and by favouring the interests of Hover4pi, and ultimately himself and his wife, by allocating the Profit-Making Allocated Trades to Hover4pi and the Loss-Making Trades to the Company." (paragraph 39 (a) of the petition). I have found no dishonesty on the part of Mr Liang. As I think the draftsman of the petition realised any honest breaches of fiduciary duties in the circumstances of this case would not have been sufficient to justify the court taking the drastic step of winding up this solvent company. This may also in part go some way to explaining why Mr Lau has grossly overstated his case from its very inception.

128. Of course I do not condone any breaches of fiduciary duty or any failures to follow regulatory guidance but these allegations must be viewed in the wider context of the relationship between Mr Liang and Mr Lau. I do not say that wrongful conduct is justifiable so long as no loss arises or that wrongful conduct is justifiable as long as a good return is provided. One must however consider the allegations that are made in this case in the context of the draconian remedy that is sought which would impact not just Mr Liang but the Company and other investors.

129. Is it proportionate to wind up the Company because Mr Liang made errors in failing to notify Mr Lau in advance of two board decisions which resulted in changes to the structure for bonus payments which favoured Mr Liang and went beyond the General Terms (the Unauthorised Scheme) and in trying to recover the Hover4ipi losses (the Late Trade Allocations)? Should a winding up order be made on the basis of the pleaded allegations? My answer to those questions is plainly in the negative. I do not condone the errors made by Mr Liang but I do not find that they were dishonest or significantly lacking in probity such that a winding up order is appropriate. I am driven to the conclusion that there has not been a justifiable loss of confidence in the management of the Company, due to the matters pleaded.

130. The overall impression I get is that Mr Lau has used the Unauthorised Scheme and the Late Trade Allocations to reverse engineer his wish to terminate his relationship with Mr Liang with "extreme prejudice" in *Apocalypse Now* terms. In my judgment there is a lot to say for the submission that Mr Lau had decided to terminate his relationship with Mr Liang well before what he describes as the Unauthorised Scheme and Late Trade Allocations came to his attention. It appears that he has focused on them and made exaggerated claims of dishonesty and serious lack of probity as a way of justifying the termination of his relationship with Mr Liang with extreme prejudice. It is difficult to identify the true reason which prompted the fallout. The fallout on the evidence presented to the court appears to have started when there was a misunderstanding on the part of Mr and Mrs Lau in respect of the calculation of the amount of Mr Liang's 2020 bonus. Mr Lau himself accepted during cross-examination that it was from February 2021 that his relationship with Mr Liang deteriorated. It appeared to be common ground that on 3 March 2021 Mr Lau (in the presence of Mrs Lau) had spoken "very harshly" to Mr Liang repeatedly accusing Mr

Liang of "crossing the line", insisting that he be permitted to redeem his money in one go, in order to "give [Mr Liang] a lesson" so that Mr Liang would "remember the pain". There may have been issues in respect of the translation of these terms but the message was clear. The relationship between Mr Lau and Mr Liang had, for some reason, deteriorated and Mr Lau, in effect, wanted Mr Liang to remember not to cross him. I do not accept Mr Said's submission that subsequent communications between Mr Lau and Mr Liang (including Mr Lau congratulating Mr Laing on the birth of his son) show that the good relations between Mr Lau and Mr Liang were fully restored before the matters complained of in the petition took place. I do not accept that Mr Lau justifiably lost confidence in Mr Liang due to the Unauthorised Scheme or the Late Trade Allocations as pleaded, which appear to have come to Mr Lau's attention in November 2021.

Removal of Mr Lau as a director

131. I do not find that Mr Liang's removal of Mr Lau from the board of the Company shows a serious lack of probity by Mr Liang. There has been no justifiable loss of confidence in the management of the Company on that basis either.

132. Mr Lau did not have a legitimate expectation of participating in the management of the Company as a director while he was a member. Indeed I go further, on the evidence I am satisfied that Mr Lau had no real interest in participating in the management of the Company at any meaningful level and was not in any event in a position to make a significant contribution to the management of the Company. He lacked the necessary skills, experience, and willingness to do so.

133. I have considered the expert evidence on whether or not Mr Lau needed to be licensed in Hong Kong to participate in the management of the Company but, in light of my findings above, do not need to make any determinations in that respect. I have concluded that whether or not he needed regulatory approval, Mr Lau had no legitimate expectation of participating in the management of the Company at any level.

Alleged Oppression

134. I am not satisfied that Mr Liang's conduct can properly be categorised as oppressive in so far as Mr Lau is concerned. When he became an investor Mr Lau should have been aware that Mr Liang held all of the management shares and that the participating shares enjoyed no voting rights. Mr Lau has the right to submit redemption requests on the terms provided for in the Company's constitutional documents. Mr Lau is not being forced to remain a member of the Company. There is an agreed, fair and reasonable route for his exit, namely the redemption route.

Alleged Need for an Investigation

135. I assume for present purposes at first instance that in Cayman law a need for an investigation into the affairs of the company is a self-standing ground for a winding up order to be made on the application by a contributory in respect of a solvent company. I have concluded, however, that in the particular circumstances of this case there is no need for any further investigations into the affairs of the Company which would justify this court taking the drastic step of making a winding up order and in effect killing the Company, just

for the purpose of another investigation into its affairs. Another investigation is simply not necessary.

136. Various issues in respect of the affairs of the Company have been investigated by the JPLs since their appointment on 10 February 2022 and two reports have been prepared and made available to the parties. The matter has been referred to the regulators who may conduct whatever investigations they see fit. The issues of which pleaded complaint has been made have been "investigated" during the course of these proceedings and in my judgment there are no issues which require further investigations which would justify a winding up order being made to enable JOLs to conduct further investigations.

Alternative remedies

137. Mr Lau has not demonstrated that he is entitled to some relief. Even if he had it would not be just and equitable to wind the company up. There is a reasonable alternative remedy available. Mr Liang has demonstrated that the redemption of Mr Lau's shareholding in the Company, pursuant to the terms of his investment and subject to compliance with the Company's constitutional documents, is a reasonable alternative to a winding up order.

138. Furthermore, Mr Lau has acted unreasonably in not pursuing a redemption of his shareholding in accordance with the terms of his investment and the terms of the Company's constitutional documents, as an alternative remedy to killing the Company and adversely impacting the reputation of Mr Liang by unreasonably insisting on a winding up order and an official liquidation.

139. Mr Liang has also demonstrated that in addition to unreasonably failing to pursue his redemption remedy Mr Lau has also unreasonably failed to limit his relief by way of progressing a complaint to the Securities and Futures Commission in Hong Kong and legal proceedings through the Hong Kong courts but instead has unreasonably insisted on a winding up order being made in addition to the progression of other legal proceedings and regulatory referrals. In my judgment these alternative remedies would be adequate remedies for Mr Lau and there is no justification for his request that this court presses the winding up order nuclear weapon button and destroy the Company. Mr Lau can exit the Company on agreed terms and the Company can continue in existence to the benefit of the other investors who do not want it liquidated.

140. I have concluded that Mr Lau has alternative remedies. He can exit the Company. He can redeem his shares in accordance with the agreement he entered into. The Company is currently liquid holding approximately US$224 million in cash as at 9 June 2022. Mr Lau should be able to redeem his remaining entire investment within a relatively short time frame following the agreed procedure. The complaints in respect of the so called Unauthorised Scheme and the Late Trade Allocations can be pursued against Mr Liang by way of litigation and regulatory referrals in Hong Kong and, if on advice it is considered appropriate, derivative actions can be commenced if need be. I hope, however, that the parties will see sense and settle matters amongst themselves to avoid further costly and time consuming destructive litigation.

141. I note the wise guidance of the Court of Appeal in *Tianrui* (in the context of an appeal against an order striking out a winding up petition) especially at paragraph 37 but in my judgment in the circumstances of the case presently before me, having heard evidence and legal argument over a number of days, there is no merit in the winding up petition and I

have not been persuaded that it is just and equitable to wind the Company up. Even if I had been satisfied that there was some merit in the petition and Mr Lau was entitled to some relief I would not have granted a winding up order as in my judgment Mr Lau has, for the brief reasons stated in this judgment, unreasonably failed to pursue his alternative remedies.

Concluding remarks

142. Now that the relationship between Mr Lau and Mr Liang has changed and sadly significantly deteriorated I am sure that Mr Liang will have learnt from this unfortunate experience and will take care in the future to observe to the letter all necessary legal formalities (for example notice of directors' meetings) and follow all applicable regulatory guidance (for example avoiding late trade allocations).

143. If he is to continue to have a successful career in the future Mr Liang must take great care to ensure that corporate governance requirements and regulatory guidance are properly followed.

144. In respect of the way forward it may be desirable if Mr Liang can do all he properly can to facilitate Mr Lau's early exit from the Company. If Mr Liang unreasonably obstructs Mr Lau's early exit from the Company he may find himself on the receiving end of another winding up petition which would be another great distraction with a lot more time and money being thrown at the lawyers. Mr Lau and Mr Liang should focus on moving forward in their own separate ways. I leave the parties to deal with the Hong Kong proceedings as they see fit but express the wish that they consider settling them through mediation if possible. It is in the best interests of both Mr Lau, Mr Liang, the Company and the Manager

that the parties put their differences behind them and move forward in their own separate ways. More or continuing litigation is not the answer.

Ancillaries

145. Counsel should provide the court with a draft order (agreed as to form and content) reflecting my dismissal of the petition for my approval within 5 days of the delivery of this judgment. Any ancillary applications (such as costs) should be filed within 14 days of the delivery of this judgment with concise (no more than 5 pages) skeleton arguments in support and any concise skeleton arguments in reply within 14 days thereafter. I intend to decide any ancillary issues on paper rather than requiring a further hearing. I am grateful to the attorneys and their respective teams for their assistance to the court.

David Doyle

THE HON. JUSTICE DAVID DOYLE
JUDGE OF THE GRAND COURT

ITEM NO. 175

JA-61

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Reason: Apex Certified
Location: Apex

IN THE GRAND COURT OF THE CAYMAN ISLANDS
FINANCIAL SERVICES DIVISION

CAUSE NOS. FSD 379 AND 380 OF 2023 (IKJ)

IN THE MATTER OF SECTION 11 OF THE EXEMPTED LIMITED PARTNERSHIP ACT (2021 REVISION)

AND IN THE MATTER OF ROTHENBERG VENTURES 2016 FEEDER FUND, L.P.

AND IN THE MATTER OF ROTHENBERG VENTURES 2016 FUND-A, L.P.

IN COURT

Before:	The Hon. Justice Kawaley (in Chambers)
Appearances:	Mr Erik Bodden, Dr Alecia Johns and Mr Romane Duncan of Conyers, Dill & Pearman LLP for CY Capital Limited, Korea Investment Partners Co. Ltd, ARCHina Capital Fund I L.P., Jiangfeng Lu and SMBC Trust Bank Ltd (the "Petitioners") The Respondents did not appear (Mr Michael Rothenberg, the controller of the Respondents' General Partner, attended remotely)
Heard:	31 January 2024
Date of Decision:	31 January 2024
Draft Reasons circulated:	27 March 2024
Reasons Delivered:	15 April 2024

JA-61

HEADNOTE

Dissolution of general partner of exempted limited partnerships -failure of general partner's controller to apply to restore general partner to the register of companies or to appoint a replacement general partner-petitions on behalf of the limited partners seeking an order authorising the signing and filing of a statutory statement on behalf of the general partner appointing a replacement general partner-effect of non-compliance with time limit for filing statutory statement-construction of limited partnership agreement-Exempted Limited Partnership Act (2021 Revision) sections 10, 11, 36

REASONS FOR DECISION

Background

1. The Petitions presented by the Limited Partners of two exempted limited partnerships (Rothenberg Ventures 2016 Feeder Fund LP ("Feeder Fund") and Rothenberg Ventures 2016 Fund-A LP ("Fund A"), together the "ELPs") primarily raised a novel question about the consequences of failing to file a statement designating a replacement general partner within the prescribed time period. The ELPs were feeder funds with non-US investors which invested in Rothenberg Ventures 2016 Fund LP of Delaware (the "Main Fund"), founded by Michael Rothenberg ("Mr Rothenberg"). Mr Rothenberg was also the sole director and shareholder of the ELPs' General Partner, Rothenberg Ventures 2016 Feeder Fund GP, Ltd. ("GP Ltd"). GP Ltd was struck-off the register on 30 April 2021 and the ELPs were struck off on 31 October 2022.

2. As a result of proceedings brought by the US Securities and Exchange Commission ("SEC"), a civil judgment was obtained against Mr Rothenberg on 17 October 2018. Shortly before this occurred, he transferred control over the Main Fund to a Mr Burke Robinson and Jefferson Eppler. Messrs Robinson and Eppler sought to assume control of the ELPs, but Mr Rothenberg remained sole director and shareholder. The Limited Partners became aware that the ELPs had been struck-off in December 2022, as a result of their status coming to the attention of the Main Fund's new managers. On or about 5 May 2023, the Limited Partners instructed Conyers to investigate the status of GP Ltd as well, and discovered that it had also been struck-off. Mr Rothenberg was

requested to restore the ELPs, which the Limited Partners wished to continue, and to regularise the position of GP Ltd.

3. When these requests were not complied with, Messrs Robinson and Eppler incorporated a replacement General Partner which the Limited Partners formally confirmed they wished to appoint in place of GP Ltd. By a letter dated 18 October 2023, Mr Rothenberg was asked to execute a Statement under section 10 of the Exempted Limited Partnership Act (2021 Revision) ("ELP Act"). He responded that he was preoccupied with a criminal trial which had commenced against him in Oakland, California that month. On 16 November 2023 Mr Rothenberg was convicted of 23 counts of fraud and money laundering in the United States District Court of Northern California. The Petitions herein were presented on 13 December 2023, each seeking an Order authorising Mr Eppler to sign and file a section 10 Statement with a view to replacing GP Ltd with the new General Partner approved by the Petitioners in their capacities as Limited Partners of the two ELPs.

4. Approximately 20 minutes into the unopposed hearing, with Mr Bodden in full flow, Mr Rothenberg communicated his desire to attend the hearing remotely. I decided to allow him to attend remotely, fully accepting that his right to formally participate in the hearing was extremely unclear. Having heard the Petitioners' counsel's full oral presentation, which made it clear that the relief sought should be granted, Mr Rothenberg made what appeared to me to be a largely symbolic plea for an adjournment. The purpose was to enable him to seek legal advice about the present proceedings. He had no standing to oppose the petitions in his personal capacity. And the registered GP had legally ceased to exist. I stated in material part as follows:

> "*May I say that I understand how difficult it is for somebody that creates a business structure to be forced, against their will, for whatever reason, to relinquish control of the structure. You are not by any means the only founder of a commercial vehicle who has found it difficult to accept the time has come to let go. But unfortunately the evidence that has been placed before me demonstrates very clearly that I should grant the Order that the petitioners seek in respect of each of these Petitions for fuller reasons which I will give later.*
>
> *And it is impossible for me to identify any proper basis for adjourning these proceedings to allow you to get counsel to appear before this Court. Because the length of the period*

of paralysis is so long and the alternative options available are so vague and intangible, that it is impossible to identify any tangible benefit which would accrue to the ELPs (which you accept need to be restored) from granting any adjournment. So the Orders sought in each of these cases are granted."

5. The substance of the application was entirely straightforward. It was obvious that, in light of all the circumstances, the Petitioners should be permitted to cause an appointment of a new General Partner for the ELPs they had invested in. The only legal wrinkle was that the application was being made long after the expiry of the prescribed time limit. Mr Bodden persuaded me, despite this being a novel point, that the Petitioners' failure to comply with the statutory time limit and/or the time limit prescribed in the Limited Partnership Agreements for seeking the present relief was not fatal to their ability to obtain it.

6. I now give reasons for this decision.

The statutory jurisdiction

7. Section 9 (1) (e) of the ELP Act mandates filing particulars of, *inter alia*, the general partner with the Registrar of Exempted Limited Partnerships when an exempted limited partnership is initially registered. Section 10 of the ELP Act pertinently provides:

"*(1) Without prejudice to subsection (2), if, during the continuance of an exempted limited partnership, any change is made or occurs in any matter specified in paragraphs (a) to (e) of section 9(1), a statement signed, subject to section 11, by a general partner specifying the nature of the change shall, within sixty days of the change, be filed with the Registrar.*

(2)A statement signed in accordance with subsection (1) in respect of any arrangement or transaction consequent upon which any person will be removed, replaced or admitted as a general partner in any exempted limited partnership, shall, within fifteen days of the arrangement or transaction, be filed with the Registrar and, until the statement is so filed, the arrangement or transaction shall, for the purposes of this Act and the partnership agreement, not be effective to remove, replace or admit that person as a general partner

of the exempt limited partnership and with respect to a replacement or admitted general partner the documentation required by subsection 9(1)(e)(i), (ii) or (iii) of this Act shall be provided as the case may require.

...

(4)If default is made in compliance with this section, each general partner in default shall incur a penalty of two hundred dollars for each day that the default continues which penalty shall be a debt due to the Registrar and the general partner shall indemnify any person who thereby suffers any loss." [Emphasis added]

8. Section 11 provides the following remedy for non-compliance with the section 10 filing obligations, which are primarily imposed on general partners:

"***Failure to file statement***

11. If a person required by section 9(1), section 10(1) or (2) or section 36, or by the partnership agreement to execute and file a statement or notice fails to do so, any other partner, and any assignee of a partnership interest who is or may be affected by the failure or refusal may petition the court to direct a person the court sees fit to sign the statement and file the same on behalf of the person in default."

9. Section 36 ("Dissolution") deals with the winding-up and dissolution of exempted limited partnerships. Of potential relevance to the present case was the following subsections:

"*(7) The general partner or its legal representative shall promptly serve notice on all limited partners informing the limited partners of —*

(a) the death;

(b) the commencement of liquidation, bankruptcy or dissolution proceedings; or

(c) the withdrawal, removal or making of a winding up or dissolution order, in relation to the sole or last remaining qualifying general partner and in this section each event is referred to an 'event of withdrawal'.

(8) If default is made in compliance with this section, each general partner or its legal representative, in default shall incur a penalty of twenty-five dollars for each day that the default continues, which penalty shall be a debt due to the Registrar.

> *(9) Unless the partnership agreement provides otherwise, if a new qualifying general partner is not elected within ninety days after the service of notice of an event of withdrawal in accordance with subsection (7), in this section referred to as 'the automatic wind up date', the exempted limited partnership shall be wound up in accordance with the partnership agreement or the orders or directions the court may make or give in accordance with subsection (3) (g).*
> *(10) The winding up of an exempted limited partnership shall be deemed to commence upon the earlier to occur of any of the following —*
>
> *(a) the passing of a resolution for winding up;*
>
> *(b) subject to subsection (9), the automatic wind up date;*
>
> *(c) the expiry of the period fixed for the duration of the exempted limited partnership by the partnership agreement;*
>
> *(d) the occurrence of an event provided by the partnership agreement upon which the exempted limited partnership is to be wound up; or*
>
> *(e) where a winding up order has been made, the presentation of the petition for winding up.*" [Emphasis added]

10. Section 36 does not prescribe any statutory consequences for the general partner or its attorney failing to file a section 36 (7) notice save for a financial penalty on the responsible general partner. Winding-up only flows from failing to appoint a replacement general partner within 90 days of the service of a notice of, *inter alia*, dissolution. However even where this time period is triggered by the service of a notice of dissolution and expires, this automatic winding-up requirement may be overridden by the terms of the partnership agreement.

11. The only potentially relevant provision in section 36 for present purposes accordingly appeared to be subsection 10 (d), which provides for a deemed commencement of a winding-up on "*the occurrence of an event provided by the partnership agreement upon which the exempted limited partnership is to be wound up*". The Exempted Limited Partnership Agreements in respect of each of the ELPs (the "LPAs") will be considered below.

12. In terms of case law on this Court's jurisdiction under section 11 of the ELP Act, Mr Bodden referred to this Court's decision in *Re Asean Infrastructure Fund II LP* [2020 (2) CILR 803], in relation which the Court of Appeal refused leave to appeal [2021 (1) CILR 100]. Smellie CJ (as he then was) identified two matters which required analysis:

(a) whether an event constituting an "*arrangement or transaction consequent upon which any person will be removed*" for the purposes of section 10 of the ELP Act had occurred (at paragraphs 25-27); and

(b) (assuming a section 10 event had occurred) whether the relevant circumstances justified the Court exercising the remedial jurisdiction created by section 11 of the ELP Act (at paragraphs 52-54).

The LPAs

Fund A LPA

13. Article 2.4 ("*Events Affecting the General Partner*") provides as follows:

> "*Except as specifically provided in paragraph 10.2, the bankruptcy, expulsion, resignation, removal, liquidation, reorganization, merger, sale of all or substantially all the stock or assets of, or other change in the ownership or nature of the General Partner shall not constitute an 'event of withdrawal' of the General Partner under the* [Act]*, and upon the happening of any such event, the affairs of the Partnership shall be continued without termination by the General Partner or any successor entity thereto*." [Emphasis added]

14. Article 10.2 ("*Early Termination of the Partnership*") provides:

> "(*a) The Partnership shall commence winding up prior to the Termination Date (or such subsequent dates to which the Partnership term has previously been extended pursuant to paragraph 10.1) ninety (90) days after the withdrawal, bankruptcy, or dissolution of the General Partner, unless a Majority in Interest of the Fund Limited Partners elect to continue the Partnership within such ninety (90) day period.*
>
> *(b)In the event that the Partnership commences winding up pursuant to the provisions of this paragraph 10.2, a Majority in Interest of the Limited Partners shall elect one or more liquidators to manage the liquidation of the Partnership… Solely for the purpose of the* [Act]*, the commencement of the winding up of the Partnership shall not commence until all filings required by the Law in connection therewith have been made.*" [Emphasis added]

Feeder Fund LPA

15. Articles 2.4 and 10.2 were in the same or substantially the same terms for the Feeder Fund as they were for Fund A.

The issue arising under the LPAs

16. Article 10.2 of the LPAs required the ELPs to commence winding up within 90 days of, *inter alia*, the dissolution of the General Partner unless the majority of the Limited Partners elected to continue. Here the majority of the Limited Partners had elected to continue, but long after the 90 day period had expired. Had their right to make this election lapsed so that a deemed winding-up had commenced under section 36 (1) (d)? According to the evidence:

(a) Messrs Eppler and Robinson learned from the former registered office that the ELPs had been struck-off the register with effect from 31 October 2022 in early December 2022;

(b) on or about 5 May 2023, Conyers was instructed to carry out searches in relation to the ELPs and the GP and (1) discovered that GP Ltd had been struck-off on 30 April 2021 and (2) confirmed that the ELPs had been struck-off with effect from 31 October 2022;

(c) on 1 June 2023 the Limited Partners wrote Mr Rothenberg as sole director of GP Ltd indicating that they "*intend to elect to continue the LPs and appoint a new General Partner*" and seeking his consent to these steps;

(d) the three Petitioners in FSD 379/2023 believe that they are the only Limited Partners of the Feeder Fund, and the Petitioner in FSD 380/2023 believes it is the only Limited Partner in Fund A;

(e) on 12 June 2023, Mr Rothenberg requested the Limited Partners to take no action before discussing the matter further. Attempts to secure Mr Rothenberg's cooperation to avoid a Court application were initiated in July without success;

(f) on 6 October 2023, the Limited Partners executed a Deed Poll formally resolving to appoint a new General Partner. On 18 and 27 October 2023, Conyers wrote Mr

Rothenberg indicating that unless GP Ltd was reinstated and filed the section 10 statement confirming its replacement as GP, an application would be made to Court to appoint someone else to make the requisite filing;

(g) on 30 October 2023, Mr Rothenberg replied querying the urgency of these demands and indicating he was about to enter trial;

(h) on 27 November 2023, the Limited Partners applied to this Court for Feeder Fund and Fund A to be restored to the register; and

(i) on 13 December 2023, the Petitions seeking Orders under section 11 of the ELP Act were filed.

17. Mr Bodden argued that reading Article 10.2 of the LPAs in accordance with commercial common sense and in light of the service of notice of dissolution requirements of section 36 (7) of the ELP Act, the 90 day period under the Articles could only sensibly be viewed as starting to run once the Limited Partners had notice of the relevant event (here the General Partner's dissolution).

Findings

When time starts running under Article 10.2 of the LPAs

18. I found the submission that the importance placed by the ELP Act in requiring a General Partner to file notice of any event which potentially triggers an automatic winding-up should inform the construction of Article 10. 2 (a) to be compelling. The importance of the notice requirement falls to be considered in light of the overall structure of the ELP regime. Limited partners are investors; general partners are managers. It is counterintuitive to construe the LPAs as imposing time limits which operate against investors so as to bring their investments, without their knowledge, to an end. The key characteristics of ELPs have been cogently explained by Parker J in his oft-cited decision in *Kuwait Ports Authority et al v Port Link GP Limited et al* [2022 (1) CILR 12]:

"*49 Another important characteristic is that the limited partners have no active involvement in the business, which is carried out by the GP. In particular, all contracts are entered into by the GP for and on behalf of the ELP: ELPA s.41 (2). The fact that a limited*

partner is prohibited from taking part in the conduct of the business of the limited partnership can be said to be the quid pro quo for having the benefit of limited liability: ELPA s.14 (1).

50 By s.19 (1) of the ELPA, the GP of an ELP is subject to an express (statutory) duty of good faith requiring the GP to act in the interests of the ELP. That is unsurprising given the GP's key role in the limited partnership's business dealings.

51 Importantly, unless the partnership agreement provides to the contrary, a limited partner owes no fiduciary duty either to the ELP or to other partners: ELPA, s.19 (2). This is of course different from an ordinary partnership where mutual and reciprocal rights and obligations are owed to each other by partners.

52 As can be seen from this analysis, the existence of the GP in an ELP introduces an important difference to ordinary partnerships with regard to the management of the partnership business and the specific duties owed.

...

55 The fact that the partnership has no separate legal personality means that the GP of an ELP holds its rights and property of every description, including choses in action, on trust for each of the partners which make up the limited partnership as a whole. There is no ability however to enforce the GP's obligations as trustee by the partnership as a whole, because it has no legal personality." [Emphasis added]

56 Moreover the GP of an ELP owes its duties to all of the individual limited partners..." [Emphasis added]

19. The Cayman Islands Court of Appeal approved Justice Parker's exegesis on the legal characteristics of ELPs in *Kuwait Ports Authority et al v Port Link GP Limited et al*, CICA (Civil) Appeals Nos 002 and 003 of 2022, Judgment dated 20 January 2023 (unreported), (Sir Richard Field, JA, at paragraphs 24-26). Limited partners are investors; general partners are managers. It is counterintuitive to construe the LPAs as imposing time limits which operate against investors so as to bring their investments, without their knowledge, to an end. That would encourage, rather

than discourage, general partners to breach the fiduciary duties they owe to individual limited partners.

20. In another case to which Mr Bodden aptly referred, *The Antaios* [1985] AC 191 at 201, Lord Diplock observed (in a frequently cited passage):

> "… *if detailed semantic and syntactical analysis of words in a commercial contract is going to lead to a conclusion that flouts business commonsense, it must yield to business commonsense.*"

21. I accordingly was satisfied that time did not start running under the prescribed 90 day time limit for the Limited Partners to elect to continue the business of the ELPs until they had notice on or about 5 May 2023 that the General Partner had been dissolved. They unambiguously manifested their election on 1 June 2023. Thereafter, consistently with the legal prohibition on their participating in the management of the ELPs, the Limited Partners sought to encourage the controller of the dissolved General Partner to rectify the situation and only resorted to direct remedial action of their own as a last resort.

The merits of the application under section 11 of the Act

22. The conclusions recorded above explaining the basis on which I concluded that the Limited Partners' Petitions for relief under section 11 was not time-barred apply with equal force to demonstrate the merits of the substantive application. It was obvious that the General Partner was either unable or unwilling to file the requisite notice which was needed to facilitate the continuation of the business of the ELPs that all known economic stakeholders support.

23. Not only had GP Ltd been dissolved, the Limited Partners had resolved to appoint a new General Partner. There had been a change in the matters specified in section 9(1) (e) of the Act, which triggered the need for a statement to be signed to that effect under section 10 (1) by the General Partner, subject to section 11. Section 11 provided that where the responsible person failed to file the requisite notice, any other partner could "*petition the court to direct a person the court sees fit to sign the statement and file the same on behalf of the person in default.*" The jurisdiction to grant relief under section 11 of the Act was clearly engaged.

24. The Petitions were supported by Affidavits sworn by Mr Jefferson Eppler of Eppler Legal Inc, San Francisco, California. He was a Manager of the Main Fund, appointed alongside a Mr Burke Robinson, shortly after the onset of Mr Rothenberg's legal travails. He was demonstrably acting on behalf of the ELPs' main economic stakeholders in seeking to revive the business operations of the languishing vehicles the Limited Partners had invested in. The Limited Partners sought an Order under section 11 of the ELP Act authorizing Mr Eppler to sign the requisite section 10 Statement and file it with the Registrar with a view to ensuring compliance with the relevant statutory obligations.

25. It was difficult to imagine a clearer case for such relief being promptly granted. In *Re Asean Infrastructure Fund II LP* [2020 (2) CILR 803], Anthony Smellie CJ stated as follows:

> "*52 It appears from the evidence presented in support of the petition that the general partner has shown a disregard for its obligations in relation to the partnership such as would ground reasonable concerns that the relationships of trust have broken down and still yet appears determined to cling to control in the face of the unanimous opposition of all the limited partners.*
>
> *53 Section 11 of the ELP Law is specifically designed to ensure that a recalcitrant general partner cannot retain power in this manner. It does so by empowering the court to appoint another person to sign and file the s.10 statement on behalf of the general partner.*
>
> *54 I am convinced that this is a paradigm case for the exercise of the court's power in this regard…*"

26. Mr Bodden rightly asserted that the present case was also a "paradigm case" for the Court to exercise its powers under section 11. I accordingly granted an Order in relation to each Petition that:

"*1. Mr Jefferson Robert Eppler be directed to sign the Section 10 Statement required by the Act and file same with the Registrar of Exempted Limited Partnerships on behalf of GP Ltd.*"

Summary

27. For the above reasons, on 31 January 2024 I granted the Petitioners the relief they sought pursuant to section 11 of the ELP Act.



THE HONOURABLE MR JUSTICE IAN RC KAWALEY
JUDGE OF THE GRAND COURT

ITEM NO. 176

JA-62

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Reason: Apex Certified
Location: Apex

IN THE CAYMAN ISLANDS COURT OF APPEAL ON APPEAL FROM THE GRAND COURT OF THE CAYMAN ISLANDS FINANCIAL SERVICES DIVISION

CICA (Civil) APPEAL No. 0011 of 2023
(Grand Court Cause No. FSD 0236 of 2020 (RPJ))

BETWEEN:

(1) MARK ERIC WILLIAMS

(2) WELLSPRING CAPITAL GROUP, INC

(3) KGL INVESTMENT COMPANY ASIA (IN VOLUNTARY LIQUIDATION)

Appellants

-AND-

(1) KUWAIT PORTS AUTHORITY

(on its own behalf and on behalf of The Port Fund L.P)

(2) THE PUBLIC INSTITUTION FOR SOCIAL SECURITY

(on its own behalf and on behalf of The Port Fund L.P)

Respondent

BEFORE:

The Hon John Martin KC, Justice of Appeal
The Hon Sir Richard Field, Justice of Appeal
The Hon Sir Michael Birt, Justice of Appeal

Appearances **Mr Graham Chapman KC and Mr Andrew Pullinger, Mr Harry Shaw and Ms Katie Logan of Campbells LLP on behalf of the Appellants**
Mr David Allison KC and Ms Jennifer Fox and Mr Harry Clark of Ogier (Cayman) LLP for the Respondents

Date of hearing: **6 March 2024**

Draft circulated: **30 July 2024**

JA-62

Judgment delivered: **15 August**

JUDGMENT

MARTIN JA:

Introduction

1. This an appeal from the order of Justice Parker ("the Judge") made under GCR O.15, r.6 on 2 June 2023 joining the respondents in as defendants to the crossclaim brought by the appellants in the proceedings designated FSD 236 of 2020 (RPJ) ("the main action").

2. The principal issue to be decided in the appeal is whether the Judge lacked jurisdiction to make the aforesaid order by reason of section 14(1) and/or section 33(1) and (3) of the Exempted Limited Partnership Act (2021 Revision) ("ELPA"), which provide:

> 14 (1) *"A limited partner shall not take part in the conduct of the business of an exempted limited partnership in its capacity as a limited partner".*
>
> 33 (1) *"Subject to subsection (3), legal proceedings by or against an exempted limited partnership may be instituted by or against any one or more of the general partners only, and a limited partner shall not be a party to or named in the proceedings".*
>
> (3) "*A limited partner may bring an action on behalf of an exempted limited partnership if any one or more of the general partners with authority to do so have, without cause, failed or refused to institute proceedings".*

3. The second issue is whether, in deciding to order joinder of the respondents into the crossclaim, the Judge exceeded the margin of discretion afforded to him under GCR O.15, r.6.

The factual background

4. The respondents are two of eleven limited partners in The Port Fund L.P. ("TPF"), an Exempted Limited Partnership ("ELP") formed under the ELPA. TPF's General Partner is Port Link GP Ltd ("GP") which was appointed pursuant to a limited partnership agreement ("the LPA") dated 21 March 2007 between it and the original partners of TPF. The whole of GP's share capital is

held by Port Link Holdings USA Inc ("PLHI") which in turn is wholly owned by the first appellant, Mr Mark Williams.

5. By a written Investment Management Agreement ("the IMA") dated 28 June 2007 made between GP and KGL Investment Cayman Ltd ("KGLI"), KGLI was appointed the Investment Manager of TPF on terms that it would be paid an annual management fee equal to 2% of TPF's aggregate Capital Commitments for the first five years of the appointment and thereafter until the termination of the fund a fee of 1.5% of TPF's aggregate Capital Commitments.

6. In July 2018, KGLI changed its name to Emerging Markets PE Management Limited ("EMPEML"). The ultimate owner of EMPEML as at the date of the IMA was KGL Investment Company K.S.C.C (the Eighth Defendant to the main claim) which is the 100% shareholder and voluntary liquidator of the third appellant, KGL Investment Company Asia ("KGLI Asia"). It is averred in paragraph 17.5 of the appellants' Defence in the main action that on or around 4 February 2019 the shares in EMPEML were acquired by Asia Alternative Asset Management Limited ("AAAML"). It is further averred in paragraph 189 of the appellants' Defence that EMPEML's claims for underpayment of fees and for indemnification under the IMA and/or the LPA were assigned to the second appellant, Wellspring Capital Group Inc ("Wellspring").

7. By a written Administrative Support Agreement ("the ASA") made effective on 1 December 2017, TPF, acting by GP, appointed the third appellant (KGLI Asia) to provide administrative and personnel support to TPF for which the third appellant was to be paid US$125,000 per month.

8. In the main action the respondents bring direct, personal claims against GP (D1) and the second and third appellants (D2-D3), and derivative claims against all three appellants (D2-D4), having obtained leave to do so from the court under section 33(3) ELPA[2]. It is alleged in all of the claims, direct and derivative, that the defendants (D1-D4) are implicated, whether as active participants and/or as wrongful recipients, in the wrongful diversion of over US$100 million held on trust for TPF and the limited partners by GP.

[2] The respondents' derivative claims against GP were struck out by order of this Court on 20 January 2023 on the alternative grounds that TPF had itself not suffered any loss since the assets of the partnership were held on trust for the benefit of the limited partners and because the plaintiffs had an alternative remedy in the form of their direct personal claims; see *Kuwait Ports Authority et al v Port Link GP Ltd et al* (Unreported, 20 January 2023, FSD 236 171 of 2023 (RPJ) at paras 146-151.

9. Against GP: (i) it is alleged that it entered into an unlawful means conspiracy with certain of the other defendants, including the first and second appellants, in connection with proceedings issued by EMPEML against GP and TPF in the Dubai International Financial Centre Court which were used as a pretext for an unlawful payment of US$59,990,461.30 of TPF's funds to the second appellant Wellspring ("the Wellspring Payment"); and (ii) there are claims for an account (whether on the basis of wilful default or a common account) in respect of information which GP should have, but has not, provided to the respondents.

10. Against the appellants, the respondents advance claims for breach of duty and/or trust regarding certain of their dealings with GP and TPF including the aforesaid unlawful conspiracy and in respect of the Wellspring Payment and receipt of US$3.3 million of TPF's monies that were paid in breach of trust and/or breach of fiduciary duty.

11. On 2 May 2023, Mr Williams procured the appointment by PLHI of joint voluntary liquidators of GP, and at the same time as the Judge ordered the joinder of the respondents as defendants to the crossclaim, the Judge granted the respondents' application for the appointment of receivers to have the conduct of the litigation to which GP is a party.

The Crossclaim against GP in its capacity as General Partner of TPF

12. The three appellants plead in paragraphs 179 – 207 of their Amended Defence, Counterclaim and Crossclaim in the main action the following crossclaims, which are brought only against GP as representative of TPF and not against any of the respondents:

    (i) A claim in damages or equitable compensation recoverable by the second appellant (Wellspring) as assignee in respect of an alleged breach by TPF of the IMA in failing to pay EMEPEML's Performance Fees in the sums of US$17,079,142 and US$11,742,344 respectively due in relation to two different transactions.

    (ii) A claim by the second appellant as assignee that it is entitled to be indemnified by TPF against all the claims made against it in the main action pursuant to clauses 11.1 and 11.2 of the IMA.

(iii) Claims by the first appellant that he is entitled to be indemnified by TPF under clauses 11.1 and 11.2 of the IMA and clauses 5.4(a)(i), 5.4(a)(ii) or 5.4(a)(iii) of the LPA against all the claims made against him in the main action.

(iv) A claim by the third appellant that it is entitled to be indemnified under clause 7 of the ASA by TPF against all the claims made against it in the main action.

13. In pleading the crossclaims the appellants repeat "the above paragraphs of the Amended Defence" which include the defence of set-off related below in the following paragraph.

The appellants' pleaded set-off

14. In paragraph 178 of the appellants' Defence in the main action, the appellants (D2-D4) plead they are entitled to set-off against any liability each of them may be found to owe to the respondents the liabilities of TPF to the appellants on the crossclaims and/or the liabilities of the respondents on the crossclaims/counterclaim subsequently pleaded in extinction or diminution of that liability on the following two alternative bases:

(1) To the extent that the respondents bring personal claims against D2 and D3 those claims are brought expressly on the basis of them being limited partners in TPF, and by reference to the value of their interests in TPF. In the premises, any such claims are franked by, and are subject to, the crossclaims against TPF.

(2) To the extent that the respondents purport to bring claims derivatively on behalf of TPF, then any such claims, if permitted, are subject to any and all equities, including equitable defences, that would have been available to the appellants had those claims been brought by TPF (acting by and through its general partner, GP). In the premises, any such claims are franked by, and are subject to, the crossclaims against TPF.

The joinder summons

15. By summons dated 13 March 2023 the respondents applied to the Grand Court for an order pursuant to GCR O.15, r.6(2)(b) that they be joined as defendants to the crossclaims against GP. This application was resisted by the appellants on the principal ground that joinder was

prohibited by the terms of sections 33 and 14 of the ELPA (quoted so far as relevant in paragraph 2 above), the submission being in essence that only the general partner was a competent party to proceedings by or against an ELP. By the order now appealed against, the Judge granted the relief sought.

16. As recorded by the Judge, the respondents' submissions before him were as follows:

(1) if successful, the crossclaim would significantly reduce and possibly completely extinguish the respondents' claims against D2-D4. Accordingly, the respondents (as opposed to GP (which currently had no assets)) had the primary economic interest in the crossclaim and should be allowed to defend it.

(2) A governance void had existed at GP since 15 February 2023, when its directors resigned. The defence of the crossclaim was therefore in jeopardy. In the absence of directors, any decisions made by GP would have to be made by its shareholder PLHI, which was controlled by Mr Williams as sole shareholder and director. As such, Mr Williams was in de facto control of GP, and accordingly was in control of both the prosecution and defence of the crossclaim.

(3) The respondents wished to ensure that (i) D2-D4 could not apply for judgment in default of GP's defence to the crossclaim or otherwise procure that GP admit the crossclaim and (ii) GP was not struck off the register for failing to comply with its administrative requirements.

<u>The Judge's reasoning in finding that sections 14 and 33(1) were not bars to the respondents defending the crossclaim</u>

17. Having observed in paragraph 76 of the judgment that the personal and derivative claims brought by the respondents had as their basis that the Plaintiffs are Limited Partners in TPF, the Judge continued as follows in paragraphs 77-83.

> *77. The proceedings in relation to which permission has been given under section 33 (3) of the ELP Act for the Limited Partners to bring derivative claims, and which the*

Limited Partners have been allowed to bring themselves claims directly without the need for permission, are those which in the Court's view must also include any counterclaims or cross claims within those proceedings. They are inextricably linked. The Court does not accept that the Crossclaim is a separate "lis" which stands alone.

78. The Plaintiffs were not required to satisfy the test contended for in section 33 (1) of the ELP Act in order to bring direct claims against D2 and D3 (or against D1) at first instance nor in the CICA. The section does not apply to prohibit their claims. The section is aimed at ensuring that if a party wishes to sue the partnership, which has no separate legal identity, they do so by suing the General Partner rather than the Limited Partners. Likewise, when a partnership decides to sue, it does so by the General Partner.

79. If a limited partner is given permission under section 33 (3) of the ELP Act, where the general partner has without cause, not pursued a claim, it would be illogical and unfair if that derivative claim could be pursued on behalf of the partnership, but the limited partner not be permitted to defend a counterclaim or a crossclaim. If the limited partner was so prevented that could stymie the derivative claims from properly proceeding.

80. As to section 14 of the ELP Act, conducting litigation in the individual capacities against third parties who have had dealings with TPF and/or the General Partner (namely, D2–4) does not in the Court's view contravene the restriction on the Limited Partners' involvement in the conduct of the business of TPF in section 14 (1) of the ELP Act (or for that matter the restriction on limited [partners] being named in proceedings commenced by or against TPF in section 33 (1) of the ELP Act). Defending the Crossclaim to protect their individual interest does not involve the Plaintiffs conducting the business of TPF.

81. The Plaintiffs seek to be joined as defendants in the Crossclaim in their capacity as the Plaintiffs in the Proceedings of which the Crossclaim forms part. The Plaintiffs are not seeking to be joined as Limited Partners nor in order to represent or replace the General Partner, but in their individual capacities as the Plaintiffs in the proceedings. The court will allow them to do so.

82. The Joinder Application is an application for the Plaintiffs to defend the claim in their own right as the Plaintiffs in the Proceedings. It is the Plaintiffs who are affected by and would suffer the loss to TPF in the event the Crossclaim against the General Partner succeeds.

83. In the event, the cross claim is successful, any recovery against the General Partner will likely be a loss to TPF of which the Plaintiffs hold the majority interest as Limited Partners.

The grounds of appeal

18. The appellants appealed on two grounds, as follows:

"*(1) The judge erred in law in finding that the court had jurisdiction to make the said Order dated 2 June 2023 notwithstanding section 33(1) and section 14 of the Exempt Limited Partnership Act.*

(2) The judge acted outside the margin of discretion afforded to him in ordering that the Plaintiffs be joined as defendants to the said crossclaim notwithstanding his decision to appoint independent receivers with specific authority to conduct the litigation on behalf of the First Defendant".

The appellants' case

19. The appellants submit that: (i) section 33(1) applied to the respondents' application to be joined in as parties to the crossclaim in the capacity of defendants because the respondents are limited partners of TPF and the crossclaim is properly and separately brought against TPF acting through the GP; (ii) the effect of the words "a limited partner shall not be a party to or named in the proceedings" in subsection (1) is to prohibit the respondents from being defendants to the crossclaim; (iii) section 33(3) does not permit a limited partner to *defend* an action or a crossclaim brought by the General Partner on behalf of an ELP; (iv) it is plain and obvious that no joinder order can be made under GCR O15 r6 if the proceedings in question are prohibited

by section 33(1); (v) it follows that the Judge had no jurisdiction to order the joinder of the respondents as defendants into the crossclaim proceedings.

20. It is also contended by the appellants that the Judge erred in finding that the respondents sought to be joined in their "individual capacities" as "plaintiffs in the Proceedings" when the respondents' claims in the main action are advanced solely in their capacity as limited partners and it is only in this latter capacity that they are able to claim they have suffered loss and have rights or interests to protect. It follows that the respondents' conduct of the defence will be in the capacity of limited partners which will amount to a clear breach of the prohibition imposed by section 14 against limited partners taking part in the conduct of the business of an exempted limited partnership in their capacity as limited partners.

The respondents' case

21. The respondents submit that the references to "limited partners" in section 33(1) & (3) are references to limited partners acting in the capacity of limited partners and not to limited partners acting in an individual, personal capacity and it is this that explains why their direct, personal claims in the main action are outside what would otherwise be the prohibitions imposed by section 33(1) on proceedings being brought on behalf of an ELP by a "limited partner" and on "limited partners" being parties to or named in proceedings brought against an ELP. It follows, say the respondents, that the Judge was correct when he found that he had jurisdiction to join the respondents as defendants in the crossclaim brought against TPF by the appellants, none of whom was a limited partner. The respondents may be bringing their direct, personal claims *by reason of* being limited partners of TPF but there is a bright line distinction between derivative claims brought by a limited partner in the capacity of a limited partner and direct, personal claims pursued by a limited partner in its individual capacity. It follows that if direct claims brought by a limited partner *ex hypothesi* in an individual capacity are not prohibited by section 33(1), it must be the case that limited partners acting in an individual, personal capacity are free to be parties or named in proceedings brought by or against an ELP as is the case with the crossclaim herein.

22. In respect of section 14 of the ELPA, the respondents contend that this provision does not apply to litigation involving GP and TPF, for if it did so the blanket ban on a limited partner taking

part in the business of an ELP in its capacity as a limited partner would be impossible to reconcile with section 33(3).

Discussion and decision

23. It is important at the outset to note two things. First, the crossclaim concerns allegations of breach of contracts (the IMA, the LPA and the ASA) which were entered into, and could only have been entered into, by GP on behalf of TPF. Secondly, the respondents made clear to the Judge that they sought to be joined in their "personal capacities", not in their capacities as limited partners, and that was the basis on which the Judge joined them (see paragraph 81 of the judgment). The initial question arising in those circumstances is whether the ELPA, and in particular section 33(1) of it, prevents joinder on that basis.

24. On the face of it, it does. The subsection provides that, subject only to subsection (3), legal proceedings against an ELP may be instituted against the general partner only, "and a limited partner shall not be a party to or named in the proceedings". Viewed in isolation, the crossclaim constitutes legal proceedings against TPF, and the only proper defendant to it is GP. As Mr Chapman KC, for the appellants, pointed out, the crossclaim could have been brought by way of separate proceedings (although it would have been less efficient to do so); and, had that happened, it would have been clear that GP was the only proper defendant. In the unlikely event that the appellants had wanted to include the respondent limited partners as defendants to those separate proceedings, they would have been debarred from doing so by the express words of section 33(1).

25. The Judge's reasons for his conclusion that section 33(1) did not prevent joinder of the respondents as defendants to the crossclaim are expressed in paragraphs 77 to 79 of the judgment (quoted in paragraph 17 above). There appear to be three strands to those reasons: (a) the proceedings, whether based on direct claims or derivative claims authorised under section 33(3), must also include any counterclaims or crossclaims within those proceedings, such that the crossclaim could not be regarded as a separate lis standing alone (paragraph 77); (b) the direct claims do not fall within section 33 (paragraph 78); and (c) it would be illogical and unfair if a limited partner permitted to pursue a derivative claim under section 33(3) were not also permitted to defend a counterclaim or a crossclaim in order that the derivative claim could proceed properly (paragraph 79).

26. Of these, (a) and (b) may be taken together. Underlying both of them is the proposition that proceedings based on direct claims do not fall within section 33(1) at all, so that no permission is needed for their institution or for the defence of counterclaims or crossclaims arising in the same proceedings. I accept this proposition in relation to the institution of proceedings and the defence of *counterclaims*; but it does not follow that section 33 can have no application to a *crossclaim*. As I have indicated above, the appellants' crossclaim constitutes legal proceedings against GP on behalf of TPF in relation to contracts which GP entered into (and only GP could have entered into) on behalf of TPF, and on the face of it constitutes – contrary to the Judge's view – a separate lis between the appellants and GP falling squarely within the terms of section 33(1). There may be cases where a crossclaim may properly be regarded as merely a facet of the existing litigation rather than as the promotion of a separate cause of action, and in such cases the Judge's underlying proposition may apply. But in the present case the position is in my view closer to the latter than the former (leaving aside any effect of the set-off defence); and I do not consider that the appellants' crossclaim can be regarded, as other aspects of the litigation can, as falling outside section 33 altogether.

27. As to (c), I agree that permission under section 33(3) to bring a derivative action includes permission to defend a counterclaim. I reject Mr Chapman's submission that the only thing capable of being authorised under section 33(3) is the "bringing" of an action: it is implicit in the subsection that the limited partner, which is taking the place in the litigation of a general partner who has without cause failed or refused to institute proceedings, has authority to conduct all aspects of the litigation to its conclusion. This is, in my view, explicitly recognised elsewhere in the ELPA. As indicated above, one of the appellants' contentions is that defence to the crossclaim is prohibited also by section 14 of the ELPA, since participating in litigation brought against an ELP involves a limited partner in taking part in the conduct of the ELP's business. However, section 20 of the ELPA, which in subsection (1)[3] in summary provides that a limited partner who does take part in the conduct of the business of an ELP "in its dealings with persons who are not partners" may lose the protection of limited liability, identifies in section 20(2) circumstances which do not constitute taking part in the conduct of the business;

[3] 20(1) If a limited partner takes part in the conduct of the business of an exempted limited partnership in its dealings with persons who are not partners, that limited partner shall be liable, in the event of the insolvency of the exempted limited partnership, for all debts and obligations of that exempted limited partnership incurred during the period that that limited partner participates in the conduct of the business as though that limited partner were, for that period, a general partner, but that limited partner shall be liable only to a person who transacts business with the exempted limited partnership during the period with actual knowledge of that limited partner's participation and who then reasonably believed the limited partner to be a general partner.

and one such circumstance, identified in paragraph (h), is "taking any action required or permitted by the partnership agreement or by law to bring, pursue, settle or terminate any action or proceedings brought pursuant to section 33(2)". Section 33(2) provides as follows:

> "*If the court considers it just and equitable any person or a general partner shall have the right to join in or otherwise institute proceedings against any one or more of the limited partners who may be liable under section 20(1) or to enforce the return of the contribution, if any, required by section 34(1)*" [liability for contributions returned or obligations released while the ELP is insolvent].

This is, of course, not the subsection under which permission is given for derivative actions, which is subsection (3); but it seems to me clear that the reference in section 20(2)(h) to section 33(2) is in fact a mistake, the true legislative intention being to refer to section 33(3). That is because section 33(2) contemplates proceedings internal to the ELP (and therefore not proceedings which are "dealings with persons who are not partners" in the terms of section 20(1)), whereas section 33(3) contemplates an action on behalf of the ELP against one or more third parties; and it is the assumption of the conduct of the ELP's affairs in relation to the outside world that carries the risk of forfeiting limited liability protection under section 20. It therefore makes no sense to state that participating in proceedings under section 33(2) does not amount to conducting the business of the ELP, since that participation falls outside section 20 in any event; but derivative proceedings under section 33(3) are prima facie within section 20(1), and for consistency need to be exempted from the inhibition on conducting business. It appears also that the legislature has realised its mistake: we were shown a consultation draft of an Exempted Limited Partnership (Amendment) Bill 2024, clause 8 of which would if enacted substitute a reference to section 33(3) for the existing reference to section 33(2) in section 20(2)(h). But on the basis that section 20(2)(h) applies to proceedings authorised under section 33(3), it clearly contemplates that a limited partner pursuing a derivative action will have authority to "bring, pursue, settle or terminate" the action; in other words, not merely to "bring" the action but to take all necessary steps in relation to it.

28. There are, however, two problems with accepting the Judge's reason (c) as a justification for his order. First, the fact that authority under section 33(3) to bring proceedings includes authority to defend a counterclaim does not necessarily have the consequence that the authority extends to intervention in a crossclaim, even one brought against a general partner whose failure

or refusal to institute proceedings has led to the institution of the original derivative claim. As with the Judge's implicit proposition that direct claims are not within section 33 at all, the question is likely to turn on the extent to which the crossclaim can be regarded as merely a facet of the existing litigation rather than as the promotion of a separate cause of action; and, as I have said, in the present case (again leaving aside any effect of the set-off defence) the position is closer to the latter than the former. But the second and major problem is that the respondents were joined as defendants to the crossclaim not in their capacities as promoters of the derivative claims but in their individual capacities as plaintiffs in the proceedings. This means that, whatever implicit authority they might have had in their representative capacities, the respondents' position in relation to the direct claims does not derive from section 33(3); and, since that subsection is an exception to the general rule contained in section 33(1), there is nothing to prevent the operation of whatever bar it is that section 33(1) imposes.

29. What, then, is that bar? This is a question of statutory construction, the principles of which were not in dispute – indeed, were barely mentioned in oral submissions. In his skeleton argument, however, Mr Chapman referred to certain authorities, including Joint Administrators of LB Holdings Intermediate 2 Ltd v Joint Administrators of Lehman Brothers Intl (Europe) [2017] UKSC 38 in which Lord Neuberger summarised the approach as follows (at [123]) in a statement I adopt:

> ". . . *[W]hen it comes to deciding the meaning of a legislative provision, judges are primarily concerned with arriving at a coherent interpretation, which, while taking into account commerciality and reasonableness, pays proper regard to the language of the provision interpreted in its context*."

30. Mr Chapman relies on the words "a limited partner shall not be a party to or named in the proceedings" as representing an absolute prohibition on a limited partner playing any part in proceedings by or against an ELP. He says those words are unequivocal in their meaning and admit of no exceptions. But in my view the section needs to be read in the context of the overall scheme of the ELPA. The essence of that scheme is expressed in section 4(2) of the ELPA as follows:

> "*An exempted limited partnership shall consist of one or more persons called general partners who shall, in the event that the assets of the exempted limited partnership are inadequate, be liable for all debts and obligations of the exempted limited partnership,*

and one or more persons called limited partners who shall not be liable for the debts or obligations of the exempted limited partnership save as provided in the partnership agreement and to the extent specified in sections 20(1) and 34(1)…".

The other provisions of the ELPA are designed to maintain that distinction. This is particularly apparent in section 14, which in subsection (1) contains the restriction on a limited partner taking part in the conduct of the ELP's business in its capacity as a limited partner quoted at paragraph 2 above and in subsection (2) provides that "all letters, contracts, deeds, instruments or documents whatsoever shall be entered into by or on behalf of the general partner… on behalf of" the ELP. Significantly, section 20 contemplates the possibility that a limited partner may participate in the business of the ELP notwithstanding the terms of section 14(1), but provides that the only sanction is loss of the protection of limited liability. I accept the submission of Mr Allison KC, for the respondents, that that means that section 14(1) is not an absolute prohibition on a limited partner participating in the business of an ELP. Taken overall, the ELPA is designed to provide a framework through which sleeping partners may invest with the protection of limited liability, all dealings with the outside world being conducted by the general partner. Viewed in that light, section 33(1) is to be regarded as merely a feature of the separation of functions between limited partner and general partner; it is designed to prevent a limited partner from being sued in respect of liabilities for which, under the scheme of the ELPA, only the general partner is liable, and to reinforce the principle set out in section 14 that a limited partner should not take part in the conduct of the ELP's business and its dealings with the outside world. It cannot, in my view be regarded as an absolute prohibition on a limited partner participating in any way in litigation, still less a prohibition on which a hostile party in the litigation is entitled to rely. On that basis, the Judge had jurisdiction to join the respondents to the crossclaim.

31. There are two other reasons why I take that view. First, even if read literally and taken at its highest, the focus of section 33(1) is on the inception of the proceedings: they may not be instituted by or against a limited partner, and a limited partner is not to be a party or even named in the proceedings. But once proceedings have been commenced in compliance with the provisions of section 33(1), as so far as was necessary the present proceedings were, they come under the control of the court in the normal way; and nothing in the terms of section 33(1) can be taken as intended or effective to limit the ordinary powers of the court – including the power to join parties under GCR O.15, r.6.

32. The second reason relates to the defence of set-off. The terms in which this is pleaded are set out in paragraph 14 above. On one level, all that is being said is that the respondents' claims, if successful, will fall to be valued by reference to the assets of the EPA, and those assets will be diminished if the crossclaim succeeds. As it was put in paragraph 16 of the appellants' skeleton argument: "The respondents' interest in the crossclaim is inseparable from that of the Fund; any loss suffered by the respondents on the crossclaim would arise solely indirectly on the basis of the respondents' capacity as limited partners in the Fund". But that is not all that the set-off does. It is pleaded specifically as a defence to the respondents' claims, and the effect of pleading it as a defence is in my view to place the merits of the crossclaim squarely in issue between the appellants and the respondents, as well as between the appellants and GP. The respondents are plainly entitled to contest the defence of set-off, but cannot do so effectively without being able to contest the underlying merits of that defence as set out in the crossclaim. That means that, whereas standing alone the crossclaim may properly be regarded as a separate lis, the defence of set off makes it a facet of the existing proceedings which, for the reasons I have given above, is not to be regarded as falling within section 33(1).

33. Accordingly, I consider that the Judge was entitled to hold that he had jurisdiction to join the respondents as defendants to the crossclaim, and I would dismiss that aspect of the challenge to his decision.

34. That leaves the question of whether or not he exceeded the proper bounds of his discretion under GCR O.15, r.6 by ordering the respondents' joinder. As indicated in the second ground of appeal, the basic contention is that the Judge's separate decision to appoint receivers of the GP to conduct its defence of the litigation made the joinder of the respondents unnecessary and vitiated the Judge's decision to join them.

35. Order 15 rule 6 provides, so far as relevant, as follows:

> "*Misjoinder and nonjoinder of parties (O.15, r.6)*
>
> *...*
>
> *(2) Subject to the provisions of this rule, at any stage of the proceedings in any cause or matter the Court may on such terms as it thinks just and either of its own motion or on application –*

> ...
> *(b) order any of the following persons to be added as a party, namely –*
> *(i) any person who ought to have been joined as a party or whose presence before the Court is necessary to ensure that all matters in dispute in the cause or matter may be effectually and completely determined and adjudicated upon; or*
> *(ii) any person between whom and any party to the cause or matter there may exist a question or issue arising out of or relating to or connected with any relief or remedy claimed in the cause or matter which in the opinion of the Court it would be just and convenient to determine as between him and that party as well as between the parties to the cause or matter*".

36. The Judge's reasons for joining the respondents are set out in paragraphs 84 to 93 of the judgment. They may be summarised as follows:

(a) The court had a wide and flexible jurisdiction to permit joinder in the interests of justice or when it was appropriate to do so (paragraph 84).

(b) The requirements of O15 were made out: the plaintiffs were necessary parties whose rights would be affected by the outcome of the crossclaim. There were legal issues, including the construction of the LPA and claims which arose in the proceedings, and it was just and convenient for the court to hear those matters together (paragraph 85).

(c) The court exercised its discretion in favour of joinder. It accepted that the need for the respondents to be joined as defendants to the crossclaim was not affected by who was in charge of GP (i.e. director, receiver or liquidator). Neither a receiver nor a liquidator would be in as good a position to defend the crossclaim as the respondents, and an officeholder would have to be funded by either the respondents or D2-D4 (paragraph 86).

(d) The parties with an acute economic interest (albeit indirectly by way of their interest in the ELP) in defending the crossclaim (and in whom the relevant knowledge to enable a defence to be advanced resided) were the respondents and they should be allowed to defend the crossclaim (paragraph 87).

(e) Irrespective of the appointment of an officeholder, in circumstances where the respondents were the parties most affected by the crossclaim and would bear the actual financial loss if it succeeded, it was just to permit the respondents to participate in defending the crossclaim in addition to the GP acting through independent officeholders (paragraph 89).

(f) It would not be in the interests of justice for Mr Williams to be permitted to be both one of the parties advancing the crossclaim as D2 (and the individual responsible for the actions of D3 and D4) and to control the party defending the crossclaim (the GP) (paragraph 90).

(g) The court was satisfied that joining the respondents as defendants to the crossclaim would not be unfair to D2-D4 (paragraph 92).

(h) Joining the respondents as defendants was a sensible way of ensuring that the claims in the crossclaim were justly, conveniently, and fairly resolved (paragraph 93).

37. In his written and oral submissions, Mr Chapman sought to raise the question of whether there were grounds on which the Judge could conclude that the respondents fell within any of the gateways defined in GCR O.15, r.6 as justifying joinder. But that question was not within the scope of the second ground of appeal, which assumed the existence of a discretion to join and took issue with the exercise of that discretion on the sole ground that the Judge's simultaneous appointment of receivers with authority to conduct the litigation on behalf of GP made joinder of the respondents unnecessary. We indicated to Mr Chapman that we were not prepared to consider arguments as to the existence of the discretion; and discussion of this topic is accordingly confined to the question of the validity of its exercise in light of the appointment of the receivers.

38. As to that, the appellants' position is adequately summarised in paragraph 69 of their skeleton, which gives the following reasons why it is said the Judge fell into error in the exercise of his discretion and misdirected himself as to the scope of that discretion:

> "*(a) The test is not about what might be perceived to be just, convenient or fair in any broad or general sense but about the exercise of a judicial discretion with regard to the more narrow object of O. 15 r. 6, namely avoiding a multiplicity of proceedings and conflicting outcomes on common issues.*

(b) On the one hand the learned judge concluded that the appointment of receivers to have conduct of the litigation on behalf of D1 was necessary, just and convenient – implicitly recognising that the receivers would be able to conduct the litigation effectively for and on behalf of D1 and TPF – yet in the very same judgment the learned judge appears to find that the receivers are in no position properly to defend the crossclaim (or at least not in as good a position as the respondents to do so) such that the respondents need to step into their shoes. Such findings are inconsistent and wrong. If the receivers' appointment would not affect the position either way, and the economic stakeholders should be permitted to advance their own position on behalf of D1 then why appoint the receivers at all?

(c) The reasons given by the Judge for exercising his discretion in the manner he did ignore or give undue weight to the fact that (i) discovery will be given by all parties in the proceedings, (ii) the respondents have no personal knowledge of the matters arising on the crossclaim which the receivers could not learn by discovery, (iii) the court-appointed receivers who were instituted for the very purpose of conducting the litigation on behalf of D1/ TPF are funded and will acquire the same documents and knowledge as all other parties by discovery, and (iv) a defendant's perceived ability to defend a claim does not provide a basis, let alone a sound one, to be joined to an action in which no relief is sought against it.

(d) The appointment of the receivers to have conduct of the litigation on behalf of D1 entirely removes the concerns raised by the respondents (which led to the respondent's filing of the joinder summons in the first place) that Mr Williams' beneficial ownership of D1 would be abused to ensure the crossclaim was not properly defended. After the learned Judge had determined to appoint the receivers over D1, he erred in failing to take account of such determination when exercising his discretion on the joinder summons. The two matters are inextricably linked; any "need" that might have existed for the respondents to be joined (it being denied any need ever existed) fell away the moment the court decided to appoint receivers. The Judge also failed to consider that it was in fact the respondents who were seeking to obtain an unfair advantage by being able to raise defences to the crossclaim which D1 was not prepared or able to advance,

not least because of the claims that D1 itself faces from the respondents in relation to the same or related subject-matter".

39. In my judgment, none of these matters is sufficient to indicate that the Judge trespassed beyond the legitimate bounds of his discretion. He was well aware that the appointment of receivers meant that there would be officeholders in place capable of dealing with some aspects of the litigation; but he took the view that no officeholder would be in as good a position as the respondents to defend the crossclaim, that a defence of the crossclaim by an officeholder would have to be funded by the respondents or (which in the circumstances is unlikely) D2-D4, and that it was the respondents who had the knowledge necessary to defend the crossclaim and the economic interest in doing so. There was ample material on which the Judge could base that view. It cannot be said that he took into account any irrelevant consideration, or failed to have regard to any relevant one, or that his decision was perverse. In my view, this ground of appeal, too, must fail.

40. For these reasons, I would dismiss the appeal. My provisional view is that the costs of the appeal should be paid by the appellants to the respondents on the standard basis; but if either party wishes to propose a different order they may do so in writing within 10 working days of the circulation in draft of this judgment and the matter will then be dealt with on the papers.

BIRT JA:

41. I agree.

FIELD JA:

42. I also agree

ITEM NO. 177

JA-63

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Location: Apex

Neutral Citation Number: [2025] CIGC (FSD) 106

Cause No: FSD 2025-0151 (JAJ)

IN THE GRAND COURT OF THE CAYMAN ISLANDS
FINANCIAL SERVICES DIVISION

IN THE MATTER OF THE EXEMPTED LIMITED PARTNERSHIP ACT (2025 REVISION), THE COMPANIES ACT (2025 REVISION) AND THE PARTNERSHIP ACT (2025 REVISION)

AND IN THE MATTER OF ATP LIFE SCIENCE VENTURES, L.P.

Appearances:	**Mr Andrew Scott KC of counsel instructed by Mr Liam Faulkner, Mr Hugo Farmer, Ms Yuan Wen and Mr Jordie Fienberg of Campbells LLP for the Petitioner** **Mr Andrew Ayres KC of counsel instructed by Ms Shelley White and Ms Rebecca Moseley of Walkers for ATP III GP, Ltd**
Before:	**The Honourable Justice Jalil Asif KC**
Heard:	**31 October 2025**
Ex tempore judgment delivered:	**2 November 2025**
Finalised judgment approved:	**6 November 2025**

Exempted limited partnership—winding up on just and equitable basis—application of CWR O.3, r.12(1)(a) or (b) to winding up of exempted limited partnership—whether court can order petition to proceed against partnership or against general partner, with partnership as subject matter

- -

JUDGMENT

- -

1. This is my judgment on a novel point that has arisen in the course of a directions hearing in connection with this just and equitable winding up petition, which concerns an exempted limited partnership formed under the Exempted Limited Partnership Act.

2. The essential background is that the exempted limited partnership in this case operates in the life sciences or biotech space. The Petitioners are limited partners in the partnership and have contributed around 98% of the capital of the partnership. Dr Seth Harrison, a successful life sciences entrepreneur, has driven the research and development of the products and the portfolio companies developing them. He has contributed approximately 2% of the partnership's capital. There are a number of other limited partners who are said to have acquired minor partnership interests in the exempted limited partnership, apparently as employee incentives.

3. The general partner of the partnership, ATP III GP, Ltd, is a limited company owned and controlled or directed by Dr Harrison.

4. In recent months, the relationship between the individuals behind the Petitioners and Dr Harrison has broken down. I do not need to go into the reasons for that for the purposes of this judgment, but they have given rise to three sets of proceedings between the parties in which their disputes are being decided:

   4.1 a contractual dispute being tried in Delaware;

   4.2 a writ action commenced in the Cayman Islands, and seeking declaratory relief regarding the validity, or otherwise, of certain steps taken by the general partner in relation to capital calls; and

   4.3 these winding up proceedings.

5. In the winding up proceedings, the Petitioners seek the winding up of the partnership on the just and equitable basis. They assert that they have lost all confidence in Dr Harrison and the general partner. This is said to be due to:

   5.1 alleged mismanagement, prejudicial conduct, and a lack of probity in the conduct of the partnership's affairs.

   5.2 alleged conflicts of interest affecting the general partner through Dr Harrison's interest in it, and breach of fiduciary duty by the general partner;

   5.3 a loss of substratum in that the general partner is set on continuing to fund non-performing portfolio companies, contrary to the limited partners' legitimate expectation for the operation of the partnership; and

   5.4 a need for an investigation of the partnership's affairs.

6. Dr Harrison, and through him the general partner, strenuously disputes the Petitioners' claims and is determined to contest the allegations that have been made against them.

7. Due to the potential effect of the dispute on the ongoing operation and management of the portfolio companies, this winding up petition and the writ action have both been advanced on a compressed timetable and are due to be tried together in early January 2026, having been filed in early June 2025.

8. The issue that has arisen in the course of the summons for directions concerns how the petition is to be contested. The Petitioners seek an order under CWR O.3, r.12, as modified by section 36(3) of the Exempted Limited Partnership Act, that the petition be treated as an inter partes proceeding between the Petitioners and the general partner. The Petitioners say that that reflects the substance of the dispute.

9. The general partner resists such an order and contends that the petition should continue between the Petitioners and the exempted limited partnership. The importance of this point is the cost consequences that follow under CWR O.24, r.8. Section 36(3) of the Exempted Limited Partnership Act provides that:

> *"(3) Except to the extent that the provisions are not consistent with this Act, and in the event of any inconsistencies, this Act shall prevail, and subject to any express provisions of this Act to the contrary, the provisions of Part V of the Companies Act (2021 Revision) and the Companies Winding Up Rules, 2018 shall apply to the winding up of an exempted limited partnership and for this purpose —*
>
> *(a) references in Part V to a company shall include references to an exempted limited partnership;*
>
> *(b) the limited partners shall be treated as if they were shareholders of a company and references to contributories in Part V shall be construed accordingly, except that the application of the provisions shall not cause a limited partner to be subject to any greater liability than that limited partner would otherwise bear under this Act, but for the application of this paragraph;*
>
> *(c) references in Part V to a director or officer of a company shall include references to the general partner of an exempted limited partnership;"*

10. Part 3 of CWR O.3 concerns petitions presented by contributories, which, by virtue of section 36(3) of the Exempted Limited Partnership Act, is the analogue for the current situation.

11. CWR O.3, r.12 requires that at the hearing of the summons for directions, the court shall give directions as appropriate in respect of certain specified matters, including:

> *"(a) whether or not the company is properly able to participate in the proceeding or should be treated merely as the subject-matter of the proceeding;*
>
> *(b) whether the proceeding should be treated as a proceeding against the company or as an inter partes proceeding between one or more members of the company as petitioners and the other member or members of the company as respondents;"*

12. CWR O.24, r.8(2) states:

> *"(2) In the case of a contributory's winding up petition under Order 3, Part III, the general rules are that —*
>
> *(a) if the Court has directed that the company itself is properly able to participate in the proceeding, the general rule is that the costs of a successful petitioner be paid out of the assets of the company; or*
>
> *(b) if the Court has directed that the winding up petition be treated as an inter partes proceeding between one or more members of the other members or members of the company as respondents, the general rule is that none of the costs should be paid out of the assets of the company and the unsuccessful parties should pay the costs of the successful party, such costs to be taxed on the standard basis unless agreed."*

13. I interpose here that there is an obvious error in CWR O.24, r.8(2)(b). The wording *"between one or more members of the other members or members of the company as respondents"* makes no grammatical sense. By comparison with CWR O.3, r.12(b) it appears that two errors have crept into the drafting of CWR O.24, r.8(2)(b). The first is that the words *"company as petitioners and the"*

has been omitted after *"between one or more members of the"*. Secondly, an *"s"* has been wrongly added to *"member"* on the second occasion that it is used in subparagraph (b). In my judgment, I should treat CWR O.24, r.8(2)(b), as if it read:

> *"(b) if the Court has directed that the winding up petition be treated as an inter partes proceeding between one or more members of the* [company as petitioners and the] *other member*[**s**] *or members of the company as respondents, the general rule is that none of the costs should be paid out of the assets of the company and the unsuccessful parties should pay the costs of the successful party, such costs to be taxed on the standard basis unless agreed."*

Counsel agreed in the course of argument with this proposition and construction of CWR O.24 r.8(2)(b).

14. To resume my summary of the Rules, CWR O.24, r.8(2) thus determines the prima facie allocation of the costs of defending the petition, as between the petitioner on one side and the company or members of the company other than the petitioner, as appropriate, on the other.

15. The Petitioners in this case argue that this provision also applies to a winding up of an exempted limited partnership. Applying section 36(3)(a) and (b) of the Exempted Limited Partnership Act, they say that *"members of the company"* in the Companies Winding Up Rules becomes *"members of the exempted limited partnership"* and the members of an exempted limited partnership are the limited partners and the general partners together. Thus, the Petitioners say, there is a direct read over without any need to strain the statutory language. The court should therefore make an order on the summons for directions determining that the petition should proceed as a claim between the Petitioners and the general partner, with the exempted limited partnership as the subject matter of the petition.

16. The Petitioners support that approach to the construction of the Companies Winding Up Rules by arguing that the purpose of CWR O.24, r.8(2) is to apply the legal costs principle, namely that a company's money should not be spent on disputes between shareholders.

17. The Petitioners say that that principle applies wherever the real contest is between parties other than the company itself, for example between its members. The Petitioners say that the reason why that principle is engaged in the context of just and equitable winding up proceedings is because, as stated by Segal J in Re Uphold Limited (unreported, 16/02/23), just and equitable proceedings are:

> *"42. […] grounded on a dispute between the shareholder petitioner and those in control of the company where those in control have behaved in a way that is fundamentally inconsistent […]*

> *with the basis on which the shareholder subscribed for or purchased his / her shares so as to justify the termination of the corporate relationship. It is usually the case that those accused of misconduct should pay for the costs of defending the petition"*

18. The Petitioners argue it would be contrary to the legal costs principle for the general partner to use assets of the partnership, which are held overwhelmingly for the benefit of the Petitioners, to defend the petition by which the Petitioners seek to impugn the general partner's own conduct and other fiduciary failings. The Petitioners say this would effectively have the result that the Petitioners would end up funding both the pursuit of the claim and also its defence.

19. The general partner disputes the Petitioners' stance, based on the wording of section 36(3) of the Exempted Limited Partnership Act. The general partner submits that the Petitioners' approach is not permitted by section 36(3) of the Exempted Limited Partnership Act, so that I do not have jurisdiction to make the order sought by the Petitioners. The general partner's argument is as follows.

    19.1 The general partner says that by virtue of section 36(3)(a) and (b), *"company"* is to be read as *"exempted limited partnership"* and *"contributories"*, in other words, shareholders or members, is to be read as *"limited partners"*.

    19.2 The general partner argues that the reference in section 36(3)(c) to the general partner being assimilated to the position of a director of the company means that the general partner is <u>not</u> to be treated as a *"member"* for the purpose of CWR O.3, r.12, and CWR O.24, r.8.

    19.3 The general partner says in paragraph 16 of its skeleton argument:

    > *"16. The choices under (a) and (b) are interdependent, and there are only two options: either (i) the Partnership is properly able to participate, and the proceeding should be treated as being against the Partnership; or (ii) the proceedings is an inter partes proceedings between different limited partners, and the Partnership is merely the subject-matter."*

    19.4 The general partner adds that the fact that there is a binary choice is clear from the structure of CWR O.24, r.8 which mirrors and follows the structure of CWR O.3, r.12.

    19.5 Therefore, the general partner argues, the only question that the court needs to ask is whether the proceedings should be treated as being between different limited partners, or as between limited partners and the exempted limited partnership itself.

20. The general partner submits that the Petitioner's construction requires that the meaning of *"members of the company"* in the Company Winding Up Rules sometimes means limited partners and sometimes means all of the partners in the exempted limited partnership, which the general partner submits indicates that the Petitioners' construction must be wrong.

21. The general partner says that Segal J's comments in *Re Uphold* are simply not relevant, as that case concerned the situation of a company, not an exempted limited partnership.

22. In response to the Petitioner's reliance on the legal costs principle, the general partner argues that there is no room for an argument based on principle where the Exempted Limited Partnership Act expressly requires the court to read the Companies Winding Up Rules in a particular way.

23. Relying on a dictum of Segal J in *Re China Shanshui Cement Group Limited* [2021] 1 CILR 253 at paragraph 39, the general partner submits that:

> *"39. A critical question is whether the company can show that it has a real interest independent of its shareholders in defending the petition (does the company have a separate interest to protect?). As Foster, J. said in* Freerider *(ibid., at para. 45), the court must decide whether the company has any independent interest in the dispute."*

In this case, I have to read *"company"* as *"limited partnership"*.

24. Finally, the general partner argues that even if the court has discretion to make an order under CWR O.3, r.12, the court should not exercise that discretion on the facts of this case. The general partner says that the exempted limited partnership has an independent interest in defending itself and continuing to exist because it has assets built up over many years that generate financial benefits for its limited partners, including 14 limited partners other than the Petitioners. Although that must be the case for many partnerships where disputes arise.

25. I agree with the Petitioners that the legal costs principle is an important one. As explained by Harman J in *Re A Company, ex parte Johnson* [1991] BCC 234, which was a case concerning an unfair prejudice petition under section 459 of the English Companies Act of 1985:

> *"The train of authority being well established, it seems to me quite clear that, if it is shown that directors of a company have been causing the company's money to be spent on financing the resistance either to a "pure" section 459 petition or, according to Plowman J in* Re A &BC Chewing Gum *and myself in* Re Hydrosan*, in financing the company's resistance to a member's winding-up petition based on the just and equitable ground, the court should prevent such*

> *expenditure. Such expenditure is a misfeasance, there is no excuse for it in law and it is not a question of an arguable case being raised showing that it might be right to permit misfeasances. Misfeasances are not matters that are permitted by the courts and there is no question of an arguable case at all."*

26. The Petitioners referred me to *Re Cybernaut Growth Fund LP* (unreported, 11/09/13), where the question of making an order under CWR O.3, r.12, and O.24, r.8 in respect of the winding up of an exempted limited partnership was dealt with by consent. Both parties before me accepted that, whilst it thus provides an example of a case where an order was made, the ability of the court to do so was not in issue and was not considered by either of the judges before whom the matter was listed. In my view, it therefore does not advance the argument.

27. In *Re Freerider Ltd* [2009] CILR 604, Foster J at paragraph 42 rejected the submission that what is now CWR O.3, r.12, was *ultra vires* the Insolvency Rules Committee because it was a legislative change or addition to the provisions of Part V of the Companies Act. He concluded that CWR O.3 r.12 is procedural in nature, giving effect to the legal costs principle, which he considered to be well established in law. In particular, he said, at paragraph 20:

> *"20. It is in this overall context that it seems to me the IRC are empowered by s.155(1)(a) of the Companies Law to make rules, in particular to enable the court giving directions to determine in its discretion in the particular circumstances which parties should most appropriately participate in winding-up proceedings brought under the Companies Law. In my view in the light of this, the relevant provisions of O.3, r.11(2)(a) and (b)* [now O.3, r.12(2)(a) and (b)] *are essentially procedural in nature and are directly related also to the provisions which the IRC is empowered to make and has properly made in relation to the costs of petitions. I do not think there can be any doubt that the IRC is empowered to make such costs rules.*
>
> *21. I also consider that it is probable that the members of the IRC were aware, or were made aware, of the English authorities in which the courts there have either restrained a company from active participation or refused a company permission to participate actively in a winding-up petition on the just and equitable basis and/or a petition under s.459 of the Companies Act 1985 and/or to do so at the expense of the company, when the reality is that the proceedings are in essence a dispute between shareholders and not a dispute with the company itself. […] Wickens, V.C. said* [in *Pickering v. Stephenson*] *(L.R. 14 Eq. at 340):*
>
> > *'It seems to me that where a quasi partnership of this sort is divided into a majority and minority who differ on a question of internal administration, and litigation results from the difference, it is contrary to the spirit of the partnership to pay the expense of the litigation out of the general fund; and that this is independent of the question whether the majority is overwhelming or a bare majority.'"*

28. At paragraph 32, Foster J commented that the provisions of CWR O.3 r.12 are a mechanism to enable the court to determine at an early stage whether the legal costs principle is engaged. He said:

> *"32. I would comment in passing that the provisions of O.3, r.11(2)(a) and (b) of the Companies Winding Up Rules may perhaps be seen as a sort of mechanism of the kind referred to by Lindsay, J. in that they will enable determination by the court at any early stage in the proceedings by way of directions of whether or not it is procedurally appropriate and desirable, in the particular circumstances, for the company concerned to participate in the petition proceedings or whether it should be treated simply as the subject-matter."*

29. The Petitioners submit at paragraph 48 of their skeleton argument:

> *"48. In the context of petitions for the just and equitable winding up of an ELP it is often the case that: (i) the dispute is grounded on the general partner's conduct of the partnership's affairs and (ii) the general partner (and the general partner alone) has the ability to access and deploy partnership assets towards funding a defence of the petition. There is no reason for the Legal Costs Principle not to apply in that context to prevent a general partner from deploying partnership assets (i.e. trust assets) towards defending allegations of misconduct against it."*

30. In my view, that understates the position. Given the statutory roles of the general partner and the limited partners, as provided for by the Exempted Limited Partnership Act, namely that the limited partners have no role in the management of the exempt limited partnership and do not owe any duties to the partnership or to the other limited partners; whereas the general partner is responsible for the management of the exempted limited partnership and does owe fiduciary and other duties to the limited partners, it is hard to see how a just and equitable petition would ever involve parties other than one or more limited partners on one side and the general partner, and possibly an intermeddling limited partner, on the other.

31. This points against the general partner's submission that the proper construction of CWR O.3 r.12 is that it is directed at limited partner on limited partner disputes. This is because it is extremely difficult to contemplate circumstances giving rise to a just and equitable petition in which the dispute would arise between the limited partners and would arise in such a way that it does not involve the general partner, given that no duties owed are owed by limited partners to each other and limited partners have no roles in management, and that the general partner is the entity that owes duties to each limited partner and is responsible for management of the partnership.

32. In addition, I consider there is a conceptual flaw in the argument that the petition should proceed as a dispute between limited partners and the exempted limited partnership. This is because an exempted limited partnership does not have any separate legal personality from the limited partners and the general partner. Neither side appears fully to have grappled with the consequences of this in the arguments that they have advanced before me.

33. By referring to the exempted limited partnership throughout as being the appropriate respondent to the petition, in the absence of separate legal personality, the effect of the general partner's position is that the Petitioners should both pursue the petition and at the same time be respondents to the petition. That is neither legally nor procedurally possible. It would necessarily involve obvious and irreconcilable conflicts of interest for the Petitioners. It also flies in the face of section 33(1) of the Exempted Limited Partnership Act, which provides that:

> *"(1) Subject to subsection (3), legal proceedings by or against an exempted limited partnership may be instituted by or against any one or more of the general partners only, and a limited partner shall not be a party to or named in the proceedings."*

Subsection (3) deals with the situation where a general partner has failed to bring proceedings against a third party and a limited partner in those circumstances wishes to pursue that claim on behalf of the exempted limited partnership. So that subsection is irrelevant for the purpose of the debate before me.

34. If, as I consider must be correct, the exempted limited partnership cannot itself be a respondent to a just and equitable petition brought by a limited partner, and that only the general partner and any intermeddling limited partners can be the respondents, then it also follows that CWR O.24 r.8(a) cannot be operative as against an exempted limited partnership because the court will not and cannot direct that the exempted limited partnership itself can participate in the proceeding. This is because the exempted limited partnership does not have separate legal personality and the petitioning limited partner cannot also be a respondent. Thus, the respondents to a just and equitable petition can only be the general partner and any limited partners who have intermeddled or who wish to take an active role in defending the petition.

35. In principle, therefore, whilst I accept that there is substantial force in the Petitioners' argument that the legal costs principle should apply equally to just and equitable petitions in the context of the winding up of an exempted limited partnership, just as it applies to companies, I find it impossible to apply the manifestation of it in the CWR, given the legal nature of an exempted limited partnership and the consequences of that nature on the operation of the CWR as regards exempted limited partnerships.

36. In my judgment, this is a situation covered by the opening words of section 36(3) of the Exempted Limited Partnership Act, namely, *"except to the extent that the provisions are not consistent with*

this Act and in the event of any inconsistencies, this Act shall prevail." The Exempted Limited Partnership Act, which creates the legal structure of an exempted limited partnership, has created an animal that does not fit within the application of the relevant rules of the CWR. The provisions of CWR O.3, r.12, and O.24, r.8, in my judgment, are therefore inconsistent with the Exempted Limited Partnership Act, and the Exempted Limited Partnership Act must prevail.

37. I therefore accept that the Court cannot make an order under CWR O.3, r.12(a) or (b) in this case, although not for the reasons advanced by the general partner.

38. It also follows from my conclusion that the joint position of counsel in *Re Cybernaut Growth Fund LP* that the court can apply CWR O.3, r.12 in the context of an exempted limited partnership was incorrect, and that *Re Cybernaut Growth Fund LP* should not be treated as authority for that proposition.

39. As required by section 33(1) of the Exempted Limited Partnership Act, the petition must continue as between the Petitioners and the general partner.

40. Mr Ayres submitted that it is important not to confuse the question of the prima facie liability for costs, which in my judgment will always be with the general partner, and the general partner's right to indemnity under the limited partnership agreement governing the partnership for the costs it has incurred. I agree with Mr Ayres on this point. There is clearly going to be a dispute in this case whether the general partner is entitled to indemnity from the exempted limited partnership's assets for the costs of defending the just and equitable petition and also the Delaware and Cayman writ proceedings.

41. I do not intend to prejudge the outcome of that debate, which will turn upon the wording of the limited partnership agreement. However, it does seem fairly plain that the real disputes are between the two Petitioners on one side and the general partner on the other. This does not appear to be a case where the exempted limited partnership has its own position to put forward, even if that were legally and procedurally possible, which I do not consider it is for the reasons I have already set out.

42. If any of the other limited partners wish to participate in the proceedings, that is a matter for them. Their position as limited partners can be put forward by them as respondents if they have a different interest to advance although, given the procedural position of these proceedings and the approaching trial, any limited partners who wish to do so should make an application to be joined urgently.

43. Finally, I record that Mr Ayres was at pains to say that the general partner does not accept the Petitioners' criticisms, either of the general partner or of Dr Harrison, and that I should avoid forming a view that there is a "good" side and a "bad" side of the court. Mr Ayres said that the general partner and Dr Harrison are very keen to vindicate the position of the general partner.

44. I acknowledge that that is Dr Harrison's and the general partners' position. However, it seems to me that there is a real danger that the general partner is failing to heed the words of Kawaley J in *One Thousand and One Voices Africa Fund I LP* [2024] 1 CILR 371 at paragraphs 30 to 34. The learned judge said:

> *"30. […] The petitioner's case, in a nutshell, amounts to this. It would be inconsistent with elementary principles of winding-up law for the court not to replace the general partner when it has unarguably lost the trust and confidence of 97% of the economic stakeholders of the ELP, no matter what the reasons may be. There is no need for the court to consider the merits of the original complaints laid against the GP. That position appears to be an unassailable one.*
>
> *31. Section 36(13) of the Act confers an unfettered discretion on the court. […] The very fact that the GP does not apparently accept the fundamental principle that in a liquidation the wishes of the majority stakeholders prevail (assuming the opposition to the petition is maintained) appears to demonstrate the need for a fresh appointment.*
>
> *32. Unfortunately, the opposition to the present petition has an all too familiar ring. The best way for a manager who has lost the confidence of the investors to demonstrate their probity is to step aside, demonstrating confidence that their impugned management of the fund will be vindicated by independent scrutiny. Instead, the importance of their continuing at the helm is apparently given priority over the wishes of the investors, and the recalcitrant manager claims to know better than the investors where their best commercial interests lie. Regrettably, whatever unique expertise the scorned manager truly possesses, the distinct impression is created that the determination to cling to office is motivated by self-interest at best, or the desire to forestall independent investigation into suspect dealings at worst.*
>
> *33. In the instant case it is admittedly extremely plausible that the GP's Mr. Jordaan has specialist knowledge of and unique contacts with the businesses the ELP has invested in. The appointment of independent liquidators would not necessarily preclude his expertise being deployed if this was demonstrably in the best interest of the investors as a whole."*

45. It is difficult not to observe the strong similarity between that case and this one on the material that I have seen so far but, as I have indicated, these are all matters that Dr Harrison, through the general

partner, wishes to contest. No doubt at the trial I will hear argument and evidence on both sides of the court in relation to the allegations that are made against Dr Harrison and the general partner by the Petitioners and the counter-allegations that are made by Dr Harrison and the general partner against the Petitioners, and I will make a final decision on the basis of the evidence and argument that I hear on that occasion. However, in doing so, both parties are likely to continue to incur very substantial costs that will have to be paid by the various parties, depending on the costs orders that are made.

46. As to the costs of arguing this issue before me, Mr Ayres contended that the general partner was the winner, albeit for different reasons than he had argued, and should have its costs. Mr Farmer addressed me on costs for the Petitioners and argued that costs should be reserved, which would be the usual outcome on a summons for directions.

47. I have concluded that the general partner has effectively been the winner on this particular issue; the Petitioners raised the specific issue of making an order under CWR O.3, r.12 and have not obtained what they were seeking, and it is right that general partner should have its costs of arguing this point on the summons for directions, to be taxed on the standard basis if not agreed. I do not consider it is appropriate to reserve the costs to the hearing of the petition.

Dated 2 November 2025



THE HONOURABLE JUSTICE JALIL ASIF KC
JUDGE OF THE GRAND COURT

ITEM NO. 178

JA-64

GOODE ON PRINCIPLES OF CORPORATE INSOLVENCY LAW

edited by

Kristin van Zwieten

SWEET & MAXWELL THOMSON REUTERS

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charge? It is thought that he can, since the purpose of s.176A is to preclude the chargee from entitlement to a share in the prescribed part in respect of debts secured by the charge.

(ii) If there are two floating charges, can the holder of one participate in the prescribed part given up by the other? It would seem not. In the first place, s.176A(2)(b) states that the liquidator shall not distribute the prescribed part to the proprietor of "a" floating charge. If it had been intended to restrict that provision to the holder of the particular floating charge from whose security the prescribed part comes, s.176A(2)(b) would surely have said so. Secondly, in the typical case, most if not all of the assets covered by one floating charge will also be covered by the other, so that to allow one holder to participate in the other's surrendered prescribed part would be to give him through the back door an interest in the same fund that he could not obtain directly as the party surrendering that fund.

(iii) What happens if there are two floating charges and the floating charge that has priority exhausts the charged assets? If, as has been suggested above, the existence of the subordinate charge precludes the holder from participating in the prescribed part surrendered by the senior floating chargee, the sensible course is for the holder of the junior charge to surrender it, since it is valueless anyway, and come in as an unsecured creditor and participate in the prescribed part.[199]

(iv) If the holder of the floating charge realises his security before the prescribed part has been distributed, can he then participate as an unsecured creditor for any balance owed to him? Again, it is thought that the answer is no. To allow the chargee to come in at this stage *qua* unsecured creditor would be to upset the neutrality which s.176A is designed to provide. Moreover, the section could not be made to work in that situation, for it envisages a distribution to the holder of the floating charge after unsecured creditors have been fully paid, whereas if the chargee shares the prescribed part *pari passu* with other creditors, this could never happen. Finally, it would be odd if the floating chargee's position depended on whether, at the time of distribution of the prescribed part, he had or had not realised his security.

4. ASSETS BELONGING TO THIRD PARTIES

6–40 Assets held by the company but belonging solely to third parties under transactions which are not subject to avoidance or capture pursuant to the statutory provisions referred to above are not available for the company's creditors. This

[199] *Kelly v Inflexion Fund II Ltd Partnership* [2010] EWHC 2850 (Ch). The junior charge holder can validly enter into a subordination agreement that requires it to hand over any amount received (on surrender of their security) from participation in the prescribed part to the senior charge holder: *Re JT Frith Ltd* [2012] B.C.C. 634 at [38]–[39]; below para.8–08.

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applies both to assets which never belonged to the company and those in which the company had an interest that has come to an end, for example, leases or rental agreements that have expired and contracts that have been terminated.[200] Three cases are deserving of particular mention, namely assets held by the company on trust, assets subject to a security interest and goods in the possession of the company as buyer under a contract reserving title to the seller until payment.[201]

Assets held on trust

(1) Trust assets do not form part of the estate

6–41 Where the company holds an asset on trust for a third party, this does not form part of its estate so as to be available for creditors. Trust property is excluded whether the trust is express,[202] implied,[203] constructive[204] or resulting[205] or is imposed by statute.[206] Thus, if money is lent to a company on terms that it is to be applied to a specific purpose which is frustrated by the advent of winding-up, there is a resulting trust in favour of the lender[207]; if a bank by mistake makes a

[200] If the company's interest comes to an end by reason of its entry into insolvency proceedings, the limitation on its interest falls to be tested by application of the anti-deprivation rule. However it is clear from *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 A.C. 383 that provisions for the forfeiture of leases or licenses by reason of the commencement of insolvency proceedings are not invalidated by the anti-deprivation rule, and reasonably clear that rights to terminate executory contracts on the basis of the counterparty's entry into insolvency proceedings will similarly not be struck down (although for a different reason): see paras 7–14, and 7–20, and 7–24 below.

[201] For an instructive analysis of a broad range of issues encompassing the second and third of these issues, see William Goodhart and Gareth Jones, "The Infiltration of Equitable Doctrine into English Commercial Law" (1980) 43 M.L.R. 489.

[202] *Re English & American Insurance Co Ltd* [1994] 1 B.C.L.C. 649; and *Re Kayford Ltd* [1975] 1 All E.R. 604.

[203] *Re Fleet Disposal Services Ltd* [1995] B.C.L.C. 345; and *Re C.A. Pacific Finance Ltd* [2000] 1 B.C.L.C. 494.

[204] *Re D&D Wines International Ltd (in liquidation)* [2016] 1 W.L.R. 3179 at [25]. Under English law such a trust may only take the form of an institutional constructive trust; there is no scope for the imposition of a remedial constructive trust: *D&D Wines* at [27]; *FHR European Ventures LLP v Cedar Capital Partners LLC* [2015] A.C. 250 at [47].

[205] *Barclays Bank Ltd v Quistclose Investments Ltd* [1970] A.C. 567.

[206] As is the case under, e.g. Ch.7 of the Client Asset Sourcebook (CASS7) issued by the Financial Conduct Authority, where money received by a broker for clients is required to be segregated from the broker's own moneys and on receipt is to be considered held on trust even before segregation (*Re Lehman Bros International (Europe) Ltd* [2012] 3 All E.R. 1).

[207] *Barclays Bank Ltd v Quistclose Investments Ltd*, cited above fn.205 (loan for the purpose of paying a dividend to shareholders); see also *Carreras Rothmans Ltd v Freeman Mathews Treasure Ltd* [1985] 1 All E.R. 155 (payments to advertising agency by client for sole purpose of discharging the agency's obligations to media creditors); *Re EVTR Ltd* (1987) 3 B.C.C. 389 (payment to be used for purchase of equipment). As to the first of these cases, see Sir Peter Millett, "The Quistclose Trust: Who Can Enforce It?" (1985) 101 L.Q.R. 269. For recent summaries of the requirements for establishing a *Quistclose* trust, see *Bieber v Teathers Ltd* [2013] 1 B.C.L.C. 248 and *Challinor v Juliet Bellis & Co* [2015] EWCA Civ 59.

payment twice over to another bank on behalf of a customer and the payee bank goes into liquidation, the mistaken payment can be recovered as money impressed with a constructive trust[208]; if an agent receives a bribe or secret commission from a third party in breach of the fiduciary duties it owes to the principal, it hold these benefits on constructive trust for the principal[209]; if money paid by a mail order customer in advance when ordering goods is, on the advice of accountants concerned about the financial position of the company, paid into a trust account to be released only on delivery of the goods, and the company goes into liquidation, money held in the account for customers to whom goods had not been delivered is held on trust for them and does not form part of the company's general assets.[210] Where the assets administered by the liquidator include assets held by the company as trustee, the costs attributable to the administration of those assets should be borne by the trust fund, not by the company's own assets.[211]

(2) Assets which cease to be trust assets

6–42 Assets initially subject to a trust may cease to be so as the result of authorised dealings by the trustee. Thus, in the case of a trading trust established by a trust instrument which authorises the trustees to carry on trade for the benefit of the beneficiaries, any disposition of a trust asset, whether absolutely or by way of security, falling within the actual or apparent authority of the trustees binds the beneficiaries, so that the asset is lost to the trust fund (in the case of an absolute disposition) or held by the trustees subject to the security interest (in the case of a disposition by way of security), and any proceeds of the disposition received by the trustees will become part of the trust fund in place of the original asset. This

[208] *Chase Manhattan Bank NA v Israel-British Bank (London) Ltd* [1979] 3 All E.R. 1025. But the authority of this decision has been weakened by the criticism made by Lord Browne-Wilkinson in *Westdeutsche Landesbank Girozentrale v Islington LBC* [1996] A.C. 669 at 715.

[209] *FHR European Ventures LLP v Cedar Capital Partners LLC* [2015] A.C. 250.

[210] *Re Kayford Ltd* [1975] 1 W.L.R. 279. The decision is controversial, but on the trusts point appears correct. There has been much debate about protection for the prepaying buyer. See, e.g. Thomas H. Jackson and Anthony T. Kronman, "A Plea for the Financing Buyer" (1975) 85 Yale L.J. 1; Aleck Dadson, "A Fresh Plea for the Financing Buyer" (1985–86) 11 C.B.L.J. 171; Martin Boodman, "The Prepaying Buyer: Another Perspective" (1986) 11 C.B.L.J. 257; Office of Fair Trading, "The Protection of Consumer Prepayments: A Discussion Paper" (London: OFT, 1984); and A.L. Ogus and C.K. Rowley, "Prepayments and Insolvency", OFT Occasional Paper (London: OFT, 1984). For a good discussion incorporating selected materials, see Jonathan Garton and Graham Moffat, *Moffat's Trusts Law: Text and Materials*, 6th edn (Cambridge: Cambridge University Press, 2015), pp.752–759. Under s.20A of the Sale of Goods Act 1979, prepaying buyers of an unidentified part of a bulk now acquire a proportionate interest in the bulk pending delivery. A recent Law Commission paper proposes reforms to improve the position of the prepaying consumer, including by affording some claims preferential status: *Consumer Prepayments on Retailer Insolvency* (Law Com No.368).

[211] See above, para.3–03.

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4. STATUTORY DEVELOPMENTS

7–29 The statute law of some jurisdictions prohibits counterparties from relying on clauses in contracts that permit termination on another party's entry into insolvency proceedings (so-called ipso facto clauses).[197] Absent statutory control, such clauses allow a counterparty to terminate even in circumstances where the debtor is ready, willing and able to perform their part of the bargain so that creditors can enjoy the benefit of performance by the counterparty.[198] Such clauses can also be wielded as leverage to extract concessions from the debtor, as where the counterparty agrees to keep the contract on foot on the proviso that any outstanding debts owing by the company to it are discharged.

English law has traditionally taken a generous approach to such clauses. The common law anti-deprivation rule does not invalidate termination clauses,[199] there being "nothing objectionable or evasive about a provision entitling one party to terminate it [a bilateral contract] if the other becomes bankrupt".[200] As David Richards J explained in the *Football Creditors* case:

> "In the absence of specific statutory provision, insolvency law does not compel a party to continue to deal with a company in administration or liquidation, nor does it prohibit a party from stipulating that all future dealings shall be on terms that not only future debts but also existing debts are paid in full. It is then for the administrator or liquidator to decide whether to accept these terms."[201]

There are few such statutory provisions. Section 233 of the Insolvency Act 1986 prevents suppliers of "essential supplies" from insisting on payment of charges outstanding on the date of a debtor's entry into insolvency proceedings as a condition of continued supply.[202] Essential supplies are however narrowly defined, being confined to utilities and (as of 2015)[203] various forms of IT supply. New s.233A of the Insolvency Act 1986, introduced in 2015,[204] deals specifically

[197] See for example, US Bankruptcy Code s.365(e) dealing with the termination or modification of executory contracts by reason of insolvency or the commencement of proceedings under the Code (the rule is subject to some important exceptions: see Moss, cited above fn.95); or the Canadian Companies Creditors' Arrangement Act 1985 s.34 discussed in A. Ho, "The Treatment of *Ipso Facto* Clauses in Canada" (2015) 61(1) McGill L.J. 139, 173–175; see also the European Commission's Proposal for a Directive of the European Parliament and of the Council on preventative restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30, (COM/2016/0723 final—2016/0359 (COD)), art.7.

[198] Ho, "The Treatment of *Ipso Facto* Clauses in Canada" (2015) 61(1) McGill L.J. 139, 146.

[199] Above, para.7–24.

[200] *Belmont* [2012] 1 A.C. 383 per Lord Mance at [177].

[201] *Revenue and Customs Commissioners v Football League Ltd* [2012] Bus.L.R. 1539 at [166].

[202] The supplier may however make it a condition of supply that the office-holder personally guarantees payment of any charges in respect of the supply: below, para.11–97.

[203] Insolvency (Protection of Essential Supplies) Order 2015 (SI 2015/989), art.2(3).

[204] SI 2015/989, art.4.

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with termination clauses in contracts for such essential supplies, but it has an even narrower scope: the provision limits reliance on such clauses only in relation to companies in administration or in respect of which a voluntary arrangement has taken effect. Liquidation is excluded.

In 2016, the Insolvency Service proposed reform that would expand the scope of ss.233 and 233A by allowing a company in administration or under a voluntary arrangement[205] to designate as essential any of its suppliers, by filing a notice to this effect in court. If the filing was not challenged, the contract would be covered by the protections in ss.233 and 233A of the Insolvency Act 1986. There are obvious direct costs associated with the notice filing system proposed, relative to a system that automatically invalidates termination clauses of specified kinds. The Insolvency Service's rationale for taking such an approach is to limit the disruptive effect of the rule to those contracts that the debtor actually regards as essential, preserving party autonomy in other cases.[206] But it is not clear that debtors will derive any benefit from this flexibility, given that counterparties will have to price in the possibility of being designated essential at some point in the future.

[205] Or the other forms of rescue-oriented procedures contemplated by the Insolvency Service, as to which see further para.12–11 below. A company in liquidation would not be able to take advantage of the provision, except where its supplies had already been designated essential in a previous insolvency proceeding: Insolvency Service, *A Review of the Corporate Insolvency Framework: A consultation on options for reform* (May 2016) [8.7].

[206] Insolvency Service, *A Review of the Corporate Insolvency Framework: A consultation on options for reform* (May 2016) [8.10], [8.14].

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Section 2. - Personal Accountability and Compensation for Breach of Trust

Lewin on Trusts 20th Ed.

Mainwork updated to include amendments from First Supplement

Volume 2

Part 7 - Proceedings and Remedies

Chapter 41 - Personal Remedies against Trustees for Breach of Trust

Section 2. - Personal Accountability and Compensation for Breach of Trust

Introduction

41-002 Once a trust is established, whether express or constructive, the beneficiaries are entitled to the carrying out by the trustee of the purposes for which the trust property was vested in him or which the law imposes, that is the proper execution of the trust. The beneficiaries also have an equitable proprietary interest in the trust property and are entitled to have the trust duly administered in accordance with the trust instrument, if any, and the general law.[1] Any failure by the trustee to comply with the terms of the trust or the duty to act in accordance with the fiduciary duty of loyalty may cause a loss to the trust fund, or to the beneficiaries personally. It is with this personal remedy available against the trustee when such breach has taken place with which we are now concerned. The claim to an account or to equitable compensation, as it is generally called,[2] must be considered in any given case together with the other remedies available where a breach has occurred. It may be possible to trace the trust property,[3] or to pursue a third party personally for dishonest assistance or knowing receipt.[4] Where, however a breach has caused loss to the fund and the trustee retains (or is able to recover) the trust property, or has the means to satisfy an award against him, the claim to compensation is the primary claim to be considered. When deciding whether to bring such a claim any defence available to the trustee must be taken into account.[5]

Forms of action

41-003 The claim to compensation for breach of trust has traditionally been brought by way of action for an account.[6] This may be for an account in common form, whereby the claimant falsifies the accounts to show the position as it was before the breach of trust was committed. Such an account would be used where, say, a trustee has paid out part of the trust fund to the wrong beneficiary.[7] If such an allegation is proved, then the account is taken as though the unauthorised payment had not been made.[8] Alternatively, the claimant may seek to argue that the breach of trust consists of an omission, for instance a failure to invest appropriately. In such circumstances, the claimant is said to surcharge the accounts, and the action is for an account on the footing of wilful default.[9] In such a case, the accounts are then sought to be amended so as to reflect the position as it would be if the omission had not occurred, and if the trustee had received what he would have received if he had exercised due care and diligence.[10] For a surcharge the challenging party has the onus of proof, but the accounting party has the onus of justifying any item in the account which a challenger seeks to falsify.[11] Very often, however, claims for compensation for breach of trust are not now brought by way of action for an account, but simply as a direct claim for such a monetary remedy, by way of equitable compensation or for the return of the missing trust property.[12] The amount of actual loss does not have to be pleaded where the basis of the claim is clearly articulated by the date of the trial and set out in the expert and factual evidence.[13]

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Footnotes

1 *Westdeutsche Landesbank Girozentrale v Islington London Borough Council [1996] A.C. 669* at 705, *per* Lord Browne-Wilkinson. See too *Target Holdings Ltd v Redferns [1996] A.C. 421* at 434, HL, and *Low v Bouverie [1891] 3 Ch. 82* at 99, CA.

2 Although this name may be criticised as failing to distinguish between the different types of loss which may be compensated, in particular reparatory and substitutive awards: see *Edelman and Elliott (2004) 18 Tru.L.I. 116*. See § 41-010. Underhill and Hayton, Law of Trusts and Trustees (20th edn), § 91.11, adopting Elliott's approach, argue that all claims to compensation against trustees can be divided into substitutive performance and reparation claims. For a critical survey of the position throughout the common law world, see *Sim Poh Ping v Winsta Holding Pte Ltd [2020] SGCA 35; [2020] 4 L.R.C. 319* at [86] onwards. And see *AIB Group (UK) Plc v Mark Redler & Co. Solicitors [2014] UKSC 58; [2015] A.C. 1503* at [50] onwards, [115], [166].

3 See Chap.44.

4 See Chap.43.

5 See sections 5 to 8 of this Chapter.

6 See generally Williams, Mortimer and Sunnucks, Executors, Administrators and Probate (22nd edn), §§ 58-23 onwards. See too *Ceredigion Recycling and Furnisture Team v Pope [2022] EWHC 1969 (Ch)* at [16]. For a useful discussion of the flexibility of the accounting process in practice, see *Trinity Concept Ltd (in liq.) v Sang [2022] HKCFI 547; [2022] 3 H.K.C. 205* at [84]–[99].

7 See § 41-047 for the rules of pleading where it is contended that a trustee has committed an active breach of trust.

8 *Ultraframe (UK) Ltd v Fielding [2005] EWHC 1638 (Ch); [2007] W.T.L.R. 835* at [1513].

9 *Barnett v Creggy [2014] EWHC 3080 (Ch); [2016] W.T.L.R. 17 at [62]–[66] (reversed on other grounds [2016] EWCA Civ 1004); [2017] Ch. 273)*. See §§ 41-048 to 41-050 for accounts on the footing of wilful default. See too *Hanbury (1936) 52 L.Q.R. 365*.

10 *Ultraframe (UK) Ltd v Fielding*, above, at [1513]. See too *Hurst v Bryk [2002] 1 A.C. 185* at 192, HL, *per* Lord Millett, for the terminology, in the context of a partnership dispute.

11 *Pit v Cholmondeley (1754) 2 Ves. Sen. 565*; *Re Ellis [2015] WASC 77* at [84].

12 As in *Target Holdings Ltd v Redferns [1996] A.C. 421* itself, where the claim was for the restitution of the fund and not for an account. For the view that all breach of trust claims should be characterised as claims to an account, see *Millett (1998) 114 L.Q.R. 214*. Lord Millett has restated this view, see *(2018) 32 Tru.L.I. 44*. Equitable compensation is not restricted to reparation for losses: *Interactive Technology Corp. Ltd v Ferster [2018] EWCA Civ 1594; [2021] W.T.L.R. 561* at [16].

13 *Ahmed v Ingram [2018] EWCA Civ 519; [2018] B.P.I.R. 535* at [40].

14 As to unauthorised investments, see § 41-056.

15 *Ultraframe (UK) Ltd v Fielding*, above, at [1513]. Lewison J. went on to say that if the unauthorised investment has appreciated in value, the beneficiary may choose not to falsify the account, in which case the asset will remain a trust asset and the expenditure on it will be allowed in taking the account. See too *Wallersteiner v Moir (No.2) [1975] Q.B. 373* at 397.

16 *Re Duckwari Plc [1999] Ch. 253* at 265.

17 See §§ 45-034 to 45-039, and Chaps 45 and 46 generally, for the rules concerning unauthorised benefits and conflicts of interest.

18 *Tang Man Sit v Capacious Investments Ltd [1996] 1 A.C. 514, PC*. See too § 45-051. It can be seen that the claim to recover profits is restitutionary in character, and the claim to compensation, reparatory. See *Edelman and Elliott (2004) 18 Tru.L.I. 116*, arguing against the blanket use of the label 'restitution' in the description of compensation for breach of trust.

19 *Partington v Reynolds (1858) 4 Drew 253*.

20 *Glazier Holdings Pty Ltd v Australian Men's Health Pty Ltd (No.2) [2001] NSWSC 6* at [38].

21 *Green v Weatherill [1929] 2 Ch. 213*; *Ahmed Angullia bin Hadjee Mohamed Salleh Angullia v Estate and Trust Agencies (1927) Ltd [1938] A.C. 624, PC*.

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ITEM NO. 180

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Section 1. - Introduction

Lightman & Moss on The Law of Administrators and Receivers of Companies 6th Ed.

Mainwork

Chapter 8 - Office-Holders

Section 1. - Introduction

8-001 The Insolvency Act 1986 created the concept of the "office-holder", a novel status carrying special statutory privileges and responsibilities, which was conferred upon administrative receivers, liquidators (including provisional liquidators) and administrators.[1] A person holding any of these offices (unless an official receiver) is required to be qualified to act as an insolvency practitioner in relation to the company.[2] The requirement for a professional qualification in part reflects the far-reaching nature of an office-holder's special statutory privileges and responsibilities. These are designed to secure the beneficial management of the company's undertaking and the proper investigation of the company's affairs, to which the office-holder will usually be a stranger.

8-002 It is important to distinguish between the statutory concept of an "office-holder", and the different concept of an "officer of the court". Historically, officers of the court[3] have been persons appointed by the court who are subject to its general supervisory jurisdiction.[4] In accordance with the rule in *Ex p. James*,[5] officers of the court are obliged to act not only lawfully, but fairly and honourably.[6] Interference with their functions may be a contempt.[7] Court-appointed receivers and administrators have always been officers of the court. Somewhat curiously, but no doubt to ensure uniformity, administrators appointed out of court following the changes introduced by the Enterprise Act 2002 have also been accorded the status of officers of the court.[8] However, even though administrative receivers may seek the directions of the court in relation to matters arising in the administrative receivership,[9] they are not officers of the court subject to the general control of the court, they are not susceptible to the rule in *Ex p. James*, and they are not protected by the principles of contempt of court.[10]

Footnotes

1 Insolvency Act 1986 s.233(1).

2 Insolvency Act 1986 s.230 in relation to administrative receivers, liquidators and provisional liquidators, and para.6 of Sch.B1 in relation to administrators.

3 Such as court-appointed receivers, administrators, provisional liquidators and liquidators in a compulsory liquidation.

4 See, e.g. *Re Atlantic Computer Systems Plc [1992] Ch. 505 (CA)*.

5 *Re Condon, Ex p. James (1873–74) L.R. 9 Ch. App. 609* (CA in Chancery).

6 See the consideration of the doctrine in *Re T&N Ltd [2004] O.P.L.R. 343*; *Re Agrimarche Ltd [2010] B.C.C. 775*; and *Re Alitalia Linee Aeree Italiane SpA [2011] 1 W.L.R. 2049*. See also the comments of Lord Neuberger in *Re Nortel Companies; Bloom v Pensions Regulator [2014] A.C. 209* at [122] onwards. Liquidators in creditors voluntary liquidations are not officers of the court and are therefore not subject to the same principle: see *Re TH Knitwear (Wholesale) Ltd [1988] Ch. 275 (CA)*. However, Lewison J commented (obiter) in *Re Agrimarche Ltd* that if the same person was an administrator (who is an officer of the court) and then became liquidator as the company, it would be odd to expect a different standard of conduct from that same person as an office-holder.

7 *Re Mead (1875) L.R. 20 Eq. 282*.

8 Insolvency Act 1986 Sch.B1, para.5.

9 Pursuant to an application under s.35 of the Insolvency Act 1986. The list of persons who can apply to the court under s.35 is limited, and it is an unresolved question whether there is a general right in other interested parties to apply to the court for directions to be given to a receiver appointed out of court.

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10 *Re Hill's Waterfall Estate and Gold Mining Co [1896] 1 Ch. 947*; *Re Magic Aust Pty Ltd (1992) 10 A.C.L.C. 929*.

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LINDLEY & BANKS ON PARTNERSHIP

TWENTY-FIRST EDITION

RODERICK I'ANSON BANKS, LLB
of Lincoln's Inn, Barrister

SWEET & MAXWELL

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LINDLEY & BANKS ON PARTNERSHIP

FIRST SUPPLEMENT TO THE TWENTY-FIRST EDITION

RODERICK I'ANSON BANKS, LL.B.
of Lincoln's Inn, Barrister

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Section 2. - Origin of the Law of Partnership

Lindley & Banks on Partnership 21st Ed.

Mainwork updated to include amendments from First Supplement

Part 1 - The Nature of Partnership

Chapter 1 - Introduction

Section 2. - Origin of the Law of Partnership

1-02 Until the Partnership Act of 1890, the law of partnership was to be found almost exclusively in legal decisions and in textbooks; few Acts of Parliament related directly to partnerships as opposed to what were then styled "joint stock companies". The law of partnership was, on the whole, a good example of judge-made law, developing slowly with the growth of trade and commerce and representing generally perceived views of justice. On the other hand, it suffered from the laws against usury, from what previous editors called "unsound views of political economy" (culminating in *Waugh v Carver*, [1] and not rectified until reviewed by the House of Lords in *Cox v Hickman* [2]) and from the parallel systems of law and equity which prevailed until 1875, when the Judicature Acts came into operation.

1-03 It was those Acts which, by merging the administration of law and equity, greatly facilitated the legislative revision and improvement of various branches of the law, including partnership which had begun as an offshoot of the law of contract but, by 1890, had become a virulent plant in its own right.

Limited partnerships

1-04 Prior to 1 January 1908, when the Limited Partnerships Act 1907 came into force, only one kind of partnership was known to English law, namely the "general" partnership, in which the liability of every partner for the debts and obligations of the firm was unlimited. The Limited Partnerships Act 1907 introduced a second kind of partnership, called limited partnership, in which the liability of one or more (but not all) of its members could be limited.

1-05 Although limited partnerships are the creation of the 1907 Act and are subject to its express provisions, they are otherwise governed by the Partnership Act 1890 and the general rules of equity and common law applicable to partnerships. For this reason, the law applicable to such partnerships is considered separately, after the treatment of general partnerships. [3]

Limited liability partnerships

1-06 Although an entity known as a limited liability partnership is now recognised under English law, [4] it does not represent a new form of partnership, but rather a body corporate to which no part of the law of partnership is applicable, either expressly or by implication. [5] In this respect, the limited liability partnership differs markedly from its equivalents in other jurisdictions. [6]

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not the other way around. In *Holme v Hammond*,[127] Cleasby B rightly rejected the notion that agency was the foundation of the idea of partnership,[128] and expressed the view that:

> "agency is deduced from partnership rather than partnership from agency. But neither does partnership always imply this mutual agency."[129]

The Tax Tribunal rightly recognised this in *Ingenious Games LLP v Revenue & Customs Commissioners*.[130] Of course, if the position were otherwise, a limited partnership could not properly be regarded as a partnership within the meaning of the 1890 Act, since a limited partner in general has *no* authority to bind the firm.[131]

2-31 The proposition that a partnership cannot exist unless all the partners undertake personal liability for the debts and obligations of the firm[132] is, in the current editor's view, equally fallacious, since not only can such personal liability be negated by express contract, but a limited partner will also, in the normal course, undertake no personal liability whatsoever,[133] yet will still be regarded as a partner in the eyes of the law.

2-32 Finally, in *Hodson v Hodson*,[134] it was held that participation in management by all partners is not essential, given the recognition long accorded to so-called "sleeping" partners.[135]

Partnership a contractual relationship

2-33 Partnership, although often called a contract, is more accurately described as a relationship *resulting from* a contract.[136] This was made clear in the original statutory definition introduced into the House of Lords[137] but not, ultimately, in the Act itself. Nevertheless, the origin of the relationship in an agreement, whether express or implied,[138] was clearly established before the Act and may legitimately be inferred from its provisions.[139] In *Hurst v Bryk*,[140] Lord Millett enlarged on this analysis and expressed the following view:

> "… while partnership is a consensual arrangement based on agreement, it is more than a simple contract (to use the expression of Dixon J in *McDonald v Dennys Lacelles Ltd, 48 C.L.R. 457, 476*); it is a continuing personal as well as commercial relationship."[141]

Like any other contract, the parties must be known and identified at the time[142] and the terms must be sufficiently certain, unless in the latter case they fall to be implied by the Partnership Act 1890.[143]

2-34 Equally, where it is found that alleged partners have either reached no binding agreement[144] or specifically agreed *not* to enter into a partnership[145] or one of them has expressly declined to enter into a partnership agreement,[146] it comes as no surprise that the existence of a partnership is unlikely to be inferred from their subsequent conduct. The fact that one party has assumed the existence of a partnership or a joint business or had aspirations to be a partner will clearly not suffice.[147]

2-35 In *Worbey v Campbell*,[148] one of the supposed partners had proposed terms which would result in him retaining control of the business but an inference of partnership would have resulted in his losing control. Moreover, an agency relationship would have resulted from a partnership which, again, was not intended. Predictably, no partnership was held to exist.[149] By way of contrast,

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128 *Holme v Hammond* at 234. In this context, it is interesting to note that mutual agency appears not to have been an original feature of societas in Roman law, but was only introduced by Justinian.

129 *Holme v Hammond* at 233. Similarly, in *Dollar Land (Cumbernauld) Ltd v CIN Properties Ltd 1996 S.L.T. 186 OH*, Lord Coulsfield, having listed the various features noted supra, para.2-25, warned (at 195B) that it was "a mistake to put too much emphasis on the question of mutual agency" and went on to observe (at 195F–G) that "the absence of one or even more of these features might be reconcilable with the existence of a partnership." See also *Phillips v Revenue & Customs Commissioners [2010] S.F.T.D. 332* at [53]. The Partnership Act 1890 itself clearly contemplates that mutual agency may, to a greater or lesser extent, be excluded: see ss.5, 8. See further, infra, paras 12-04, 12-226, et seq. For a different (and, in many ways, more extreme) perspective on the place of mutual agency in the law of partnership, see *Pooley v Driver (1876) 5 Ch D. 458* at 476 per Jessel MR.

130 *[2017] S.F.T.D. 1158* at [1176] per Judge Charles Hellier. This aspect was not raised in the Upper Tribunal (*[2019] S.T.C. 1851*) or the Court of Appeal *[2021] EWCA Civ 1180*).

131 See the Limited Partnerships Act 1907 s.6(1), considered infra, para.30-08, et seq. In the current editor's view this cannot merely be explained away as a consequence of an express statutory provision, since a limited partnership is a "firm" (Limited Partnerships Act 1907 s.3) and the Partnership Act 1890 and partnership law generally are applicable to such partnerships (Limited Partnerships Act 1907 s.7).

132 See the Partnership Act 1890 s.9, infra, para.13-02, et seq.

133 See the Limited Partnerships Act 1907 s.4(2), infra, para.30-19, et seq.

134 *[2009] P.N.L.R. 23*. This decision was affirmed sub nom. *Rowlands v Hodson at [2010] P.N.L.R. 8 CA*, albeit without specifically referring to this point.

135 See infra, para.13-74, et seq.

136 For affirmations of this, see *Philips v Symes [2002] 1 W.L.R. 853* at [43] per Hart J; *Khan v Nationwide Solicitors [2014] EWHC 841 (QB)* at [13] per Simler J; *Dutia v Geldof [2016] 2 B.C.L.C. 252* at [5], [93]–[96] per Nugee J; *Worbey v Campbell [2017] CSIH 49* at [68], [72] per Lord Glennie.

137 According to Lord Lindley's Supplement on the Partnership Act, p.13, the original definition was: "Partnership is the relation which subsists between persons who have agreed to carry on a business in common with a view of profit". Lord Lindley commented: "This definition was inaccurate, for, as pointed out by Parke J in *Dickinson v Valpy [(1829) 10 B. & C. 128* at 141–142 persons who have entered into an agreement that they will at some future time carry on business as partners, can *not* be considered as partners until the arrival of that time". This, of course, accords with the present position: see infra, para.2-37, et seq.

138 In *Dutia v Geldof [2016] 2 B.C.L.C. 252* at [96], Nugee J stated, on the basis of the authorities, that "the test for the implication of a contract is necessity". This, perhaps, puts the proposition too dogmatically, in the face of s.1(1) of the 1890 Act; sed quaere. See also *McPhail v Bourne [2008] EWHC 1235 (Ch)*, where it was held that neither an express nor an implied agreement for partnership had come into existence between the original members of the group "Busted"; see also *Achom v Lalic [2014] EWHC 1888 (Ch)* at [77] per Newey J. To the same effect was the decision of the Royal Court of Jersey in *Bennett v Lincoln [2005] J.L.R. 125* at [22], although it should be noted that there the position was governed by the customary law, including the writings of *Pothier*. In *Wilson v Dodd [2012] EWHC 3727 (Ch)* at [75], Stephen Morris QC (sitting as a deputy judge of the Chancery Division) stated the requirement in terms of "a binding contractual relationship between the parties"; see also the judgment of Tom Leech QC (sitting as a judge of the High Court) in *Sidhu v Rathor [2020] EWHC 1916 (Ch)* at [44]. No agreement to be a partner was inferred in *Primlake Ltd v Matthews Associates [2007] B.C.L.C. 666* at [330] (although a holding out was acquiesced in) or *Oberman v Collins [2021] W.T.L.R. 267* (despite the fact that the defendant had described the claimant as his "business partner").

139 See especially the Partnership Act 1890 ss.1, 2, 19, 24, 32, 33, 40 and 41; and *Davis v Davis [1894] 1 Ch. 393*. This passage was cited with apparent approval by Arnold J in *Hodson v Hodson [2009] P.N.L.R. 23* at [13]. His decision was affirmed sub nom *Rowlands v Hodson at [2010] P.N.L.R. 8 CA*.

140 *[2002] 1 A.C. 185* at 194. The remaining members of the House of Lords appear to have concurred in this view.

141 This passage was cited in *Marsh v Marsh [2010] EWCA 1563 (Ch)* at [13] per Sir Edward Evans-Lombe (sitting as a Judge of the Chancery Division). See also *Boyle v Burke [2020] Bus. L.R. 220* at [61] per Michael Green QC (sitting as a Deputy Judge of the Chancery Division).

142 *BCM Cayman LP v Revenue & Customs Commissioners [2023] S.T.C. 1738* CA at [43]. It follows that a person cannot automatically be admitted to a firm without more, as was unsuccessfully argued in that case. See also infra, para.10-542, et seq.

143 See *Cayzer v Beddow [2007] EWCA Civ 644*, where the terms for the particular venture were wholly *uncertain*; similarly in *Younes v Chrysanthou [2016] EWHC 3269 (QB)*. See also *Achom v Lalic*, supra, at [79]; *Campbell v Campbell [2017] EWHC 182 (Ch)* at [113] per M.H. Rosen QC (sitting as a deputy judge of the Chancery Division); *Worbey v Campbell [2017] CSIH 49* at [72]; *Sidhu v Rathor [2020] EWHC 1916 (Ch)* at [308].

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Section 1. - The Commercial and Legal Views

Lindley & Banks on Partnership 21st Ed.

Mainwork updated to include amendments from First Supplement

Part 1 - The Nature of Partnership

Chapter 3 - General Nature of a Partnership

Section 1. - The Commercial and Legal Views

The commercial view

3-01 Partners are, in both commercial and legal terms, collectively referred to as "a firm",[1] but with very different underlying perspectives.[2] Thus, the usual commercial view of partnership, as reflected in the approach of many accountants, involves treating a firm in much the same way as a company, i.e. as an entity distinct from its members and with independent rights and obligations.[3] As a consequence, in drawing up partnership accounts, where money is due to or from a partner he will normally be shown as a creditor or debtor of the *firm* and not as a creditor or debtor of his co-partners.[4]

3-02 Consistently with its perceived status as a separate entity, there is a tendency to regard a firm's rights and obligations as unaffected by any change in its membership: in effect, the rights and obligations of the "old" firm prior to the change are automatically deemed to have been assumed by the "new" firm. Lord Lindley summarised the thinking which lies at the heart of the commercial view in the following terms:

> "The partners are the agents and sureties of the firm: its agents for the transaction of its business; its sureties for the liquidation of its liabilities so far as the assets of the firm are insufficient to meet them. The liabilities of the firm are regarded as the liabilities of the partners only in case they cannot be met by the firm and discharged out of its assets."

3-03 This attitude is, if anything, encouraged by certain attributes displayed by a majority of firms, ranging from the adoption of a distinctive name which is unrelated to the names of the partners to the maintenance of a separate bank account in the firm name. Because of these attributes, changes in a firm tend to have no visible effect on its existence or on the continuity of its business; in short, partners may come and go but the firm *appears* to go on.

3-04 Equally, a single partner cannot constitute a firm in anything *other* than a commercial sense.[5]

The legal view and its implications

3-05 The legal view of a firm is very different: in English law, the firm is not generally recognised as an entity distinct from the partners composing it.[6] Admittedly, in taking partnership accounts and in administering partnership assets, the courts have to some extent adopted the commercial view; moreover, actions may be brought by or against partners in the firm name.[7] There

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are also a number of statutory exceptions.[8] These apart, the general rule holds good, although there are occasional anomalies. Thus, whilst it has been held that a firm as such cannot be a tenant and claim protection under Part II of the Landlord and Tenant Act 1954,[9] in *Prudential Assurance Co Ltd v Ayres*[10] a lease was purportedly assigned to a firm and no issue was taken as to the validity of that assignment.

3-06 Lord Lindley stated the orthodox legal view as follows:

> "The law, ignoring the firm, looks to the partners composing it; any change amongst them destroys the identity of the firm; what is called the property of the firm is their property,[11] and what are called the debts and liabilities of the firm are their debts and their liabilities.[12] In point of law, a partner may be the debtor or the creditor of his co-partners, but he cannot be either debtor or creditor of a firm of which he is himself a member."[13]

3-07 The following helpful statement of principle was made by Eichelbaum CJ in *Hadlee v Commissioner of Inland Revenue*[14]:

> "In law the retirement of a partner or the admission of a new partner, constitutes the dissolution of the old partnership, and the formation of a new partnership.[15] Here upon the happening of such events there were no overt signs of dissolution; the partnership's financial structure and arrangements were such that none was required but that does not alter the underlying legal significance of any retirement or new admission."[16]

Although it has been held that Lord Lindley's formulation of the principles is not of general application and is dependent on the precise terms of the partnership agreement,[17] it is submitted that this decision is unsupported by any authority and must be regarded as per incuriam.

3-07A The practical effects of the legal view have recently been graphically illustrated by the decision in *BCM Cayman LP v Revenue & Customs Commissioners*,[18] where it was sought to be argued that the appellant firm as from time to time constituted was a member of a UK limited partnership. The Court of Appeal held that such a proposition could not stand in the face of the legal view of a firm.[19]

Position in Scotland

3-08 The position is exactly the same in Scotland, but the new firm is a separate legal person from the old firm.[20] It was in that context that Lord Drummond young explained the tension between the commercial and legal views of a firm in *Scottish Pension Fund Trustees Ltd v Marshall Ross & Munro*.[21]

Agreements overriding the legal view

3-09 It is, of course, open to the partners to agree as between themselves that a change in the firm will not affect the continuation of their partnership,[22] but this only has effect as a matter of contract and does not alter the legal analysis set out above.

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Claims between partners and against third parties

3-10 It follows that any breach of a duty which one partner owes to his fellow partners prior to a change in the firm will be actionable as between those partners but, because the right of action cannot properly be regarded as a partnership asset,[23] it will not pass automatically to the "new" firm which comes into existence by virtue of the change.

3-11 However, the position may be different where the claim lies against a third party, such as a manager or operator of a limited partnership. If the claim can, in this case, be regarded as a partnership asset,[24] it would seem that it may pass automatically to the "new" firm.[25] Equally, the claim would, in the case of a limited partnership, have to be brought by the general partner in any event.[26]

3-12 Needless to say, it also follows that, where a partnership has brought a claim against a third party and settled that claim, a partner cannot argue that he personally can thereafter pursue a similar claim, whether as an assignee from the partnership or otherwise.[27]

Partners and firm as employees

3-13 It should be added that a partner cannot be employed by his own firm, since it is traditionally said that "no man can employ himself",[28] although the principle seems likely to be challenged at some point in the near future.[29] Equally, it would seem that a partnership cannot itself be an employee.[30] Moreover, where a partnership agreed to provide services to a third party, none of the partners can properly claim to be employees of that third party.[31]

Firm as a partner

3-14 In the same way, as will be seen hereafter,[32] a partnership cannot be a partner in another firm nor can it, as such, become a member of a limited liability partnership.[33] A Scottish partnership, which has separate legal personality,[34] will be in a different position.

Status and liability of a partner

3-15 Also central to an understanding of the law of partnership is the dual capacity in which a partner acts, i.e. both as a principal and an agent. Lord Lindley explained:

> "As a principal [*a member of an ordinary partnership*[35]] is bound by what he does himself and by what his co-partners do on behalf of the firm,[36] provided they keep within the limits of their authority; as an agent, he binds them by what he does for the firm, provided he keeps within the limits of his authority."

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Thus, where a partner receives money belonging to the firm, he will do so both as principal (i.e. for himself) and as agent for his co-partners; in those circumstances, he cannot be treated as having received the money in a fiduciary capacity. [37]

3-16 However, as Lord Lindley took care to point out, it is wrong to regard a partner as a mere surety for the firm's debts [38]: as a principal, he is personally liable to meet those debts, whether or not they could be met out of the partnership assets. [39]

Footnotes

1 Partnership Act 1890 s.4. See, as to the effect of this section under Scots law (where the firm has separate legal personality), *Jardine-Paterson v Fraser 1974 S.L.T. 93 (Ct. of Sess)*; also *Maillie v Swanney 2000 S.L.T. 464* at 468F per Lord Penrose.

2 In drawing a distinction between the two views, which he styled the mercantile and the legal, Lord Lindley acknowledged his obligations to Cory's Treatise on Accounts, 2nd edn (London: Pickering & Chatto, 1839) and to a paper by J.M. Ludlow entitled "On the mercantile notion of the firm, and the need of its legal recognition", in the 2nd volume of the Papers read before the Juridical Society, p.40.

3 See supra, para.2-57. For a more recent summary of the commercial view, see *R. v L [2009] 1 Cr. App. R. 16* at [14].

4 An example (albeit ultimately unsuccessful) of this approach can be seen in *MacKinlay v Arthur Young McClelland Moores & Co [1990] 2 A.C. 239*.

5 *Oswald Hickson Collier & Co v Carter-Ruck [1984] A.C. 720* note at 721G per Denning MR; *Re C & M Ashberg, The Times, 17 July 1990*; *Re Rogers [2006] 1 W.L.R. 1577* at 1581B per Lightman J. See also infra, para.3-18.

6 See *Meyer & Co v Faber (No. 2) [1923] 2 Ch. 421*; see also *Hoare v Oriental Bank Corp (1877) 2 App. Cas. 589*; *Ex p. Corbett (1880) 14 Ch D. 122* at 126 per James LJ; *Ex p. Gliddon (1884) 13 Q.B.D. 43*; *Sadler v Whiteman [1910] 1 K.B. 868* at 889 per Farwell LJ (affirmed *[1910] A.C. 674*); *R. v Holden [1912] 1 K.B. 483*; *Malkinson v Trim [2003] 1 W.L.R. 463* at [23] per Chadwick LJ; *Hammonds (A Firm) v Danilunas [2009] EWHC 216 (Ch)* at [8(b)], [106] per Warren J (this aspect was not commented on in the Court of Appeal sub nom *Hammonds (A firm) v Jones [2009] EWCA Civ 1400*); *Ward v Hutt [2018] 1 W.L.R. 1789* at [24], noticed infra para.14-42. Note also, in this context, *BP Oil UK Ltd v Lloyds TSB Bank Plc [2005] 3 E.G. 116 (CS) CA* (although this brief report does not disclose that the three companies were originally partners); *Kelly v Northern Ireland Housing Executive [1999] A.C. 428 HL*; *Samarkand Films Partnership No.3 v Revenue & Customs Commissioners [2012] S.F.T.D. 1 (FTT(TC))* at [198], [199] (this aspect being recited, but not otherwise referred to on the appeal to the Upper Tribunal at *[2015] S.T.C. 2135* or in the Court of Appeal at *[2017] S.T.C. 926*).

7 As to actions, see CPR r.7.2A, 7APD, paras 5A.1, 5A.3, infra, paras A2-04, A2-06. And see also infra, para.14-08, et seq.

8 Thus, a firm may be registered in the firm name under Value Added Tax Act 1994 s.45(1) (see infra, paras 37-06, 37-07) and may be appointed as a statutory auditor under Companies Act 2006 ss.1212, 1216(1) and (2).

9 *Kissane & Clarke v Jones unreported 26 September 1975 and 1 March 1976*, discussed at *(1976) 120 S.J. 827 and 850* and the Landlord and Tenant Act 1954 Pt II s.41A, as added by the Law of Property Act 1969 s.9 and amended by The Regulatory Reform (Business Tenancies) (England and Wales) Order 2003 (SI 2003/3096) Sch.5 para.5. But note the decisions in *Wray v Wray [1905] 2 Ch. 349* and *Vanquish Properties (UK) Ltd v Brook Street (UK) Ltd [2016] EWHC 1508 (Ch)*, both noticed infra, para.3-24. The position is more complex in Scotland: see *IRC v Graham's Trustees 1971 S.L.T. 46 HL*; *Jardine-Paterson v Fraser 1974 S.L.T. 93 (Ct of Sess.)*; *Lujo Properties Ltd v Green 1997 S.L.T. 225*; *Moray Estates Development Co v Butler 1999 S.C.L.R. 447 OH*; *Hiskett v The Now Dissolved Firm of G & G Wilson 2003 G.W.D. 38–1036 OH*; *Oag v Oag's Executors 2017 G.W.D. 25-423 (Land Ct)*.

10 *[2008] 1 All E.R. 1266 CA*. As to the effect in law, see infra, para.18-99.

11 Despite this clear principle, the First-tier Tribunal in *Bayonet Ventures LLP v Revenue & Customs Commissioners [2018] UKFTT 262 (TC)* at [47] misguidedly observed: "Property which belongs to a partnership, whether a limited liability partnership or a non-LLP, is no more the property of the individual partners than the property of a body corporate is the property of its shareholders. Such property might become the property of members and/or shareholders upon winding up or dissolution once debts and liabilities have been paid, but until that time it is the property of the partnership (firm) or, as appropriate, the LLP; *each of which are recognised in law as having a legal persona separate and distinct from the members of the partnership*." (Emphasis supplied.) The latter proposition is, of course, only true of an LLP.

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12 This sentence was approved by the Supreme Court of Canada in *Backman v R., 3 I.T.L. Rep. 647* at [41] and by the Court of Appeal in *Procter v Procter [2024] EWCA Civ 324* at [54], [55]. See also *Byford v Oliver [2003] E.M.L.R. 20* at [26]; *Wan v General Commissioners for Division of Doncaster, 76 T.C. 211*.

13 *Green v Hertzog [1954] 1 W.L.R. 1309*. See also Lord Cottenham's judgment in *Richardson v The Bank of England (1838) 4 My. & Cr. 165* at 171, 172; *De Tastet v Shaw (1818) 1 B. & A. 664*; *Lee v Neuchatel Asphalte Co (1886) 41 Ch D. 1*. And see *Ellis v Kerr [1910] 1 Ch. 529*; *Napier v Williams [1911] 1 Ch. 361*, as to the invalidity of covenants entered into by a man with himself and others jointly before the alteration of the law by the Law of Property Act 1925 s.82. See also the analysis of those cases and the decision in *Rye v Rye [1962] A.C. 496* by the Court of Appeal in *Procter v Procter [2021] Ch. 395 CA*.

14 *[1989] N.Z.L.R. 447* at 455. This case went to the New Zealand Court of Appeal and, ultimately, to the Privy Council (see *[1993] A.C. 524*), but Eichelbaum CJ's original decision was upheld.

15 To the same effect is the judgment of Judge Mackie QC sitting as a judge of the Chancery Division in *HLB Kidsons v Lloyd's Underwriters [2009] 1 All E.R. (Comm) 760* at [16].

16 At this point Eichelbaum CJ cited *IRC v Gibbs [1942] A.C. 402*; *Brace v Calder [1895] 2 Q.B. 253* and an earlier edition of this work. See also *Commissioners of State Taxation v Cyril Henschke Pty Ltd [2010] HCA 43 (High Ct. of Australia)* at [10]–[12]; *Rojoda Pty Ltd v Commissioner of State Revenue [2018] WASCA 224* and, on appeal, sub nom. *Commissioner of State Revenue v Rojoda Pty Ltd*, noticed infra, para.24-05.

17 *Cummings v Stockdale, 11 November 2008*, a decision of HHJ Raynor, sitting as a judge of the Chancery Division. See further as to this decision, infra, paras 9-18, 10-544.

18 *[2023] EWCA Civ 1179*.

19 See *[2023] EWCA Civ 1179* at [42]–[44].

20 See the Partnership Act 1890 s.4(2); *Sim v Howat [2011] CSOH 115* at [13] (per Lord Hodge). See also *Jardine-Paterson v Fraser 1974 S.L.T. 93 (Ct. of Sess.)*; *Arif v Levy & McRae 1992 G.W.D. 3-156*; *Eason v Miller [2016] CSOH 59*. However, as regards prosecutions against the firm and/or its partners, the legal view has now been statutorily overridden by Section 4(3), (4) of the Partnerships (Prosecution) (Scotland) Act 2013. Note, also that, in the case of a limited partnership formed under the Limited Partnerships Act 1907, s.4(2) of the 1890 Act will, as from a date to be appointed, only apply where the firm was registered in Scotland: see the Partnership Act 1890 s.4(3), as inserted by the Economic Crime and Corporate Transparency Act 2023 s.150. Thus, when that amendment is in force, moving the principal place of business of an English registered limited partnership to Scotland will not result in it enjoying separate personality: see para.576 of the Explanatory Notes to the Economic Crime and Corporate Transparency Bill.

21 *[2018] CSIH 39* at [62]–[64]. See further as to this decision infra, para.10-111, fn.330.

22 See the remainder of the passage from the judgment in *Hadlee v Commissioner of Inland Revenue*, supra, reproduced infra, para.10-82; also infra, para.24-03.

23 See *Global Partners Fund Ltd v Babcock & Brown Ltd [2010] NSWSC 270* at [87], [88] per Hammerschlag J (this aspect not, ultimately, being decisive on the appeal at *[2010] NSWCA 196*); *Certain Partners in Henderson PFI Secondary Fund II LP v Henderson PFI Secondary Fund II LP [2013] Q.B. 934* at [28] per Cooke J.

24 In *Global Partners [2010] NSWSC 270*, Hammerschlag J was forcibly of the view that the pleaded duties could only be owed to the partners individually, so could not be partnership assets: see [87]. However, in *Henderson [2013] Q.B. 934*, it was not disputed that a claim by a limited partnership against its manager was a partnership asset "owned jointly by the Partners": see [26] per Cooke J; similarly in *Allianz Global Investors GmbH v Barclays Bank Plc [2022] EWCA Civ 353* at [58]. In *The Connaught Income Fund, Series 1 v Capita Financial Managers Ltd [2014] EWHC 3619 (Ch)*, it was conceded that claims by incoming partners against the operators of a limited partnership in connection with its promotion were not partnership assets until they had been assigned to the partnership, after it was ordered to be wound up as an unregistered company: see [13].

25 Thus, in *Henderson [2013] Q.B. 934*, it was held that the claim against the manager passed automatically to the newly constituted partnership by virtue of the terms of the agreement: see [41], [61]. Save as regards the claim against the general partner, this is inconsistent with the decision in *Global Partners [2010] NSWSC 270*. Given that the decision in *Henderson* was founded on a questionable concession by the parties and that no consideration was given to the implications of the duties being owed to all the partners (including the former general partner), it should, in the current editor's view, be approached with some caution See further infra, paras 14-83, 18-39.

26 See *Henderson [2013] Q.B. 934* at [26], [34]; *Allianz Global Investors GmbH v Barclays Bank Plc [2022] EWCA Civ 353* at [103]. In *Marigold Holdings Ltd v Norem Construction Ltd [1988] 5 W.W.R. 710* it was held that only the general partner or the firm can sue for damages for breach of contract on the basis that it is the limited partnership which has suffered loss and the limited partners have no interest in the partnership property (thus, perhaps, foreshadowing the conclusion reached in *Henderson*). However, this decision should also be approached with caution as much seemingly

depended on the terms of the applicable Canadian legislation. The decision is again inconsistent with *Global Partners [2010] NSWSC 270*. The editor is grateful to Joel Nitikman for drawing his attention to this decision.

27 *Evans v Trebuchet Design Ltd [2020] EWHC 3037 (IPEC)*.

28 On this basis, it was held in *Ellis v Joseph Ellis & Co [1905] 1 K.B. 324* that a partner who worked for the partnership at a weekly wage was not entitled to compensation under the Workman's Compensation Act 1897; see also *Cowell v Quilter Goodison Co Ltd [1989] I.R.L.R. 393 CA*; *Train v DTE Business Advisory Services Ltd (UKEAT/0201/08/LA), 6 January 2009*; *Protectacoat Firthglow Ltd v Szilagyi [2009] I.R.L.R. 365* at [35] per Smith LJ; *Tiffin v Lester Aldridge LLP [2012] 1 W.L.R. 1887 CA* at [31]; *Reinhard v Ondra LLP [2016] 2 B.C.L.C. 571, 585* at [42] per Warren J. It follows that such a partner's "salary" will inevitably be treated as part of his profit share for tax purposes: *MacKinlay v Arthur Young McClelland Moores & Co [1990] 2 A.C. 239* at 249C. Note, however, that in *Rowley Holmes & Co v Barber [1977] 1 W.L.R. 371*, it was held that a legal executive in his capacity as executor of a deceased sole proprietor of a firm of solicitors *could* employ himself for redundancy payment purposes. In the case of a limited liability partnership, it has been held that, notwithstanding the obscure wording of section 4(4) of the Limited Liability Partnerships Act 2000, an LLP member cannot also be an employee of the LLP: see *Reinhard v Ondra LLP [2016] 2 B.C.L.C. 571* (where both judgments delivered in the case are reported); also *Altus Group (UK) Ltd v Baker Tilly Tax and Advisory Services LLP [2015] S.T.C. 788*; *Wilson v Revenue & Customs Commissioners [2020] S.F.T.D. 827 (FTT (TC))* although, when affirming this decision, the Upper Tribunal declined to rule on this issue: see *[2021] S.T.C. 1044* at [67] (UT(TCC)). See further infra, para.5-98, fn.315.

29 See infra, para.5-98.

30 See the obiter view expressed by Sedley LJ in *Protectacoat Firthglow Ltd v Szilagyi [2009] I.R.L.R. 365* at [74]; also *Puttnam v Revenue & Customs Commissioners [2019] UKFTT 389 (TC)* at [72]; *Green v Revenue & Customs Commissioners [2019] UKFTT 390 (TC)* at [92].

31 See *Firthglow Ltd (t/a Protectacoat) v Descombes* (UKEAT/0916/03), 19 January 2004, as applied in *Anglian Windows Ltd (t/a Anglian Home Improvements) v Webb [2024] I.C.R. 339* EAT. In *Anglian Windows*, there was no question as to the genuineness of the partnership: see *[2024] I.C.R. 339* at [9]. The result might have been different if there had been an agreement with the partnership and a separate agreement with one or more of the partners: see *[2023] EAT 178* at [58].

32 See infra, para.4-42.

33 See the Companies Act 2006 s.164(d), as substituted by The Limited Liability Partnerships (Application of Companies Act 2006) Regulations 2009 (SI 2009/1804) reg.18. *Per contra* if, under the law of its formation, the partnership has separate legal personality. This was decided in *BCM Cayman LP v Revenue & Customs Commissioners [2023] EWCA Civ 1179* at [47] and reflects the pre-existing view of the Registrar of Companies. The argument that the expression "person" in the Limited Liability Partnerships Act 2000 s.4 includes an unincorporated body by virtue of section 5, Schedule 1 of the Interpretation Act 1978 (as advanced in J. Whittaker and J. Machell, The Law of Limited Liability Partnerships, 5th edn (London: Bloomsbury Professional, 2021), para.2.3) was rejected on the basis that the 2000 Act contains a contrary intention, relying on ss.2(1), (2)(e) (in its original form), 9(1)(b) and 18 (the definitions of "address", now repealed, and "name"). Reference might also be made to the difficulty of applying ss.6 (members as agents), 7 (ex-members) and 8 (designated members).

34 Partnership Act 1890 s.4(2). Note, however, that a Scottish *limited* partnership will not, as from a date to be appointed, have separate legal personality unless it is registered in Scotland under the Limited Partnerships Act 1907: Partnership Act 1890 s.4(3), as inserted by the Economic Crime and Corporate Transparency Act 2023 s.150.

35 It is presumed that, when using the expression "ordinary partnership", Lord Lindley was referring to a partnership governed by the general law (rather than by some special contractual arrangement), since it is difficult to see what other form of partnership could have existed at that time. Now, of course, there exists the limited partnership, in which the limited partners have *no* authority to bind the firm: see the Limited Partnerships Act 1907 s.6(1) and infra, para.30-08, et seq.

36 Ironically, the use of the expression "the firm" in this context itself gives succour to the commercial view.

37 *Piddocke v Burt [1894] 1 Ch. 343*. Note that, in *BCM Cayman LP v Revenue & Customs Commissioners [2023] EWCA Civ 1179* at [84], the court declined to decide whether *Piddocke v Burt* was distinguishable or wrongly decided, as had been argued by the appellant.

38 See supra, para.3-02.

39 Until the law was altered by the Partnership Act 1890 s.23, the property of the firm was, of course, liable to be seized for the private debts of any of the partners composing it.

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(a) - Firm name

Lindley & Banks on Partnership 21st Ed.

Mainwork updated to include amendments from First Supplement

Part 1 - The Nature of Partnership

Chapter 3 - General Nature of a Partnership

Section 2. - Status of Firm in Specific Contexts

(a) - Firm name

3-17 It is important to identify the precise significance of a firm name since, as previously noted,[40] it represents an attribute which tends to encourage the commercial rather than the legal view of a firm. Lord Lindley put it in this way:

> "… the name under which a firm carries on business is in point of law a conventional name applicable only to the persons who, on each particular occasion when the name is used, are members of the firm."[41]

Once this point is understood, the fallacy of the commercial view becomes apparent. The firm name is a convenient method of describing a group of persons associated together in business at a certain point of time: no more and no less.[42]

3-18 It follows that confusion will inevitably arise where an individual "A" trades under the name "A & Co" or continues to trade in the name of a former firm, either because he has become the sole continuing "partner" or because he is otherwise to be regarded as its successor, e.g. following a purchase of its goodwill. In such cases A is, and at all times remains, a sole proprietor and no question of partnership arises. When applied to such a person, the term "sole partner", although used in common parlance, is both inappropriate and misleading.[43]

3-19 When a firm is referred to by its name or trading style, evidence is admissible to show who in fact was a member of the firm at the relevant time.[44] If a number of people carry on business under such a name or style, anything which they may do in that name or style will be just as effective as if their individual names had been used. An obvious example of this is the use of firm names on bills of exchange and promissory notes; indeed, more formal contracts *may* be valid, even though some of the executing parties are described as "A & Co".[45] It was formerly the case that partners might be registered as shareholders in the firm name,[46] although they could not insist on being so registered,[47] but it is now an express requirement of the Companies Act 2006 that the register of members state the name of each joint holder separately, even if they are otherwise regarded as a single member.[48] Partners are just as much joint holders as others in that position.

Effect of change in the partners

3-20 Because the firm name represents no more than a convenient means of describing the partners who for the time being make up the firm, whenever the partners change that name must take on a new meaning. This can lead to a number of complications, as the following examples (which are, for convenience, arranged in alphabetical order) demonstrate.

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show that, by reason of the breach, he has been unable to pursue a claim against the firm arising out of the contract or that he has suffered some financial loss in connection therewith. [175] This would appear to be the position even though the breach was the fault of only one partner and unknown to the other partners. [176] However, the court is given a residual discretion to permit the proceedings to continue, if it would be just and equitable so to do. [177]

3-60 The disability imposed by the Act is limited to the firm itself; it prima facie has no application to persons claiming under it, e.g. a trustee in bankruptcy or liquidator. [178]

3-61 Notwithstanding the above disability, where a contract appears to have been entered into by one partner, there is nothing to prevent the partners from seeking to demonstrate that the firm was, on a true analysis, the party to the contract, even if by so doing they are forced to admit a breach of their obligations under the Act. [179]

Footnotes

40 See supra, para.3-03.

41 See the Partnership Act 1890 s.4(1). A firm should now be described in the claim form as "XYZ & Co (A Firm)": see CPR 16PD para.2.6(c)(i), infra, para.A2-13. It would seem that the former alternatives, i.e. "XYZ & Co (sued as a firm)" or "X, Y and Z trading as XYZ & Co" should no longer be used.

42 See, for example, *Ernst & Young v Butte Mining Plc (No. 2) [1997] 1 W.L.R. 1485* at 1491E–1492C per Lightman J; *Hammonds (A Firm) v Danilunas [2009] EWHC 216 (Ch)* at [106] per Warren J (this point was not discussed on the appeal). Of less interest in this context is the exceptional decision in *United Video Properties/Program Guide (T482/02) [2005] E.P.O.R. 42*, where a firm's opposition to a European patent failed because it was submitted in the firm name rather than in the names of the partners. However, the firm in question had been requested to provide proof of its legal status and had declined to do so and had, moreover, failed to provide details of the relevant partners' names and addresses. No principle of general application is established thereby.

43 *Alexander Mountain & Co v Rumere [1948] W.N. 243*, reversed (on the facts) at *[1948] 2 K.B. 436*; *Oswald Hickson Collier & Co v Carter Ruck [1984] A.C. 720* note at 721G per Denning MR; *Re C & M Ashberg, The Times, 17 July 1990*; *Re Rogers [2006] 1 W.L.R. 1577* at 1581B per Lightman J. See also *W Hill & Son v Tannerhill [1944] K.B. 472 CA*, where Hill, trading without partners as W. Hill & Son, issued a writ in the supposed firm name contrary to what was then RSC Ord.48A (see now CPR 7APD paras 5A.1, 5A.3). The relevant limitation period having expired, it was held that Hill might nevertheless amend the writ by substituting himself as plaintiff. Note also the decisions in *Harold Fielding Ltd v Mansi [1974] I.C.R. 347*; *Allen & Son v Coventry [1980] I.C.R. 9*; *Jeetle v Elster [1985] I.C.R. 389*.

44 *Carruthers v Sheddon (1815) 6 Taunt. 15*; *Bass v Clive (1815) 4 M. & S. 13*; *Stubbs v Sargon (1838) 3 My. & Cr. 507*; also *Latouche v Waley (1832) Hayes & Jones (Ir.Ex.) 43*.

45 See further infra, para.12-243, et seq.

46 *Weikersheim's Case (1873) L.R. 8 Ch. App. 831*.

47 *Re Vagliano Anthracite Collieries Ltd [1910] W.N. 187*, where the definition of "person" contained in the Interpretation Act 1889 s.19 (now the Interpretation Act 1978 Sch.1), was not adverted to. Note also that, in *Dunster's Case [1894] 3 Ch. 473*, the Registrar of Joint Stock Companies appears to have insisted that the company's memorandum of association could not properly be signed in a firm name; it is assumed that a similar attitude would be adopted in the case of a firm seeking to subscribe to a memorandum of association under Companies Act 2006 s.8 in its firm name.

48 Companies Act 2006 s.113(5); and note also Sch.1A Pt 3 para.11, as added by the Small Business, Enterprise and Employment Act 2015 Sch.3 Pt 1 para.2. Cf. the approach adopted in the case of the register kept by a limited liability partnership: section 164(d) of the Companies Act 2006, as substituted and applied by The Limited Liability Partnerships (Application of Companies Act 2006) Regulations 2009 (SI 2009/1804) reg.18.

49 See *Fowler v Reynal (1851) 3 Mac. & G. 500*; *Re Tucker [1894] 1 Ch. 724, affirmed [1894] 3 Ch. 429*; *Smith v Patrick [1901] A.C. 282*.

50 *Barron v Fitzgerald (1840) 6 Bing.N.C. 201*. But, of course, a continuance of the authority may be inferred from subsequent dealings with the new firm. See *Pariente v Lubbock (1856) 8 De G. M. & G. 5*.

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Section 1. - The Nature of a Partnership Share

Lindley & Banks on Partnership 21st Ed.

Mainwork updated to include amendments from First Supplement

Part 4 - The Rights and Obligations of Partners Between Themselves

Chapter 19 - Partnership Shares

Section 1. - The Nature of a Partnership Share

Precise definition impossible

19-01 Although it is convenient to refer to a partner's interest in the firm as his "share," that expression is notoriously difficult to define, not least because its meaning differs according to the context in which it is used. In common parlance, a share is usually seen merely in terms of an interest in the profits of a business [1] and of a capital or "equity" stake therein; indeed, this may well be the partners' own perception. However, in legal terms, such an approach is too simplistic, since the constituent elements which go to make up a share are not only infinitely variable but subject to potential alteration during the continuance of the partnership and thereafter. Thus, whilst the "share" of an outgoing partner may quite properly be viewed solely in financial terms, [2] reference to the "share" of a *continuing* partner must include the totality of the rights which he enjoys under the partnership agreement and under the general law. [3] It follows that no single meaningful definition is possible and, if the expression is used without regard to the context, confusion and potential disputes are inevitable. It was for this reason that the Court of Appeal in *Ham v Ham* [4] emphasised that the meaning to be ascribed to the expression "share" in a partnership agreement will ultimately be a matter of construction rather than "the application of a well defined term". [5]

19-02 In *Commissioner of State Revenue v Danvest Pty Ltd*, [6] a share was described by the court as an "equitable chose in action", an expression also adopted in the dissenting judgment of Gageler J in *Commissioner of State Revenue v Rojoda Pty Ltd.* [7] However, both in the majority judgment of the High Court of Australia in the latter case [8] and in *Horsford v Horsford*, [9] the expression "equitable interest" was preferred. [10]

Proprietary nature of a share

19-03 It has already been seen that partnership is a relationship which results from a contract, [11] although the House of Lords has been at pains to point out that the relationship involves far more than a simple contract. [12] Although generalisation is dangerous in this (as in any other) area, it might be said that one particular feature which distinguishes a partnership from an ordinary contract [13] is that, in addition to creating contractual rights and obligations between the partners, it will usually (but by no means necessarily) [14] confer on each partner certain proprietary rights in respect of the partnership assets. [15] As Arden LJ put it in *Revenue & Customs Commissioners v Anson* [16]:

> "A partner in an English partnership has an equitable interest in the partnership assets and thus will be able to show that he had a proprietary interest to the extent of his profit and share in the partnership."

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Certainly, it is difficult to imagine a partnership which involves no proprietary rights whatsoever, even though the only partnership property may be of an intangible nature, e.g. goodwill, or of negligible value. Of course, the proprietary rights or interest referred to do not generally equate to a direct interest in or ownership of a defined share of the partnership assets, but the position may be otherwise on a dissolution. [17]

The internal and external perspectives

19-04 When analysing the proprietary nature of a partnership share, it is necessary to distinguish between the internal and external perspectives, since they are very different. The distinction was clearly drawn by Lord Justice Hoffmann in *IRC v Gray* [18] in these terms:

> "As between themselves, partners are not entitled individually to exercise proprietary rights over any of the partnership assets. This is because they have subjected their proprietary interests to the terms of the partnership deed which provides that the assets shall be employed in the partnership business, and on dissolution realised for the purposes of paying debts and distributing any surplus. As regards the outside world, however, the partnership deed is irrelevant. The partners are collectively entitled to each and every asset of the partnership, in which each of them therefore has an undivided share." [19]

This distinction was most recently cited with apparent approval by the Court of Appeal in *Thomas v Luv One Luv All Promotions Ltd* [20] and at first instance in *Procter v Procter*. [21] Although it was also referred to in argument in *Commissioner of State Revenue v Danvest Pty Ltd*, [22] in its detailed review of the Australian cases, the Court of Appeal of Victoria did not, in the event, address it any further. It was recognised by the Irish court in *Re Bloxham*, [23] noted in *Bloomberg Inc (UK Permanent Establishment) v Revenue & Customs Commissioners* [24] and *Morton v Morton*, [25] and may have underpinned the ultimately erroneous view expressed by the First Tier Tribunal in *Bayonet Ventures LLP v Revenue & Customs Commissioners*. [26] The distinction was also referred to in the majority and dissenting judgments in *Commissioner of State Revenue v Rojoda Pty Ltd*, [27] although the majority made it clear that it "does not change the nature of the rights held by partners. The distinction merely contrasts the contractual restrictions within the partnership deed with the partners' rights in relation to partnership assets". [28]

19-05 The current editor is aware of the view that there is, in any event, no substantial difference between the internal and external perspectives and that, on both views, the partners must together be regarded as jointly owning the partnership assets but, on the internal view, as having subjected their ownership rights to their mutual obligations under section 39 of the 1890 Act. [29] If that analysis were correct, McLeish JA's proposition in *Commissioner of State Revenue v Danvest Pty Ltd* [30] that "the partner has a presently existing equitable chose in action which does not, prior to dissolution, represent a proprietary interest in partnership assets" could not be supported. The current editor hesitates to go that far. Surely on the internal perspective, all that the partner owns is his share (defined in the manner set out later in this chapter) and his right to insist that the partnership assets are applied for proper purposes whilst the partnership subsists and, after it is dissolved, in the manner contemplated by section 39. To talk about ownership rights in the *collective* sense (and they cannot exist in any other sense) is inevitably to bring one back to the external perspective. In his dissenting judgment in *Commissioner of State Revenue v Rojoda Pty Ltd*, Gageler J opined that "The nature of the undivided interest that each partner has as a co-owner (whether in law or in equity) of each item of partnership property (whether real or personal) is that of a tenant in common with all of the other partners" [31] and that "the fixed share that each partner on dissolution of [*a*] solvent partnership had as a tenant in common in the beneficial interest in the land held on trust for the partnership" could properly be recognised "as ascertainable and as ascertained". [32] But even that approach does not go so far as to blur the distinction between the two perspectives. [33]

19-05A Equally, it should be noted that, in *Hedges v Commissioner of Taxation*, [34] the Federal Court of Australia recently observed that:

Conversion of shares in partnership land

19-27 Writing prior to the Partnership Act 1890, Lord Lindley said:

> "From the principle that a share of a partner is nothing more than his proportion of the partnership assets after they have been turned into money and applied in liquidation of the partnership debts, it necessarily follows that, in equity, a share in a partnership, whether its property consists of land or not, must, as between the real and personal representatives of a deceased partner, be deemed to be his personal and not real estate, unless indeed such conversion is inconsistent with the agreement between the parties." [124]

19-28 Although this principle was duly reflected in section 22 of the Partnership Act 1890, [125] that section has now been repealed. [126] In addition the general doctrine of conversion has been abolished, but *only* in the case of land held on trust for sale. [127] It has already been seen [128] that partnership land will in all cases be held on a trust of land and instances in which the potential application (or non-application) of the doctrine of conversion, in so far as it still survives, will be of any relevance to partners are likely to be extremely rare. [129] However, the logic behind the doctrine as applied to partnership property and analysed by Lord Lindley in the above passage, is still compelling when viewed in terms of the true nature of a partnership share.

19-29 It should also be noted that, even in those rare cases in which the doctrine of conversion applies, the court might still, in exceptional circumstances, be prepared to treat a partner's share in land as identified with the land itself. [130]

Footnotes

1 *Quaere* whether it is right to regard the partners as "owning" the profits: see infra, para.21-01.

2 See for example, the Partnership Act 1890 s.43, considered infra, paras 23-47, 26-03. And see infra, para.19-20, et seq.

3 As a result, a share is often conveniently referred to as a "bundle of rights": see, for example, infra, para.35-33.

4 *[2014] W.T.L.R. 255 CA*.

5 See at [24] per Lewison LJ. See also *Lane v Lane [2024] EWHC 275 (Ch)* at [25] per Jonathan Hilliard KC (sitting as a deputy judge of the High Court).

6 *[2017] VSCA 382* at [2], [5], [164(b)], [165] (the latter two passages being reproduced infra, paras 19-12, 19-05 respectively).

7 *[2020] HCA 7* at [73]. It was used more extensively in the original judgments of the Supreme Court of Western Australia (sub nom *Rojoda Pty Ltd v Commissioner of State Revenue [2018] WASCA 224*), even though the actual decision was overturned on the appeal: see further infra, paras 19-13, 19-14, 19-19. The current editor is grateful to Joel Nitikman for drawing his attention to these decisions. See also *Chiam Heng Hsien v Chiam Heng Chow [2015] SGCA 27* at [118].

8 *[2020] HCA 7* at [33], [35], [38].

9 *[2020] EWHC 584 (Ch)* at [201], per M.H. Rosen QC sitting as a judge of the Chancery Division.

10 In *Canny Gabriel Castle Jackson Advertising Pty Ltd v Volume Sales (Finance) Pty Ltd (1974) 131 C.L.R. 321* a partner's share was described as an equitable interest and not a "mere" equity; see also *Connell v Bond Corp Pty Ltd (1992) 8 W.A.R. 352*.

11 See supra, para.2-33.

12 See *Hurst v Bryk [2002] 1 A.C. 185* at 194 per Lord Millett. See further, as to this decision, infra, para.24-010, et seq.

13 Certain other distinguishing features are identified in *Hurst v Bryk [2002] 1 A.C. 185* at 194.

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14 Note, however, that one of the primary attributes of a so-called "salaried" or "fixed share" partner may be the absence of any interest in partnership property: see *Stekel v Ellice [1973] 1 W.L.R. 191* and, generally, supra, paras 5-91, 10-165, et seq., 18-02.

15 With the proliferation of contractual arrangements (other than partnership) which involve the creation of proprietary rights, this feature is, perhaps, less distinctive than it once was. Equally, it is wrong to speak of the partnership assets "belonging to" or being "owned" by the partners in certain proportions, as the agreements purported to do in, for example, *Byford v Oliver [2003] E.M.L.R. 20* at [19] (cited in *Gill v Frankie Goes to Hollywood Ltd [2008] E.T.M.R. 4* (OHIM, Opposition Division); *Re Bloxham [2017] IEHC 664* at [6]; *Deacon v Yaseen [2020] EWHC 465 (Ch)* at [13]. Consistently therewith, the Tribunal in both *Beadnall Copley Ltd v Revenue & Customs Commissioners [2022] UKFTT 183 (TC)* and *Armour Veterinary Group Ltd v Revenue & Customs Commissioners [2024] UKFTT 539 (TC)* held that the partners did not own the goodwill of the partnership at the relevant time, albeit that this appears to ignore the external perspective noted in the following paragraphs.

16 *[2013] S.T.C. 557 CA* at [60]. The Court of Appeal's decision was, ultimately, reversed at *[2015] S.T.C. 1777*, but the Supreme Court did not see the need to delve into the partnership analogy in the same way: see [117]–[121]. See also, as to this decision, infra, para.21-01.

17 See infra, paras 19-07, 19-18, 19-19.

18 *[1994] S.T.C. 360* at 377c–e. This distinction was cited with approval by the Tribunal in *Bloomberg Inc v Revenue & Customs Commissioners [2018] S.F.T.D. 1079* (FTT(TC)) at [159], [166]. See also *Chiam Heng Hsien v Chiam Heng Chow [2015] SGCA 27* at [113]–[116].

19 See also *Re Fuller's Contract [1933] Ch. 652* at 656 per Luxmoore J. The position is otherwise in Scotland, because the partnership is a separate legal person: see *Revenue & Customs Commissioners v Anson [2015] S.T.C. 1777 (SC)* at [39]. Note also, in this context, the decision in *Edenvale Restoration Specialists Ltd v British Columbia 2013 BCCA 85 (CA, British Columbia)*, where a limited partnership, acting through its general partner, had acquired certain tangible personal property from an incoming limited partner who, it was accepted, would have a continuing beneficial interest in that property. However, for the purposes of the sales tax legislation under consideration, that continuing beneficial interest was irrelevant because the general partner fell to be treated as the purchaser, having acquired it on behalf of a principal, i.e. the partnership. Interestingly, had the sale been to a general partnership, no sales tax would have been payable on the share retained by the vendor partner: *Seven Mile Dam Contractors v British Columbia (1979) 104 D.L.R. (3d) 274*. This might usefully be compared with Lewison J's analysis of the generic rights of members of an unincorporated association in *Hanchett-Stamford v Att-Gen [2009] Ch. 173* at [47].

20 *[2022] 4 W.L.R. 9 CA* at [58]. This decision was relied on in *Beadnall Copley Ltd v Revenue & Customs Commissioners [2022] UKFTT 00183 (TC)*, noticed supra, fn.15.

21 *[2022] EWHC 1202 (Ch)* at [62] per HHJ Davis-White QC (sitting as a judge of the High Court). This point was not addressed on the appeal at *[2024] EWCA Civ 324*.

22 *[2017] VSCA 382* at [116]: see also supra, para.19-02.

23 *[2017] IEHC 664* at [34].

24 *[2018] UKFTT 205 (TC)* at [159], [166], [168].

25 *[2022] EWHC 163 (Ch)* at [138].

26 *[2018] UKFTT 262 (TC)* at [47], noticed supra, para.3-06.

27 *[2020] HCA 7* at [43], [73], [74],

28 *[2020] HCA 7* at [43]. Note also *Hedges v Commissioner of Taxation [2023] FCAFC 105*, noted infra, para.19-05A.

29 See, generally, infra, para.19-41, et seq.

30 *[2017] VSCA 382* at [165].

31 *[2020] HCA 7* at [77].

32 *[2020] HCA 7* at [99].

33 The current editor is again grateful to Joel Nitikman for debating this issue.

34 *[2023] FCAFC 105*.

35 *[2023] FCAFC 105* at [17], citing *Commissioner of State Revenue v Rojoda Pty Ltd [2020] HCA 7* at [33].

36 *[2023] FCAFC 105* at [18].

37 See infra, para.19-100.

38 *Thomas v Luv One Luv All Promotions Ltd [2022] 4 W.L.R. 9 CA*; also, *Byford v Oliver [2003] E.M.L.R. 20*.

39 See the (ultimately inconclusive) discussion of the position of nominee shareholdings in *Rose v Lynx Express Ltd [2004] 1 B.C.L.C. 455*.

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Section 1. - Introduction

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Part 5 - Dissolution and Winding-up

Chapter 24 - Dissolution and its Causes

Section 1. - Introduction

Meaning of dissolution

24-01 What is meant by the "dissolution" of a partnership is often misunderstood, not only because that word is used in two distinct senses but also because it has a very different meaning when applied to a company or limited liability partnership.[1] In the case of a partnership, it invariably refers to the moment of time when the ongoing nature of the partnership relation terminates, even though the partners may continue to be associated together in a new partnership or merely for the purposes of winding up the old firm's affairs.[2] Indeed, the outward appearance of a partnership immediately prior to and immediately following a dissolution will frequently be unchanged. For a company or LLP, on the other hand, dissolution marks not the commencement of the winding up but its conclusion, i.e. the moment of extinction.[3]

24-02 It should be noted that dissolution is an absolute concept: there is no such thing as a "partial" dissolution.[4]

Distinction between a technical and general dissolution

24-03 It does not necessarily follow from the fact that a partnership has been dissolved that its affairs will fall to be wound up in the manner prescribed by the Partnership Act 1890.[5] It has already been seen that, as a matter of law, a change in the composition of a partnership results in a dissolution of the existing firm and the creation of a new firm[6]; in such a case, the new firm will usually take on the assets and liabilities of the old, without any break in the continuity of the business.[7] This is often referred to as a "technical" dissolution and is usually, but not always,[8] the result of agreement. Such a dissolution will almost inevitably require the taking of accounts to ascertain the entitlement of the outgoing or deceased partner.[9]

24-04 In contrast, the expression "general" dissolution is used to denote a dissolution involving a full scale winding up, which may well have been brought about at the instance of one partner against the wishes of the others. When a firm is referred to as "in dissolution", this usually indicates that a general dissolution has taken place, but that the winding up of its affairs is still continuing. Once the winding up is complete and the accounts are finally settled as between the partners,[10] there will be nothing left which could properly be referred to as a partnership, whether in dissolution or otherwise.

24-05 The above distinction between a technical and a general dissolution was accepted without demur in *HLB Kidsons v Lloyd's Underwriters*,[11] when considering the potential application of section 38 of the Partnership Act 1890[12] on a change in a firm,

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and again in *Boyle v Burke*. [13] It was also accepted by the Supreme Court of Western Australia in *Rojoda Pty Ltd v Commissioner of State Revenue*, [14] albeit that Murphy JA correctly observed [15] that:

> "The reference to a 'technical' or 'notional' dissolution is somewhat of a misnomer, because it is not the dissolution itself, but, at most, the winding up of the partnership which is notional. The partnership practising after the retirement of a partner is a different partnership than prior to that partner retiring, but the assets and responsibility for liabilities of the partnership are taken over by the remaining partners."

Although it has been suggested that the expression technical dissolution is "best avoided", [16] the Court of Appeal in *Procter v Procter* [17] appeared to have no such compunction.

24-06 This and subsequent chapters are primarily concerned with dissolution in the second sense.

Causes of dissolution

24-07 The general dissolution of a partnership may undoubtedly be brought about in a number of well recognised ways, which can be classified into the following groups:

1. By mutual agreement of the partners. Thus, whatever duration may have been agreed at the outset, the partners can, if they so wish, bring the partnership to an end at an earlier date [18] and their agreement to do so can, in an appropriate case, be inferred. [19] However, unanimity is a prerequisite. [20]

2. By the exercise of an express power to dissolve reserved by the agreement, [21] although it cannot necessarily be *presumed* that such a power has been duly exercised. [22]

3. By rescission for fraud or misrepresentation. [23]

4. By the service of notice or the occurrence of some other determining event prescribed by the Partnership Act 1890. [24] It should, however, be appreciated that the relevant provisions of the Act can, for the most part, be excluded by agreement. [25]

5. By order of a court of competent jurisdiction or, where relevant, by an arbitration award. [26]

Subsequent sections of this chapter principally concentrate on dissolutions brought about in the fourth and fifth ways, after a consideration of the potential application of the normal contractual doctrines of repudiation and frustration.

Footnotes

1 The words "dissolved" and "dissolution" are not defined by the Partnership Act 1890.

2 Partnership Act 1890 s.38, supra, para.13-86, et seq.

3 Insolvency Act 1986 ss.202(5), 205(2) (as amended), as applied to LLPs (with modifications) by The Limited Liability Partnerships Regulations 2001 (SI 2001/1090) art.5. See also infra, para.24-80.

4 See *Boyle v Burke [2020] Bus. L.R. 220* at [81(1)] per Michael Green QC (sitting as a Deputy Judge of the Chancery Division).

5 See ss.39, 44: see further, supra, paras 19-16, et seq., 19-42, et seq., 23-314, et seq. and infra, para.25-73, et seq.

6 See supra, para.3-01, et seq. And see *Hadlee v Commissioner of Inland Revenue [1989] 2 N.Z.L.R. 447* at 455 per Eichelbaum J (this aspect was not pursued on appeal: see *[1993] A.C. 524*); also *Chiam Heng Hsien v Chiam Heng Chow*

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[2015] SGCA 27 at [56]–[58]. The only authority to the contrary is *Cummings v Stockdale unreported 11 November 2008*, which is, for the reasons noted supra, para.3-07, in the current editor's view clearly per incuriam. As to the position in Scotland, where a firm has separate legal identity, see *Jardine-Paterson v Fraser 1974 S.L.T. 93* at 97 per Lord Maxwell; *Sim v Howat [2011] CSOH 115* at [13] per Lord Hodge; *Eason v Miller [2016] CSOH 59*.

7 Note, however, that a creditor of the old firm is unlikely to acquire rights against the new firm, even where the liabilities are taken over: see supra, para.13-34, et seq. See also supra, paras 10-111, 10-112.

8 See, for example, *Hudgell Yeates & Co v Watson [1978] Q.B. 451*, where the partnership was dissolved under the Partnership Act 1890 s.34. See infra, paras 24-92, 24-93.

9 Note that it was observed in *Chiam Heng Hsien v Chiam Heng Chow [2015] SGCA 27* at [58] that "The rendering of accounts is *not* a *pre-requisite* for the technical dissolution of a partnership to occur; rather it would be a *consequence* of it."

10 See supra, para.23-115, et seq. and infra, para.25-73, et seq.

11 *[2009] 1 All E.R. (Comm) 760* at [16] per HHJ Mackie QC (sitting as a judge of the Chancery Division).

12 See, as to this section supra, para.13-86, et seq.

13 *[2020] Bus. L.R. 220* at [3] per Michael Green QC (sitting as a Deputy Judge of the Chancery Division). Note that the distinction also appears not to have been challenged in *Summers v Smith unreported 27 March 2002* at [65].

14 *[2018] WASCA 224*. The distinction was only adverted to in passing on the appeal sub nom. *Commissioner of State Revenue v Rojoda Pty Ltd [2020] HCA 7* at [7]. See further, as to this decision, supra, para.19-19.

15 See [102].

16 See Blackett-Ord and Haren, Partnership Law, 6th edn (London: Bloomsbury Professional, 2020) at para.16.1, as referred to in *Procter v Procter [2024] EWCA Civ 324* at [44].

17 *[2024] EWCA Civ 324* at [50], [58].

18 If authority were required for this self evident proposition, reference should be made to the Partnership Act 1890 s.19, supra, para.10-32; *Hurst v Bryk [2002] 1 A.C. 185* at 195C per Lord Millett; *Boyle v Burke [2020] Bus. L.R. 220* at [64]. See also infra, para.24-171. Merely agreeing in principle that the partnership has been dissolved by one partner's "resignation" and that he has thereby been released from his obligations will not make any difference if that partner continues to act as a partner: see The *Northampton Regional Livestock Centre Co Ltd v Cowling [2016] 1 B.C.L.C. 431 CA* at [74]. In any event, any duties owed to third parties by definition cannot be affected by such an agreement.

19 See, for example, *Deputy Commissioner of Taxation v O'Donoghne [2022] WASC 153* at [25], [433]–[436]. See also, infra, para.29-94, et seq.

20 It is not possible for a majority to vary the terms of the partnership unless they have an express power so to do: see supra, para.10-34, et seq. Cf. the terms of the Partnership Act 1890 s.24(8), supra, para.15-06, et seq.

21 Such a power may be explicit in its terms (see supra, para.10-287, et seq.) or may merely authorise a majority to take any decision in relation to the partnership's affairs, including the decision to dissolve (see supra, para.10-204, et seq.).

22 See *Frontiers Capital I Ltd Partnership v Flohr [2023] EWHC 2723 (Ch)* at [32], where Master Brightwell declined to apply the maxim *omnia praesumuntur rite esse acta*.

23 See supra, para.23-78, et seq. Note *Chall v Chall [2023] SAC (Civ) 27* at [14], albeit a case where the Partnership Act 1890 s.41 was not invoked.

24 See ss.26(1), 32–34, infra, para.24-38, et seq.

25 Partnership Act 1890 s.19, supra, para.10-32; see also infra, paras 24-38, 24-46, 24-69, 24-72. It is, however, impossible to exclude s.34, even though the practical effects of that section may be avoided: see infra, paras 24-94, 24-95.

26 Partnership Act 1890 s.35, infra, para.24-100, et seq. As to the power of an arbitrator to order a dissolution, see supra, para.10-573.

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Section 4. - Distribution of Assets and Adjustment of Accounts

Lindley & Banks on Partnership 21st Ed.

Mainwork updated to include amendments from First Supplement

Part 5 - Dissolution and Winding-up

Chapter 25 - Winding Up the Partnership Affairs

Section 4. - Distribution of Assets and Adjustment of Accounts

Importance of the agreement

25-73 Before the winding up of the partnership affairs can be concluded, it is necessary to complete the partnership accounts by incorporating any final adjustments which may be required to reflect the respective rights, entitlements and obligations of each partner. [201] At this point it will be necessary to pay close attention to the terms of the partnership agreement, [202] as well as to the partners' subsequent conduct, even though this is not always decisive. As Lord Lindley explained prior to the Partnership Act 1890:

> "… an express agreement with reference to the taking of accounts may be, and frequently is, only applicable to the case of a continuing partnership, and may not be intended to be observed on a final dissolution of the firm, or even on the retirement of one of its members. [203] A similar observation applies to the mode in which the partners themselves have been in the habit of keeping their accounts: that which has been done for the purpose of sharing annual profits or losses is by no means necessarily a precedent to be followed when a partnership account has to be finally closed." [204]

Any lacuna in the agreement regarding the taking of dissolution accounts will mean that the statutory regime considered below will apply. [205]

Partnership Act 1890 section 44

25-74 Subject to any contrary agreement, the rules which govern the final settlement of a partnership account on dissolution are contained in section 44 of the Partnership Act 1890, [206] which provides as follows:

> Section 44
>
> **"44.—**
>
> In settling accounts between the partners after a dissolution of partnership, the following rules shall, subject to any agreement, be observed:
>
> **(a)** Losses, including losses and deficiencies of capital, [207] shall be paid first out of profits, next out of capital, and lastly, if necessary, by the partners individually in the proportion in which they were entitled to share profits:

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(b) The assets of the firm including the sums, if any, contributed by the partners to make up losses or deficiencies of capital, shall be applied in the following manner and order:

1. In paying the debts and liabilities of the firm [208] to persons who are not partners therein:

2. In paying to each partner rateably what is due from the firm to him for advances as distinguished from capital [209]:

3. In paying to each partner rateably what is due from the firm to him in respect of capital:

4. The ultimate residue, [210] if any, shall be divided among the partners in the proportion in which profits are divisible."

211

25-75 Although it is traditionally said that only debts and advances have priority over the costs of dissolution proceedings, [212] it would seem that each partner's capital entitlement should also be taken into account before determining how any excess costs are to be borne. [213]

Effect of the section

25-75A In *Shah v Shah* [214] it was suggested, albeit on an obiter basis, that the section "is not intended to impose on an individual partner, as opposed to the partners as a whole, particular obligations in respect of monies coming into his, or her, hands."

Application of the section

25-76 Section 44(b) requires the partners to proceed through each of the four stages in turn, and to identify whether there is a deficiency of assets at any of the first three stages. If there is, that deficiency must be treated as a loss and borne by the partners as such. Writing prior to the Partnership Act 1890, Lord Lindley explained the process in this way:

> "If the assets are not sufficient to pay the debts and liabilities to non-partners, the partners must treat the difference as a loss and make it up by contributions inter se. If the assets are more than sufficient to pay the debts and liabilities of the partnership to non-partners, but are not sufficient to repay the partners their respective advances, the amount of unpaid advances ought, it is conceived, to be treated as a loss, to be met like other losses. In such a case the advances ought to be treated as a debt of the firm, but payable to one of the partners instead of to a stranger. [215] If, after paying all the debts and liabilities of the firm and the advances of the partners, there is still a surplus, but not sufficient to pay each partner his capital, the balances of capitals remaining unpaid must be treated as so many losses to be met like other losses." [216]

25-77 Thus, if there is an insufficiency at stage 1, the overall loss borne by the partners will be that amount together with any sums which would otherwise be payable to them at stages 2 and 3 (which, by definition, cannot be returned to them); if the

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insufficiency occurs at stage 2, the loss will comprise that amount together with any sum otherwise payable at stage 3. In either of these cases, a global calculation of each partner's share of the loss may be possible. [217]

Income carried by the capital contributions

25-78 It has already been seen [218] that where realisation of the surplus assets has produced a fund which is more than sufficient to repay all the partners' capital contributions, they may, at the end of stage 3, be entitled to claim such part of the income of that fund as was carried by those contributions. [219] It is only after those shares of the income have been accounted for that the ultimate residue will be established for the purposes of stage 4.

Division of the ultimate residue

25-79 If there is an ultimate residue to be divided between the partners at stage 4, [220] the relevant profit shares will be those applied to residual or capital profits. [221] Any form of preferential profit share which is only applicable to profits of an *income* nature, e.g. so-called "salaries", "bonus shares" or "incentive profit shares", must be left out of account. [222] In the case of a graduated profit sharing system, whether by reference to a partner's holding of "points" or his position on a "lockstep" system, the relevant profit sharing proportions will in general be those which applied at the date of dissolution. [223]

25-80 Of course, it may be that a partner, though entitled to a share of the firm's income profits, is excluded from participating in the division of capital profits. [224] The existence of such a partner will naturally be ignored for present purposes. [225]

Equality of loss and inequality of capital

25-81 Where the partners have contributed (and thereafter own) [226] capital in unequal proportions but share profits and losses equally, any loss of capital must in general be shared *equally*, in the same way as any other loss. [227] Accordingly, any surplus assets remaining after payment of the debts and advances must be distributed between the partners in such a way as to achieve that equality. [228] Thus, if partner A has contributed capital of £10,000 and partner B £5,000, but the surplus is only £10,000, the loss of £5,000 must be shared equally, so that A will receive £7,500 and B £2,500. If equality cannot be achieved in this way, then the necessary contributions must be made as between the partners. [229] Thus if, in the previous example, the surplus is only £3,000, in order to ensure that the loss of £12,000 is shared equally A must receive the entire surplus of £3,000, together with a contribution from B of a further £1,000. Although at first sight surprising, this result is, in fact, entirely logical, once it is appreciated that the benefit of the lost capital must have accrued to the partners in their profit sharing ratios, since it will either have been applied in the acquisition of additional assets [230] or in reducing the trading losses. The same principles will, of course, be applied where the partners share profits and losses otherwise than in equal proportions.

25-82 If, however, the partners' true intention is that, once the debts and advances have been paid, any surplus assets will be divided between them in their normal profit sharing ratios or in proportion to their original capital contributions or in some other manner, effect must be given to that agreement; in such a case, those partners with the largest capital contributions will bear the majority of the loss. [231]

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The rule in Garner v Murray

25-83 The position is more complex where one of the partners is insolvent and thus unable to contribute his share of the lost capital. In *Garner v Murray*,[232] Joyce J held that section 44 of the Partnership Act 1890 does not compel the solvent partners to make up any shortfall resulting from that inability, so that a deficiency in the capital available for distribution is inevitable. Since such capital as is available must be distributed rateably, the deficiency will ultimately be borne by the partners pro rata to their capital contributions and not equally. This is, with deceptive simplicity, styled "the rule in *Garner v Murray*".

25-84 Thus, suppose that partner A has contributed capital of £10,000, partner B, £5,000 and partner C, £1,000, but that profits and losses are shared equally. C is insolvent and the surplus remaining after discharging the debts and advances is £10,000, i.e. a loss of £6,000. A, B and C each bear £2,000 of that loss, but C is unable to contribute his share. Accordingly, the total assets available for distribution consist of the surplus (£10,000) and the notional contributions of lost capital from A and B (£4,000), i.e. £14,000. That amount is shared rateably between A and B in the proportions 2:1 (reflecting the size of their original capital contributions),[233] i.e. A notionally receives £9,333 and B, £4,666. However, there must be deducted from each partner's entitlement his share of the loss, so that A ultimately receives £7,333 and B, £2,666.[234]

25-85 Where the insolvent partner's capital account is already overdrawn before the loss of capital is deducted,[235] there appear to be two schools of thought as to the correct method of proceeding. Either that deficit is ignored when applying the rule or the deficit is itself treated as a loss *which must be shared between all the partners*. It has been submitted that the latter represents the true effect of the decision in *Garner v Murray*,[236] but this cannot be elicited from the terms of the judgment reportedly delivered by Joyce J.[237]

25-86 The application of the rule would seem to presuppose that the insolvent partner's capital account is overdrawn either at the date of dissolution or when his share of the lost capital is debited thereto.[238]

25-87 It was submitted in earlier editions of this work that the rule works logically, since the insolvent partner must already have received his share of the lost capital in one of the ways previously described[239] or by making excessive (and presumably unauthorised) drawings on his capital account, so that there is no justification for requiring the solvent partners to restore sums which they have not received prior to the return of their capital. However, in the current editor's view, this somewhat over-simplifies the position, particularly if it is right that the deficit on the insolvent partner's capital account must itself be treated as a loss.

Need for a court order

25-88 There is no reason why the affairs of a partnership should not be wound up by the partners or their representatives without the intervention of the court,[240] save where disputes arise.[241]

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Adjustments pursuant to a court order

25-89 If the surplus assets are distributed amongst the partners pursuant to a court order which is later reversed, any partner who has received more than his true entitlement will be ordered to repay the excess. [242]

Footnotes

201 This has been said to represent an obligation of all the partners under the Partnership Act 1890 s.28: see *Winning v Cunningham 2009 GWD 01–19 (Sh.Ct.)*. Semble it was to just this situation which HHJ Thornton QC referred in *Barber v Rasco International Ltd [2012] EWHC 269 (QB)* at [62]: see supra, para.23-119. For an example of a case in which such final adjustments were made, see *Stocking v Montila [2005] EWHC 2210 (Ch)*. It goes without saying that account must be taken of any sums due *from* a partner to the firm: *Stocking v Mantilla*, supra. And see supra, para.19-41, et seq.

202 In *Faulks v Faulks [1992] 1 E.G.L.R. 9*, the agreement provided for a tenancy of certain land (which enjoyed the benefit of a milk quota) to revert to the ownership of a particular partner in the event of a dissolution. It was held that because milk quota could not exist independently of the land to which it related, the quota could not be treated as a partnership asset and its value fell to be ignored on the dissolution. This decision should, however, be read subject to the views expressed by Jacob J in *Swift v Dairywise Farms Ltd [2000] 1 W.L.R. 1177* (although an appeal from that decision ultimately went off on other grounds: see *[2003] 1 W.L.R. 1606*) and to the fact that milk quota was, in any event, abolished in 2018, when The Dairy Produce Quotas Regulations 2005 (SI 2005/465) were revoked by The Food and Rural Affairs (Miscellaneous Revocations) Regulations 2018 (SI 2018/908) reg.3. There can be no such doubts over the existence of work in progress: *Browell v Goodyear, 24 October 2000*; cf. the unsatisfactory decision in *Robertson v Brent [1972] N.Z.L.R. 406*, noted supra, para.23-361. For another example of a case where special arrangements, by way of consolidation of all undrawn profit shares, capital contributions and loans, applied on dissolution, see *Bieber v Teathers Ltd [2012] 2 B.C.L.C. 585* and, on appeal, *[2013] 1 B.C.L.C. 248 CA*.

203 See supra, paras 10-144, 10-145, 10-343, et seq.; also *Watson v Haggitt [1928] A.C. 127*; and note *Re London India Rubber Co (1868) L.R. 5 Eq. 519*; *Re Bridgewater Navigation Co [1891] 2 Ch. 317*, varied sub nom. *Birch v Cropper (1889) L.R. 14 App. Cas. 525*. Cf. *Re Barber (1870) L.R. 5 Ch. App. 687*.

204 e.g. goodwill rarely, if ever, features in a firm's annual accounts but may, nevertheless, be one of its most valuable assets: see *Wade v Jenkins (1860) 2 Giff. 509*; *Steuart v Gladstone (1878) L.R. 10 Ch D. 626* at 659 per Jessel MR. See also supra, paras 10-144, 10-145, 10-343, et seq. Where an asset has been realised, regard must naturally be had to its actual rather than its book value: *Re Bridgewater Navigation Co [1891] 2 Ch. 317* at 329 per Lindley LJ.

205 *Buchanan v Nolan [2013] CSIH 38 (Ex.D)* at [37].

206 See generally, as to this section, *Duncan v The MFV Marigold PD145 2006 S.L.T. 975 OH* at [19], et seq. per Lord Reed.

207 There can be no such deficiency caused by a partner's own failure to contribute capital: *Re Ward [1985] 2 N.Z.L.R. 352* at 355.

208 It is inherently unlikely that a firm would agree to pay a third party's liability: see *Khan v Khan [2014] EWCA Civ 1077*. There the partners had agreed that their partnership was entitled to 50% of the "net equity" in certain properties jointly owned with others. It was held that only partnership liabilities, not those incurred by the non-partner co-owners, should be taken into account, at least to the extent that the latter could be repaid out of those co-owners' shares.

209 It follows that a partner will have no independent cause of action to recover an advance: *Green v Hertzog [1954] 1 W.L.R. 1309*. See also supra, paras 19-09, 22-07, 22-08.

210 Before quantifying this ultimate residue, it may be necessary to ascertain whether a share of any post-dissolution income is carried by the partners' capital contributions: see supra, para.20-51 and infra, para.25-78.

211 In his Supplement on the Partnership Act 1890, Lord Lindley rightly pointed out that the section follows "almost word for word" the statement of the law set out in the 5th edition of this work at p.402. See further, as to the position prior to the Act, *Crawshay v Collins (1826) 2 Russ. 325*; *Richardson v Bank of England (1838) 4 Myl. & Cr. 165*; *Binney v Mutrie (1886) L.R. 12 App. Cas. 160*.

212 See *Austin v Jackson (1879) L.R. 11 Ch D. 942*, note; *Potter v Jackson (1880) L.R. 13 Ch D. 845*.

213 *Ross v White [1894] 3 Ch. 326*. See also supra, para.23-208.

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214 See *[2019] EWHC 535 (Ch)* at [68] per Deputy Master Bowles. A similar observation was made about the Partnership Act 1890 s.39: see supra, para.19-42A.

215 See *Wood v Scoles (1866) L.R. 1 Ch. App. 369*.

216 See now the Partnership Act 1890 s.24(1), supra, para.20-03, et seq. Cf. *Binney v Mutrie (1886) L.R. 12 App. Cas. 160*. As to costs, see supra, paras 23-208, 25-75.

217 Thus, suppose that partners A and B share profits and losses equally. A has made an advance of £1,000 and a capital contribution of £2,000, whilst B has made an advance of £2,000 and a capital contribution of £2,000. The surplus assets remaining after stage 1 are merely £1,500, so that £1,500 of the advances and the entirety of the capital has been lost. Technically, the £1,500 will at stage 2 be divided rateably between A and B, A receiving £500 and B £1,000. The lost balance of £1,500 will be shared equally between them, so that A must in fact refund £250 of the £500 notionally received which is payable to B. The lost capital will not require an adjustment. The same result could be achieved by taking the overall loss of £5,500, of which A and B each bear £2,750. B is thus entitled to the return of his advance and capital contribution (£2,000 + £2,000) less his share of the loss (£2,750) = £1,250. He should thus be paid that sum out of the available surplus, the remainder being paid to A. See also infra, paras 25-81, 25-82.

218 See supra, para.20-51.

219 This should not be confused with a partner's entitlement to a share of *profits* under the Partnership Act 1890 s.42(1), as to which see supra, para.25-37, et seq.

220 See, however, supra, para.25-78.

221 See supra, paras 10-150, 17-06.

222 See supra, paras 10-151, 10-161.

223 But see supra, para.10-164.

224 e.g. in the case of a salaried partner: see supra, para.18-02.

225 In *Stekel v Ellice [1973] 1 W.L.R. 191* at 202, Megarry J expressed doubts whether such a partner could properly seek an order for the winding up of the firm's affairs.

226 See supra, para.17-12, et seq.

227 Partnership Act 1890 s.24(1), supra, para.20-03, et seq. Cf. *Binney v Mutrie (1886) L.R. 12 App. Cas. 160*.

228 See *Ex p. Maude (1867) L.R. 6 Ch. App. 51*; *Re Weymouth Steam Packet Co [1891] 1 Ch. 66*; *Re Wakefield Rolling Stock Co [1892] 3 Ch. 165*.

229 *Binney v Mutrie (1886) L.R. 12 App. Cas. 160*; also *Nowell v Nowell (1869) L.R. 7 Eq. 538*. And see *Re Anglesea Colliery Co (1866) L.R. 1 Ch. App. 555*; *Re Crookhaven Mining Co (1866) L.R. 3 Eq. 69*.

230 Those additional assets (or their proceeds) will prima facie have been applied in liquidation of debts owed to third parties.

231 See *Wood v Scoles (1866) L.R. 1 Ch. App. 369*; also *Re Holyford Mining Co (1869) I.R. 3 Eq. 208*; *Re Eclipse Gold Mining Co (1874) L.R. 17 Eq. 490*; *Binney v Mutrie (1886) L.R. 12 App. Cas. 160*.

232 *[1904] 1 Ch. 57*.

233 If, in fact, any partner has withdrawn a part of his original contribution, regard will be had to the partners' respective capital entitlements as at the date of dissolution (as in *Garner v Murray* itself).

234 This appears to be the conventional method of calculation and reflects the requirements of the words "including the sums, if any, contributed by the partners to make up losses or deficiencies of capital" in the Partnership Act 1890 s.44(b), supra, para.25-74. However, precisely the same result is in fact achieved if the partners' respective shares of the loss are deducted from their capital entitlements and the deficiency attributable to C's failure to contribute his share (i.e. £1,000–£2,000, a net deficiency of £1,000) is shared between A and B pro rata to their original contributions.

235 This was in fact the position in *Garner v Murray*.

236 This view appears to be based on the actual terms of the order made by Joyce J, although this is not set out in the reports; *quaere* is it borne out by the statement of the facts at *[1904] 52 W.R. 208*? The whole question appears to have been subject to detailed analysis in Australia: the current editor expresses his gratitude to Professor K.A. Houghton for drawing his attention to various articles in the journal Abacus. See in particular, Vol.17, No.1, p.41 and Vol.18, No.1, p.91. The issue is also considered in K. Fletcher, The Law of Partnership in Australia, 9th edn (Canberra: Lawbook Co., 2007) at para.7–200.

237 But see the terms of the Partnership Act 1890 s.44(a), supra, para.25-74.

238 If there were a positive balance *after* debiting the insolvent partner's share of the loss, there would in fact be no shortfall.

239 See supra, para.25-81.

240 See *Lyon v Haynes (1843) 5 Man. & G. 505*.

241 See the Partnership Act 1890 s.39, supra, para.19-42, et seq. Lord Lindley, referring to the (then exclusive) jurisdiction of the Chancery Division, observed that, in the event of any dispute, "it is under [that Division's] superintendence only

that the assets of the partnership can be properly sold and applied, that the partnership accounts can be satisfactorily taken, and that contribution can be enforced." To the same effect were Lord Millett's observations in *Hurst v Bryk [2002] 1 A.C. 185 HL* at 194. See also *Campbell v Campbell [2017] EWHC 182 (Ch)* at [155(a)] per M.H. Rosen QC (sitting as a deputy judge of the Chancery Division).

242 *Re Birkbeck Permanent Building Society [1915] 1 Ch. 91*.

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Form and service of the petition

27-24 Save where it is presented by an insolvency practitioner,[94] the petition will be in the normal form,[95] but must be verified by an affidavit in a specific form.[96] Service will, in general, be effected at the firm's principal place of business by handing the petition to a partner (including any person held out as such), employee or other person authorised to accept service.[97]

27-25 Presentation of the petition will be to the High Court[98] or to a county court within whose insolvency district the firm has (or has at any time had) "a" principal place of business[99] or, in the case of a creditor's petition based on a debt,[100] premises at which the firm's business was carried on when the debt was incurred.[101] If a petition has been presented to a county court, there is jurisdiction to transfer the whole insolvency proceedings or a particular application to be made therein to the High Court.[102]

Consequences of the presentation of a petition

Avoidance of transactions

27-26 Since the winding up of a partnership is generally deemed to commence when the petition is presented,[103] any disposition of partnership property, transfer of shares or "alteration in the status of the [*partners*]" after that date is void unless sanctioned by the court.[104] This would clearly invalidate any agreement between the partners to treat a partnership asset as belonging to one or more of their number[105] and would also, seemingly, operate to freeze the membership of the firm so that no existing partner may retire or be expelled nor any new partner be admitted after the relevant date.[106] A fortiori in the case of an attempt to turn the firm into a limited partnership.[107]

Stay of proceedings

27-27 An application to the court to stay any proceedings pending against the firm or any member thereof may be made at any time after the presentation of the petition and prior to a winding up order being made, by the firm itself or by any partner or creditor.[108]

Appointment of a provisional liquidator

27-28 A provisional liquidator may be appointed following the presentation of the petition,[109] and may, in the case of a petition presented by an insolvency practitioner,[110] be the petitioner himself.[111]

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88 Insolvency Act 1986 s.221A(1), as added by The Insolvent Partnerships Order 1994 (SI 1994/2421) art.9(a), Sch.5 para.2.

89 For the form of the demand, see The Insolvent Partnerships Order 1994 (SI 1994/2421) Sch.9 Form 10.

90 Insolvency Act 1986 s.221A(2)(a), (b), as added by The Insolvent Partnerships Order 1994 (SI 1994/2421) art.9(a), Sch.5 para.2. The amount of £750 may be increased under the Insolvency Act 1986 s.416: see s.221A(3). Since the debt will, by definition, already have been paid, questions of uncertainty as to the amount will not arise: cf. supra, para.27-16, fn.55.

91 *Quaere*, can such an order ever be obtained without taking an account as between the partners. See further, supra, para.23-115, et seq.; also the decision in *Hurst v Bennett [2001] B.P.I.R. 287 CA*, noted infra, para.27-71.

92 Other than insolvency proceedings.

93 Insolvency Act 1986 s.221A(2)(c), as added in the manner set out in fn.90. Note that Blackett-Ord and Haren, Partnership Law, 6th edn (London: Bloomsbury Professional, 2020) at para.22.56 speculates that this cumulative second requirement may be an error, although no further rationale for this suggestion is supplied. Once the partner has obtained permission, he can serve a petition on any applicable ground set out supra, para.27-14, other than the last. However, given the written demand procedure outlined in the text, he will almost inevitably petition on the basis of the firm's inability to pay its debts.

94 Insolvency Act 1986 s.221A(1), as added by The Insolvent Partnerships Order 1994 (SI 1994/2421) art.7(1) (as amended: see supra, para.27-21, fn.80), (2), Sch.3 Pt I para.3; The Insolvent Partnerships Order 1994 Sch.9 Form 3, as substituted by The Insolvent Partnerships (Amendment) Order 2002 (SI 2002/2708) art.6, Sch.

95 The Insolvency Rules (England and Wales) 2016 (SI 2016/1024) r.7.5(1), as applied by The Insolvent Partnerships Order 1994 (SI 1994/2421) art.18(1), Sch.10 as amended. The form of the petition is no longer set out in a Schedule to the Rules.

96 Insolvency Act 1986 s.221(8), as amended and applied by The Insolvent Partnerships Order 1994 (SI 1994/2421) art.7(1) (as amended: see supra, para.27-21, fn.80), (2), Sch.3 Pt I para.3 (creditor's petition) and art.9(a), Sch.5 (member's petition); The Insolvent Partnerships Order 1994 Sch.9 Form 2.

97 The Insolvency Rules (England and Wales) 2016 (SI 2016/1024) rr.1.2(2) (definitions of "serve" and "service"), 7.9(2), Sch.4 para.2(1), as applied by and read subject to the Insolvent Partnerships Order 1994 art.18(1), Sch.10 (as amended). Note also the terms of The Insolvency (England and Wales) Rules 2016 Sch.4 para.2(2)–(4) for alternative methods of service.

98 Insolvency Act 1986 s.117(1), as amended, in the case of a creditor's petition, by The Insolvent Partnerships Order 1994 (SI 1994/2421) Sch.3 Pt II para.6 and applied by the Insolvency Act 1986 s.221(5) (as itself amended and applied by The Insolvent Partnerships Order 1994 art.7(1) (as amended: see supra, para.27-21, fn.80), (2), Sch.3 Pt I para.3) and as amended and applied, in the case of a member's petition, by The Insolvent Partnerships Order 1994 art.9(a), Sch.5 para.1.

99 Insolvency Act 1986 s.117(2)(a), as amended, in the case of a creditor's petition, by The Insolvent Partnerships Order 1994 (SI 1994/2421) Sch.3 Pt II para.6 and applied by the Insolvency Act 1986 s.221(5), as itself amended and applied in the manner set out in the preceding footnote. In the case of a member's petition, see the Insolvency Act 1986 s.117(2), as amended and applied by The Insolvent Partnerships Order 1994 art.9(a), Sch.5 para.1. Note that, in each case, the existence of more than one principal place of business is clearly contemplated.

100 See supra, para.27-14, et seq.

101 Insolvency Act 1986 s.117(2)(b), as amended and applied in the manner set out in fn.99.

102 The Insolvency Rules (England and Wales) 2016 (SI 2016/1024) r.12.30(2); *Bell v Ide [2021] 1 W.L.R. 1076 CA*. See also CPR PD (Insolvency Proceedings) 2018 para.3.6.

103 Insolvency Act 1986 s.129 (as amended by the Enterprise Act 2002 Sch.17 para.16), as applied by The Insolvent Partnerships Order 1994 (SI 1994/2421) s.221(5) (as amended and applied by The Insolvent Partnerships Order 1994 art.7(1) (as amended: see supra, para.27-21, fn.80), (2), Sch.3 Pt I para.3 (creditor's petition) and art.9(a) Sch.5 para.2 (member's petition)).

104 Insolvency Act 1986 s.127 (as amended by the Enterprise Act 2002 Sch.17 para.15 and the Corporate Insolvency and Governance Act 2020 Sch.3 para.12), as applied in the manner set out in the preceding footnote. The discretion under the section (and its predecessors) is a wide one: see *Re Burton & Deakin Ltd [1977] 1 W.L.R. 390*; *Re Gray's Inn Construction Co Ltd [1980] 1 W.L.R. 711 CA*; *Denney v John Hudson & Co Ltd [1992] B.C.L.C. 901 CA*; *Hollicourt (Contracts) Ltd v Bank of Ireland [2001] Ch. 555 CA*; *Royal Bank of Scotland Plc v Bhardwaj [2002] B.C.C. 57*; *Wilson v SMC Properties Ltd [2015] 2 B.C.L.C. 173*; *Express Electrical Distributors Ltd v Beavis [2016] 1 W.L.R. 4783 CA*. It is not a defence to show that the payment was received in good faith or for valuable consideration: *Officeserve Technologies Ltd v Annabel's (Berkeley Square) Ltd [2019] Ch. 103*.

105 See, as to such agreements, supra, para.18-69, et seq. and infra, para.27-147, et seq.

106 See further, as to retirement from an insolvent firm, supra, para.24-176, et seq. Even if the incoming partner does not acquire any interest in the capital or assets of the firm, the creation of his profit share will almost inevitably involve

a "transfer" of part of the existing partners' profit shares as well as a change in their status, i.e. when they become members of the "new" firm constituted following the incoming partner's admission.

107 See generally, as to the formalities which would otherwise be required in order to effect such conversion, infra, para.29-01, et seq. An attempt to form a limited liability partnership would be even more objectionable, since it would necessarily involve the dissolution of the existing firm: see further, as to such "partnerships", supra, para.2-61, et seq.

108 Insolvency Act 1986 ss.126 (as amended), 227, as respectively applied by s.221(5) (as itself amended and applied in the manner set out supra, para.27-25, fn.98). For these purposes a partner is clearly a "contributory": see the Insolvency Act 1986 s.226(1) and infra, paras 27-87, 27-91, et seq. Although s.227 refers to "actions or proceedings against any contributory", thus seemingly including actions in respect of a partner's separate debts, the current editor submits that it should not be so construed: cf. s.228 (as amended), where the position is clear.

109 Insolvency Act 1986 s.135(1), (2), as applied by s.221(5) (as itself amended and applied in the manner set out supra, para.27-25, fn.98). As to the manner in which the application is made, see The Insolvency Rules (England and Wales) 2016 (SI 2016/1024) r.7.33, as amended by The Insolvency (Amendment) (EU Exit) Rules 2019 (SI 2019/146) reg.2 Sch. Pt 4 para.81 and The Insolvency (England and Wales) (No.2) (Amendment) Rules 2021 (SI 2021/1028) Pt 3 r.37, and applied by The Insolvent Partnerships Order 1994 (SI 1994/2421) art.18(1), Sch.10, as amended. Note, as to the circumstances in which a provisional liquidator can apply for a freezing order against a partner or alleged partner, *Hunt v Ubhi [2023] 4 All E.R. 530* CA.

110 Insolvency Act 1986 s.221A(1), as added by The Insolvent Partnerships Order 1994 (SI 1994/2421) art.7(1) (as amended: see supra, para.27-21, fn.80), (2), Sch.3 Pt I para.3. See further supra, para.27-21.

111 Insolvency Act 1986 s.221A(4), as added in the manner set out in the preceding footnote.

112 Insolvency Act 1986 s.125(1), as applied by s.221(5) (as itself amended and applied in the manner set out supra, para.27-25, fn.98).

113 See, as to such orders, infra, para.27-241, et seq.

114 Note, however, that the form is no longer set out in The Insolvency Rules (England and Wales) 2016 (SI 2016/1024).

115 Insolvency Act 1986 s.130(2), as applied by s.221(5) (as itself amended and applied in the manner set out supra, para.27-25, fn.98). The discretion is a wide one: *Re Aro Ltd [1980] Ch. 196*; as to the factors to be taken into account, see *Re Exchange Securities & Commodities Ltd [1983] B.C.L.C. 186*; *New Cap Reinsurance Corp Ltd v HIH Casualty & General Insurance Ltd [2002] B.C.L.C. 228*; *Bourne v Charit-Email Technology Partnership LLP [2010] 1 B.C.L.C. 210*. Permission to continue the proceedings was, in fact, granted in *Mortgage Trust Ltd v Willmett Solicitors (A Firm) [2018] EWHC 488 (Ch)*: see [19]. See further as to this decision, supra, para.14-38.

116 Insolvency Act 1986 s.228, as applied by the Insolvent Partnerships Order 1994 art.7(1) (as amended: see supra, para.27-21, fn.80) (creditor's petition) and art.9(b) (member's petition). For these purposes a partner is clearly a "contributory": see the Insolvency Act 1986 s.226(1) (as applied by in the like manner) and infra, paras 27-87, et seq., 27-91, et seq. Cf. the terms of s.227: see supra, para.27-27, fn.108. And see also *Re Scott-Hake [2021] 2 B.C.L.C. 460* at [47].

117 Insolvency Act 1986 s.128(1), as applied by s.221(5) (as amended and applied in the manner set out supra, para.27-25, fn.98). Although seemingly absolute in its terms, the section may be overridden by an order under the Insolvency Act 1986 s.130(2) (as applied in the same manner): see *The Constellation [1966] 1 W.L.R. 272* (a decision under the Companies Act 1948 ss.228, 231).

118 *Re Artistic Colour Printing Co (1880) L.R. 14 Ch D. 502* at 505 per Jessel MR; *The Constellation [1966] 1 W.L.R. 272*. Note that, before its replacement by the Enterprise Act 2002 s.248(1), it had been held that "proceedings" for the purposes of the Insolvency Act 1986 s.11(3)(d) must be of a legal or quasi-legal nature: *Bristol Airport Plc v Powdrill [1990] Ch. 744*.

119 Insolvency Act 1986 s.228, as applied by The Insolvent Partnerships Order 1994 (SI 1994/2421) art.7(1) (as amended: see supra, para.27-21, fn.80) (creditor's petition) and art.9(b) (member's petition). It is submitted that proceedings by the liquidator in order to enforce a call on a partner qua contributory (see infra, para.27-94) would also require permission: see *Williams v Harding (1866) L.R. 1 H.L. 9*; sed quaere.

120 The Insolvency Act 1986 s.228 will not apply in such a case; *per contra* if the proceedings are brought in respect of a partnership debt.

121 As added by the Insolvent Partnerships Order 1994 art.14(1).

122 This will include a person who is merely held out as a partner: see the definition of "member" in The Insolvent Partnerships Order 1994 (SI 1994/2421) art.2(1), as added to the Insolvency Act 1986 s.436 by art.2(2). Cf. *Re C & M Ashberg, The Times, 17 July 1990*, noted supra, para.27-09.

123 See further, as to the directions which may be made, the Insolvency Act 1986 s.168(5B), as also added by The Insolvent Partnerships Order 1994 (SI 1994/2421) art.14(1).

124 As added by The Insolvent Partnerships Order 1994 (SI 1994/2421) art.14(2).

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Where a disqualification order or undertaking is in place, a compensation order or undertaking may be made or accepted for the benefit of the insolvent firm's creditors who have suffered loss as a result of that partner's conduct. [342]

Bankruptcy restrictions orders

27-101 Where the firm is *not* wound up as an unregistered company, no disqualification orders can be made [343] but, if one or more partners are individually made bankrupt, [344] the court may, on the application of the Secretary of State or (at his direction) the official receiver, [345] make a bankruptcy restrictions order against an individual partner if his conduct before or after the making of the relevant bankruptcy order warrants it. [346] Equally, a bankrupt partner may offer the Secretary of State a bankruptcy restrictions undertaking. [347] The order or undertaking must be of not less than two nor more than 15 years' duration, [348] and will, inter alia, subject the partner in question to the same restrictions on obtaining credit and carrying on business as applied to him when the bankruptcy was continuing. [349]

Delivery up of partnership property

27-102 Where a winding up order is made against a firm, whether or not there are concurrent petitions against one or more of the partners, [350] the authority of all the partners (solvent and insolvent) to bind the firm or to dispose of its assets [351] is automatically terminated and each partner is obliged to deliver up to the liquidator any partnership property [352] in his hands. [353] A similar obligation is imposed on former partners. If such property is in the hands of a third party, e.g. a partner's spouse, the liquidator can apply to the court for an order for such delivery up. [354]

27-103 Where orders are made on a joint bankruptcy petition, [355] the partners will be subject to the same obligation as regards the trustee. [356]

Statement of affairs

27-104 Once a winding up order has been made against a firm or a provisional liquidator appointed, [357] the official receiver may require any of the partners or former partners to submit a statement of the firm's affairs, including particulars of its assets, debts and liabilities. [358] Where an insolvency order has been made against a corporate or individual partner on a concurrent petition, [359] the statement in relation to that partner must distinguish between the assets and liabilities of the firm and of the partner in question. [360] Where an individual partner is bankrupted on a joint bankruptcy petition, [361] the normal provisions regarding his statement of affairs apply. [362]

Footnotes

287 As applied to partnerships, the Insolvency Act 1986 s.79(1) (as amended by The Companies Act 2006 (Consequential Amendments, Transitional Provisions and Savings) Order 2009 (SI 2019/1941) Sch.1 para.75(8)(a)) provides that "the

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339 See *Secretary of State for Business, Energy and Industrial Strategy v Geoghegan [2021] Bus. L.R. 776*; also J. Whittaker and J. Machell, The Law of Limited Liability Partnerships, 5th edn (London: Bloomsbury Professional, 2021), paras 37.1, 37.2. An LLP is, of course, not a partnership: see the Limited Liability Partnerships Act 2000 s.1(2).

340 The Insolvency Act 1986 s.216 does not apply in such a case: see *Newton v The Secretary of State for Business, Energy and Industrial Strategy [2016] B.C.C. 34*.

341 Company Directors Disqualification Act 1986 s.7A, as substituted by The Insolvency (Miscellaneous Amendments) Regulations 2017 (SI 2017/1119) Sch.2 para.8(4) and applied in the manner set out supra, para. 27-97, fn.335.

342 Company Directors Disqualification Act 1986 ss.15A, 15B, as substituted by The Insolvency (Miscellaneous Amendments) Regulations 2017 (SI 2017/1119) Sch.2 para.8(9) and applied in the manner set out supra, para. 27-97, fn.335. An application for such an order must be made by the Secretary of State and must be sought within two years of the disqualification order or undertaking: see s.15A(1), (5). See, as to the operation of the equivalent provisions in the case of a company, *Re Noble Vintners Ltd [2020] B.C.C. 198*.

343 See *Official Receiver v Lloyd [2015] B.P.I.R. 374*.

344 See supra, para.27-62, et seq.

345 Insolvency Act 1986 Sch.4A para.1(2), as added by the Enterprise Act 2002 s.257(2), Sch.20.

346 Insolvency Act 1986 s.281A, Sch.4A para.2(1), as respectively added by the Enterprise Act 2002 s.257(1), Sch.20. The factors to be taken into account by the court are listed in Sch.4A para.2(2), as subsequently amended by the Enterprise and Regulatory Reform Act 2013 Sch.19 para.63. See, as to the type of conduct attracting such an order, *Official Receiver v Lloyd [2015] B.P.I.R. 374*.

347 Insolvency Act 1986 Sch.4A para.7, as added by the Enterprise Act 2002 Sch.20.

348 Insolvency Act 1986 Sch.4A para.4(2) (order), 9(1), (2) (undertaking), both as added by the Enterprise Act 2002 Sch.20. In *Official Receiver v Lloyd [2015] B.P.I.R. 374*, the orders against the father and son were made for 10 and 12 years respectively.

349 See the Insolvency Act 1986 s.360(5), (6), as added by the Enterprise Act 2002 s.257(3), Sch.21 para.3. A bankruptcy restrictions undertaking has the same effect as a bankruptcy restrictions order: Insolvency Act 1986 Sch.4A para.8, as added by the Enterprise Act 2002 s.257(2), Sch.20. As to the effect of s.360(1), see supra, para.4-30. As to the other effects of such an order/undertaking, see the Enterprise Act 2002 Sch.21.

350 See supra, paras 27-14, et seq., 27-36, et seq.

351 In such a case, the Partnership Act 1890 s.38 clearly has no application: see *Connaught Income Fund, Series 1 v Capita Financial Managers Ltd [2015] 1 All E.R. 751* at [18] per HHJ Mackie (sitting as judge of the Chancery Division); also supra, para.13-86, et seq.

352 This expression is defined by reference to the Partnership Act 1890: The Insolvent Partnerships Order 1994 (SI 1994/2421) art.2(1). See further supra, para.18-03, et seq.

353 Insolvency Act 1986 s.234, as amended, where there are no concurrent petitions, by The Insolvent Partnerships Order 1994 (SI 1994/2421) Sch.3 Pt II para.9 and applied by the Insolvency Act 1986 s.221(5), as itself amended by The Insolvent Partnerships Order 1994 art.7(1) (as amended by the Insolvent Partnerships (Amendment) Order 1996 (SI 1996/1308) art.2 and The Insolvent Partnerships (Amendment) Order 2002 (SI 2002/1308) art.3), (2), Sch.3 Pt I para.3 (creditor's petition) and art.9(a) Sch.5, para.2 (member's petition)) and as amended, where there *are* concurrent petitions, by The Insolvent Partnerships Order 1994 Sch.4 Pt II para.27 and applied by the Insolvency Act 1986 s.221(5), as itself amended by The Insolvent Partnerships Order 1994 art.8(1) (as amended by The Insolvent Partnerships (Amendment) Order 2002 art.4(1)), (2), Sch.4 Pt I para.3 (creditor's petition) and art.10(1)(a) (as amended by The Insolvency (Miscellaneous Amendments) Regulations 2017 (SI 2017/1119) Sch.2, para.3), Sch.6 para.4 (member's petition).

354 Insolvency Act 1986 s.234(3); see also s.237, as applied in the same manner as set out in the preceding footnote.

355 See supra, para.27-62.

356 Insolvency Act 1986 s.312(2), as amended and applied by The Insolvent Partnerships Order 1994 (SI 1994/2421) art.11, Sch.7 para.20.

357 See, as to the appointment of provisional liquidators, supra, para.27-28.

358 Insolvency Act 1986 s.131, as amended by The Insolvent Partnerships Order 1994 (SI 1994/2421) Sch.3 Pt II para.7 (where there are no concurrent petitions) and Sch.4 Pt II para.10 (where there are concurrent petitions) and applied in the manner set out supra, para.27-102, fn.352.

359 See supra, para.27-54, et seq.

360 Insolvency Act 1986 s.131(1)(b), (c), (3)(a), as amended by The Insolvent Partnerships Order 1994 (SI 1994/2421) Sch.4 Pt II para.10 and applied by art.8(4)–(8) (as amended by the Insolvent Partnerships (Amendment) Order 2006 (SI 2006/622) art.3) (creditor's petition) and art.10(2)–(6) (as respectively amended by The Insolvent Partnerships (Amendment) Order 2006 art.4, The Enterprise and Regulatory Reform Act 2013 (Consequential Amendments)

Chapter 29 - Nature, Formation, Registration and Designation

Lindley & Banks on Partnership 21st Ed.

Mainwork updated to include amendments from First Supplement

Part 6 - Limited Partnerships

Chapter 29 - Nature, Formation, Registration and Designation

29-01 A limited partnership is not a legal entity like a limited company [1] or a limited liability partnership [2] but a form of partnership with a number of special characteristics introduced by the Limited Partnerships Act 1907. [3] Although it is necessary to ensure strict compliance with the statutory conditions if the benefit of limited liability is to be obtained for all the partners, [4] such a partnership is otherwise governed by the general law of partnership, [5] although provision will, as from 2026, be made for any aspects of company law to be applied to such partnerships and, equally, for any parts of partnership law to be disapplied by regulations made by the Secretary of State. [6]

Footnotes

1 See *Re Barnard [1932] 1 Ch. 269* at 272.

2 Limited Liability Partnerships Act 2000 s.1(2).

3 This proposition was accepted in *Vanquish Properties (UK) Ltd Partnership v Brook Street (UK) Ltd [2016] L. & T.R. 33* at [7] per Chief Master Marsh, also citing *Re Barnard [1932] 1 Ch. 269* at 272.

4 Limited Partnerships Act 1907 s.4 (as amended by The Legislative Reform (Limited Partnerships) Order 2009 (SI 2009/1940) art.8, only as regards limited partnerships registered after 1 October 2009), infra, para.A3-05. See further infra, paras 29-60, 29-61, 29-69, 29-70.

5 Limited Partnerships Act 1907 s.7, infra, para.A3-09.

6 Limited Partnerships Act 1907 s.7A, as inserted (as from a date to be appointed, which will not be before 2026) by the Economic Crime and Corporate Transparency Act 2023 s.149, infra, para.A3A-10.

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Section 1. - The Authority of Partners to Bind the Firm

Lindley & Banks on Partnership 21st Ed.

Mainwork updated to include amendments from First Supplement

Part 6 - Limited Partnerships

Chapter 30 - The Rights and Obligations of the Partners as Regards Third Parties

Section 1. - The Authority of Partners to Bind the Firm

General partners

30-01 A general partner in a limited partnership has the same implied authority to bind the firm as a member of an ordinary partnership: the limits of that authority will accordingly be determined by the nature of the business and the way in which it is usually carried on.[1] Thus, a general partner can, in appropriate circumstances,[2] enter into an agreement which will be binding on all the limited partners.[3] However, whilst such a partner has the exclusive right to manage the partnership business,[4] it is considered that he does not have power, without the consent of the limited partners, to alter the nature of that business in order to extend his authority.[5] This proposition is, to an extent, supported by section 6A(2)(a)(ii) of the 1907 Act,[6] which provides that a limited partner in a private fund limited partnership[7] who takes part in a "decision about … whether the general nature of the partnership business should change" will not, of itself, involve him in taking part in the management of that business.

30-02 Provided that he does not become insolvent,[8] a general partner's authority will continue after the dissolution of the firm for so long as is necessary to wind up its affairs and to complete any unfinished business[9]; indeed, in the absence of a court order to the contrary,[10] it is the duty of a general partner to attend to such winding up[11] along with the depositary in the case of a partnership which constitutes a partnership scheme.[12]

Deeds

30-03 In earlier editions of this work it has been submitted that section 6(1) of the Limited Partnerships Act 1907 so modified the general rule that a partner has no implied authority to bind his firm by deed[13] as to confer such authority on the general partner(s), provided that the deed in question is framed and executed in the appropriate manner.[14] However, the current editor ventures to suggest that, even if this proposition is right, it will only rarely have any practical significance. If a deed is binding on the general partner, any claim thereunder will be enforceable against him and, if it was executed in pursuance of his authority as such, he will have authority to apply the partnership assets in settlement of that claim or otherwise to comply with any order a court may make, e.g. an order for specific performance. This is entirely consistent with the views expressed by Farwell J in *Re Barnard*,[15] to the effect that there is no question of joint liability where there is only one general partner, since he alone is, in a normal case, liable for the debts.[16] The position is a fortiori in a case where a partnership scheme is wound up as an unregistered company,[17] since then even the general partner is exempted from personal liability.[18]

Conveyances, security, etc.

30-04

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8 This is now specifically provided for in the case of a private fund limited partnership: see the Limited Partnerships Act 1907 s.6(3A), infra, para.A3-07.

9 Partnership Act 1890 s.38, infra, para.A1-39; Limited Partnerships Act 1907 s.7 (as amended), infra, para.A3-09. See also supra, para.13-86, et seq.

10 See the Limited Partnerships Act 1907 s.6(3D), infra, para.A3-07.

11 See the Limited Partnerships Act 1907 s.6(3A), infra, para.A3-07.

12 See the Limited Partnerships Act 1907 s.6(3), as amended by The Legislative Reform (Private Fund Limited Partnerships) Order 2017 (SI 2017/514) art.2(4)(b) and further amended (in the case of a partnership scheme) by The Collective Investment in Transferable Securities (Contractual Scheme) Regulations 2013 (SI 2013/1388) reg.16(4)(b).

13 See supra, paras 12-103, et seq., 12-251, et seq.

14 See the Partnership Act 1890 s.6, infra, para.A1-08 and supra, paras 12-251, 12-252. *Quaere*, does it matter that the partnership was not itself created by deed: see supra, para.12-103.

15 *[1932] 1 Ch. 269* at 274. See further infra, para.33-07, et seq.

16 *Per contra*, if a limited partner has forfeited his limited liability by participating in the management of the firm: Limited Partnerships Act 1907 s.6(1) (as amended): see infra, para.31-07, et seq.

17 See, generally, supra, para.27-11, et seq.

18 The Collective Investment in Transferable Securities (Contractual Scheme) Regulations 2013 (SI 2013/1388) reg.18(3). As to Scotland, see reg.19(3) of those Regulations.

19 See the Law of Property Act 1925 s.34(2) (as amended by the Trusts of Land and Appointment of Trustees Act 1996 Sch.2 para.3(2)), as considered in *Vanquish Properties (UK) Ltd v Brook Street (UK) Ltd [2016] L.& T.R. 33*, a decision of Chief Master Marsh. And see also supra, paras 3-24, 18-94.

20 See supra, paras 19-04, 19-05.

21 See supra, para.3-05, et seq.

22 See the Partnership Act 1890 s.4(1) (definition of "firm"), infra, para.A1-05, as applied by the Limited Partnerships Act 1907 s.3, infra, para.A3-04; and see infra, paras 30-33, 31-45.

23 There is, of course, an obligation to register the change: see supra, para.29-65.

24 See the Partnership Act 1890 s.36(1), infra, para.A1-37. And see generally, supra, para.13-55, et seq.

25 Limited Partnerships Act 1907 s.6(6) (as added by The Legislative Reform (Private Fund Limited Partnerships) Order 2017 (SI 2017/514) art.2(4)(c)), infra, para.A3-07. And see infra, paras 30-12, 30-15, 30-32.

26 See the Limited Partnerships Act 1907 s.10(1A), infra, para.A3-16. See also infra, para.30-15.

27 Limited Partnerships Act 1907 ss.9(1), (1A)(a)(iv), 10(1), (1A), infra, paras A3-15, A3-16. And see infra, para.30-16, et seq. Note, however, that s.10 does not apply to a partnership scheme: see the Collective Investment in Transferable Securities (Contractual Scheme) Regulations 2013 reg.16(7).

28 See supra, para.29-38.

29 Limited Partnerships Act 1907 s.10(1A)–(1C), infra, para.A3-16. And see further infra, para.30-14, et seq.

30 Limited Partnerships Act 1907 s.6(1) (as amended), infra, para.A3-07.

31 But note, in this context, *PWA Corp v Gemini Group Automated Distribution Systems Inc [1993] 103 D.L.R. (4th) 609*, a decision under a procedural regime which is not replicated in the CPR. Cf. the Partnership Act 1890 s.15, infra, para.A1-16; and see supra, para.12-38, et seq.

32 cf. the Partnership Act 1890, s.16, infra, para.A1-17; see also supra, para.12-42, et seq.

33 Limited Partnerships Act 1907, ss.6(1), 9(1) (as amended), infra, paras A3-07, A3-15; see also supra, para.29-68.

34 Although such conduct will make him liable for the debts of the partnership whilst he so takes part *as though* he were a general partner (see the Limited Partnerships Act 1907 s.6(1)), it does not actually make him a general partner or give him the authority to act as such.

35 See *Collen v Wright (1857) 8 E. & B. 647*; *Starkey v Bank of England [1903] A.C. 114*; *Yonge v Toynbee [1910] 1 K.B. 215*.

36 See *Halbot v Lens [1901] 1 Ch. 344*.

37 As to how far registration constitutes notice of the fact that a person is a limited partner, see supra, paras 29-72, 29-73.

38 Limited Partnerships Act 1907 s.6(1), infra, para.A3-07. See further infra, para.31-03, et seq.

39 See the Limited Partnerships Act 1907 s.6A(2)(d), which applies to a limited partner "entering into, or acting under, a contract with the other partners … provided that the contract does not require, or the action under the contract does not involve a limited partner taking part in the management of the partnership business". It follows that the danger referred to in the text remains. See further, as to this "white list", infra, para.31-16, et seq.

40 See supra, para.30-08, et seq.

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B. - Grounds for dissolution by the court

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Part 6 - Limited Partnerships

Chapter 32 - Dissolution and Winding Up

Section 2. - Dissolution by the Court

B. - Grounds for dissolution by the court

Mental incapacity of a general or limited partner

32-15 In the case of a general partner's lack of mental capacity, it would seem that the court will have power to dissolve the partnership in the normal way.[41] However, the Limited Partnerships Act 1907 provides that the mental disorder of a *limited* partner is not a ground for dissolution by the court unless his share "cannot be otherwise ascertained and realised."[42] The underlying assumption appears to be that such a partner will usually enjoy a right to have his share ascertained and realised without a dissolution, even though the Act does not expressly provide for this.[43] In earlier editions of this work it was argued that such an assumption is inconsistent with section 4 of the Limited Partnerships Act 1907[44] but, in the current editor's view, this argument is at the very least questionable.[45] An explanation may be that the reference to the realisation of the limited partner's share is no more than an allusion to his power to assign his share with the consent of the general partners[46] or to those cases in which the agreement contains provision for the purchase of a mentally incapacitated partner's share,[47] but this is admittedly not supported by the recent amendments to section 4 of the Act.[48]

32-16 It would seem to follow from the foregoing that, if the other partners are to avoid a general dissolution resulting from the mental incapacity of a limited partner, they must themselves purchase his share, whether pursuant to a provision of the agreement[49] or, perhaps, on an ad hoc basis,[50] or arrange for its assignment to a third party who is acceptable to them as a partner.

Other grounds affecting a limited partner

32-17 Where dissolution proceedings are brought by a limited partner or are framed by reference to the conduct of, or some other matter directly affecting, such a partner, the exercise of the court's discretion will inevitably be influenced by his special status under the Act.[51] However, it does not follow that the court will necessarily be unsympathetic to such an application, as is evidenced by the decision in *Re Hughes & Co*,[52] where an order appears to have been made on the "just and equitable" ground.

Winding up of a corporate partner

32-18

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The existence of a corporate partnership [53] is not expressly contemplated by the Partnership Act 1890 or by the Limited Partnerships Act 1907, [54] so that no statutory provision establishes the effect of a winding up order against a corporate partner. [55] It is submitted that, in the event of a corporate *general* partner going into liquidation, the court would in all probability order a dissolution on the "just and equitable" ground [56]; a fortiori if it was the sole general partner. [57] Moreover, the dissolution of such a partner would almost inevitably bring about a dissolution of the firm, in the absence of some other agreement. [58] However, the same cannot be said of a corporate limited partner: in either of the above instances, there is perhaps little more than an arguable case for a dissolution on the "just and equitable" ground. [59]

32-19 It should be noted that various special provisions apply under the insolvency legislation in the case of a corporate partner which is sought to be wound up on a petition presented concurrently with a petition for the winding up of the firm. [60]

Insolvency

32-20 The grounds on which an insolvent partnership may be wound up as an unregistered company under the Insolvency Act 1986 are considered elsewhere in this work. [61]

Footnotes

41 i.e. under the Partnership Act 1890 s.35, infra, para.A1-36. It is, however, by no means clear whether the Court of Protection has a right to order a dissolution under the Mental Capacity Act 2005 s.18(1): see supra, paras 24-101, 24-125, et seq. In the case of a Scottish or Northern Irish limited partnership, note the terms of the Partnership Act 1890 s.35(a) which will, as from a date to be appointed, be substituted by the Economic Crime and Corporate Transparency Act 2023 s.130(1).

42 Limited Partnerships Act 1907 s.6(2), infra, para.A3-07.

43 This is, however, now indirectly provided for in the case of an outgoing limited partner in a partnership scheme: see the Limited Partnerships Act 1907 s.4(2AB), (2AC), as added by The Collective Investment in Transferable Securities (Contractual Scheme) Regulations 2013 (SI 2013/1388) reg.16(3)(b), as amended by The Legislative Reform (Private Fund Limited Partnerships) Order 2017 (SI 2017/514) art.5(2)(c), infra, para.A3-05. As to such partnerships, see supra, para.29-03.

44 See supra, para.31-44.

45 See supra, paras 30-35, 31-45.

46 Limited Partnerships Act 1907 s.6(5)(b), infra, para.A3-07: see supra, para.31-38.

47 Such a construction would support the arguments advanced supra, paras 30-35, 31-45.

48 See supra, fn.43.

49 See supra, para.10-314, et seq.

50 Note also the so-called *Syers v Syers* jurisdiction considered supra, para.23-325, et seq.

51 See, generally, the Partnership Act 1890 s.35, supra, paras 24-100, 24-131, et seq. Note, however, that this did not appear to figure as a consideration in *PWA Corp v Gemini Group Automated Distribution Systems Inc [1993] 103 D.L.R. (4th) 609 (CA, Ontario)*, noted supra, para.24-164.

52 *[1911] 1 Ch. 342*, where a petition had been brought by the limited partner under the Companies (Consolidation) Act 1908. See also *Muirhead v Borland 1925 S.C. 474 (Ct. of Session)*. And see, as to the current position in Scotland, *Smith v Smith 1998 S.C.L.R. 818 (Sh. Ct)*.

53 See, as to the meaning of this expression, supra, para.11-02.

54 Despite the limited terms of s.4(4), infra, para.A3-05.

55 See further, supra, para.32-02.

56 Partnership Act 1890 s.35(f), infra, para.A1-36; and see supra, paras 24-77, et seq., 24-158, et seq. The liquidation of a corporate partner by no means implies that it is insolvent; see supra, para.11-13.

57 A limited partnership must comprise at least one general partner: Limited Partnerships Act 1907 s.4(2), infra, para.A3-05.

58 Partnership Act 1890 s.33(1), infra, para.A1-34; see also supra, paras 24-80, 32-02.

59 Since the dissolution of a company may be equated with the death of an individual, it might be argued that the Limited Partnerships Act 1907 s.6(2), infra, para.A3-07 (which prevents the death of a limited partner from automatically dissolving the firm) is effective to prevent such a dissolution being ordered; sed quaere.

60 See The Insolvent Partnerships Order 1994 (SI 1994/2421) art.8(4), (5) (as amended by The Insolvent Partnerships (Amendment) Order 2006 (SI 2006/622) art.3), (8), (creditor's petition), art.10(2), (3), (6), as amended, in the case of art.10(3), by The Insolvent Partnerships (Amendment) Order 2006 art.4 and, in the case of art.10(6), substituted by The Insolvent Partnerships (Amendment) Order 2005 (SI 2005/1516) art.5(b) (members' petition). See further supra, paras 27-39, et seq., 27-51, et seq.

61 See supra, paras 27-07, et seq., 32-10, et seq.

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ITEM NO. 182

JA-68

UNITED STATES BANKRUPTCY COURT
DISTRICT OF DELAWARE

In re	)	Chapter 11
	)	
SEA LAUNCH COMPANY, L.L.C., *et al.*,[1]	)	Case No. 09-12153 (BLS)
	)	
	)	Jointly Administered
Debtors.	)	
	)	

DISCLOSURE STATEMENT FOR THE DEBTORS' SECOND AMENDED JOINT PLAN OF REORGANIZATION

ALSTON & BIRD LLP
Dennis J. Connolly
Matthew W. Levin
1201 West Peachtree Street, N.E.
Atlanta, Georgia 30309-3424
Telephone: (404) 881-7940
Facsimile: (404) 881-7777

- and -

YOUNG CONAWAY STARGATT & TAYLOR, LLP
Joel A. Waite (No. 2925)
Kenneth J. Enos (No. 4544)
The Brandywine Building
1000 West Street, 17th Floor
P.O. Box 391
Wilmington, Delaware 19801-0391
Telephone: (302) 571-6600
Facsimile: (302) 571-1253

Counsel to the Debtors and Debtors in Possession

Dated: June 21, 2010

[1] The last four digits of the taxpayer identification numbers for each of the Debtors follow in parenthesis: (i) Sea Launch Company, L.L.C. (1590); (ii) Sea Launch Limited Partnership (Cayman) (8182); (iii) Sea Launch ACS Limited (5999); (iv) Sea Launch ACS Limited Partnership (Isle of Man) (6216); (v) Platform LDC (3177); and (vi) Platform Limited Partnership (3173). The mailing address for all of the Debtors is 2700 Nimitz Road, Long Beach, CA 90802.

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I. INTRODUCTION AND PLAN SUMMARY

Sea Launch Company, L.L.C. ("**Sea Launch**"), a Delaware limited liability company, Sea Launch Limited Partnership ("**SLLP**"), a Cayman Islands exempted limited partnership, and its direct and indirect subsidiaries, Sea Launch ACS Limited ("**ACS Ltd.**"), an Isle of Man exempted company, Sea Launch ACS Limited Partnership ("**ACS LP**"), an Isle of Man exempted limited partnership, Platform LDC ("**Platform LDC**"), a Cayman Islands exempted limited duration company, and Platform Limited Partnership ("**Platform LP**"), a Cayman Islands exempted limited partnership (each a "**Debtor**", and collectively, the "**Debtors**"), hereby submit this disclosure statement (the "**Disclosure Statement**") pursuant to Section 1125, Title 11, United States Code (the "**Bankruptcy Code**") in connection with the solicitation of acceptances for their Joint Plan of Reorganization (the "**Plan**"), a copy of which is attached hereto as Exhibit A. The purpose of this Disclosure Statement, in accordance with the requirements of Section 1125 of the Bankruptcy Code, is to provide "adequate information" concerning the Plan, of a kind and in sufficient detail to enable a hypothetical reasonable investor, typical of holders of the Classes[2] of Claims being solicited, to make an informed judgment whether to accept or reject the Plan. This Disclosure Statement should be read in conjunction with the Plan and the other exhibits to this Disclosure Statement. Nothing in this Disclosure Statement shall be regarded as a statement or admission by any of the members of Sea Launch or the Partners (as such term is defined below) or their affiliates as to any of the facts surrounding the failure of the business or within the framework or connected or related to any present or future disputes among them in other fora. Further, the members of Sea Launch and the Partners (as such term is defined below), do not necessarily agree with all of the factual assertions set forth in this Disclosure Statement, and, therefore, expressly reserve all of their rights with respect to such assertions. Finally, Boeing (as defined in the Plan) and Aker (as defined in the Plan) do not support the Plan as currently proposed and believe that the Plan is not confirmable unless, among other things, the terms of the Boeing Aker UCC Settlement Agreement (as defined in the Plan) are implemented. Boeing and Aker, therefore, expressly reserve all of their rights to object to the confirmation of the Plan in the event that the Boeing Aker UCC Settlement Agreement has not been approved at a subsequent date, notwithstanding the Bankruptcy Court's approval of this Disclosure Statement, and the Debtors and the Committee reserve all of their rights in connection with any such objections. Yuzhmash maintains that the proposed modification and assumption of the Yuzhmash BOA by Reorganized Sea Launch is impermissible without Yuzhmash's prior consent to any such modification, and absent such assumption of the Yuzhmash BOA the Plan is not feasible.

A. Case Background.

On June 22, 2009, the Debtors filed their bankruptcy cases under Chapter 11 of the Bankruptcy Code (the "**Bankruptcy Cases**"). As discussed in more detail below, the Bankruptcy Cases were commenced in order to effectuate a restructuring of the Debtors business and debts. Accordingly, since that time, the Debtors have negotiated new supply agreements and

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2 Capitalized terms not defined herein shall have the meaning ascribed to them in the Plan.

customer contracts, reached an arrangement for an exit equity investment of $140 million, negotiated an exit financing agreement in the amount of $200 million, and otherwise restructured their business model around which the Debtors intend to reorganize.

The Plan attached hereto represents the Debtors' best judgment as to how to allocate the value of the Debtors' estates, so as to continue operating as a going concern upon the conclusion of these Bankruptcy Cases. The Debtors have actively worked with the New Investor and the Committee to formulate the Plan, and they expect that the Committee will support the Plan.

B. Summary of Classes Under the Plan and Their Treatment.

Set forth below is a summary description of the treatment of all Claims and Interests provided for in the Plan. The summary is qualified in its entirety by reference to the more detailed information elsewhere in this Disclosure Statement, to the Plan and to the exhibits to this Disclosure Statement and the Plan. This summary does not purport to be complete and should not be relied upon for voting purposes. A more complete description of the Plan is provided in *Section V, The Plan of Reorganization*, below. Finally, the estimate of the amount of Claims in each category or Class listed below represents the Debtors' best reasonable estimate, based on information received to date, and based on what the Debtors believe are reasonable and correct grounds for which to object to certain Claims that have been filed. If the amount of Claims is greater than the estimates set forth below, then creditors may receive a lower recovery than what is estimated by the Debtors. By the same token, the Debtors are still in the process of completing their Claims reconciliation, and certain of the Claim amounts set forth below may be further reduced, after the Debtors have completed this task.

Administrative Claims Estimated Amount of Allowed Claims: $21,000,000 (this number does not include amounts due to the DIP Lender, and will drop as claims are paid in the ordinary course of business)	**Unimpaired.** Each Administrative Claim that is or becomes an Allowed Claim against a particular Debtor shall be paid in full in cash by the particular Debtor on the later of (i) the Effective Date and (ii) a date within 30 days after the date such Administrative Claim becomes an Allowed Claim; *provided however,* that any Administrative Claims representing liabilities incurred by a Debtor in the ordinary course of business during the Reorganization Case shall be paid by the respective Debtor in accordance with the terms and provisions of the particular transactions and agreements and orders of the Bankruptcy Court, if any, relating thereto. **Estimated Recovery:** Payment in full, in cash, of the Allowed amount of each Administrative Claim.
DIP Facility Claims Estimated Amount of Claims:	**Unimpaired.** In full satisfaction, settlement, release, and discharge of and in exchange for each DIP Facility Claim, on the Effective Date, all Allowed DIP Facility Claims shall, at the election of the DIP Lender, either

$32,000,000	(a) be paid in full and in Cash from the proceeds of the Exit Financing, or (b) be converted into New Common Stock to the extent requested by the DIP Lender in accordance with the DIP Facility Agreement. **Estimated Recovery:** Payment in full.
Priority Tax Claims Estimated Amount of Claims: $250,000	**Unimpaired.** Each Priority Tax Claim that is or becomes an Allowed Claim against a particular Debtor, shall, at the option of that Debtor, (i) be paid Cash equal to the amount of such Priority Tax Claim; (ii) receive such other treatment as to which the Debtors or the Reorganized Debtors and the Holder of such Priority Tax Claims shall have agreed upon in writing; or (iii) such other treatment as will cause such Claims not to be Impaired, including, but not limited to, payment as set forth in Section 1129(a)(9)(C) of the Bankruptcy Code; provided, however, that any Priority Tax Claim not due and owing on the Effective Date will be paid when such Claim becomes due and owing. **Estimated Recovery:** Payment in full, in cash or in deferred cash payments, of the Allowed amount of each Priority Tax Claim.
Class 1 – Priority Claims Estimated Allowed Amount of Claims: $1,000,000	**Unimpaired.** To the extent not previously paid as allowed by the Bankruptcy Court, each Class 1 Claim that is or becomes an Allowed Claim shall, at the option of the Debtors, either (i) be paid in Cash equal to the amount of such Priority Non-Tax Claim; (ii) receive such other treatment as to which the Debtors or the Reorganized Debtors and the Holder of such Priority Tax Claims shall have agreed upon in writing; or (iii) receive such other treatment as will cause such Claims not to be Impaired; provided, however, that any Priority Non-Tax Claim not due and owing on the Effective Date will be paid when such Claim becomes due and owing. **Estimated Recovery:** Payment in full, in cash, of the Allowed amount of each Priority Claim.
Class 2 – Other Secured Claims Estimated Allowed Amount of Claims:	**Unimpaired.** On the Effective Date, each Holder of an Other Secured Claim, if any, shall have its Claim

$50,000	Reinstated. **Estimated Recovery:** Payment in full.
Class 3 – Current Trade Vendor Unsecured Claims Estimated Allowed Amount of Claims: $5,800,000	**Impaired.** On the Effective Date, or as soon as practicable after the Effective Date, in full satisfaction, settlement, release, and discharge of and in exchange for each Current Trade Vendor Unsecured Claim, if any, each Holder of an Allowed Current Trade Vendor Unsecured Claim, if any, shall be paid seventeen and a half percent (17.5%) of such Allowed Current Trade Vendor Unsecured Claim in Cash on the Effective Date from the proceeds of the Exit Financing or otherwise (to the extent unpaid prior to the Effective Date). **Estimated Recovery:** Seventeen and a half percent (17.5%)
Class 4 – Customer or Trade Vendor Unsecured Claims Estimated Allowed Amount of Claims: $114,000,000	**Impaired.** This Class includes all Customer or Trade Vendor Unsecured Claims against any Debtor other than Current Trade Vendor Claims. Unless the Holder of an Allowed Customer or Trade Vendor Unsecured Claim agrees to a different treatment with the Debtors approved by the Bankruptcy Court pursuant to a settlement under Bankruptcy Rule 9019 or the modification, assumption and assignment of an executory contract, and provided Class 4 accepts the Plan, on the Effective Date, or as soon as practicable after the Effective Date, in full satisfaction, settlement, release, and discharge of and in exchange for all Allowed Customer or Trade Vendor Unsecured Claims, if any, each Holder of an Allowed Customer or Trade Vendor Unsecured Claim shall receive a Pro Rata share of the Customer Recovery Fund and the proceeds of the Creditor Trust Actions against Holders of Claims in Class 7, not to exceed an Allowed Claim dividend of seventeen and one-half percent (17.5%), provided, however, that if aggregate dividends payable to Allowed Customer or Trade Vendor Unsecured Claims pursuant to such calculation would be less than the Customer Class Recovery Floor, in such event the dividend payable to Holders of Allowed Customer or Trade Vendor Unsecured Claims shall only be limited by the amount of the Customer Class Recovery Floor. If Class 4 does not accept the Plan, each Holder of an

	Allowed Customer or Trade Vendor Claim will receive a Pro Rata share of the Creditor Trust Equity Interests attributable to the Customer Equity Recovery. **Estimated Recovery:** Unknown. If Class 4 accepts the Plan, the estimated recovery will be between $9,000,000 and $15,000,000, which should be approximately 17.5% of the total Allowed Claims in the Class. If Class 4 does not accept the plan, the value of the Creditor Trust Equity Interests will be determined at the Confirmation Hearing. The amounts to be received from the Creditor Trust cannot be determined or estimated at this time.
Class 5 – Aker and Boeing Claims Estimated Allowed Amount of Claims: $1,755,772,000 (Claims are currently the subject of objection by the Committee)	**Impaired.** Unless Aker, Boeing and the Committee agree to a different treatment, on the Effective Date, or as soon as practicable after the Effective Date, in full satisfaction, settlement, release, and discharge of and in exchange for all Allowed Partner Claims held by Aker and Boeing, if any, Aker and Boeing shall receive, on account of their respective Allowed Partner Claims, a Pro Rata share of the Creditor Trust Equity Interests attributable to the Partner Equity Recovery (the Partner Equity Recovery being a total of 5% of the of the stock of Reorganized Sea Launch. **Estimated Recovery:** Unknown (depends of the value of the Creditor Trust Equity Interests).
Class 6 – Energia Claims Estimated Allowed Amount of Claims: $76,053,000 (Claims are currently the subject of objection by the Committee, which the Committee has advised will be withdrawn without prejudice subject to confirmation of the Plan)	**Impaired.** Unless Energia agrees to a different treatment, on the Effective Date, or as soon as practicable after the Effective Date, in full satisfaction, settlement, release, and discharge of and in exchange for each Allowed Partner Currency Control Claim held by Energia, Energia shall receive $28,800,000 in Preferred Stock of Reorganized Sea Launch, and shall be deemed to have waived Partner Claims held by Energia that are not Allowed Partner Currency Control Claims. **Estimated Recovery:** Unknown (depends of the value of the Preferred Stock).
Class 7 – Yuzhmash and Yuzhnoye Claims	**Impaired.** Unless Yuzhmash and Yuzhnoye (with the approval of the New Investor) agree to a different treatment with the Debtors, on the Effective Date, or

Estimated Allowed Amount of Claims: $147,630,000 (Claims are currently the subject of objection by the Committee)	as soon as practicable after the Effective Date, in full satisfaction, settlement, release, and discharge of and in exchange for each Allowed Partner Currency Control Claim held by Yuzhmash and Yuzhnoye, if any, Reorganized Sea Launch shall assume and modify the Yuzhmash and Yuzhnoye BOAs to provide for (i) cure of any previously deferred payments for hardware or services ordered by the Debtors, but not yet delivered to the Debtors, at the time of delivery or over a period of not more than two years from the Effective Date, and (ii) future incremental payments of five hundred thousand ($500,000) per successful launch up to a maximum of six million six hundred thousand dollars ($6,600,000), and Yuzhmash and Yuzhnoye shall be deemed to have waived Partner Claims held by Yuzhmash and Yuzhnoye that are not Allowed Partner Currency Control Claims, provided Class 7 accepts the Plan. In the event Class 7 does not accept the Plan, for each Allowed Partner Claim, Yuzhmash and Yuzhnoye shall receive a Pro Rata share of the Creditor Trust Equity Interests up to a maximum of one half percent (0.5%) attributable to the Partner Equity Recovery and shall not be entitled any separate distribution or treatment for Allowed Partner Currency Control Claims. **Estimated Recovery:** Unknown (depends of the value of the Creditor Trust Equity Interests and whether the Class accepts the Plan). If Class 7 accepts the Plan, the estimated recovery is $6,600,000, plus cure of deferred amounts over time.
Class 8 – Sea Launch Equity Interests Estimated Allowed Amount: N/A.	**Impaired.** No property or assets of any kind shall be distributed to, or retained by, the holders of Interests classified in Class 8 in respect of any such Interest so classified, regardless of whether such Interest is Allowed. **Estimated Recovery:** Nothing.

Class 9 – Subsidiary Interests Estimated Allowed Amount: N/A.	**Unimpaired.** Each holder of an Allowed Class 9 Interest shall retain such Interest. provided, however, that with respect to Class 9 Subsidiary Interests, on or after the Effective Date, the Subsidiary Interests in those Debtors shall be cancelled, with the consent of the holders thereof, if there is a dissolution of those Debtors; if, after the Effective Date, those Debtors are instead merged with other Debtors or other corporate transactions take place under and in accordance with applicable state or foreign law to dispose of those Debtors, then the Class 9 Subsidiary Interests shall be disposed of as part of such transactions. **Estimated Recovery:** Retention of all Interests (unless cancelled as noted above), the value of which is unknown.

C. Impaired Claims Entitled to Vote.

Holders of Allowed Claims in each of Class 3 (Current Trade Vendor Unsecured Claims), Class 4 (Customer or Trade Vendor Unsecured Claims), Class 5 (Aker and Boeing Claims), Class 6 (Energia Claims), and Class 7 (Yuzhmash and Yuzhnoye Claims) are impaired and will receive a partial recovery under the Plan, and as such, are entitled to vote on the Plan. Please refer to the summary instructions below and the more detailed instructions in the enclosed Order [name of voting procedures order] for how to vote on the Plan and related deadlines.

D. Claims and Interests Not Entitled to Vote.

Holders of Allowed Claims in the unclassified Classes (Administrative Claims and Priority Tax Claims), and Holders of Allowed Claims in Class 1 (Other Priority Claims) and Class 2 (Other Secured Claims) are unimpaired and therefore are presumed to have accepted the Plan, and are not entitled to vote. Holders of Interests in Class 8 (Interest in Sea Launch) are impaired and shall not receive or retain any property or distribution under the Plan on account of their respective Claims or Interests. As such, they are presumed to have rejected the Plan and are not entitled to vote.

E. The Debtors' and Other Parties' Recommendation.

The Plan reflects the Debtors' negotiations with their customers, major suppliers and the Committee. The Debtors and the Committee believe that acceptance of the Plan is in the best interests of Creditors and will maximize the return to all Creditors. Accordingly, you are urged to support the Plan and if you are entitled to vote on the Plan, to vote to accept the Plan. However, for a discussion of certain factors that should be considered in connection with a vote on the Plan, see *Section X, Certain Risk Factors to be Considered*, below.

F. Plan Voting Procedures and Deadlines.

To vote in favor of, or against, the Plan, you must be a holder of record of a Class 3, Class 4, Class 5, Class 6 or Class 7 Claim as of May 1, 2010. To vote, you must fill out and sign a separate Ballot. Enclosed herewith are:

(i) A Class 3 Ballot, for holders of Current Trade Vendor Unsecured Claims;

(ii) A Class 4 Ballot, for holders of Customer or Trade Vendor Unsecured Claims;

(iii) A Class 5 Ballot for holders of Aker and Boeing Claims; and

(iv) A Class 6 Ballot for holders of Energia Claims.

(v) A Class 7 Ballot for holders of Yuzhmash and Yuzhnoye Claims.

Once you have completed your Ballot, send it to the Debtors' claims and balloting agent at the following address:

[to be provided]

The voting deadline to accept or reject the Plan is 4:00 p.m., prevailing Eastern Time, on [_____ __, 2010] unless extended by the Debtors. All votes must be received by the above-listed party by that time on that date, or they will not be counted.

G. Reservations and Disclaimers, Available Information and Cautionary Statement Concerning Forward-Looking Statements.

The Plan has not been approved or disapproved by the U.S. Securities and Exchange Commission (the "**Commission**"), any state securities commission or the Bankruptcy Court, nor has the Commission, any state securities commission or the Bankruptcy Court passed upon the fairness or merits of these transactions. Any representation to the contrary is a criminal offense.

In addition, the Debtors have filed various pleadings and other papers with the Bankruptcy Court since the commencement of these cases, which may contain information you would want to know. All such documents may be viewed at the office of the Clerk of the Bankruptcy Court, 5th Floor, 824 Market Street, Wilmington, Delaware 19809, or may be viewed by visiting the Bankruptcy Court's website, located at http://www.deb.uscourts.gov/, or at http://chapter11.epiqsystems.com/slc.

No person has been authorized to give any information or make any representation not contained in this Disclosure Statement and, if given or made, such information or representation should not be relied upon. This Disclosure Statement does not constitute an offer to sell or the solicitation of an offer to buy any securities other than those to which it relates, or an offer to sell or a solicitation of an offer to buy any securities in any jurisdiction in which, or to any person to whom, it is unlawful to make such offer or solicitation. The delivery of this Disclosure Statement after the date hereof should not, under any circumstances, create an implication that

there has been a change in the affairs of the Debtors or in the information contained herein since the date hereof.

Certain statements in this Disclosure Statement are forward-looking statements that involve known and unknown risks, uncertainties and other factors which may cause the actual results of the Debtors to be materially different from any future results expressed or implied by such forward-looking statements. Forward-looking statements include, among others, statements regarding the ability of the Debtors to successfully complete the restructuring outlined in this Disclosure Statement and achieve the business plan projections and the projected or assumed future operations and financial results of the Debtors. Factors that may cause actual results of the Debtors to differ from future results expressed or implied by forward-looking statements include, among others, the following: the likelihood of the Debtors' success in developing and expanding their businesses and maintaining financing on reasonable terms; general economic and business conditions, both in the United States and other countries in which the Debtors sell or purchase services and products; the effect of competition in the markets served by the Debtors; the risks described in *Section X, Certain Risk Factors to be Considered*, below; and the ability of the Debtors to obtain confirmation of the Plan. Some of these assumptions inevitably will not materialize, and unanticipated events may occur which could materially affect the Debtors' results and financial performance. Given these uncertainties, holders of Claims entitled to vote on the Plan are cautioned not to place undue reliance on any forward-looking statements in determining whether to vote to accept or reject the Plan or to take other action under the Plan.

II. GENERAL INFORMATION ABOUT THE DEBTORS AND THESE CASES

A. The Debtors and their Pre-Petition Operations.

The Debtors were formed in May 1995 by Boeing Commercial Space Company ("**Boeing**"); S.P. Korolev Rocket and Space Company, Energia, a corporation partly owned by the Government of Russia ("**Energia**"); Kvaerner Moss Technology a.s., located in Oslo, Norway ("**Kvaerner**"),[3] KB Yuzhnoye ("**Yuzhnoye**"), a corporation wholly owned by the Government of Ukraine; and PO Yuzhny Mashinostroitelny Zavod, a corporation wholly owned by the Government of Ukraine ("**Yuzhmash**" and, collectively with Boeing, Energia, Kvaerner and Yuzhnoye, the "**Partners**").

Though the Debtors have approximately 100 suppliers of goods and services, the goods and services provided by the Partners make up a substantial portion of the costs associated with the Debtors' day-to-day operations and the costs incurred in connection with the commercial launch of satellites. For example, the majority of all capital equipment purchased by the Debtors related to their commercial launch of satellites was either purchased from or constructed and installed by the Partners.

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[3] Kvaerner was ultimately taken over by Aker Maritime Finance, AS and its affiliates (collectively, "**Aker**") in 2000. Accordingly, references to Kvaerner after 2000 are to Aker.

The Debtors comprise a business that draws upon an international consortium of American, Russian, Ukrainian and Norwegian businesses and provides a reliable, cost effective, heavy-lift commercial satellite launch service for primarily satellite operators. The Debtors offer a one-of-a-kind sea-based equatorial launch site that provides the most direct route to geostationary orbit, offering maximum lift capacity for increased payload mass and/or extended spacecraft life.

For equatorial launches, the Debtors provide fully integrated launch services out of their home port in Long Beach, California. Specifically, following completion of fueling and encapsulation in the state-of-the-art payload processing facility, the satellite is transferred to the assembly command ship named "Sea Launch Commander" (the "**ACS**") for integration with the launch vehicle. After the encapsulated payload is integrated into the launch vehicle, the integrated launch vehicle (the "**ILV**") is transferred to the semi-submersible launch platform named "Odyssey" (the "**Launch Platform**"), where it is stored in an environmentally controlled hangar during transit to the launch site at the equator.

At the equatorial launch site, once the Launch Platform is positioned, the ILV is rolled out of its environmentally controlled hangar and erected on the Launch Platform and prepared for launch. After the ILV receives its final preparations, the ILV is a "go" for launch.

In 2005, using existing infrastructure at the Baikonur Space Center, in Kazakhstan, the Debtors supplemented their equatorial sea-based launch operations with a land-based launch system based upon the Debtors' sea-based launch vehicle. At the land-based site, the Debtors provide contracting and management functions for the land launch system. Space International Services, Ltd., based in Moscow, provides hardware and services originating in Russia, Ukraine and Kazakhstan, in a subcontracting arrangement with the Debtors.

In addition to forming Sea Launch LP, Yuzhnoye, Yuzhmash, Energia, and Boeing have provided and continue to provide certain goods and services to the Debtors. Yuzhnoye and Yuzhmash design and manufacture the first and second stages of the rocket that the Debtors use to launch their customers' commercial satellites. Yuzhnoye also provides payload integration and mission analysis ("**PIMA**") services to the Debtors, along with Energia and Boeing. The PIMA services are required to launch each particular satellite into its proper orbit. Yuzhnoye and Yuzhmash also provide the Debtors with necessary personnel to conduct and oversee the launch operations, along with Energia and Boeing.

Energia designs and builds the third or upper stage of the rocket that provides the final propulsion to place the satellites into geosynchronous orbit. As described above, in addition to the upper stage, Energia also provides the Debtors with essential PIMA services and necessary personnel to conduct and oversee the launch operations. Boeing designs and builds the payload assembly that encapsulates and protects the satellite during the initial ascent of the launch. As described above, in addition to the payload assembly, Boeing also provides the Debtors with essential PIMA services and necessary personnel to conduct and oversee the launch operations. Kvaerner designed, built, and modified the ACS and the Launch Platform, both of which form the infrastructure of the Debtors' marine-based satellite launch system. Yuzhnoye, Yuzhmash,

and Energia manufactured and installed the launch support systems on the ACS and the Launch Platform.

B. Launch History

On March 27, 1999, the Debtors executed an inaugural launch that demonstrated their sea-based launch system. The success of the Debtors' inaugural mission represented the culmination of four years of intense development work performed by aerospace and marine professionals throughout the world. Since the Debtors' inaugural mission, the Debtors have experienced performance enhancements that have enabled them to increase the payload capacity of their launch vehicle, increase reliability, and streamline processing operations.

Since the successful inaugural launch, the Debtors have experienced thirty-two (32) successful launches, twenty-eight (28) from the Launch Platform (sea-based) and four (4) from the Baikonur Space Center (land-based), the most recent of which occurred on November 30, 2009.

C. Launch Anomaly

On January 30, 2007, the Debtors experienced an unsuccessful launch on their 24th sea-based mission (the "**Launch Anomaly**"). The incident occurred seconds after ignition, resulting in the loss of both the launch vehicle and its payload. While the Launch Platform remained intact and suffered no significant structural damage, critical launch support equipment was damaged. Accordingly, the Debtors decided to bring the Launch Platform and ACS back to home port for inspection and necessary repairs.

As a result of the Launch Anomaly and the required inspection and repair, the Debtors informed Hughes Network Systems, LLC ("**Hughes**") that it would be unable to proceed with the Hughes launch scheduled to occur in May 2007 (the "**Hughes Launch**"). Hughes entered into negotiations with one of the Debtors' competitors to arrange a replacement launch in July or August 2007. Thereafter, Hughes announced that it had entered into a launch services agreement with that competitor for the replacement launch.

In response to Hughes' launch services agreement with Arianespace, a dispute arose between the Debtors and Hughes concerning Hughes' obligation to proceed with the Hughes Launch, the status of the Hughes Launch, the effect of Hughes' contract with Arianespace, and the parties' rights and obligations. On May 11, 2007, Hughes terminated the launch services agreement relating to Hughes' Spaceway-3 Launch as a result of the Launch Anomaly and filed a claim for the refund of $44.4 million in advance payments plus interest related to the launch contract. The Debtors contested the validity of Hughes' termination and/or its entitlement to any amounts. In March 2009, the International Centre for Dispute Resolution concluded that Hughes was entitled to recover the amounts advanced plus simple interest at a rate of 10% per annum on the advances, accruing from July 10, 2007, plus the arbitration expenses, totaling approximately $53.2 million (the "**Hughes Arbitration Award**").

After the International Centre for Dispute Resolution entered the Hughes Arbitration Award, Hughes and the Debtors entered into a standstill agreement whereby Hughes agreed not to confirm or otherwise seek to enforce the Hughes Arbitration Award. After the expiration of the standstill agreement, Hughes filed its Petition for Confirmation of Arbitration Award in the Superior Court of the State of California for the County of Los Angeles on June 4, 2009. Hughes and the Debtors subsequently entered into a stipulation extending the time within which the Debtors had to answer the petition to enforce the Hughes Arbitration Award through and including June 22, 2009.

D. Return to Sea-Based Launch Capabilities

On November 1, 2007, the Debtors dispatched the Launch Platform and ACS for the launch of the Thuraya-3 satellite. After minor weather delays, the first post-anomaly liftoff proceeded without complication on January 15, 2008. Since the January 15, 2008 launch, the Debtors have had eight (8) successful launches, five (5) from the Launch Platform (sea-based) and three (3) from the Baikonur Space Center (land-based).

The most recent sea-based launch occurred on April 20, 2009, when the Debtors successfully launched Telespazio's SICRAL 1B communications satellite from the Launch Platform. The most recent land launch occurred on November 30, 2009, when the Debtors successfully launched Intelsat's IS-15 satellite from the Baikonur Space Center.

E. Customer Payments/Obligations

The Debtors' primary customers consist of commercial satellite manufacturers and operators in the United States and throughout the world. Due to timing and financial requirements associated with launching commercial satellites, pursuant to the terms of the parties' launch services agreement, customers remit initial payments and progress payments (collectively, the "**Payments**") to the Debtors for launch services to be provided in the future.

All customer launch services agreements contain termination clauses that enable customers to terminate the agreements for cause or to repurpose (i.e., modify) the launch detail. Depending on the reason for the termination, a creditor may be entitled to a return of all of the Payments or a fraction thereof.

In essence, the customers hold contingent claims of varying amounts against the Debtors pending the launch of their satellites. It is contemplated, as part of the confirmation of the Plan, that most, if not all, of the customer contracts will be modified and assumed, thereby dealing with the majority of the customer contingent claims.

III. DEBTORS' PREPETITION DEBT STRUCTURE

A. Bank Debt

On October 13, 2004, Debtor ACS LP completed the financing of its Sea Launch ACS Loan (the "**ACS Loan**") for $31.0 million with Sumitomo Mitsui Banking Corporation. The ACS Loan accrued interest at a rate of 4.0375% and matured on October 13, 2009. As of the

Petition Date, the balance on the ACS Loan was approximately $3.1 million and Boeing and Aker guaranteed the ACS Loan in full.

On July 13, 2005, SLLP entered into a $100.0 million Private Placement Loan through Citibank (the "**Citibank Loan**"). The Citibank Loan was to mature on July 12, 2015, with a balloon payment of full principal amount due at maturity. Interest on the Citibank Loan accrued at a floating rate, based on the three-month USD Libor and was paid quarterly. As of the Petition Date, the balance on the Citibank Loan was approximately $100.0 million and Boeing and Aker guaranteed the Citibank Loan in full.

On August 31, 2005, SLLP entered in a $100.0 million credit agreement arranged by Sumitomo Mitsui Banking Corporation (the "**Sumitomo Loan**"). The Sumitomo Loan was to mature on August 31, 2010, with a balloon payment of full principal amount due at maturity. Interest on the Sumitomo Loan accrued at a floating rate, based on the three-month USD Libor and was paid quarterly. As of the Petition Date, the balance on the Sumitomo Loan was approximately $100 million and Boeing and Aker guaranteed the Sumitomo Loan in full.

On June 19, 2006, SLLP signed an amended and restated credit agreement with Citicorp USA, Inc. (the "**Citibank $260m Loan**") that replaced a previous loan with Citicorp USA, Inc. On June 12, 2008, Sea Launch signed letter Amendment No. 1 to the Citibank $260m Loan, which eliminated the installment payment due in 2008 and revised the amount due upon maturity to $245.0 million. Interest on the Citibank $260m Loan accrued at a floating rate, based on the USD Libor rate. As of the Petition Date, the balance on the Citibank $260m Loan was approximately $245.0 million and Boeing and Aker guaranteed the Citibank $260m Loan in full.

The principal payment requirements associated with the ACS Loan, the Citibank Loan, the Sumitomo Loan, and the Citibank $260m Loan (collectively, the "**Bank Loans**") required principal payments of $251.2 in 2009; $100.0 million in 2010; no payments in 2011, 2012, or 2013; and $100.0 million thereafter. Subsequent to the Petition Date, the various bank lenders called the guarantees, and Boeing satisfied the Bank Loans in full. Boeing and Aker subsequently entered into an agreement under which Aker agreed to pay Boeing a portion of the amount Boeing paid to satisfy the bank guarantees. Boeing and Aker now assert claims against the Debtors equivalent to the Bank Loans that Boeing satisfied.

B. Partner Debt

In addition to providing essential goods and services to the Debtors, since the Debtors' formation, the Partners have provided significant financial resources to the Debtors. First, in February 1996, Boeing and Kvaerner entered into loan agreements with the Debtors whereby Boeing and Kvaerner lent the Debtors $275,000,000 (the "**Partner Loans**"). Energia, Yuzhnoye, and Yuzhmash guaranteed respective shares of the Partner Loans pro-rata to their shares of interest in the Debtors. In 1997 Boeing and Kvaerner agreed to lend the Debtors $1,000,000 more without any guarantees. Upon the issuance of the Bank Loans, the Partners subordinated the Partner Loans to the Bank Loans.

The Partner Loans originally accrued interest at an annual rate of interest of 12% per year, compounded quarterly. In February 2002, Boeing and Aker agreed to lower the interest rate on the Partner Loans to 6% effective January 1, 2002, and continuing through December 31, 2004. Subsequently, Boeing and Aker agreed to maintain the interest rate at 6% through December 2008, at which time the interest rate would be reevaluated. As of December 31, 2008, the balance of the Partner Loans, increased by $1,000,000, including principal and interest, totaled $760,801,984.

Pursuant to the terms of the Partner Loans, the Debtors' repayment obligations are tied to the Debtors' ability to make distributions to the Partners. Specifically, the Debtors are required to pay Boeing and Aker 100% of cash available for distribution to the Partners, after all external debts have been repaid, until the Partner Loans are repaid in full.

In connection with the Partner Loans, SLLP purportedly granted Boeing and Aker a security interest in all revenues, income, receipts, and money received by or on behalf of SLLP, as a stand-alone entity, and real property, equipment furnishings, fixtures, and other tangible personal property owned by SLLP, in existence or acquired. Boeing and Aker, however, took no steps to perfect their security interests and, therefore, do not hold perfected security interests in any property of the Debtors.

During the Debtors' development phase, the Partners experienced cost overruns on certain fixed-price contracts that the Partners had with the Debtors. The Debtors also experienced indirect cost overruns. By the end of the Debtors' development phase, unpaid cost overruns totaled $136,000,000, although they were reduced by a $17,000,000 payment to Kvaerner, and are now approximately $119,000,000 (the "**Cost Overruns**"). In 1998, the Partners determined that the Debtors would reimburse the Partners for the Cost Overruns. However, due to insufficient funds, in 2000 the Partners agreed to defer the Debtors' obligation to repay the Cost Overruns for an indefinite period of time without interest. The Cost Overruns remain outstanding.

IV. THE CHAPTER 11 CASES

As result of the Debtors' liquidity position, recurring losses from operations, declining conditions, the Launch Anomaly, and the Hughes Arbitration Award, the Debtors began to consider various alternatives to maximize the value of their businesses for the benefit of all of their stakeholders. Working with their counsel and advisors, the Debtors determined that commencing cases under Chapter 11 of the Bankruptcy Code provided the best avenue to preserve value and maximize the value of their estates.

A. Matters Leading to the Bankruptcy Cases.

Since their formation, the Debtors have struggled to recognize the success envisioned by the Creation Agreement. Because the Debtors were not immediately able to provide commercial launch services, the Debtors incurred indebtedness to finance their developmental costs as well as day-to-day cash needs. Though the Debtors successfully completed the design and construction of the ACS and Launch Platform, and have had a number of significant and valuable

launch services contracts, due to the cost of its debt, an increased cash demand for flight hardware production due to increased number of launches per year, unexpected increases in the costs of launch hardware, and government-financed competition, the Debtors were not able to stabilize their business or meet their financial targets. As a result, the Debtors' cost structure was not in line with the revenues they could generate and resulted in operating losses.

To manage the Debtors' liquidity position, the Partners agreed to defer the Debtors' obligation to repay the balance of Cost Overruns for an indefinite period of time without interest. When the Debtors' liquidity worsened, to enable the Debtors to make required cash payments due and owing to unaffiliated creditors, the Debtors' decided to postpone partially paying the Partners for goods and services that the Partners provided to the Debtors in connection with the Debtors' launch services.

Prior to the Petition Date, the Debtors actively pursued launch opportunities with numerous customers. However, the Debtors' operating results were negatively impacted by the worldwide economic recession, a glut of available launch slots offered by competitors, and the Launch Anomaly. Given the ongoing credit constrictions, economic decline, weakness in the commercial satellite industry, and the effect of the Launch Anomaly, the Debtors were unable to resolve their liquidity and cash flow problems prior to their bankruptcy filings. While the Partners disagree as to the underlying cause of the bankruptcy and reserve their rights thereto, there is no dispute that the inability to settle with Hughes Network Systems was the immediate cause.

B. The Filing of the Bankruptcy Cases.

On June 22, 2009, the Debtors filed their Chapter 11 petitions for relief.

C. Significant Post-Petition Events.

i. Obtaining Post-Petition Financing.

On November 6, 2009, the Debtors filed their first motion seeking approval of debtor-in-possession financing (the "**First DIP Motion**"). On November 10, 2009, the Court entered an interim order approving the First DIP Motion and on December 3, 2009, the Court entered a final order approving the First DIP Motion (the "**First DIP Order**"). Pursuant to the First DIP Order, the Debtors borrowed $12.5 million (the "**First DIP Loan**") from Space Launch Services, LLC (the "**First DIP Lender**"), on the terms and conditions of the loan documents approved by the aforementioned orders.

As noted by the Debtors in the First DIP Motion and at the interim and final hearings held to consider same, the amount committed by the First DIP Lender under the First DIP Loan was not projected to be sufficient to provide the Debtors the necessary liquidity to carry them through a plan of reorganization in these cases. As noted by the Debtors, further financing was necessary to see the Debtors through to an exit. Although the orders approving the First DIP Motion approved the Debtors' borrowing up to $25 million from the First DIP Lender, the First DIP Lender would only commit to lend the $12.5 million already borrowed.

The Debtors ultimately reached an agreement with the First DIP Lender and The Heinlein Prize Trust (the "**Trust**") to advance an additional $12 million to the Debtors. On February 22, 2010, the Debtors filed the Second Emergency Motion (the "**Second DIP Motion**") seeking the entry of Interim And Final Orders Authorizing The Debtors To Obtain Postpetition Secured Financing Pursuant To 11 U.S.C. §§ 364(c)(1), 364(c)(2), 364(c)(3), 364(d)(1) and 364(e) and Scheduling A Final Hearing.

On February 24, 2010, the Court held an interim hearing on the Second DIP Motion, and granted interim relief authorizing the Debtors to borrow an additional $3 million from the First DIP Lender on the same terms and conditions as set forth in the First DIP Facility and First DIP Order (the "**Additional Borrowing**"). On March 17, 2010, the Court held a final hearing on the Second DIP Motion, and entered an order granting final relief on the Second DIP Motion (the "**Second DIP Order**"), and authorizing the Debtors to borrow an additional $9 million from the Trust and the First DIP Lender on the terms and conditions of the Amended and Restated Debtor in Possession Financing Agreement (the "**Amended DIP Facility**").

Although the Trust funded the Debtors' initial $3 million draw on its $6 million commitment, unfortunately, the Trust refused to fund the second draw on its $6 million commitment as required by the terms of the Amended DIP Facility. The Trust appeared to be claiming that the Debtors had failed to satisfy one or more of the conditions to the funding set forth in section 2.2(b) of the Amended DIP Facility. Although the Debtors strongly dispute the Trust's contention, and intend to bring appropriate claims for breach of contract against the Trust at the appropriate time, they simply did not have the time at this moment to force the issue with the Trust in lengthy and costly litigation.

Accordingly, the Debtors sought and obtained a third lender, Energia Overseas Limited (Russia), a Russian Federation limited liability company (the "**Third DIP Lender**"), an entity related to Energia, which is one of the Debtor's equity holders, to provide the financing that was necessary, in the amount of $30 million ($12.5 million to pay off the First DIP Loan, $3 million to pay off the Additional Borrowing, $3 million to pay off the first draw on the Amended DIP Facility, $9.5 million in incremental liquidity, and $2 million is original issue discount), on the terms and conditions as set forth in the third Debtor in Possession Financing Agreement, dated April 29, 2010 (the "**Third DIP Facility**"). This Third DIP Facility was approved by the Bankruptcy Court by interim and final orders entered on April 27, 2010 and May 12, 2010, respectively.

ii. Retention of Professionals.

Early in the Bankruptcy Cases, pursuant to Sections 327 and 328 of the Bankruptcy Code and Bankruptcy Rule 2014 and orders of the Bankruptcy Court, the Debtors retained the following professionals in the case: (i) Alston & Bird LLP and Young Conaway Stargatt & Taylor LLP as bankruptcy counsel, (ii) Jefferies & Company, Inc. ("**Jefferies**") as financial advisor, and (iii) Epiq Bankruptcy Solutions ("**Epiq**") as noticing and claims agent. With the exception of Epiq, since the Petition Date these professionals have been paid 80% of their fees and 100% of their expenses on a monthly basis, pursuant to the professional fee procedures approved by the Bankruptcy Court. Pursuant to Bankruptcy Court order, Epiq has been paid for

its fees and expenses in full, as billed to the Debtors in the ordinary course of business. On November 16, 2009, nunc pro tunc to October 16, 2009, the Debtors obtained authorization from the Bankruptcy Court to retain Christopher L. Picone of Buccino & Associates, LLC as Chief Restructuring Officer (the "**CRO**"). The CRO has been paid 100% of his fees and expenses on a monthly basis.

iii. Evaluating the Debtors' Assets.

Upon its appointment as the Debtors' financial advisors, Jefferies, and later with the assistance of the CRO, undertook a thorough review and evaluation of the Debtors' operations, in order to (i) raise DIP financing, (ii) determine means to conserve cash during the Bankruptcy Cases, (iii) determine potential values for the Debtors as going concerns, and (iv) in conjunction with the Debtors' management, develop a reorganization strategy.

Jefferies and the CRO have been largely successful in these endeavors, as they assisted the Debtors in obtaining operational efficiencies and decreasing costs. In addition, Jefferies thoroughly marketed the Debtors, leading to several parties expressing interest in providing the DIP and becoming an equity sponsor of the Debtors reorganization efforts. At least two of those parties did extensive due diligence on the Debtors, ultimately leading to the Plan.

iv. Implementation of Employee Retention Programs.

The Debtors have enjoyed relatively low turnover of management and employees during the pendency of these cases. Despite numerous layoffs and increased responsibilities falling upon the shoulders of remaining management and employees, the existing labor force has performed remarkably well in maintaining the value of the enterprise. As discussed below, the Debtors' senior executives have many years experience with the Debtors, and have long-standing relationships with key customers and suppliers. *See Section V, Post-Confirmation Management of the Debtors.*

Finally, to maintain the loyalty and confidence of their employees, the Debtors obtained Bankruptcy Court approval at various times in these cases (i) to pay merit or performance based bonuses to certain key members of management, and (ii) to enter into retention plans providing "stay bonuses" for certain key, non-management employees. The time period for non-management employees to remain with the Debtors in order to obtain their stay bonuses is confirmation of a plan of reorganization, and all obligations under the retention plans are anticipated to be satisfied on the Effective Date of the Plan. With regard to the management incentive plan, various amounts are payable depending on the occurrence and timing of certain trigger events. Some amounts are anticipated to be paid (or, in the case of equity in the reorganized Debtors, distributed) upon the Effective Date of the Plan. Other amounts are payable post-confirmation depending on the occurrence and timing of certain trigger events. No other retention plans currently are in place.

v. Setting a Bar Date, Objecting to and Resolving Certain Claims.

On October 6, 2009, this Court established November 20, 2009 (the "**General Bar Date**") as the final date to file proofs of claim on account of pre-petition Claims against the Debtors for non-governmental entities, and December 21, 2009 as the final date to file proofs of claim on account of pre-petition Claims against the Debtors for governmental entities. As of the date of this Disclosure Statement, 130 proofs of claim have filed. The Debtors expect in to file objections to certain of those claims, so that the final group of creditors may be determined.

vi. Rejection of Certain Executory Contracts and Unexpired Leases.

Since the Petition Date, the Debtors have engaged in aggressive cost-cutting actions, including the rejection of their headquarters office lease of non-residential real property, and consolidation of operations at the Debtors Home Port facility. In addition, the Debtors have rejected several executory contracts which were not needed during the pendency of the Bankruptcy Cases. The rejection of these contracts and leases has given rise to pre-petition rejection damage Claims, but has saved the Debtors in excess of $2,650,000 million per year in operational costs, allowing the Debtors to emerge from bankruptcy with a healthier balance sheet and more cost-effective operations.

vii. Modification and Assumption of Home Port Lease.

The Debtors, as a cost savings measure, decided, in their reasonable business judgment, to operate their businesses out of their Port of Long Beach office and pier space (the "**Home Port**") on a go-forward basis. The Home Port is also the location of the Debtors' state-of-the-art Payload Processing Facility, and the location where the ACS and the Launch Platform are docked when not conducting launch operations.

The Debtors operate the Home Port pursuant to that certain unexpired nonresidential real property lease by and between Sea Launch Company and The City of Long Beach (the "**City**"), dated as of January 15, 2003, as the same has been amended and proposed to be amended by the parties thereto (the "**Lease**"). After the Petition Date, the Debtors and the City negotiated a rent reduction and deferral on the Lease. Those negotiations resulted in an agreement by the City and Sea Launch to amend the Lease to provide for a substantial rent deferral on the Lease, as well as for the assumption thereof. By order dated December 3, 2010, the Court authorized the assumption of the Lease, as amended, subject to certain conditions subsequent.

viii. Resolution of Certain Contract Issues with Boeing.

Boeing and Sea Launch are parties to a Loan of Personnel Agreement that became effective November 1, 2005 (Contract No. BCSC-SLC-LOP-05-01) (the "**Personnel Agreement**"). Pursuant to the Personnel Agreement, Boeing provides the Company with approximately 36 loaned employees (the "**Loaned Employees**"). The Loaned Employees are utilized by the Debtors across all levels of employment and including executive positions at the Debtors, engineering staff, spacecraft processing and launch personnel, environmental safety and

health personnel, export compliance personnel, and operational staff in the areas of contracts, marketing, and security.

Prior to the Petition Date, Sea Launch and Boeing also entered into that certain Services Agreement (Contract No. BCSC-SLC-05-01), dated as of January 1, 2005, (as amended, supplemented, or restated, the "**Old Services Agreement**"). On October 8, 2009, the Bankruptcy Court entered the Order Approving Debtors; Motion (I) to Approve Postpetition Contract with The Boeing Company and Boeing Commercial Space Company, and (II) for Allowance of Administrative Claims (the "**Contract Approval Order**"), which approved, among other things, the Debtors' entry into that certain Services Contract with Boeing (Contract No. BCSC-SLC-08-07-09, dated as of August 7, 2009 (the "**New Services Agreement**"). Under the New Services Agreement, Boeing still supplies certain engineering services (and has the obligation to "ramp up" those services) in order to allow the Debtors to continue to offer new launches to its customers. The New Services Agreement, approved by the Court via Stipulation, was intended to reduce the run-rate of administrative expenses for the Company while in Chapter 11.

In addition, the Contract Approval Order provided that Boeing Commercial Space Company is entitled to priority as administrative expenses pursuant to Sections 503(b) and 507(a)(2) of the Bankruptcy Code and that are not subject to any subordination, recharacterization, or other attempt to reduce the priority of such amounts (it being the intention of the parties that the immediately foregoing clause shall be construed to mean that the referenced claims shall be treated as ordinary course administrative expenses arising under Sections 503(b) and 507(a)(2), and shall not be treated differently from other ordinary course administrative expenses arising under Sections 503(b) and 507(a)(2) based solely on the fact that the amounts are due to Boeing, as opposed to some other party) in the amounts of (a) $1,581,014 for amounts accruing during the period from the Petition Date through the Effective Date of the New Services Agreement under the Old Services Agreement, and (b) $2,492,616 for amounts accruing on and after the Petition Date through August 27, 2009, under the Personnel Agreement, and such other amounts accruing after August 27, 2009 through the date that the Court enters an order authorizing the Debtors to assume or reject the Personnel Agreement.

ix. The Committee Litigation Against the Partners.

The Committee initially filed a motion on October 8, 2009, requesting the Bankruptcy Court to grant the Committee standing to pursue a claim against Boeing (the "**Standing Motion**"), asserting a debt recharacterization and/or equitable subordination claim against Boeing dealing with about 35% to 40% of the asserted claims of Boeing (principally the Subordinated Loans). The Standing Motion was continued from time to time and never granted. In light of the continued inability to obtain standing, on March 4, 2010, the Committee filed an objection to the Boeing and Aker claims under Section 502 of the Bankruptcy Code (the "**First Claim Objection**"). The Committee sought an accelerated discovery schedule in respect of the litigation of the First Claim Objection. Ultimately, the parties agreed to mediate the First Claim Objection on a non-binding basis. As noted above, the indications arising out of the mediation are that the parties have reached a settlement, but that settlement has not been effectuated as of the date of this Disclosure Statement. The parties indicate that they have reached a tentative agreement, subject to the fulfillment of certain conditions. That settlement will provide for a

release by the Debtors' estates, the Committee, each of the Committee members and the other creditors in these cases other than the Partners (subject to opt out), of all claims against Boeing and Aker. In exchange, Boeing and Aker will accept their treatment under the Plan. All of this is conditioned upon the Boeing Aker UCC Settlement Agreement being approved at or prior to the Confirmation Hearing.

Separately, the Committee also filed an objection to the claims of Energia, Yuzhmash and Yuzhnoye on much the same grounds as the First Claim Objection (the "**Second Claim Objection**", and together with the First Claim Objection, the "**Claims Objection**"). As of the date of this Disclosure Statement, no significant progress has been made on the Second Claim Objection. However, the Committee has indicated that it will withdraw the Second Claim Objection as to Energia without prejudice, pending confirmation of the Plan (as it may be amended from time to time).

D. The Debtors in Their Reorganized Form

Upon consummation of the Plan, certain of the Debtors will merge into others of the Debtors, all as described in the New Investment Agreement, with the result being that the Reorganized Debtors will be streamlined into fewer entities. In addition, certain of the Debtors will be re-incorporated (or re-formed) as Swiss entities.

V. THE PLAN OF REORGANIZATION

A. Explanation of Chapter 11.

Chapter 11 is the principal business reorganization chapter of the Bankruptcy Code. Under Chapter 11 of the Bankruptcy Code, a debtor is authorized to reorganize its business for the benefit of itself, its creditors and stockholders. In addition to permitting rehabilitation of a debtor, another goal of Chapter 11 is to promote equality of treatment of creditors and equity security holders of equal rank with respect to the distribution of a debtor's assets.

The consummation of a plan of reorganization is the principal objective of a Chapter 11 reorganization case. A plan of reorganization sets forth the means for satisfying claims against, and equity interests in, a debtor. Confirmation of a plan of reorganization by the bankruptcy court makes the plan binding upon a debtor, any issuer of securities under the plan, any person acquiring property under the plan and any creditor or equity security holder of a debtor. Subject to certain limited exceptions, the confirmation order discharges a debtor from any debt that arose prior to the date of confirmation of the plan and substitutes therefor the obligations specified under the confirmed plan.

After a plan of reorganization has been filed, the holders of claims against or interests in a debtor are permitted to vote to accept or reject the plan. Before soliciting acceptances of the proposed plan, however, Section 1125 of the Bankruptcy Code requires a debtor to prepare a disclosure statement containing adequate information of a kind, and in sufficient detail, to enable a hypothetical reasonable investor to make an informed judgment about the plan. This

Disclosure Statement is presented to holders of Claims against and Interests in the Debtors to satisfy the requirements of Section 1125 of the Bankruptcy Code.

Chapter 11 does not require that each holder of a claim against or interest in a debtor vote in favor of a plan of reorganization in order for the bankruptcy court to confirm the plan. At a minimum, however, the plan of reorganization must be accepted by a majority in number and two-thirds in amount of those claims actually voting in at least one class of impaired claims under the plan of reorganization. Holders of impaired claims or interests who fail to vote will not be counted as either accepting or rejecting the plan.

In general, a class is "impaired" if the legal, equitable, or contractual rights attaching to the claims or equity interests of that class are modified under the plan of reorganization. Classes of claims that are not impaired under a plan of reorganization are conclusively presumed to have accepted the plan of reorganization and thus are not entitled to vote. Classes of claims or equity interests receiving no distribution under a plan are impaired and are conclusively presumed to have rejected the plan and thus are not entitled to vote. Acceptances of the Plan in this case are being solicited only from those persons who hold Claims in an impaired Class that is not a deemed accepting or rejecting Class.

Even if all classes of claims and equity interests accept a plan of reorganization, the bankruptcy court may nonetheless find such a plan unconfirmable. Section 1129 of the Bankruptcy Code sets forth the requirements for confirmation of a plan of reorganization and, among other things, requires that a plan of reorganization meet the "best interests" test and be feasible. The "best interests" test generally requires that the value of the consideration to be distributed to the holders of claims or equity interests under a plan may not be less than those parties would receive if the debtor were liquidated under a hypothetical liquidation occurring under Chapter 7 of the Bankruptcy Code. Under the "feasibility" requirement, the court must find that there is a reasonable probability that the debtor will be able to meet its obligations under its plan of reorganization without the need for further financial reorganization. The Debtors believe that both of these requirements are satisfied by the Plan. *See Section XIII, Confirmation of the Plan.*

The proponents of the plan of reorganization (in this case, the Debtors) also must meet all other applicable requirements of Section 1129(a) of the Bankruptcy Code (except Section 1129(a)(8) if the proponent proposes to seek confirmation of the plan under the provisions of Section 1129(b) of the Bankruptcy Code). These other requirements include, among other things, that the plan comply with applicable provisions of Title 11 and other applicable law, that the plan be proposed in good faith and that at least one impaired class of creditors has voted to accept the plan. The Debtors believe that the Plan satisfies all of these and all other applicable requirements of Section 1129(a) of the Bankruptcy Code.

The bankruptcy court may confirm a plan of reorganization even though fewer than all the classes of impaired claims and interests accept it. For a plan of reorganization to be confirmed despite the rejection of a class of impaired claims or interests, the proponent of the plan of reorganization must show, among other things, that the plan of reorganization does not

discriminate unfairly and that the plan of reorganization is fair and equitable with respect to each impaired class of claims or interests that has not accepted the plan of reorganization.

Under Section 1129(b) of the Bankruptcy Code, a plan is "fair and equitable" as to a class if, among other things, the plan provides: (a) with respect to secured claims, that each holder of a claim included in the rejecting class will receive or retain, on account of its claim, property that has a value, as of the effective date of the plan of reorganization, equal to the allowed amount of such claim; and (b) with respect to unsecured claims and equity interests, that the holder of any claim or equity interest that is junior to the claims or equity interests of such class will not receive or retain, on account of such junior claim or equity interests, any property at all unless the senior class is paid in full. The bankruptcy court must further find that the economic terms of the plan of reorganization do not unfairly discriminate, as provided in Section 1129(b) of the Bankruptcy Code, with respect to the particular objecting class. The Debtors believe they will be able to satisfy these requirements of Section 1129(b) of the Bankruptcy Code, as well.

B. Description of the Claims Against and Interests in the Debtors.

i. Unsecured Non-Insider Claims.

As of the Petition Date, the Debtors had, on a consolidated basis, approximately $106 million in unsecured, non-insider claims. In addition, the Debtors owed an additional approximately $285 million on a contingent basis to customers representing amounts paid by such customers in advance of certain launches.

Classes 3 and 4 consist largely of (i) Claims by unaffiliated trade vendors, (ii) lease and executory contract rejection Claims, (iii) certain pre-petition litigation Claims, (iv) certain unpaid employee Claims, and (v) contingent and non-contingent current and former customer Claims.

As set forth in Section 3.2 of the Plan and as discussed below, by accepting this Plan, the holders of Current Trade Vendor Unsecured Claims (Class 3) will receive, in full satisfaction, settlement, release, and discharge of and in exchange for each Current Trade Vendor Unsecured Claim, Cash in the amount of seventeen and a half percent (17.5%) of such Allowed Current Trade Vendor Unsecured Claim. The holders of Customer or Trade Vendor Unsecured Claims (Class 4) (which Class includes all non-insider unsecured Claims that are not Current Trade Vendor Unsecured Claims) will receive, if Class 4 accepts the Plan, Cash in the minimum amount of nine million dollars ($9,000,000), and up to a maximum of seventeen and a half percent (17.5%) of such Allowed Customer or Trade Vendor Claims, subject to a hard cap of fifteen million dollars ($15,000,000) for all Allowed Claims in Class 4, in full satisfaction, settlement, release, and discharge of and in exchange for each Customer or Trade Vendor Unsecured Claim. Other proceeds would potentially be available to support this recovery, including Creditor Trust Actions against members of Class 7 and SLS, and if the Administrative Expense Ceiling of fifteen million dollars ($15,000,000) is not reached. However, this recovery could be degraded if the actual administrative expenses exceed the Administrative Expense Claim Ceiling, as then the amounts due under the SLEIP would be paid out of the Customer/Trade Vendor Recovery Fund. If Class 4 does not accept the Plan, it will receive a Pro

Rata share of the membership interests in the Creditor Trust on account of the Customer Equity Recovery (which will be ten percent (10%) of the equity interests in Reorganized Sea Launch).

ii. Aker and Boeing Claims.

The Boeing and Aker Claims consist of various amounts, including loans, guarantees of loans, cost overruns experienced on certain fixed-price contracts, trade claims for goods and services provided, and total approximately $1.755 billion. The Committee has filed objections to substantially all of said Claims, and thus the ultimate allowance of such Claims remains uncertain. Boeing, Aker and the Committee have engaged in mediation of the objections, and indications of a settlement are positive, but as of the date of this Disclosure Statement, no settlement had been finalized.

iii. Energia, Yuzhmash and Yuzhnoye Claims.

The Energia, Yuzhmash and Yuzhnoye Claims consist of cost overruns experienced on certain fixed-price contracts, trade claims for goods and services provided, and total approximately $224 million. The Committee has filed objections to substantially all of said Claims, and thus the ultimate allowance of such Claims remains uncertain.

iv. Interests in the Debtors.

As of the Petition Date, the identity and the amounts of the holders of the membership interests in Sea Launch, and the limited partnership interests in SLLP, were as follows: Boeing held approximately 40% of such interests, Energia held approximately 25% of such interests, Aker held approximately 20% of such interest, Yuzhmash held approximately 10% of such interests, and Yuzhnoye held approximately 5% of such interests. The interests in the other Debtors are held by Sea Launch and SLLP.

C. Key Terms of the Plan of Reorganization.

i. Classification And Treatment Summary.

See Section I.B, Summary of Classes Under the Plan and Their Treatment.

ii. Vesting of Assets.

On the Effective Date the property of the Debtors' Estates will vest in the respective Reorganized Debtors, free and clear of liens not specifically contemplated to either survive the Reorganization Cases or be created or granted in connection therewith. Claims of the Debtors' Estates not released under the Plan or transferred to the Creditor Trust are preserved for the benefit of the respective Reorganized Debtor or the beneficiaries under the Plan.

iii. Pursuit of Avoidance Actions.

The Debtors have identified approximately $22.59 million in payments made to non-insider vendors during the ninety days prior to the Petition Date against which they may assert

causes of action as voidable preferences pursuant to Section 547 of the Bankruptcy Code. As with all litigation, the potential recovery on these claims cannot be determined with any certainty, although the Debtors and their professionals believe that some of the claims may be meritorious and that a recovery may occur by prosecuting these actions. However, it is likely that many of such claims will be subject to valid defenses, such as the ordinary course of business defense or the new value defense. Under the Plan, the Avoidance Actions will be transferred to the Creditor Trust, with the Class 4 (if it does not accept the Plan), 5 and 7 (if it does not accept the Plan) Creditors receiving in return membership interests in the Creditor Trust, unless otherwise agreed.

iv. Issuance of New Interests and Cancellation of Old Interests.

On the Effective Date of the Plan, Sea Launch and SLLP will be merged, the existing interests in Sea Launch and SLLP shall be canceled, and reorganized Sea Launch ultimately will become a corporation organized under the laws of Switzerland, and will issue new equity interests in the form of shares of common stock, to be distributed 85% to 95% to the New Investor, and 5% to 15% to the Creditor Trust (depending on whether Class 4 accepts the Plan), for the benefit of Classes 4 (if it does not accept the Plan), 5 and 7 (if it does not accept the Plan, each to the extent provided in the Plan. In addition, certain shares of preferred stock will be issued to Energia on account of approximately $28.8 million in Partner Currency Control Claims. The articles of incorporation and other relevant formation documents of the Reorganized Debtors will govern the rights, obligations and preferences under the Preferred Stock. Further, the articles of incorporation and other formation documents may be amended in accordance with applicable law.

v. Creditor Trust

As set forth in *Section IV.C.ix, The Committee Litigation Against the Partners*, above, the Committee believes that the Debtors' estates have causes of action against Aker, Boeing, Energia, Yuzhmash and Yuzhnoye consisting of a combination of avoidance action claims, equitable subordination and recharacterization claims, and potentially other causes of action.

The Plan contemplates the creation of the Creditor Trust, and to the extent that such claims against the Partners are not resolved prior to the Effective Date, control of the litigation against the Partners, other than Energia, including the Claim Objections, shall shift to the Creditor Trust, with the Class 4 (if it does not accept the Plan), 5 and 7 (if it does not accept the Plan) Creditors receiving in return membership interests in the Creditor Trust.

Pursuant and subject to the Creditor Trust Agreement, the affairs of the Creditor Trust shall be managed by one Creditor Trust Manager, who shall be designated in accordance with the provisions of the Creditor Trust Agreement. Pursuant to the Creditor Trust Agreement, decisions regarding the administration of the Creditor Trust and the prosecution and settlement of the claims and avoidance actions transferred to the Creditor Trust shall be made by the sole Creditor Trust Manager.

It is contemplated that the Creditor Trust Manager shall hire employees and retain professionals as needed to bring these claims, and that proceeds received through the prosecution

and/or settlement of the claims and avoidance actions transferred to the Creditor Trust, net of professional fees, costs and expenses incurred by the Creditor Trust, shall be distributed to the holders of Creditor Trust Equity Interests, as provided in the formation documents for the Creditor Trust.

vi. Management and Board of Directors.

See Section VI, Post-Confirmation Management of the Debtors.

vii. Post-Confirmation Funding of the Debtors.

The Debtors anticipate that their post-Effective Date funding needs will be met by a combination of the New Investment Amount and the Exit Financing. Other than these amounts, the Debtors do not anticipate any financing needs, and their projections show adequate funds on hand throughout the post-Effective Date period with which to satisfy all business obligations and obligations under the Plan. However, during the period between Confirmation of the Plan and the Effective Date, the Debtors may have certain funding needs, which they anticipate will be met by an additional loan from the New Investor, to be credited against the New Investment Amount. The amount of the additional funding is currently unknown, as it will vary depending on the length of time between the Confirmation Date and the Effective Date.

viii. Filing of Amended Organizational Documents.

On the Effective Date, each Reorganized Debtor's organizational documents will be deemed to be amended and restated in their entirety, and each Reorganized Debtor shall file such amended and restated organizational documents with the appropriate jurisdiction in which they are organized in accordance with the applicable laws of that jurisdiction.

ix. Assumption of Contracts and Leases.

All contracts and leases not expressly assumed or rejected by the Debtors pursuant to a Bankruptcy Court order entered prior to the Confirmation Date, or subject to a motion for assumption or rejection filed on or before the Confirmation Date, shall be deemed rejected, unless assumed pursuant to the Plan. The issuance of the Preferred Shares to Energia under the terms of the Plan shall be deemed to cure contractual defaults for purposes of assumption. It is anticipated that the Debtors will assume, and thus continue to honor post-confirmation as fully enforceable obligations, most, if not all, of their contracts with their customers, as such contracts have been amended during the pendency of these cases. It is not anticipated that the Debtors will have to cure any defaults under these contracts or leases, nor that such assumption will create any Administrative Claims that are immediately due or payable. However, with respect to certain of those customer contracts, it is likely that some of their contingent claims will remain as general unsecured claims in Class 4. It is currently unknown how much of those claims will remain. In addition, with respect to other customer contracts, while such contracts will be assumed, and thus the contingent claims associated with such contracts will be resolved by giving the customers credits against future launches, it is possible that those claims may be reasserted in certain

situations (for example, if the post-reorganization Debtors were to default on such a contract). Accordingly, some reserve will have to be made for such potential claims.

x. Discharge of Debtors.

On the Effective Date except as otherwise provided in the Plan or the Confirmation Order, the Reorganized Debtors will be discharged from liability on all Claims which arose prior to Confirmation.

xi. Exculpations.

The Plan contains an exculpation provision that is consistent with those that have been approved by the Bankruptcy Court and other courts of the Third Circuit. The exculpation provision provides as follows:

> **From and after the Effective Date, the Released Parties shall neither have nor incur any liability to, or be subject to any right of action by, any Holder of a Claim or Interest, or any other party in interest, or any of their respective employees, representatives, financial advisors, attorneys, or agents acting in such capacity, or affiliates, or any of their successors or assigns, for any act or omission in connection with, relating to, or arising out of, the Chapter 11 Cases, formulating, negotiating or implementing this Plan, the solicitation of acceptances of this Plan, the pursuit of approval of the Disclosure Statement and confirmation of this Plan, the confirmation of this Plan, the Plan Documents, the consummation of this Plan or the administration of this Plan or the property to be distributed under this Plan, or the restructuring transactions contemplated hereunder; provided, however, that the foregoing provision shall not apply to an act or omission that is determined by a Final Order of the Bankruptcy Court to have constituted willful misconduct or gross negligence. Any of the Released Parties shall be entitled to rely, in all respects, upon the advice of counsel with respect to their duties and responsibilities under the Plan.**

Plan at § 10.2(a).

In addition, the Debtors will be releasing the Released Parties as well, pursuant to the following provision:

> **As of the Effective Date, for good and valuable consideration, the adequacy of which is hereby confirmed, the Debtors and Reorganized Debtors in their individual capacities and as debtors-in-possession on behalf of each of the Debtors' Estates will be deemed to release and forever waive and discharge all claims, obligations, suits, judgments, damages, demands, debts, rights, causes of action and liabilities whether liquidated or unliquidated, fixed or contingent, matured or unmatured, known or unknown, foreseen or unforeseen, then existing or thereafter arising, in law, equity or otherwise against the Released Parties, that are based in whole or part on any act,**

> **omission, transaction, event or other occurrence taking place on or prior to the Effective Date in any way relating to the Debtors, the Reorganized Debtors, the Chapter 11 Cases, this Plan or the Disclosure Statement, or any document or agreement related thereto; provided, however, that the foregoing provision shall not apply to an act or omission that is determined by a Final Order of the Bankruptcy Court to have constituted willful misconduct or gross negligence.**

Plan at § 10.2(b).

The Plan also provides for a voluntary release of claims by Holders of Claims and Interests of the Released Parties, in exchange for entitlement to participate in the Call Option, as follows:

> **As of the Effective Date, to the fullest extent permitted by law, each Holder of a Claim or Interest that does not otherwise elect in accordance with voting on this Plan, shall in consideration for the obligations of the Debtors and the Reorganized Debtors under this Plan and the Cash, the securities, including the Call Option under the Exit Financing Commitment Letter and New Investment Agreement, contracts, instruments, releases and other agreements or documents to be delivered in connection with this Plan, be deemed to have forever released, waived and discharged all claims, demands, debts, rights, causes of action or liabilities, whether liquidated or unliquidated, fixed or contingent, matured or unmatured, known or unknown, foreseen or unforeseen, then existing or thereafter arising, in law, equity or otherwise, relating to the Debtors, the Reorganized Debtors, the Chapter 11 Cases, this Plan or the Disclosure Statement, the Plan Documents, or the restructuring transactions contemplated thereby, existing as of the Effective Date or thereafter that are based in whole or part on any act, omission, transaction event, or other occurrence taking place on or prior to the Effective Date, against the Released Parties. Any Holder of a Claim or Interest who does not elect to offer the Releases described in this paragraph shall not be entitled to any direct or indirect benefits from the Call Option under the Exit Financing Commitment Letter and New Investment Agreement as may be more fully described in the Shareholders Agreement between reorganized Sea Launch, the Creditor Trust and the New Investor.**

Plan at § 10.2(c).

Finally, the Plan provides for a voluntary release of claims by Holders of Claims and Interests of Boeing and Aker:

> **Subject to Bankruptcy Court approval of Boeing Aker UCC Settlement Agreement (as such term is defined below), as of the Effective Date, to the fullest extent permitted by law, each Holder of a Claim or Interest that does not otherwise elect in accordance with voting on this Plan, shall, in**

consideration for Boeing and Aker agreeing to the Boeing Aker UCC Settlement Agreement, be deemed to have forever released, waived and discharged all claims, demands, debts, rights, causes of action or liabilities, whether liquidated or unliquidated, fixed or contingent, matured or unmatured, known or unknown, foreseen or unforeseen, then existing or thereafter arising, in law, equity or otherwise, relating to the Debtors, the Reorganized Debtors, the Chapter 11 Cases, this Plan or the Disclosure Statement, the Plan Documents, or the restructuring transactions contemplated thereby, existing as of the Effective Date or thereafter that are based in whole or part on any act, omission, transaction event, or other occurrence taking place on or prior to the Effective Date, against Boeing and Aker, provided that nothing in such agreement shall contradict Section 10.5 of the Plan.

Plan at § 10.2(h).

With regard to the releases, the Plan provides the following exception:

Nothing in the Plan, including, but not limited to, Sections 10.2 and 10.3 of the Plan, Confirmation Order, or any other document in connection with such documents shall release or discharge the claims, if any, of The Boeing Company, Boeing Commercial Space Company, Kvaerner Sea Launch Limited, Kvaerner Sea Launch U.S., Inc., Aker Maritime Finance AS, Kvaerner AS, Aker ASA, S.P. Korolev Rocket and Space Corporation Energia, KB Yuzhnoye, and PO Yuzhny Mashinostroitelny Zavod Production Association, against entities other than the Debtors; provided, however, that nothing contained in this Section 10.5 shall constitute an acknowledgement by any party of any right or fact with respect to any claims.

Plan at § 10.5.

xii. The Filing of Plan Documents

Not later than five (5) Business Days prior to the objection deadline set with respect to the Plan, the Debtors shall File the various documents comprised within the Plan Supplement including, but not limited to, the Articles of Incorporation, the By-Laws, the term sheet for the Exit Financing Credit Agreement, the Reorganized Sea Launch Shareholders Agreement, the Reincorporation Transactions Document, the Current Trade Vendor List, the Creditor Trust Agreement, the Exit Financing Commitment Letter, Sea Launch Board Resolution No. 2010-04-1-103 dated April, 2010, and any other documents relevant to the implementation of this Plan, except for the list of directors and officers of Reorganized Sea Launch and the Reorganized Debtors, which shall be filed with the Bankruptcy Court not later than three (3) Business Days prior to the Confirmation Hearing, and the New Investment Agreement, which shall be filed with the Bankruptcy Court not later than five (5) days prior to the objection and voting deadline on the Plan.

xiii. Post-Confirmation Reports and Fees

Post-confirmation, the Reorganized Debtors shall continue to file such operating reports as are required by the Bankruptcy Code and Rules, and shall continue paying such U.S. Trustee fees as are owed, until such time as the Chapter 11 Cases are closed.

D. Securities Law Matters.

With respect to the New Common Stock and the New Preferred Stock and any warrants or options to purchase New Common Stock (collectively, the "**New Securities**") to be issued or exchanged under and pursuant to the Plan, the Debtors intend to rely upon the exemptions from the registration requirements of the Securities Act of 1933 (as amended, the "**Securities Act**"), and of equivalent state securities or "blue sky" laws, provided by Section 1145(a)(1) and (a)(2) of the Bankruptcy Code.

i. Issuance of New Securities under the Plan.

Sections 1145(a)(1) and 1145(a)(2) of the Bankruptcy Code exempt the issuance of securities, including warrants, options, rights to subscribe or conversion privileges, under a plan of reorganization from registration under the Securities Act and under equivalent state securities or "blue sky" laws if three principal requirements are satisfied: (i) the securities must be issued "under a plan" of reorganization by the debtor or its successor under a plan; (ii) the recipients of the securities must hold a claim against the debtor, an interest in the debtor or a claim for an administrative expense against the debtor; and (iii) the securities must be issued entirely in exchange for the recipient's claim against or interest in the debtor, or "principally" in such exchange and "partly" for cash or property. The Debtors believe that the exchange of the New Securities for Claims under the Plan satisfies the requirements of Section 1145(a)(1) or 1145(a)(2) of the Bankruptcy Code and is, therefore, exempt from registration under federal and state securities laws.

ii. Transfer of New Securities.

(A) <u>New Securities Issued Pursuant to Section 1145 Exemption</u>

Except to the extent provided in the Shareholders Agreement, the New Securities (all of which will be issued under the Section 1145(a)(1) or 1145(a)(2) exemption discussed above) may be freely transferred by most recipients thereof, and all resales and subsequent transfers of the New Securities are exempt from registration under federal and state securities laws, unless the holder is an "underwriter" with respect to such securities. Section 1145(b)(1) of the Bankruptcy Code defines four types of underwriters:

> (i) persons who purchase a claim against, an interest in, or a claim for administrative expense in a case concerning a debtor with a view to distributing any security received in exchange for such a claim or interest;
>
> (ii) persons who offer to sell securities issued under a bankruptcy plan on behalf of the holders of such securities;

(iii) persons who offer to buy securities issued under a bankruptcy plan from the persons receiving such securities, if the offer to buy is made with a view to distributing such securities and under an agreement made in connection with the plan, with the consummation of the plan, or with the offer of securities under the plan; and

(iv) a person who is an "issuer" with respect to the securities, as the term "issuer" is used in Section 2(11) of the Securities Act.

Under Section 2(11) of the Securities Act, an "issuer" includes any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer. "Control" (as such term is defined in Rule 405 of Regulation C under the Securities Act) means the possession, direct or indirect, of the power to direct or cause the direction of the policies of a person, whether through the ownership of voting securities, by contract, or otherwise. Accordingly, an officer or director of a reorganized debtor (or its affiliate or successor) under a plan of reorganization may be deemed to "control" such debtor (and therefore be an underwriter for purposes of Section 1145), particularly if such management position is coupled with the ownership of a significant percentage of the debtor's (or affiliate's or successor's) voting securities. Moreover, the legislative history of Section 1145 of the Bankruptcy Code suggests that a creditor who owns at least 10% of the securities of a reorganized debtor may be presumed to be a "control person."

To the extent that persons deemed to be "underwriters" receive New Securities pursuant to the Plan, resales by such persons would not be exempted by Section 1145(a)(1) of the Bankruptcy Code from registration under the Securities Act or other applicable law. Persons deemed to be underwriters, however, may be able to sell such securities without registration subject to other exemptions available under the Securities Act, including the provisions of Rule 144 under the Securities Act as discussed below.

(B) New Securities Held by Underwriters.

Holders of New Securities who are deemed to be "underwriters" within the meaning of Section 1145(b)(1) of the Bankruptcy Code or who may otherwise be deemed to be "affiliates" of, or to exercise "control" over, the Debtors within the meaning of Rule 405 of Regulation C under the Securities Act, may, in addition to any other exemptions that may be available under federal and state securities laws, under certain circumstances, be able to sell their securities pursuant to the more limited safe harbor resale provisions of Rule 144 under the Securities Act. Generally, Rule 144 provides that if certain conditions are met (e.g., volume limitations, manner of sale, availability of current information about the issuer, etc.), specified persons who resell such securities and are "affiliates" of the issuer of the securities sought to be resold, will not be deemed to be "underwriters" as defined in Section 2(11) of the Securities Act.

The foregoing summary discussion is general in nature and has been included in this Disclosure Statement solely for informational purposes. The Debtors do not make any representations concerning, and do not provide any opinion or advice with respect to, the securities law and bankruptcy law matters described above. In view of the uncertainty

concerning the availability of exemptions from the registration requirements of the Securities Act and equivalent state securities or "blue sky" laws to a recipient of New Securities who may be deemed to be an "underwriter" (within the meaning of Section 1145(b)(1) of the Bankruptcy Code) and/or an "affiliate" of, or a person who exercises "control" over, the Debtors under applicable federal and state securities laws, the Debtors encourage each person who is to receive New Securities pursuant to the Plan to consider carefully and consult with its own legal advisor(s) with respect to such (and any related) matters.

VI. POST-CONFIRMATION MANAGEMENT OF THE DEBTORS

The current executive officers of the Debtors, a brief biography of each, and their salaries for the past fiscal year are as follows:

Name	**Position**	**Salary – Fiscal 2009**
Kjell J. Karlsen	President and General Manager	Salary: $309,000/year
Brett A. Carman	Vice President and Chief Financial Officer	Salary: $206,000/year

Kjell J. Karlsen: Mr. Karlsen joined the Debtors in 1999 as Vice President and Chief Financial Officer. He was promoted to Executive Vice President in 2002, and became President and General Manager in July of 2008. Prior to joining the Debtors, Mr. Karlsen was employed for 2 years by Kvaerner, Inc. and Kvaerner Financial Services, and from 1988-1997, he held increasingly responsible executive positions with Den norske Bank of Oslo, Norway, and its New York-based operation. He obtained his B.S. from the University of Oregon and his M.B.A. from Lehigh University. He is also a graduate of the Executive Development Program of The Wharton School at the University of Pennsylvania.

Brett A. Carman: Mr. Carman officially joined the Debtors in 2001 as Controller. He was promoted to Vice President and Chief Financial Officer in 2008. Prior to joining the Debtors, Mr. Carman worked from 1983 to 1997 for Rockwell International in various accounting and management positions in the Space & Satellite Systems Division, including four years at Kennedy Space Center. He then worked for Boeing Space & Defense Systems as a Senior Manager in Financial Accounting and Accounting Systems from 1997 to 2001 after Boeing purchased Rockwell's space and defense divisions (during which time he began serving as the Debtors' Controller). Mr. Carman obtained his B.S. from California State University, Long Beach, and his M.B.A. from Florida Tech.

It is expected that Messrs. Karlsen and Carman will continue in their current positions post-Confirmation, although such decisions are ultimately the responsibility of the New Investor. It is expected that Messrs. Karlsen and Carman will, shortly before or after the Confirmation Date, execute employment agreements with the New Investor. It is also expected that post-Confirmation, Messrs. Karlsen and Carman and perhaps other members of management will be

granted a certain amount of New Common Stock or options to purchase New Common Stock in order to align their interests with the success of the Reorganized Debtors. Some or all of such New Common Stock will be awarded pursuant to the SLEIP, approved by the Court during the pendency of the Bankruptcy Cases.

As to directors, on the Effective Date, the current directors shall be deemed to have resigned, without any further action on the part of any Person. On the Effective Date, the boards of directors of each Reorganized Company shall consist of the parties designated in a "Notice of Filing of Initial Board Members" to be filed with the Plan Supplement.

VII. CERTAIN FEDERAL INCOME TAX CONSEQUENCES OF THE PLAN.

A. Introduction.

Implementation of the Plan may have federal, state, local or foreign tax consequences to the Debtors as well as to Creditors and Interest Holders. No tax opinion or ruling has been sought or will be obtained with respect to any tax consequences of the Plan, and the following discussion does not constitute and is not intended to constitute either a tax opinion or tax advice to any person.

The following discussion does not address every aspect of the U.S. federal income tax laws that may be relevant to Creditors or Interest Holders in light of their individual circumstances, or to certain types of Creditors or Interest Holders subject to special treatment under U.S. federal income tax laws (such as financial institutions, mutual funds, broker-dealers, tax-exempt entities, insurance companies, foreign persons and persons to whom property was or is transferred in connection with the performance of services). The following discussion does not attempt to consider any facts or limitations applicable to any particular Creditor or Interest Holder which may modify or alter the consequences described below. This disclosure also does not address state, local, or foreign tax consequences, other than certain California tax issues noted below, or the consequences of any federal tax other than the federal income tax.

The following discussion is based upon the provisions of the Internal Revenue Code of 1986, as amended (the "**Internal Revenue Code**"), the Treasury regulations promulgated thereunder, and published rulings and court decisions in effect as of the date hereof, all of which are subject to change, possibly retroactively, and such changes could modify or adversely affect the federal income tax consequences summarized below. There can be no assurance that the Internal Revenue Service (the "**Service**") will agree with the federal income tax consequences described below.

The federal income tax consequences of the Plan are complex. All Creditors and Interest Holders are strongly urged to consult their own tax advisors as to the particular federal, state, local and foreign income and other tax consequences of the transactions contemplated by the Plan.

B. Federal Income Tax Consequences To the Debtors.

i. Generally

Subject to certain exceptions, a debtor realizes income (referred to herein as "cancellation of debt" or "COD" income) upon the discharge or cancellation of its outstanding indebtedness in an amount equal to the excess (if any) of: (i) the amount of the indebtedness discharged over (ii) the amount of cash plus the issue price of any new indebtedness issued plus the fair market value of any other consideration (including New Common Stock) given in satisfaction of the indebtedness.

One of the exceptions to this general rule provides that a debtor is not required to include COD income in gross income if the debtor is under the jurisdiction of the court in a Title 11 case and the discharge is granted by the court or it is pursuant to a plan approved by the court (the "**Bankruptcy Exception**"). Instead, the amount excluded from gross income is applied to reduce the following tax attributes in the following order: (a) net operating losses and net operating loss carryovers ("**NOLs**"); (b) general business credits; (c) minimum tax credits; (d) capital loss carryovers; (e) basis of property of the taxpayer; (f) passive activity loss or credit carryovers; and (g) foreign tax credit carryovers. Tax attributes generally are reduced by one dollar for each dollar excluded from gross income, except that tax credits are reduced by one-third of the amount excluded from gross income. Notwithstanding the general order of attribute reduction, the Internal Revenue Code provides a debtor with an election to reduce its tax basis in depreciable assets prior to reducing NOLs. The reduction in tax attributes generally takes place after the federal income tax is determined for the tax year in which the debt discharge occurs. As Sea Launch is a partnership for Federal income tax purposes, these rules will apply at the partner level only. Consequently, Sea Launch cannot in all circumstances exclude COD income even though it is under the jurisdiction of a Title 11 case.

ii. Issues Relating to COD Income.

The Debtors anticipate that a significant amount of its indebtedness will be discharged in the bankruptcy proceeding. For Federal and State of California income tax purposes, COD income is treated as taxable income. Accordingly, during the Debtors' 2010 tax year, the Debtors anticipate that they will realize a substantial amount of COD income.

In general, the Debtors are required to pay a Federal withholding tax under Section 1446 of the Internal Revenue Code if they have any effectively connected income attributable to a U.S. trade or business that is allocable to a foreign partner. A portion of the COD income to be realized by the Debtors may be characterized as "effectively connected income" within the meaning of Section 1446(c) of the Internal Revenue Code. The State of California has withholding tax obligation rules similar to the Federal rules, and, as a result, the Debtors may be liable for State of California withholding tax obligations.

Section 108 of the Internal Revenue Code allows taxpayers in certain situations to exclude COD income from taxable income. In the case of a partnership, the Section 108 rules generally apply at the partner level (and not at the partnership level). The Debtors have not

determined whether the partners can exclude their allocable shares of COD income under Section 108 (at the partner level). However, pursuant to the rules of Section 1446 of the Internal Revenue Code, the Debtors may be liable for withholding tax obligations at the partnership level regardless of the income tax treatment of the partners.

A partnership is legally obligated to withhold the Section 1446 tax if it applies. Each foreign partner is then allowed a credit for the partner's share of the withholding tax paid by a partnership under Section 1446 on its Federal corporate income tax return and, if appropriate, receives a refund. As with the Federal income tax, any California tax withheld on behalf of a partner is creditable on the partner's California corporate income tax return.

Since its inception, the Debtors have reported losses for tax purposes. Each partner's allocable share of the Federal and State of California income tax losses have been reported to it on annual Forms K-I, Partner's Share of Income, Credits, Deductions and Other Items. The Debtors do not have knowledge of the Federal and State of California income tax positions of its foreign partners (nor its domestic partners). However, it is anticipated that the tax losses allocable to the foreign partners have given rise to "net operating loss carryovers" for Federal and State of California income tax purposes equal to a portion or to all of the allocable tax losses. The Regulations permit foreign partners to certify their net operating loss carryovers to the Debtors, who can rely on such certifications to offset such partner's allocable share of U.S. effectively connected taxable income from the partnership. In that case, the Debtors may reduce or eliminate their obligation to withhold under Section 1446. The State of California effectively adopts the same regime and uses the federal rules and forms in computing the required State of California withholding.

As part of the Debtors' ongoing efforts to emerge from the bankruptcy proceeding as a going concern, the Debtors have requested the assistance of each foreign partner to prepare and submit to it a Form 8804-C, Certificate of Partner-Level Items to Reduce Section 1446 Withholding. Any failure by non-U.S. resident partners to submit the requested Form 8804-C will have an adverse impact on the Debtors' estimate of potential claims. *See* Section VII.B.iii, *infra*.

iii. Analysis And Treatment Of Potential CMDI Claims Asserted By The U.S. And California Taxing Entities.

To address the contingent claims of the U.S. and the California Franchise Board in respect of the argument that the Debtors are responsible to withhold, on behalf of its foreign partners, sums due in the approximate amount of $250,000, the Plan shall provide that the claims of the U.S. and the California Franchise Board will be addressed as follows:

A. The Plan will treat any putative or contingent claim of the United States for the State of California as a prepetition unsecured claim under Section 101(5) of the Bankruptcy Code. *See also In re Roth American*, 975 F.2d 949 (3d Cir. 1992); *In re Sunarhauserman*, 126 F.3d 811 (6th Cir. 1992). Neither the United States nor the State California has filed a proof of claim in respect of the contingent claims and, as a result, the Debtors' position is that the claims

will be barred and discharged under the provisions of Section 1141 of the Bankruptcy Code. *See also* 11 U.S.C. § 502(b)(9).

B. To the extent that the taxing authorities are able to demonstrate cause for the late filing of the claims in respect of the withholding liability, the Debtors shall provide payment for the claim if allowed pursuant to the terms of the Plan.

C. The Plan shall provide that the liability for withholding will be capped in the amount of $250,000 and be capped for distributional purposes under Section 502(c) of the Bankruptcy Code. In order for the Debtors to stay within this cap, the non-U.S. resident partners must submit the requested Form 8804-C to the Debtors. Any failure to timely deliver the form to the Debtors will have an adverse impact on the Debtors' estimate of potential claims. *See* Section VII.B.ii, *supra*.

D. If and to the extent that the Debtors receive a discharge pursuant to Sections 524 and 1141(d) of the Bankruptcy Code, the Debtors shall have no further liability for such claims other than as set forth in the Plan.

C. Federal Income Tax Consequences To Creditors.

i. Generally.

The federal income tax consequences of the Plan to a Creditor will depend upon several factors, including but not limited to: (i) whether the Creditor's Claim (or portion thereof) constitutes a Claim for principal or interest; (ii) the type of consideration received by the Creditor in exchange for the Claim; (iii) whether the Creditor is a resident of the United States for tax purposes (or falls into any of the special classes of taxpayers excluded from this discussion as noted above); and (iv) whether the Creditor has taken a bad debt deduction or worthless security deduction with respect to its Claim. **Creditors are strongly advised to consult their tax advisors with respect to the tax treatment under the Plan of their particular Claims.**

ii. Potential Bad Debt Deduction

Section 166(a)(1) of the Internal Revenue Code allows a deduction for "any debt which becomes worthless during the taxable year." Section 166(a)(2) allows a deduction for partially worthless debts. *See* Treas. Reg. § 1.166-2(b) (a bad debt deduction is warranted if "the surrounding circumstances indicate that a debt is worthless and uncollectible and that legal action to enforce payment would in all probability not result in the satisfaction of execution on judgment . . . .") Each partner must make its own determination as to whether and when the Section 166 criteria are met with respect to their loans. Notwithstanding whatever election any particular partner may make, the treatment of any putative liability to the United States or to the California Franchise Board shall be defined and governed by the terms of the Plan. In particular, the Plan shall effect a discharge, pursuant to Sections 524 and 1141 of the Bankruptcy Code, of any and all claims arising by virtue of any putative holding liability or responsibility of the Debtors pursuant to the Internal Revenue Code of 1986, as amended.

iii. Creditors Holding "Securities".[4]

(A) Generally.

The federal income tax consequences of the Plan to Creditors who will receive membership interests in the Creditor Trust (which in turn will receive, in part, shares of New Common Stock) will depend in large part on whether the exchange of their Claims for such consideration will be treated, in part, as a "recapitalization" within the meaning of Section 368(a)(1)(E) of the Internal Revenue Code.

If the exchanges contemplated by the Plan are made pursuant to such a recapitalization, then an exchanging Creditor generally will not recognize any gain (except to the extent of "boot" and any consideration attributable to accrued but unpaid interest) or loss for federal income tax purposes. See "Federal Income Tax Consequences to Creditors - Accrued Interest" below. If an exchange is not made pursuant to a recapitalization, then an exchanging Creditor will recognize gain or loss on such exchange. This discussion assumes that each Creditor will hold any membership interests in the Creditor Trust received under the Plan, as "capital assets" within the meaning of Section 1221 of the Internal Revenue Code.

In order for an exchange contemplated by the Plan to constitute a tax-free recapitalization, the Claim exchanged by a Creditor must qualify as a "security" for federal income tax purposes, and the Creditor must receive stock (and/or securities) in the exchange. The term "security" is not defined in the Internal Revenue Code or the regulations issued thereunder, and has not been clearly defined by court decisions. In general, a debt instrument constitutes a "security" if it represents a participating, continuing interest in the issuer, rather than merely the right to a cash payment. Thus, the term of the debt instrument is usually regarded as a significant factor in determining whether it is a security. The Service has ruled that a debt instrument with a maturity of ten (10) years or more is treated as a security. However, under the case law, debt instruments with maturities ranging between five (5) and ten (10) years are often held to be securities. Instruments with a five-year term or less rarely qualify as tax securities. Further, claims arising out of the extension of trade credit or litigation generally will not constitute tax securities.

(B) Tax Consequences of an Exchange.

If an exchange of a Claim for membership interests in the Creditor Trust is treated as a recapitalization within the meaning of Section 368(a)(1)(E) of the Internal Revenue Code, the federal income tax consequences to such Creditors would be as follows:

(i) Subject to the discussion below with respect to accrued but unpaid interest, a Creditor would not recognize loss on the exchange, but would recognize gain to the extent of the lesser of (a) the amount of gain realized in the exchange and (b) the fair market value of any property and cash, if any, received (hereinafter referred to as "boot"). The amount of gain

[4] It is likely that the discussion in this Section applies, if at all, only to the Partners in Classes 5, 6 and 7.

realized, if any, would be equal to the excess of (a) the sum of the fair market value of the membership interests in the Creditor Trust and boot received, over (b) such Creditor's adjusted tax basis in its Claim.

(ii) Any such gain recognized on the exchange would constitute capital gain, and such capital gain would qualify as long-term capital gain if such Creditor held the Claim for more than one year as of the Effective Date.

(iii) Except for the consideration treated as received in exchange for accrued but unpaid interest: (A) a Creditor should have an aggregate tax basis in the membership interests in the Creditor Trust equal to such Creditor's adjusted tax basis in the Claims exchanged therefor, reduced by the amount of any boot received and increased by any gain recognized on the exchange, and (B) the holding period of the membership interests in the Creditor Trust should include the holding period of the Claims exchanged therefor.

If the exchange by a Creditor for membership interests in the Creditor Trust and boot, if any, does not qualify as a "recapitalization" within the meaning of Section 368(a)(1)(E) of the Internal Revenue Code, but instead constitutes a taxable exchange under Section 1001 of the Internal Revenue Code, the federal income tax consequences to the Creditors of such Claims would be as follows:

(i) Subject to the discussion below as to accrued but unpaid interest, a Creditor would recognize gain or loss on the exchange in an amount equal to the difference between (A) the sum of the fair market value of the membership interests in the Creditor Trust and boot as of the Effective Date and (B) such Creditor's adjusted tax basis in its Claim.

(ii) Any such gain or loss should constitute capital gain or loss, and such capital gain or loss should qualify as long-term capital gain or loss if such Creditor held its Claim for more than one year as of the Effective Date.

(iii) A Creditor's tax basis in the membership interests in the Creditor Trust would be equal to the fair market value of the membership interests as of the Effective Date. The holding period of the membership interests would begin on the day immediately following the Effective Date.

iv. Accrued Interest.

A Creditor will recognize ordinary income to the extent that any consideration received pursuant to the Plan is allocable to accrued but unpaid interest not previously included in such Creditor's taxable income. If the amount of accrued but unpaid interest previously included in such Creditor's taxable income exceeds the amount of consideration allocable to such interest, the Creditor should be treated as recognizing an ordinary loss.

v. Backup Withholding.

A noncorporate Creditor may be subject to backup withholding at the rate of 28% through the end of 2010 on the proceeds from the exchange of his or her Claim if he or she fails to supply his or her taxpayer identification number, furnishes an incorrect taxpayer identification number, receives a notification from the Service that he or she is subject to backup withholding, or, under certain circumstances, fails to provide a certified statement, under penalties of perjury, that he or she is not subject to backup withholding. Any amount withheld by the Debtors is not an additional tax, but will be credited against such Creditor's U.S. federal income tax liability.

D. Federal Income Tax Consequences To Interest Holders.

Under the Plan, all Interests in Sea Launch and SLLP will be canceled, and the holders thereof will not be entitled to any distribution under the Plan. Each holder of an Interest in Sea Launch and SLLP will be entitled to recognize a loss on its Interests at the time such Interests became worthless for tax purposes, in an amount equal to its tax basis in the Interests. If the Interests were held as a capital asset, the loss will be a long-term capital loss, if the Interest Holder's holding period is greater than one year, or a short-term capital loss, if the Interest Holder's holding period is not greater than one year.

E. General Disclaimer.

The U.S. federal income tax consequences of the Plan are complex. The foregoing discussion is not intended to be a substitute for careful tax planning, particularly since certain of the federal income tax consequences of the Plan will not be the same for all Creditors or Interest Holders due to their individual circumstances. Each Creditor and Interest Holder is strongly urged to consult with its own tax advisor in determining the federal, state, local, and foreign income and other tax consequences of the transactions contemplated by the Plan.

VIII. FINANCIAL INFORMATION

Attached as Exhibit B to this Disclosure Statement is a consolidated pro forma balance sheet as of September 1, 2010, reflecting the effects of a successful Plan. Attached also as part of Exhibit B are the Debtors' pro forma consolidated income statement, balance sheet and statement of cash flows, for the balance of 2010, and for 2011, 2012 and 2013.

The Debtors do not generally publish their business plans and strategies or make public projections of anticipated financial positions or results of operations. Accordingly, after the Effective Date, the Reorganized Debtors do not intend to update or otherwise revise the projections to reflect circumstances existing since their preparation or to reflect the occurrence of unanticipated events, even in the event that any or all of the underlying assumptions are shown to be in error. Furthermore, the Reorganized Debtors do not intend to update or revise the projections to reflect changes in general economic or industry conditions.

The feasibility of the Plan, and the Debtors' ability to meet their obligations in the future, is premised upon their anticipated financial performance after the Effective Date. The financial

projections are provided to demonstrate the feasibility of the Plan. Although all projections are based on assumptions of future events and circumstances that necessarily are uncertain in nature, the Debtors' management believes the financial projections are reasonable. Inclusion of these projections in this Disclosure Statement should not be regarded as a representation by any person that the projected results would be achieved.

Nevertheless, the actual results achieved from time to time during the projection period may vary from projected results and no assurance can be provided that these projections will be realized. The financial projections are based generally upon overall economic assumptions, and specifically on certain assumptions regarding the general demand for the services of the Debtors and the competitive position of the Debtors in meeting that demand, and the ability to operate profitably under the anticipated conditions that the Debtors will face in the near and long-term. These projections do not attempt to quantify any adverse effect on projected operations or cash flows that may result from any bankruptcy filing by the Debtors, if necessary.

Certain of the assumptions on which the financial projections are based may not materialize and unanticipated events and circumstances beyond the Debtors' control may occur subsequent to the Effective Date, that may materially affect the Debtors' actual financial results. In the past, the Debtors' results have varied, at times significantly, from their prior forecasts. Actual profitability achieved during any period may also vary from year to year due to factors that are exceedingly difficult to predict.

Although the Debtors believe that their assumptions are reasonable in light of the circumstances under which they were made, no assurance can be given that the financial projections will be realized. The Debtors urge that the financial projections be examined carefully by each party in evaluating the Plan. The Debtors' independent auditors have not examined or compiled the financial forecast presented herein and, accordingly, assume no responsibility for it.

IX. LIQUIDATION VALUE OF THE DEBTORS

See Exhibit C hereto for a liquidation value of the Debtors.

X. CERTAIN RISK FACTORS TO BE CONSIDERED

In determining how to vote with respect to the Plan, each holder of a Claim should carefully consider the following factors, together with all of the other information contained in this Disclosure Statement.

A. Risks Relating to the Projections.

The Debtors have prepared projections of the financial performance of their business following the consummation of the Plan. The projections represent the Debtors' best estimate of the most likely results of their operations following consummation of the Plan. However, consistent with the disclaimers and statements in *Section VIII, Financial Information*, above, the projections were based on numerous assumptions with respect to industry performance, general

business and economic conditions and other matters, such as interest rates, that are beyond the Debtors' control.

In addition, the Debtors' operations are subject to customer demand, as well as general economic conditions. Customer demand will have a strong impact on the performance of the Debtors in the future, and although the Debtors' services have proven desirable in the past, there is no guarantee this will continue. As to economic factors, the Debtors have been impacted by the general economic downturn that has affected the global economy over the last 24 months. Thus, the slowness of the recovery, and any further negative changes to the economy would likely result in lower earnings for the Debtors, as well. The Debtors also source critical components from the USA, Ukraine and Russia. The sourcing of these products could be negatively impacted by ITAR or export control regulations and economic conditions in those regions or by international trade restrictions due to political changes over which the Debtors have no control. Further, positive financial performance for the Debtors is also dependent on strong relations with their customers; although the Debtors believe they will maintain such relations in the future, various factors could strain or negatively affect these relationships.

B. Market for New Common Stock.

The Debtors will not apply for listing of the New Common Stock or any other securities on any major exchange, and thus there will likely be little or no market for the New Common Stock.

C. General Business Risks.

After the Plan is confirmed, the Debtors' principal business risk is whether they can achieve the financial results the Plan requires, under certain adverse circumstances. A deterioration in required financial performance could result in the Debtors being unable to achieve the results predicted under the Plan.

In addition to the various uncertainties described above, the Debtors will continue to be subject to the normal operational risks associated with their operations. Such risks include, among others, the possibility of demographic and economic factors causing certain of the Debtors' operations to be less successful, the difficulty in attracting and retaining a sufficient quality workforce and the ability to obtain and maintain necessary liquidity. While the Debtors do not feel such risks are extraordinary and they have historically acted in ways to minimize such risks, there can be no assurance that such risks will remain minimal and not have a material adverse effect on the business or results of operations of the Debtors.

D. Continuing Leverage.

The Debtors will remain leveraged once they emerge from bankruptcy. The Debtors and their financial advisors believe that completion of the restructuring will significantly reduce the Debtors' debt obligations, and that the obligations of the Debtors under the Plan can be satisfied, but this is no guarantee. In addition, after consummation of the Plan, a substantial amount of the Debtors' obligations will be secured by virtually all of the assets of the Debtors.

E. No Dividends.

The Debtors do not anticipate paying any significant dividends on the New Common Stock in the foreseeable future.

F. Applicable Law and Regulations.

The Debtors' businesses are subject to a high degree of regulation, and thus, changes in tariffs, excise taxes, or trade regulations could adversely affect the Debtors.

XI. ALTERNATIVES TO CONFIRMATION AND CONSUMMATION OF THE PLAN

A. Liquidation Alternative.

If no plan can be confirmed, the Debtors' Chapter 11 cases may be converted to cases under Chapter 7 of the Bankruptcy Code. Under Chapter 7, a trustee would be elected or appointed to liquidate the assets of the Debtors for distribution to the creditors in accordance with priorities established by the Bankruptcy Code. Discussion of the effect that a Chapter 7 liquidation would have on the recovery of holders of impaired claims and Interests is set forth above at *Section IX, Liquidation Value of the Debtors*, which refers to the liquidation analysis attached as part of Exhibit C. The Debtors believe that liquidation under Chapter 7 would result in little or no distributions being made to Creditors because of (a) additional administrative expenses involved in the appointment of a trustee, attorneys and other professionals to assist such trustee, (b) additional expenses and claims, some of which would be entitled to priority, which would be generated during the liquidation and from operating losses and the rejection of leases and other executory contracts in connection with the cessation of the Debtors' operations, (c) the likelihood that the assets of the Debtors would have to be sold or otherwise disposed of expeditiously, and (d) costs to be incurred in the removal of ITAR and other protected technology and equipment before certain of the assets (i.e., the ASC and the Launch Platform) can be sold or transferred.

In a liquidation under Chapter 11, the Debtors' assets would be sold in an orderly fashion over a more extended period of time than in a liquidation under Chapter 7, probably resulting in somewhat greater recoveries. Further, if a trustee were not appointed, as one is not required under a Chapter 11 case, the expenses for professional fees may be lower than in a Chapter 7 case. Although preferable to a Chapter 7 liquidation, the Debtors still believe that a liquidation under Chapter 11 would still not realize the full going-concern value of the Debtors' assets, especially given the amount of time the Debtors have already spent in bankruptcy and the concerns that would be raised by employees, suppliers and customers and, as it is likely to be a more protracted proceeding than the Chapter 11 case effected by the Plan, would involve greater administrative expenses. Consequently, the Debtors believe that a liquidation under Chapter 11 is a much less attractive alternative to creditors than the Plan because the Plan provides for a greater return to creditors than what would likely be realized in a Chapter 11 liquidation. As to Interest Holders, the Debtors believe that under a Chapter 7 or 11 liquidation, they would receive

nothing on account of their Interests. The highly specialized nature of the assets makes them significantly less valuable if not sold in connection with an ongoing launch services business.

B. Other Alternatives if the Plan is Not Confirmed.

If the Plan is not confirmed, the Debtors could attempt to formulate a different plan, as could any other party in interest, if the Debtors' exclusive right to file a plan is lost during the cases. Such a plan might involve either reorganization or continuation of the Debtors' business or an orderly liquidation of their assets. With respect to an alternative plan, the Debtors and their financial advisors have explored various other alternatives in connection with the formulation and development of the Plan. The Debtors believe the Plan as described herein enables Creditors to realize far greater value under the circumstances than available alternatives.

XII. VOTING PROCEDURES AND REQUIREMENTS FOR CONFIRMATION

A. Acceptance of the Plan.

As a condition to confirmation, the Bankruptcy Code requires that each impaired Class of claims or interests accept a plan of reorganization, except as described at Section 12.D hereof relating to "cram down." Classes of claims or interests that are not "impaired" under a plan are deemed to have accepted the plan and are not entitled to vote.

B. Parties in Interest Entitled to Vote.

Chapter 11 of the Bankruptcy Code does not require or entitle each holder of a claim against a debtor or each Interest Holder to vote in favor of the plan of reorganization in order for the Bankruptcy Court to confirm the plan. Pursuant to the Bankruptcy Code, only classes of claims or interests that are "impaired" are entitled to vote on the plan. Generally speaking, a claim or interest is impaired under a plan of reorganization if the plan provides that such claim or interest will not be repaid in full or that the legal, equitable or contractual rights of the holder of such claim or interest are altered. Only Claims in Classes 3, 4, 5, 6 and 7 are impaired under the Plan and are therefore entitled to vote.

Claims and Interests in Classes 1, 2 and 9 are unimpaired under Section 1124 of the Bankruptcy Code and holders of Claims or Interests in these unimpaired Classes are deemed to have accepted the Plan pursuant to Section 1126(f) of the Bankruptcy Code.

Class 8 receives nothing under the Plan, and is deemed to have rejected the Plan because the members of this Class will receive or retain nothing on account of their Interests.

C. Vote Required for Acceptance by Class of Claims or Interests.

The Bankruptcy Code defines acceptance of a plan of reorganization by a class of claims as acceptance by a majority in number and at least two-thirds in amount of the claims of that class allowed under the Bankruptcy Code that have actually voted on the plan. The Bankruptcy Code defines acceptance of a plan of reorganization by a class of holders of interests as acceptance by the holders of at least two-thirds in number of the shares of that class allowed

under the Bankruptcy Code that have actually voted on the plan. Because, under the Bankruptcy Code, only those who vote to accept or to reject the Plan will be counted for purposes of determining acceptance or rejection of the Plan by any impaired class of claims or interests, the Plan could be approved by any impaired class of claims with the affirmative vote of significantly less than two-thirds in principal amount and a majority in number of the claims in such class.

If the Bankruptcy Court confirms the Plan, each holder of an Allowed Claim or Allowed Interest in a Class will receive the same consideration in respect of such Allowed Claim or Allowed Interest as the other members of such Class receive in respect of their Allowed Claims or Allowed Interests in such Class, whether or not such holder voted to accept the Plan. Moreover, upon Confirmation, the Plan will be binding on all Creditors and Interest Holders of the Debtors regardless of whether such Creditors or Interest Holders voted to accept the Plan, or voted at all.

D. Confirmation Without Acceptance by All Impaired Classes.

In the event that any impaired Class or Classes reject the Plan, Section 1129(b) of the Bankruptcy Code provides that, so long as at least one impaired Class has accepted the Plan, the Debtors may seek confirmation of the Plan under a process known as "cram down." To obtain such confirmation, the Debtors must demonstrate to the Bankruptcy Court that the Plan "does not discriminate unfairly" and is "fair and equitable" with respect to any dissenting Class. The "unfair discrimination" test requires, among other things, that the Plan recognize the relative priorities among unsecured Creditors and Interest Holders. *See also Section XIII, Confirmation of the Plan.* The Debtors believe that the Plan satisfies all of the prerequisites to confirmation of the Plan through the "cram down" process.

XIII. CONFIRMATION OF THE PLAN

A. Requirements for Confirmation of the Plan.

The Debtors will request that the Bankruptcy Court hold a Confirmation Hearing as promptly as practicable, upon such notice to parties in interest as is required by the Bankruptcy Code and the Bankruptcy Court. Section 1128(b) of the Bankruptcy Code provides that any party in interest may object to confirmation of the Plan. Any procedures established by the Bankruptcy Court for the filing and service of objections to confirmation of the Plan will be provided to parties in interest.

In order for the Plan to be confirmed, and regardless of whether all impaired Classes of Claims vote to accept the Plan, the Bankruptcy Code requires that the Bankruptcy Court determine that the Plan complies with the requirements of Section 1129 of the Bankruptcy Code. Section 1129 of the Bankruptcy Code requires for confirmation, among other things, that: (i) the Plan be accepted by the requisite votes of holders of impaired Claims and Interests except to the extent that confirmation, despite dissent, is available under Section 1129(b) of the Bankruptcy Code (*see Section XIII.D, Cram Down*, below), (ii) the Plan is feasible (that is, there is a reasonable probability that the Debtors will be able to perform their obligations under the Plan and continue to operate their businesses without further financial reorganization); and (iii) the

Plan meets the requirements of Section 1129(a)(7) of the Bankruptcy Code, which requires that with respect to each impaired Class, each holder of a Claim or Interest either (a) accepts the Plan or (b) receives at least as much pursuant to the Plan as such holder would receive in a liquidation of the Debtors under Chapter 7 of the Bankruptcy Code.

Although the Debtors believe that the Plan will meet such tests, as well as the other requirements of Section 1129, there can be no assurance that the Bankruptcy Court will reach the same conclusion.

i. Feasibility of the Plan.

The Bankruptcy Code requires that, in order to confirm the Plan, the Bankruptcy Court find that confirmation of the Plan will not likely be followed by the liquidation or the need for further financial reorganization of the Debtors (the "**Feasibility Test**"). For the Plan to meet the Feasibility Test, the Bankruptcy Court must find that the Debtors will possess the resources and working capital necessary to operate profitably and will be able to meet the obligations under the Plan.

The Debtors have analyzed their ability to meet their obligations under the Plan. As part of this analysis, the Debtors have prepared projections of their financial performance for the three-year period ending December 31, 2013. These projections, and the significant assumptions on which they are based, are included as Exhibit B to this Disclosure Statement. The Debtors believe, based on this analysis, that the Plan provides a feasible means of reorganization and operation from which there is a reasonable expectation that, subject to the risks disclosed in this Disclosure Statement, the Debtors will be able to perform pursuant to the Plan. Neither the Debtors, the Debtors' professionals, nor the Committee's professionals have performed an independent investigation of the accuracy or completeness of such financial projections, and Creditors are cautioned not to place undue reliance on the projections.

The Debtors do not as a matter of course make public projections as to future sales, earnings or other results. However, the management of the Debtors have prepared the projected consolidated information set forth herein to present the anticipated effects of the restructuring contemplated by the Plan.

The projections in this Disclosure Statement were not prepared with a view toward public disclosure, or with a view toward complying with the guidelines established by the American Institute of Certified Public Accountants with respect to prospective financial information, but, in the view of the Debtors' management, were prepared on a reasonable basis, reflect the best currently available estimates and judgments and present, to the best of management's knowledge and belief, the expected course of action and expected future financial performance of the Debtors assuming the consummation of the Plan. However, this information is not fact and should not be relied upon as necessarily indicative of future results, and readers of this Disclosure Statement are cautioned not to place undue reliance on the projected consolidated financial information.

The projections indicate that the Reorganized Debtors should have sufficient cash flow to make the payments required under the Plan on the Effective Date and to repay and service their debt obligations to maintain their operations. Accordingly, the Debtors believe that the Plan complies with the standard of Section 1129(a)(11) of the Bankruptcy Code. As noted in the projections, however, the Debtors caution that no representation can be made as to the accuracy of the projections or as to the Debtors' ability to achieve the projected results after the Effective Date. Many of the assumptions upon which the projections are based are subject to uncertainties outside the control of the Debtors. Some assumptions inevitably will not materialize, and events and circumstances occurring after the date on which the projections were prepared may be different from those assumed or may be unanticipated, and may adversely affect the Debtors' financial results, both during and after the Bankruptcy Cases.

ii. Best Interests Test.

With respect to each impaired Class, confirmation of the Plan requires that each holder of a Claim or Interest either (a) accept the Plan or (b) receive or retain under the Plan property of a value, as of the Effective Date, that is not less than the value such holder would receive or retain if the Debtors were liquidated under Chapter 7 of the Bankruptcy Code (the "**Best Interests Test**").

To determine what holders of each impaired Class of Claims and Interests would receive if the Debtors were liquidated, the Bankruptcy Court must determine the dollar amount that would be generated from the liquidation of the Debtors' assets and properties in the context of a Chapter 7 liquidation case. Secured Claims (resulting from the DIP Facility) and the costs and expenses of the liquidation case or resulting from the original Chapter 11 case would be paid in full from the liquidation proceeds before the balance of those proceeds would be made available to pay prepetition unsecured Claims and Interests.

In applying the Best Interests Test, it is possible that Claims and Interests in the Chapter 7 case may not be classified according to the classification provided in the Plan. In the absence of a contrary determination by the Bankruptcy Court, all unsecured Claims arising prior to the Petition Date which have the same rights upon liquidation and would be treated as one Class for purposes of determining the potential distribution of the liquidation proceeds resulting from the Debtors' Chapter 7 cases. The distributions from the liquidation proceeds would be calculated ratably according to the amount of the Claim held by each Creditor holding a Claim. Therefore, Creditors who claim to be third-party beneficiaries of any contractual subordination provisions might be required to seek to enforce such contractual subordination in the Bankruptcy Court or otherwise. Section 510 of the Bankruptcy Code specifies that such contractual subordination provisions are enforceable in a Chapter 7 liquidation case. Section 510(b) also requires, among other things, that any claim for damages arising from the purchase or sale of a security of the Debtors shall be subordinated to all claims or interests that are senior to or equal the claim or interest represented by such security.

After consideration of the effect that a Chapter 7 liquidation would have on the ultimate proceeds available for distribution to Creditors and Interest Holders, including (i) increased costs and expenses of liquidation under Chapter 7 arising from fees payable to a trustee in bankruptcy

and professional advisors to such trustee, (ii) in the erosion in value of assets in the context of the expeditious liquidation required under Chapter 7 and the "forced sale" atmosphere that would prevail, (iii) the adverse effects on the salability of business that could result from the probable departure of key employees, (iv) the costs attributable to the time value of money resulting from what is likely to be a more protracted proceeding than if the Plan is confirmed (because of the time required to liquidate the assets of the Debtors, resolve Claims and related litigation and prepare for distributions) and (v) the application of the rules of distribution under a Chapter 7 liquidation, the Debtors have determined that confirmation of the Plan will provide each Creditor or holder of an Interest in an impaired Class with a greater recovery (or in the case of holders of Interests, the same recovery) than such Creditor or Interest Holder would receive pursuant to a liquidation of the Debtors under Chapter 7 of the Bankruptcy Code. *See also* comments in Section XI.A.

The Liquidation Analysis for the Debtors is found in Exhibit C of this Disclosure Statement. The Liquidation Analysis was substantially completed as of May 28, 2010, and the Debtors are not aware of any events subsequent to such date that would materially impact the Liquidation Analysis.

Accordingly, while the analyses that follow are necessarily presented with numerical specificity, there can be no assurances that the values assumed would be realized if the Debtors were in fact liquidated, nor can there be any assurance that a Bankruptcy Court would accept these analyses or concur with such assumptions in making its determination under Section 1129(a) of the Bankruptcy Code.

Actual liquidation proceeds could be materially lower or higher than the amounts set forth in Exhibit C. No representation or warranty can be or is being made with respect to the actual proceeds that could be received in Chapter 7 liquidations of the Debtors.

The liquidation valuations have been prepared solely for purposes of estimating the proceeds available in Chapter 7 liquidations of the Debtors' Estates and do not represent values that may be appropriate for any other purpose. Nothing contained in these valuations is intended to constitute a concession or admission of the Debtors for any other purposes.

As set forth in the Liquidation Analysis, the Debtors believe that conversion to Chapter 7 and resulting pendency of liquidation sales of the Debtors' business operations and assets would adversely affect the Debtors and the morale of their employees as well as significantly impair their ability to maintain adequate working capital. Further, there can be no assurance that the conversion to Chapter 7 liquidations would result in the Debtors' ability to continue to raise working capital under any credit facilities. As a result, secured creditors may not voluntarily finance efforts to maximize assets beyond that necessary to satisfy secured creditor's claims, and recoveries could therefore be even lower than set forth on the liquidation analysis.

B. Conditions Precedent to the Effective Date of the Plan.

Except as expressly waived by the Debtors (with the prior written consent of the New Investor where required), the following conditions must occur and be satisfied before the Effective Date may take place:

(1) The Confirmation Order confirming this Plan shall have been entered by the Bankruptcy Court and shall not have been stayed.

(2) The final version of the Plan Supplement and all of the schedules, documents, and exhibits contained therein (including the Plan Documents) shall have been Filed without prejudice to the Reorganized Debtors' rights under the Plan to alter, amend, or modify certain of the schedules, documents, and exhibits contained in the Plan Supplement in accordance with the terms hereof.

(3) All other documents and agreements necessary to implement this Plan on the Effective Date, including, but not limited to the Plan Supplement and the Plan Documents, shall have been duly and validly executed and delivered by all parties thereto

(4) All other actions, documents, and agreements determined by the Debtors to be necessary to implement the Plan shall have been effected or executed.

(5) The Exit Financing Credit Agreement and the New Investment Agreement and all related documents provided for therein or contemplated thereby shall have been duly and validly executed and delivered by all parties thereto, all conditions precedent thereto shall have occurred or shall have been satisfied or waived in the manner provided therein.

(6) The entire proceeds of the New Investment Amount shall be made available to the Reorganized Debtors to fund distributions under the Plan.

(7) All of the Conditions Preceding the Effective Date set forth in the Exit Financing Commitment Letter shall have occurred or have been waived by the New Investor.

(8) All DIP Facility Claims shall have been paid in full and in Cash or converted to New Common Stock at the election of the DIP Lender, or the Debtors shall have provided reasonably satisfactory evidence that such Claims shall be paid from the proceeds of the Exit Financing.

(9) Prior to or at the Hearing on the Disclosure Statement, the Bankruptcy Court shall have entered an order that the "Right to Match" provision of, SLS DIP Financing Agreement has been fully offered by the Debtors and shall be of no further force and effect, and such order shall not have been stayed.

(10) All corporate actions required to be taken by Article VII of this Plan shall have been taken.

(11) Any material alteration to, or interpretation of, any term or provision of this Plan by the Bankruptcy Court shall have been acceptable to the Debtors and the New Investor.

(12) The Articles of Incorporation and other organizational documents of the reorganized Debtors, as necessary, shall have been adopted and filed with the applicable authorities of the relevant jurisdictions of incorporation or organization and shall have become effective in accordance with the corporate laws of such jurisdictions.

(13) All authorizations, consents, certifications, approvals, rulings, no-action letters, opinions or other documents or actions required by any law, regulation or order to be received or to occur in order to implement this Plan on the Effective Date shall have been obtained or shall have occurred unless failure to do so will not have a material adverse effect on Reorganized Sea Launch.

(14) All conditions set forth in the New Investment Agreement shall have been satisfied or waived in the manner provided therein.

(15) All conditions to Confirmation have been satisfied and remain true, unless expressly waived by the Debtors and the New Investor.

C. Amendments to or Modification of the Plan.

The Debtors reserve the right to amend or modify the terms of the Plan in accordance with the provisions of Section 1127 of the Bankruptcy Code, including the right to amend the treatment of any rejecting class to meet the minimum requirements of Section 1129(b) of the Bankruptcy Code. Under the Bankruptcy Rules, such amendments or modifications may be approved by the Bankruptcy Court at confirmation without resolicitation of the votes of the members of any class whose treatment is not adversely affected by such amendment or modification. The Debtors will give holders of Claims and Interests such notice of such amendments or waivers as may be required by applicable law. The Debtors reserve the right to use acceptances of the Plan to confirm any amendment of the Plan to the extent permitted by law.

After the date on which the Plan has been confirmed by the Bankruptcy Court and the Confirmation Order has been entered by the Clerk, the Debtors may institute proceedings in the Bankruptcy Court to remedy any defects or omissions or reconcile any inconsistencies in the Plan or the Confirmation Order as may be necessary to carry out the purposes and intent of the Plan so long as the holders of Claims and Interests are not adversely affected and prior notice of such proceeding is served as may be required by applicable law or Bankruptcy Court order.

D. Cram Down.

To obtain confirmation under the concept known as "cram down," the Debtors must demonstrate to the Bankruptcy Court that the Plan "does not discriminate unfairly" and is "fair and equitable" with respect to any dissenting Class. The "unfair discrimination" test requires, among other things, that the Plan recognize the relative priorities among unsecured Creditors and Interest Holders. The Bankruptcy Code establishes different "fair and equitable" tests for

secured creditors, unsecured creditors and equity interest holders. The respective tests are as follows:

i. Secured Creditors.

Either (i) each impaired creditor of the rejecting class (x) retains its liens in the collateral securing such Creditor's claim or in the proceeds thereof to the extent of the Allowed amount of its secured claim and (y) receives deferred cash payments in at least the Allowed amount of such secured claim with a present value at the Effective Date at least equal to such creditor's interest in its collateral or in the proceeds thereof or (ii) the plan provides each impaired secured creditor with the indubitable equivalent of its claim.

ii. Unsecured Creditors.

Either (i) each impaired unsecured Creditor of the rejecting class receives or retains under the plan property of a value equal to the amount of its Allowed Claim or (ii) the holders of claims and interests that are junior to the claim of the dissenting class do not receive or retain any property under the plan.

iii. Equity Interest Holders.

Either (i) each equity interest holder of the rejecting class receives or retains under the plan property of a value equal to the greater of (x) the fixed liquidation preference or redemption price, if any, of the equity interest it holds or (y) the value of such equity interest or (ii) the holders of interests that are junior to such equity interest do not receive or retain any property under the plan.

If all other conditions to confirmation are met, the Debtors will seek to apply Section 1129(b) of the Bankruptcy Code to the extent the Plan is not accepted by any impaired Class of unsecured Claims or Interests.

XIV. CONCLUSION

The Debtors believe that the Plan is in the best interests of the Debtors' Creditors, Interest Holders and all other parties in interest. If you are a member of Class 3, Class 4, Class 5, Class 6 or Class 7, the Debtors urge you to vote in favor of the Plan.

Sea Launch Company, L.L.C.
Sea Launch Limited Partnership
Sea Launch ACS Limited
Sea Launch ACS Limited Partnership
Platform LDC
Platform Limited Partnership

By:



Kjell Karlsen
President and General Manager

Dated: June 21, 2010

YOUNG CONAWAY STARGATT
& TAYLOR LLP
Joel A. Waite (No. 2925)
Kenneth J. Enos (No. 4544)
The Brandywine Building
1000 West Street, 17th Floor
Wilmington, Delaware 19899-0391
(302) 571-6600

- and -

ALSTON & BIRD LLP
Dennis J. Connolly
Matthew W. Levin
1201 West Peachtree Street
Atlanta, GA 30309-3424
(404) 881-7000

Counsel for the Debtors and Debtors in Possession

ITEM NO. 183

JA-69

UNITED STATES BANKRUPTCY COURT
DISTRICT OF DELAWARE

In re	)	Chapter 11
	)	
SEA LAUNCH COMPANY, L.L.C., *et al.*,[1]	)	Case No. 09-12153 (BLS)
	)	
	)	Jointly Administered
Debtors.	)	
	)	

DEBTORS' SECOND AMENDED JOINT PLAN OF REORGANIZATION

ALSTON & BIRD LLP
Dennis J. Connolly
Matthew W. Levin
1201 West Peachtree Street, N.E.
Atlanta, Georgia 30309-3424
Telephone: (404) 881-7940
Facsimile: (404) 881-7777

- and -

YOUNG CONAWAY STARGATT & TAYLOR, LLP
Joel A. Waite (No. 2925)
Kenneth J. Enos (No. 4544)
The Brandywine Building
1000 West Street, 17th Floor
P.O. Box 391
Wilmington, Delaware 19801-0391
Telephone: (302) 571-6600
Facsimile: (302) 571-1253

Counsel to the Debtors and Debtors in Possession

Dated: June 21, 2010

[1] The last four digits of the taxpayer identification numbers for each of the Debtors follow in parenthesis: (i) Sea Launch Company, L.L.C. (1590); (ii) Sea Launch Limited Partnership (Cayman) (8182); (iii) Sea Launch ACS Limited (5999); (iv) Sea Launch ACS Limited Partnership (Isle of Man) (6216); (v) Platform LDC (3177); and (vi) Platform Limited Partnership (3173). The mailing address for all of the Debtors is 2700 Nimitz Road, Long Beach, CA 90802.

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INTRODUCTION

Sea Launch Company, L.L.C., a Delaware limited liability company, Sea Launch Limited Partnership, a Cayman Islands exempted limited partnership, and its direct and indirect subsidiaries, Sea Launch ACS Limited, an Isle of Man exempted company, Sea Launch ACS Limited Partnership, an Isle of Man exempted limited partnership, Platform LDC, a Cayman Islands exempted limited duration company, and Platform Limited Partnership, a Cayman Islands exempted limited partnership (each a "Debtor", and collectively, the "Debtors"), propose the following joint plan of reorganization for the resolution of the outstanding claims against and interests in the Debtors. Reference is made to the Disclosure Statement (as defined herein), distributed contemporaneously herewith, for a discussion of the Debtors' history, business, properties and operations, projections for those operations, risk factors, a summary and analysis of this Plan (as defined herein), and certain related matters including, among other things, the securities to be issued under this Plan. Subject to certain restrictions and requirements set forth herein and in 11 U.S.C. § 1127 and Fed. R. Bankr. P. 3019, the Debtors reserve the right to alter, amend, modify, revoke or withdraw this Plan prior to its substantial consummation in accordance with the terms hereof, the Confirmation Order (as defined herein), and the Bankruptcy Code (as defined herein).

ARTICLE I

DEFINED TERMS AND RULES OF INTERPRETATION

A. Defined Terms. As used herein, capitalized terms shall have the meanings set forth below. Any term that is not otherwise defined herein, but that is used in the Bankruptcy Code or the Bankruptcy Rules, shall have the meaning given to that term in the Bankruptcy Code or the Bankruptcy Rules, as applicable.

1.1 Administrative Expense Claim means a Claim against any Debtor for costs and expenses of administration of the Chapter 11 Cases (including, without limitation, Claims arising under Sections 328, 330, 363, 364(c)(1), 365, 503(b), and 507(a)(2) and 1114(e) of the Bankruptcy Code) including, without limitation, (a) any actual and necessary costs and expenses of preserving the Debtors' Estates and operating the businesses of the Debtors; (b) all compensation for legal, financial, advisory, accounting and other services and reimbursement of expenses Allowed by the Bankruptcy Court under Sections 328, 330 or 503(b) of the Bankruptcy Code; (c) any indebtedness or obligations incurred or assumed by the Debtors, as debtors in possession, during the Chapter 11 Cases; (d) any payment to be made under this Plan or Order of this Court to cure a default on an assumed executory contract or unexpired lease; and (e) Claims for out-of-pocket expenses incurred by members of the Committee (excluding any fees or expenses for legal or financial advisors except as otherwise provided herein). All fees and charges assessed against the Debtors' Estates under Section 1930, Chapter 123, of Title 28 of the United States Code are excluded from the definition of Administrative Expense Claim and shall be paid in accordance with Section 12.7 of the Plan.

1.2 Administrative Expense Claim Ceiling means for purposes of the Customer Claim Recovery Fund, the amount of $15,000,000.

1.3 Affiliate Debtor(s) means, individually or collectively, a Debtor or Debtors other than Sea Launch, as applicable.

1.4 Aker means Aker Maritime Finance AS, a Norwegian joint stock company, and Kvaerner AS, a Norwegian joint stock company, as assignee, and any other assignees of any of the proofs of claims, or portions thereof, originally filed by Aker Maritime Finance AS in the Bankruptcy Cases, but as to such assignees, only in their capacity as assignees of such proofs of claims.

1.5 Allowed means, with respect to a Claim or Interest against any Debtor, or any portion thereof, in any Class or category specified, (a) a Claim or Interest which has been listed by the Debtors in their Schedules, as may be amended by the Debtors from time to time, in accordance with Bankruptcy Rule 1009, as liquidated in amount and not disputed or contingent and for which no contrary assertion has been filed, (b) a Claim or Interest as to which no objection or request for estimation has been filed or as to which any objection has been determined by a Final Order to the extent such objection is determined in favor of the respective holder of such Claim or Interest; or (c) a Claim or Interest that is expressly allowed (i) by a Final Order, or (ii) pursuant to the terms of this Plan; provided, however, that Claims or Interests allowed solely for the purpose of voting to accept or reject the Plan pursuant to an order of the Bankruptcy Court shall not be considered "Allowed" Claims or Interests hereunder.

1.6 Articles of Incorporation means the amended and restated articles of incorporation of Reorganized Sea Launch, in substantially the form to be included in the Plan Supplement.

1.7 Ballot means the forms distributed to each holder of impaired Claims and Interests entitled to vote on the Plan for the purposes of accepting or rejecting this Plan, as approved by the Bankruptcy Court.

1.8 Bankruptcy Code means Title 11 of the United States Code, as now in effect or hereafter amended, as applicable to the Chapter 11 Cases.

1.9 Bankruptcy Court means the United States Bankruptcy Court for the District of Delaware or any other court with jurisdiction over the Chapter 11 Cases.

1.10 Bankruptcy Rules means the Federal Rules of Bankruptcy Procedure as promulgated by the United States Supreme Court under Section 2075 of Title 28 of the United States Code, as now in effect or hereafter amended and any Local Rules of the Bankruptcy Court.

1.11 Boeing means, collectively, Boeing Commercial Space Company, a Delaware corporation, and The Boeing Company.

1.12 Boeing Aker UCC Settlement Agreement means a settlement agreement between the Debtors, the Committee, each member of the Committee, Boeing and Aker, which implements the Draft Term Sheet for a Boeing/BCSC/Aker/Debtors/OCUC Settlement Agreement, a copy of which was attached as Exhibit A to the Certification of Counsel Regarding Order Approving Modified Scheduling Order [Docket No. 638], Filed on April 13, 2010, provided that nothing in such agreement shall contradict Section 10.5 of the Plan.

1.13 Business Day means any day other than a Saturday, a Sunday or "legal holiday" (as defined in Bankruptcy Rule 9006(a)).

1.14 By-Laws means the by-laws of Reorganized Sea Launch, in substantially the form to be included in the Plan Supplement.

1.15 Cash means legal tender of the United States of America.

1.16 Causes of Action means all Claims, rights, causes of action, defenses, demands, damages, suits or proceedings of any kind or nature, whether under contract or tort, in law or in equity or otherwise, whether known or unknown, contingent or matured, liquidated or unliquidated, and all rights and remedies with respect thereto, including causes of action arising under Chapter 5 of the Bankruptcy Code or similar state statutes, that any Debtor or Estate may hold against any person or entity as of the Effective Date.

1.17 Chapter 11 Cases means the voluntary cases commenced on June 22, 2009 by the Debtors in the Bankruptcy Court under Chapter 11 of the Bankruptcy Code.

1.18 Claim means a "claim," as defined in Section 101(5) of the Bankruptcy Code.

1.19 Class means each category of Holders of Claims or Interests established under Article II of this Plan pursuant to Sections 1122 and 1123(a)(1) of the Bankruptcy Code.

1.20 Committee means the Official Committee of Unsecured Creditors appointed and acting in the Chapter 11 Cases, including all individual members thereof, and all professionals retained by the Committee pursuant to an order of the Bankruptcy Court.

1.21 Confirmation Date means the date on which the clerk of the Bankruptcy Court enters the Confirmation Order.

1.22 Confirmation Hearing means the hearing held by the Bankruptcy Court on confirmation of the Plan, as such hearing may be adjourned or continued from time to time.

1.23 Confirmation Order means the order of the Bankruptcy Court confirming this Plan pursuant to Section 1129 of the Bankruptcy Code.

1.24 Creation Agreement means that certain Agreement for Creation of Sea Launch Companies dated May 3, 1995 as amended.

1.25 Creditor Trust means the Sea Launch Creditor Trust, a limited liability company (or such other corporate form as shall be agreed to by the Debtors and the Committee) to be established no later than the Effective Date for the purposes of holding the Partner Equity Recovery and the Customer Equity Recovery, if any, and the proceeds of any Creditor Trust Actions against holders of Claims in Class 7 and, if pursued, against SLS.

1.26 Creditor Trust Actions means (a) all claims that the Debtors may hold against any party that accrued prior to the Confirmation Date, and (b) all claims arising under Sections 544, 547, 548, 549 or 552 of the Bankruptcy Code that the Debtors may hold against any party, except

that the New Investor shall have the right to exclude any claims described above from the definition of Creditor Trust Actions, but, notwithstanding anything set forth above, the term Creditor Trust Actions specifically excludes any claims the Debtors and the Reorganized Debtors may hold against non-Debtor counterparties to executory contracts and/or leases that are being assumed under the Plan.

1.27 Creditor Trust Agreement means that certain limited liability company operating agreement (or such other organizational document(s), as applicable) of the Creditor Trust, to be Filed in draft form with the Plan Supplement, pursuant to which, among other things, the Partner Equity Recovery is held for the benefit of creditors in Classes 5 and 7, and the Customer Equity Recovery is held for the benefit of creditors in Class 4, and Creditor Trust Actions against holders of Claims in Class 7 shall be pursued and liquidated and the proceeds thereof distributed all in accordance with the terms of this Plan. The Creditor Trust Agreement shall be satisfactory to the Committee in its reasonable discretion.

1.28 Creditor Trust Assets means (i) certain proceeds of the Creditor Trust Actions as provided for in the Plan, (ii) any New Common Stock issued to the Creditor Trust pursuant to the Customer Equity Recovery and the Partner Equity Recovery and (iii) the Creditor Trust Cash Deposit.

1.29 Creditor Trust Cash Deposit means cash which shall be deposited in the Creditor Trust on the Effective Date from the proceeds of the New Investment Amount in accordance with the Reorganized Sea Launch Shareholders Agreement for the purposes of pursuing, among other things, the Creditor Trust Actions against Holders of Claims in Class 7. For the avoidance of doubt, the Creditor Trust Cash Deposit shall not affect or reduce the distributions provided to Holders of Claims in Class 4 pursuant to Section 3.2(d) of the Plan.

1.30 Creditor Trust Equity Interests means the membership or other equity interests in the Creditor Trust to be issued to Holders of Allowed Claims in Classes 4, 5 and 7 as provided in this Plan and by the Creditor Trust Agreement.

1.31 Creditor Trust Manager means the manager of the Creditor Trust to be appointed in the manner provided in the Creditor Trust Agreement and in consultation with the Committee.

1.32 Cure Amount means the dollar amount required under Section 365 of the Bankruptcy Code to cure a Debtor's defaults, if any, under an executory contract or unexpired lease and to compensate the non-debtor party or parties to such contract or lease for any actual pecuniary loss to such party resulting from such default, at the time such contract or lease is assumed by that Debtor.

1.33 Current Trade Vendor means a non-insider trade vendor (a) with whom the Debtors are currently engaged in a trade relationship, or (b) with whom the Debtors have engaged in a trade relationship within the past three (3) years, and with whom, subject to the approval of the New Investor, the Debtors anticipate engaging in a trade relationship in the future, as listed in the Current Trade Vendor List.

1.34 Current Trade Vendor List means a list of Current Trade Vendors to be filed with the Plan Supplement.

1.35 Current Trade Vendor Unsecured Claim means a General Unsecured Claim held by a Current Trade Vendor.

1.36 Customer means an entity that was a party to a prepetition launch services contract with one of the Debtors.

1.37 Customer Class Recovery Floor means nine million dollars ($9,000,000), which shall be the minimum recovery to Holders of Allowed Claims in Class 4 in the event Class 4 votes to accept the Plan.

1.38 Customer Equity Recovery means, solely in the event that Class 4 does not accept the Plan, a contribution of New Common Stock to the Creditor Trust equal to ten percent (10%) of the total issued and outstanding New Common Stock as of the Effective Date.

1.39 Customer or Trade Vendor Claim means a General Unsecured Claim held by a Customer, trade vendor that is not a Current Trade Vendor, or any other non-insider creditor that is not a Current Trade Vendor.

1.40 Customer/Trade Vendor Recovery Fund means a reserve held by Reorganized Sea Launch for the exclusive benefit of holders of Allowed Claims in Class 4 to be funded by a maximum contribution of fifteen million dollars ($15,000,000) from the proceeds of the New Investment Amount, less any deferred and/or unpaid amounts payable to employees or management under the SLEIP; provided, however, that to the extent the aggregate amount of Allowed Administrative Expense Claims is less than the Administrative Expense Ceiling, the difference shall be added to the maximum contribution of fifteen million dollars ($15,000,000) referenced above, solely for the purpose of satisfying amounts due under the SLEIP.

1.41 Debtor(s) shall have the meaning set forth in the introduction to this Plan.

1.42 DIP Lender means Energia Overseas acting by agreement as the Debtors' DIP Lender.

1.43 DIP Facility Agreement means that certain Debtor in Possession Financing Agreement, by and among the DIP Lender and the Debtors, dated as of April 29, 2010, together with all related documents and instruments delivered pursuant to or in connection therewith, as may be amended from time to time (or any other Debtor in Possession financing agreement that replaces such facility and is in effect as of the Confirmation Date).

1.44 DIP Facility Claims means all Claims held by the DIP Lender pursuant to the DIP Facility Agreement and the Final DIP Order.

1.45 Disallowed Claim means all or such part of a Claim that is disallowed by a Final Order of the Bankruptcy Court or other court of competent jurisdiction.

1.46 Disbursing Agent means any entity designated by the Debtors as such, in its capacity as a disbursing agent under Section 6.3 hereof.

1.47 Disclosure Statement means that certain disclosure statement relating to this Plan, including, without limitation, all exhibits and schedules thereto, as the same may be amended, supplemented or otherwise modified from time to time, as approved by the Bankruptcy Court pursuant to Section 1125 of the Bankruptcy Code.

1.48 Disputed Claim means any Claim against any Debtor, including any portion thereof (a) that is neither an Allowed Claim nor a Disallowed Claim or (b) for which a written request for payment has been made, to the extent the Debtors or any party in interest has interposed a timely objection or request for estimation, which objection or request for estimation has not been withdrawn or determined by a Final Order.

1.49 Distribution Record Date means, with respect to all Classes, the Effective Date or such other date as may be designated in the Confirmation Order.

1.50 DTC means The Depository Trust Company.

1.51 Effective Date means a Business Day on or after the Confirmation Date specified by the Debtors on which (i) no stay of the Confirmation Order is in effect, and (ii) the conditions to effectiveness of this Plan specified in Article IX hereof have been satisfied or waived in accordance with the terms hereof.

1.52 Energia means S.P. Korolev Rocket & Space Corporation, Energia, a Russian Federation joint stock company, and any of its affiliates as defined in the Creation Agreement, excluding Energia Overseas and Energia Logistics.

1.53 Energia Overseas means Energia Overseas Limited Russia and its subsidiary Energia Overseas LLC (Del).

1.54 Energia Logistics means Energia Logistics Limited Russia and Energia Logistics Ltd. (US).

1.55 Estate(s) means, individually, the estate of Sea Launch, SLLP or any of the Affiliate Debtors and, collectively, the estates of the Debtors created under Section 541 of the Bankruptcy Code.

1.56 Exhibit means an exhibit to this Plan or the Disclosure Statement, filed herewith, with the Disclosure Statement or with the Plan Supplement.

1.57 Existing Claim Equity Amount means up to fifteen percent (15%) of the New Common Stock in Reorganized Sea Launch to be issued on account of the Customer Equity Recovery and the Partner Equity Recovery.

1.58 Exit Financing means the investment or financing facility arising in connection with the Exit Financing Commitment Letter to be entered into by the Reorganized Debtors on the Effective Date, in such amount and on such terms as are satisfactory to the Debtors.

1.59 Exit Financing Commitment Letter means the Exit Financing Commitment Letter from Energia Overseas dated March 29, 2010, as modified by Sea Launch Board Resolution No. 2010-04-1-103 dated April, 2010.

1.60 Exit Financing Credit Agreement means the financing agreement relating to the Exit Financing, and all agreements (including security agreements and pledge agreements), documents and instruments delivered in connection therewith, which shall be in form and substance satisfactory to the Debtors.

1.61 Fee Auditor means Warren H. Smith & Associates, P.C., and any successor thereto as appointed by the Bankruptcy Court.

1.62 File, Filed or Filing means file, filed or filing with the Bankruptcy Court or its authorized designee in the Chapter 11 Cases.

1.63 Final DIP Order means the Final Order (1) Authorizing Incurrence of Secured Indebtedness, (2) Granting Security Interests and Superpriority Claims, (3) Approving Agreement related to the Foregoing, and (4) Granting Other Relief, as entered by the Bankruptcy Court on May 12, 2010, and as amended, modified or supplemented by the Bankruptcy Court from time to time.

1.64 Final Order means an order or judgment of the Bankruptcy Court (or other court of competent jurisdiction) entered by the clerk of the Bankruptcy Court on the docket in the Chapter 11 Cases (or on the docket of any other court of competent jurisdiction), which has not been reversed, vacated or stayed and as to which (a) the time to appeal, petition for certiorari or move for a new trial, reargument or rehearing has expired and as to which no appeal, petition for certiorari or other proceedings for a new trial, reargument or rehearing shall then be pending, or (b) if an appeal, writ of certiorari, new trial, reargument or rehearing thereof has been sought, such order or judgment of the Bankruptcy Court shall have been affirmed by the highest court to which such order was appealed, or certiorari shall have been denied or a new trial, reargument or rehearing shall have been denied or resulted in no modification of such order, and the time to take any further appeal, petition for certiorari or move for a new trial, reargument or rehearing shall have expired; provided, however, that the possibility that a motion under Rule 59 or Rule 60 of the Federal Rules of Civil Procedure, or any analogous rule under the Bankruptcy Rules, may be filed relating to such order shall not cause such order not to be a Final Order.

1.65 General Unsecured Claim means any Claim against the Debtors that is not an Administrative Expense Claim, a DIP Facility Claim, a Priority Tax Claim, a Priority Non-Tax Claim, a Partner Currency Control Claim or an Other Secured Claim, and shall include, without limitation, all Claims that are not Administrative Expense Claims or Partner Currency Control Claims held by Aker, Boeing, Energia, Yuzhmash and Yuzhnoye, but shall not include Claims that are disallowed or released, whether by operation of law or pursuant to order of the Bankruptcy Court, written release or settlement, the provisions of this Plan or otherwise.

1.66 Governmental Unit means the United States, any State thereof, including, but not limited to, the State of California, any commonwealth, district, territory, municipality, foreign

state, department, agency or instrumentality of a State, a commonwealth, district or territory or municipality of a foreign state or other foreign or domestic government.

1.67 Holder means an entity holding a Claim or Interest.

1.68 Impaired means, with respect to any Class of Claims or Interests, "impaired" within the meaning of Section 1124 of the Bankruptcy Code.

1.69 Initial Distribution Date means a date selected by the Reorganized Debtors that is not later than ninety (90) days after the Effective Date.

1.70 Intercompany Claims means all prepetition Claims against any of the Debtors held by a Debtor.

1.71 Interest means, without limitation, any equity security in a Debtor that is of a kind specified in Section 101(16) of the Bankruptcy Code and any options, warrants, puts, calls, subscriptions or other similar rights or other agreements, commitments, or outstanding securities obligating the Debtor to issue, transfer, purchase, redeem, or sell any shares of capital stock or other securities, any claims arising out of any appraisal or dissenter's rights, any claims arising from rescission of a purchase, sale or other acquisition of any common stock or other equity security (or any right, claim, or interest in and to any common stock or equity security) of the Debtor, and any claims for damages or any other relief arising from any such purchase, sale, or other acquisition of such common stock or other equity security.

1.72 Interim Compensation Order means the Order Establishing Procedures for Interim Compensation and Reimbursement of Expenses of Professional, entered by the Bankruptcy Court on July 15, 2009.

1.73 Lien means, with respect to any interest in property, any mortgage, lien, pledge, charge, security interest, easement or encumbrance of any kind whatsoever affecting such interest in property to secure payment of a debt or performance of an obligation.

1.74 Limited Partner means those entities who were limited partners of SLLP or any other limited partnership agreement of the Debtors.

1.75 New Common Stock means the shares of common stock of Reorganized Sea Launch, authorized and issued hereunder to be (i) delivered to New Investor and to the Creditor Trust for the benefit of Holders of certain Claims under the Plan or (ii) authorized for the purposes specified herein.

1.76 New Investment Agreement means that certain Investment Agreement between Energia Overseas and the Debtors and any related documents provided for in such agreement implementing the Exit Financing Commitment Letter all of which are to be Filed after consultation with the Committee and not less than five (5) business days prior to the objection and voting deadline on the Plan.

1.77 New Investment Amount means one hundred and forty million dollars ($140,000,000), to be invested by the New Investor in exchange for the New Investor Equity

Amount, less the conversion, if requested by the New Investor, of some or all of the outstanding amounts due to the New Investor under the DIP Facility Agreement (if the New Investor is also the DIP Lender), provided, however, that in the event Class 4 accepts the Plan, the New Investment Amount shall increase to one hundred and fifty-five million dollars ($155,000,000).

1.78 New Investor means Energia Overseas.

1.79 New Investor Equity Amount means not less than eighty-five percent (85%) and provided Class 4 accepts the Plan, not more than ninety-five (95%) of the New Common Stock in Reorganized Sea Launch.

1.80 Non-Insider General Unsecured Claim means any General Unsecured Claim, other than an Administrative Expense Claim, a DIP Facility Claim, a Current Trade Vendor Unsecured Claim or a Partner Claim.

1.81 Other Secured Claim means any Secured Claim, other than an Administrative Expense Claim or a DIP Facility Claim.

1.82 Partner Claim means any General Unsecured Claim held by Aker, Boeing, Energia, Yuzhmash or Yuzhnoye.

1.83 Partner Currency Control Claim means any claim, including but not limited to, any eligible account receivable claim, arising from or relating to the export of hardware and/or services actually delivered to the United States by a Limited Partner to the extent such claim is or was subject to national legislation or regulations restricting currency control issues.

1.84 Partner Equity Recovery means a contribution of New Common Stock to the Creditor Trust equal to five percent (5%) of the outstanding common stock of Reorganized Sea Launch on the Effective Date.

1.85 Pension and Retirement Plans means the Debtors' defined contribution plan, or any similar pension or retirement plan related to the employees of the Debtors.

1.86 Person means an individual, corporation, partnership, joint venture, association, joint stock company, limited liability company, limited liability partnership, trust, estate, unincorporated organization, governmental unit (as defined in Section 101(27) of the Bankruptcy Code, or other entity.

1.87 Petition Date means June 22, 2009, the date on which the Debtors commenced their Chapter 11 Cases.

1.88 Plan means this Chapter 11 plan of reorganization, including the Exhibits and all supplements, appendices and schedules thereto, either in its present form or as the same may be altered, amended or modified from time to time in accordance with the provisions of the Bankruptcy Code and the terms hereof.

1.89 Plan Documents means the documents to be executed, delivered, assumed, and/or performed in conjunction with the consummation of the Plan on or about the Effective Date,

including, but not limited to, the Articles of Incorporation, the By-Laws, the term sheet for the Exit Financing Credit Agreement, the Reorganized Sea Launch Shareholders Agreement, the Reincorporation Transactions Document, the Current Trade Vendor List, a list of executory contracts to be assumed by the Debtors, a list of directors and officers of Reorganized Sea Launch and the Reorganized Debtors, the Creditor Trust Agreement, the Exit Financing Commitment Letter, Sea Launch Board Resolution No. 2010-04-1-103 dated April, 2010, and any other documents relevant to the implementation of this Plan. Each of the Plan Documents shall be filed in draft form in the Plan Supplement.

1.90 Plan Supplement means the supplement to this Plan containing the Plan Documents, to be filed with the Bankruptcy Court not later than five (5) Business Days prior to the objection and voting deadline on the Plan, except for the list of directors and officers of Reorganized Sea Launch and the Reorganized Debtors, which shall be filed with the Bankruptcy Court not later than three (3) Business Days prior to the Confirmation Hearing.

1.91 Preferred Stock means the shares of preferred stock of Reorganized Sea Launch, authorized and issued hereunder to be (i) delivered to Energia under the Plan or (ii) authorized for the purposes specified herein.

1.92 Priority Non-Tax Claim means any Claim against any Debtor other than an Administrative Expense Claim or a Priority Tax Claim, entitled to priority in payment as specified in Section 507(a) of the Bankruptcy Code.

1.93 Priority Tax Claim means any Claim against any Debtor of a Governmental Unit of the kind entitled to priority in payment as specified in Sections 502(i) and 507(a)(8) of the Bankruptcy Code.

1.94 Pro Rata means, with respect to a Claim or Interest, that proportion that a Claim or Interest in a particular Class bears to the aggregate amount of all Claims or Interests in such Class (other than any Claims or Interests held by the Debtors) except in cases where Pro Rata is used in reference to multiple Classes in which case, Pro Rata means the proportion that a Claim or Interest in a particular Class bears to the aggregate amount of all Claims in such multiple Classes.

1.95 Reincorporation Transactions Document means the document outlining the transactions to be implemented for purposes of reincorporating Reorganized Sea Launch and certain of the other Affiliate Debtors as Delaware corporations or limited liability companies, in substantially the form to be included in the Plan Supplement.

1.96 Reinstated or Reinstatement means (a) leaving unaltered the legal, equitable and contractual rights to which a Claim entitles the Holder of such Claim so as to leave such Claim Unimpaired, or (b) notwithstanding any contractual provision or applicable law that entitles the Holder of such Claim to demand or receive accelerated payment of such Claim after the occurrence of a default, (i) curing any such default that occurred before or after the Petition Date, other than a default of a kind specified in Section 365(b)(2) of the Bankruptcy Code; (ii) reinstating the maturity (to the extent such maturity has not otherwise accrued by the passage of time) of such Claim as such maturity existed before such default; (iii) compensating the Holder

of such Claim for any damages incurred as a result of any reasonable reliance by such Holder on such contractual provision or such applicable law; (iv) if such Claim arises from any failure to perform a nonmonetary obligation other than a default arising from failure to operate a nonresidential real property lease subject to Section 365(b)(1)(A) of the Bankruptcy Code, compensating the Holder of such Claim (other than the debtor or an insider) for any actual pecuniary loss incurred by such Holder as a result of such failure; and (v) not otherwise altering the legal, equitable or contractual rights to which such Claim entitles the Holder of such Claim. The Debtors reserve their legal, equitable and contractual rights and defenses to dispute the liability and/or the amount of any Reinstated Claim.

1.97 Released Parties means (i) the Debtors, (ii) the Debtors' present and former Board representatives, (iii) the present and former officers and employees of the Debtors who were serving in such capacity on or after the Petition Date, (iv) the Chief Restructuring Officer of the Debtors and his employer, Buccino & Associates, Inc., (v) Energia, (vi) the New Investor, (vii) the Committee and its members (but only in their capacity as members of the Committee), and (viii) any attorneys, financial advisors, investment bankers, accountants, consultants, or other professionals of the parties described in clauses (i) through (vii) hereof; provided, however, that such attorneys and professional advisors shall only include those that provided services related to the Debtors, the Chapter 11 Cases, the Plan, and the transactions contemplated by this Plan.

1.98 Reorganized Debtors means the reorganized Debtors or any successors thereto by merger, consolidation or otherwise, on or after the Effective Date, after giving effect to the restructuring transactions occurring on or before the Effective Date in accordance with this Plan.

1.99 Reorganized Sea Launch means reorganized Sea Launch and reorganized SLLP, collectively, or any successors thereto by merger, consolidation or otherwise, on or after the Effective Date, after giving effect to the restructuring transactions contemplated by the New Investment Agreement occurring on or before the Effective Date in accordance with this Plan.

1.100 Reorganized Sea Launch Shareholders Agreement means that certain shareholders agreement to be entered into (or deemed to be entered into) by the Holders of New Common Stock and Preferred Stock on the Effective Date, substantially in the substantially in the form filed with the Plan Supplement.

1.101 Schedules means the schedules of assets and liabilities and the statements of financial affairs filed by the Debtors pursuant to Section 521 of the Bankruptcy Code, Bankruptcy Rule 1007, and the Official Bankruptcy Forms of the Bankruptcy Rules, as such schedules and statements have been or may be supplemented or amended through the Confirmation Date.

1.102 Sea Launch means Sea Launch Company, L.L.C., a Delaware limited liability company, and a debtor in possession in these Chapter 11 Cases pending in the Bankruptcy Court.

1.103 Sea Launch Equity Interests means any Interests, other than those held by any Debtor in any other Debtor, of any of the Debtors represented by any issued and outstanding shares of common stock, preferred stock, membership interests, partnership interests, capital stock or other ownership interest in any of the Debtors, whether or not transferable, or any

option, warrant, or right, contractual or otherwise, to acquire any such interest or to convert into any such interest.

1.104 Section 1446 Claim means any claim arising under Section 1446 of the Internal Revenue Code or any applicable State law by virtue of any release, settlement, forgiveness or discharge under, in connection with, or by virtue of the pendency of these Chapter 11 Cases or any orders entered by the Bankruptcy Court herein against or in respect of the Debtors or any Released Party, regardless of whether such Section 1446 Claim was contingent, unmatured, disputed, unliquidated, or unasserted as of the Petition Date.

1.105 Secured Claim means, pursuant to Section 506 of the Bankruptcy Code, that portion of a Claim against any Debtor that is reflected in the Schedules or a proof of claim as a Secured Claim which is (a) secured by a valid, perfected and enforceable security interest, lien, mortgage or other encumbrance, that is not subject to avoidance under applicable bankruptcy or non-bankruptcy law, in or upon any right, title or interest of a Debtor in and to property of the relevant Estate, to the extent of the value of the Holder's interest in such property as of the relevant determination date or (b) Allowed as such pursuant to the terms of this Plan (subject to the occurrence of the Effective Date). The defined term Secured Claim includes any Claim against any Debtor that is subject to a permissible setoff under Section 553 of the Bankruptcy Code, to the extent of such permissible setoff.

1.106 SLEIP means the Sea Launch Emergence Incentive Plan, approved by the Bankruptcy Court by orders entered on January 4, 2010 and March 2, 2010.

1.107 SLLP means Sea Launch Limited Partnership, a Cayman Islands exempted limited partnership, and a debtor in possession in these Chapter 11 Cases pending in the Bankruptcy Court.

1.108 SLS means Space Launch Services, LLC, The Robert A. and Virginia Heinlein Prize Trust, and all of their respective affiliates, successors and assigns.

1.109 SLS DIP Financing Agreement means the Debtor-in-Possession Financing Agreement dated November 11, 2009 between Space Launch Services LLC and the Debtors, as amended and restated as of March 17, 2010, together with all related documents and instruments delivered pursuant to or in connection therewith.

1.110 Subsidiary Interests means, collectively, all of the issued and outstanding shares of stock, membership interests or partnership interests of any of the Debtors, existing prior to the Effective Date, which stock and interests are owned, directly or indirectly, by Sea Launch or SLLP, or by one of the Affiliate Debtors.

1.111 Tax Withholding Advances means any postpetition and pre-Effective Date payments to any Governmental Unit on account of state, federal or foreign tax withholding obligations of any Limited Partner or other person holding an Interest in one of the Debtors.

1.112 Unimpaired means, with respect to a Claim or Interest, that such Claim or Interest is not Impaired within the meaning of Section 1124 of the Bankruptcy Code as a result of being

either (a) Reinstated or (b) paid in full and in Cash on or prior to the Effective Date pursuant to the terms of this Plan or any order of the Bankruptcy Court.

1.113 Yuzhmash means PO Yuzhnoye Mashinostroitelny Zavod, a Ukranian organization.

1.114 Yuzhnoye means KB Yuzhnoye, a Ukranian organization.

B. Rules of Interpretation. For purposes of this Plan, unless otherwise provided herein: (a) whenever from the context it is appropriate, each term, whether stated in the singular or the plural, will include both the singular and the plural; (b) unless otherwise provided in this Plan, any reference in this Plan to a contract, instrument, release, or other agreement or document being in a particular form or on particular terms and conditions means that such document will be substantially in such form or substantially on such terms and conditions; (c) any reference in this Plan to an existing document, schedule or exhibit Filed or to be Filed means such document, schedule, or exhibit, as it may have been or may be amended, modified, or supplemented pursuant to this Plan; (d) any reference to an entity as a Holder of a Claim or Interest includes that entity's successors and assigns; (e) the words "herein," "hereof," "hereto," "hereunder" and other words of similar import refer to this Plan as a whole and not to any particular section, subsection or clause contained in this Plan; (f) captions and headings to Articles and Sections are inserted for convenience of reference only and are not intended to be a part of or to affect the interpretation of this Plan; (g) subject to the provisions of any contract, certificates or articles of incorporation, by-laws, instruments, releases, or other agreements or documents entered into in connection with this Plan, the rights and obligations arising under this Plan shall be governed by, and construed and enforced in accordance with, federal law, including the Bankruptcy Code and Bankruptcy Rules; (h) the rules of construction set forth in Section 102 of the Bankruptcy Code will apply; and (i) in computing any period of time prescribed or allowed by this Plan, the provision of Bankruptcy Rule 9006(a), as then in effect, will apply.

C. Exhibits and Plan Supplement. All Exhibits as well as the Plan Supplement, are incorporated into and are a part of this Plan as if set forth in full herein, and, to the extent not annexed hereto, such Exhibits and Plan Supplement shall be timely Filed in accordance with this Plan. Holders of Claims and Interests may obtain a copy of the Filed Exhibits and Plan Supplement upon written request to the Debtors. Upon their Filing, the Exhibits and Plan Supplement may be inspected in the office of the clerk of the Bankruptcy Court or its designee during normal business hours. The documents contained in the Exhibits and Plan Supplement shall be approved by the Bankruptcy Court pursuant to the Confirmation Order.

ARTICLE II

CLASSIFICATION OF CLAIMS AND INTERESTS

All Claims and Interests, except Administrative Expense Claims, DIP Facility Claims and Priority Tax Claims, are placed in the Classes set forth below. In accordance with Section 1123(a)(1) of the Bankruptcy Code, Administrative Expense Claims, DIP Facility Claims and Priority Tax Claims, as described below, have not been classified.

This Plan constitutes a single plan of reorganization for all Debtors. A Claim or Interest is placed in a particular Class only to the extent that the Claim or Interest qualifies within the description of such Class and is in a different Class to the extent that it qualifies within the description of such different Class, but the same portion of a Claim may not be in more than one Class. A Claim or Interest is also placed in a particular Class for all purposes, including voting, confirmation and distribution under this Plan and under Sections 1122 and 1123(a)(1) of the Bankruptcy Code. However, a Claim or Interest is placed in a particular Class for the purpose of receiving distributions pursuant to this Plan only to the extent that such Claim or Interest is an Allowed Claim or Interest in that Class and such Claim or Interest has not been paid, released or otherwise settled prior to the Effective Date.

2.1 Unclassified Claims. The following Claims are Unimpaired under this Plan.

(a) Administrative Expense Claims.

(b) DIP Facility Claims.

(c) Priority Tax Claims.

2.2 Classes of Claims.

(a) *Class 1: Priority Non-Tax Claims*. Class 1 consists of all Priority Non-Tax Claims against each applicable Debtor. Claims in Class 1 are Unimpaired. Holders of Claims in Class 1 will be deemed to accept the Plan and are not entitled to vote to accept or reject the Plan.

(b) *Class 2: Other Secured Claims*. Class 2 consists of all Other Secured Claims against each applicable Debtor. Claims in Class 2 are Unimpaired. Holders of Claims in Class 2 will be deemed to accept the Plan and are not entitled to vote to accept or reject the Plan.

(c) *Class 3: Current Trade Vendor Unsecured Claims*. Class 3 consists of all Current Trade Vendor Unsecured Claims against any Debtor. Claims in Class 3 are Impaired. Holders of Claims in Class 3 are entitled to vote to accept or reject the Plan. Class 3 is a substantively consolidated Class for purposes of distribution, whereby the members of Class 3 shall share in their recovery under and in accordance with Article III of this Plan regardless of the Debtor against which they hold a Claim.

(d) *Class 4: Customer or Trade Vendor Unsecured Claims*. Class 4 consists of all Customer or Trade Vendor Claims. Claims in Class 4 are Impaired. Holders of Claims in Class 4 are entitled to vote to accept or reject the Plan. Class 4 is a substantively consolidated Class for purposes of distribution, whereby the members of Class 4 shall share in their recovery under and in accordance with Article III of this Plan regardless of the Debtor against which they hold a Claim.

(e) *Class 5: Aker and Boeing Claims*. Class 5 consists of all Partner Claims held by Aker and Boeing against any Debtor. Claims in Class 5 are Impaired. Holders of Claims in Class 5 are entitled to vote to accept or reject the Plan. Class 5 is a substantively consolidated Class for purposes of distribution, whereby the members of Class 5 shall share in their recovery under and in accordance with Article III of this Plan regardless of the Debtor against which they hold a Claim.

(f) *Class 6: Energia*. Class 6 consists of all Partner Claims held by Energia against each applicable Debtor. Claims in Class 6 are Impaired. Holders of Claims in Class 6 are entitled to vote to accept or reject the Plan. Class 6 is a substantively consolidated Class for purposes of distribution, whereby the members of Class 6 shall share in their recovery under and in accordance with Article III of this Plan regardless of the Debtor against which they hold a Claim.

(g) *Class 7: Yuzhmash and Yuzhnoye Claims*. Class 7 consists of all Partner Claims held by Yuzhmash and Yuzhnoye against each applicable Debtor. Claims in Class 7 are Impaired. Holders of Claims in Class 7 are entitled to vote to accept or reject the Plan. Class 7 is a substantively consolidated Class for purposes of distribution, whereby the members of Class 7 shall share in their recovery under and in accordance with Article III of this Plan regardless of the Debtor against which they hold a Claim.

2.3 Classes of Interests.

(a) *Class 8: Sea Launch Equity Interests*. Class 8 consists of all Interests directly arising from, under, or relating in any way to, the Sea Launch Equity Interests held by any Holder other than the Debtors, and all Claims arising out of or relating thereto. Interests in Class 8 are Impaired. As Holders of Interests in Class 8 will not receive or retain any property under the Plan, Holders of Interests in Class 8 will be deemed to reject the Plan and are not entitled to vote to accept or reject the Plan.

(b) *Class 9: Subsidiary Interests*. Class 9 consists of all Interests directly arising from, under, or relating in any way to, the Subsidiary Interests held by any Holder that is a Debtor, and all Claims arising out of or relating thereto. Interests in Class 9 are Unimpaired. Holders of Interests in Class 9 will be deemed to accept the Plan and are not entitled to vote to accept or reject the Plan.

ARTICLE III

TREATMENT OF CLAIMS AND INTERESTS

3.1 Unclassified Claims.

(a) *Administrative Expense Claims*. Unless otherwise agreed by the Holder of an Administrative Expense Claim, in full satisfaction, settlement, release, and discharge of and in exchange for each Administrative Expense Claim, each Holder of an Allowed Administrative Expense Claim will receive payment in full and in Cash of any unpaid portion of such Allowed Administrative Expense Claim as follows:

(i) in the case of professional advisors, subject to the provisions of Sections 328, 330, 331 and 503(b) of the Bankruptcy Code and the Interim Compensation Order, as soon as practicable after final Bankruptcy Court approval thereof,

(ii) with respect to each other Allowed Administrative Expense Claim, (x) payment in the ordinary course of business as such claims become due; provided, however, that Administrative Expense Claims not yet due or that represent obligations incurred by the Debtors in the ordinary course of business during these Chapter 11 Cases, or assumed by the Debtors during these Chapter 11 Cases, shall be paid or performed when due in the ordinary course of business and in accordance with the terms and conditions of the particular agreements governing such obligations, (y) such other date as may be agreed upon between the Holder of such Administrative Expense Claim and the Debtors, or (z) as provided for in a Final Order.

(b) *DIP Facility Claims*. In full satisfaction, settlement, release, and discharge of and in exchange for each DIP Facility Claim, on the Effective Date, all Allowed DIP Facility Claims shall, at the election of the DIP Lender, either (a) be paid in full and in Cash from the proceeds of the Exit Financing, or (b) be converted into New Common Stock to the extent requested by the DIP Lender in accordance with the DIP Facility Agreement, and, in each case, all commitments under the DIP Facility Agreement shall be canceled. Notwithstanding anything to the contrary herein, the liens and security interests securing the DIP Facility Claims shall continue in full force and effect until such time as the Allowed DIP Facility Claims have been paid in full and in Cash or converted into New Common Stock, after which such liens and security interests shall be deemed canceled.

(c) *Priority Tax Claims*.

(i) In full satisfaction, settlement, release, and discharge of and in exchange for each Priority Tax Claim, in the ordinary course of business as such claims become due, each Holder of an Allowed Priority Tax Claim shall receive in full satisfaction, settlement and release of and in exchange for such Priority Tax Claim, at the election of the Debtors: (i) Cash equal to the amount of such Priority Tax Claim; (ii) such other treatment as to which the Debtors or the Reorganized Debtors and the Holder of such Priority Tax Claims shall have agreed upon in writing; or (iii) such other treatment as will cause such Claims not to be Impaired, including, but not limited to, payment as set forth in Section 1129(a)(9)(C) of the Bankruptcy Code; provided, however, that any Priority Tax Claim not due and owing on the Effective Date will be paid when such Claim becomes due and owing.

(ii) Section 1446 Claims

To the extent that any Governmental Unit asserts a Section 1446 Claim, such Section 1446 Claim shall be addressed and treated as a Priority Tax Claim and shall be treated as follows:

(a) pursuant to 11 U.S.C. § 502(c), the aggregate amount of such claims shall not exceed, and shall be estimated for purposes of distribution, voting and all other purposes under the Plan, the amount of $250,000;

(b) at the option of the Reorganized Debtors, such amount referred to in Section 3.1(c)(ii)(a) of this Plan shall either be held in reserve in the Creditor Trust for and on behalf of such Governmental Unit(s) or shall be paid by the Reorganized Debtors pursuant to the provisions of Section 3.1(c)(i) above, provided, however, that pending the adjudication of the issue of whether such Governmental Unit filed a timely proof of claim under 11 U.S.C. § 502(b)(9), and, in the event the Court determines that no Section 1446 Claim was timely filed, said liability shall be discharged and forever barred;

(c) any such Governmental Unit asserting a Section 1446 Claim shall be enjoined from enforcing or making any claim for any penalty, interest or attorney's fees in respect of such withholding liability arising on or before the Effective Date of the Plan; and

(d) the order on confirmation of the Plan shall enjoin, on a permanent basis, any action on the part of any such Governmental Unit from and against the collection of such

Claim other than against the Reorganized Debtors or the successor to the Estate for this purpose, the Creditor Trust, as appropriate. Any such Governmental Unit shall be limited in its rights to seek Bankruptcy Code § 502(j) relief and shall be required to seek such relief in respect of any such Section 1446 Claim estimated under Bankruptcy Code § 502(c) no later than 20 days after the entry of the Confirmation Order.

3.2 Classes of Claims. Unless the Holder of a Claim and the applicable Debtors agree to a different treatment, each Holder of a Claim shall receive as follows:

(a) *Class 1: Priority Non-Tax Claims*. In full satisfaction, settlement, release, and discharge of and in exchange for each Priority Non-Tax Claim, in the ordinary course of business as such claims become due, or, if due now, on the Effective Date, each Holder of an Allowed Priority Non-Tax Claim shall receive in full satisfaction, settlement and release of and in exchange for such Priority Non-Tax Claim, at the election of the Debtors: (i) Cash equal to the amount of such Priority Non-Tax Claim; (ii) such other treatment as to which the Debtors or the Reorganized Debtors and the Holder of such Priority Tax Claims shall have agreed upon in writing; or (iii) such other treatment as will cause such Claims not to be Impaired; provided, however, that any Priority Non-Tax Claim not due and owing on the Effective Date will be paid when such Claim becomes due and owing.

(b) *Class 2: Other Secured Claims*. Each Holder of an Other Secured Claim, if any, shall have its Claim Reinstated.

(c) *Class 3: Current Trade Vendor Unsecured Claims*. On the Effective Date, or as soon as practicable after the Effective Date, in full satisfaction, settlement, release, and discharge of and in exchange for each Current Trade Vendor Unsecured Claim, if any, each Holder of an Allowed Current Trade Vendor Unsecured Claim, if any, shall be paid seventeen and a half percent (17.5%) of such Allowed Current Trade Vendor Unsecured Claim in Cash on the Effective Date from the proceeds of the Exit Financing or otherwise (to the extent unpaid prior to the Effective Date).

(d) *Class 4: Customer or Trade Vendor Unsecured Claims*. Unless the Holder of an Allowed Customer or Trade Vendor Unsecured Claim agrees to a different treatment with the Debtors approved by the Bankruptcy Court pursuant to a settlement under Bankruptcy Rule 9019 or the modification, assumption and assignment of an executory contract, and provided Class 4 accepts the Plan, on the Effective Date, or as soon as practicable after the Effective Date, in full satisfaction, settlement, release, and discharge of and in exchange for all Allowed Customer or Trade Vendor Unsecured Claims, if any, each Holder of an Allowed Customer or

Trade Vendor Unsecured Claim shall receive a Pro Rata share of the Customer/Trade Vendor Recovery Fund and the proceeds of the Creditor Trust Actions against Holders of Claims in Class 7, not to exceed an Allowed Claim dividend of seventeen and one-half percent (17.5%), provided, however, that if aggregate dividends payable to Allowed Customer or Trade Vendor Claims pursuant to such calculation would be less than the Customer Class Recovery Floor, in such event the dividend payable to Holders of Allowed Customer or Trade Vendor Unsecured Claims shall only be limited by the amount of the Customer Class Recovery Floor. If Class 4 does not accept the Plan, each Holder of an Allowed Customer or Trade Vendor Claim will receive a Pro Rata share of Creditor Trust Equity Interests attributable to the Customer Equity Recovery.

(e) *Class 5: Aker and Boeing Claims*. Unless Aker, Boeing and the Committee agree to a different treatment, on the Effective Date, or as soon as practicable after the Effective Date, in full satisfaction, settlement, release, and discharge of and in exchange for all Allowed Partner Claims held by Aker and Boeing, if any, Aker and Boeing shall receive, on account of their respective Allowed Partner Claims, a Pro Rata share of the Creditor Trust Equity Interests attributable to the Partner Equity Recovery.

(f) *Class 6: Energia Claims*. Unless Energia agrees to a different treatment, on the Effective Date, or as soon as practicable after the Effective Date, in full satisfaction, settlement, release, and discharge of and in exchange for each Allowed Partner Currency Control Claim held by Energia, Energia shall receive $28,800,000 in Preferred Stock of Reorganized Sea Launch, and shall be deemed to have waived Partner Claims held by Energia that are not Allowed Partner Currency Control Claims.

(g) *Class 7: Yuzhmash and Yuzhnoye Claims*. Unless Yuzhmash and Yuzhnoye (with the approval of the New Investor) agree to a different treatment with the Debtors, on the Effective Date, or as soon as practicable after the Effective Date, in full satisfaction, settlement, release, and discharge of and in exchange for each Allowed Partner Currency Control Claim held by Yuzhmash and Yuzhnoye, if any, Reorganized Sea Launch shall assume and modify the Yuzhmash and Yuzhnoye BOAs to provide for (i) cure of any previously deferred payments for hardware or services ordered by the Debtors, but not yet delivered to the Debtors, at the time of delivery or over a period of not more than two years from the Effective Date, and (ii) future incremental payments of five hundred thousand ($500,000) per successful launch up to a maximum of six million six hundred thousand dollars ($6,600,000), and Yuzhmash and Yuzhnoye shall be deemed to have waived Partner Claims held by Yuzhmash and Yuzhnoye that are not Allowed Partner Currency Control Claims, provided Class 7 accepts the Plan. In the event Class 7 does not accept the

Plan, for each Allowed Partner Claim, Yuzhmash and Yuzhnoye shall receive a Pro Rata share of the Creditor Trust Equity Interests up to a maximum of one half percent (0.5%) attributable to the Partner Equity Recovery and shall not be entitled any separate distribution or treatment for Allowed Partner Currency Control Claims.

3.3 Classes of Interests. Unless the Holder of an Interest and the Debtors (with the approval of the Committee) agree to a different treatment, on the Effective Date, or as soon as practicable after the Effective Date, in full satisfaction, settlement, release, and discharge of and in exchange for each Interest, each Holder of an Interest that is not a Debtor shall receive as follows:

(a) *Class 8: Sea Launch Equity Interests*. Each non-Debtor Holder of a Sea Launch Equity Interest shall have its Sea Launch Equity Interests cancelled, annulled and extinguished on the Effective Date and shall neither receive nor retain any property on account of such Sea Launch Equity Interests.

(b) *Class 9: Subsidiary Interests*. Each holder of an Allowed Class 9 Subsidiary Interest shall retain such Subsidiary Interest, provided, however, that with respect to Class 9 Subsidiary Interests, on or after the Effective Date, the Subsidiary Interests in those Debtors shall be cancelled, with the consent of the holders thereof, if there is a dissolution of those Debtors; if, after the Effective Date, those Debtors are instead merged with other Debtors or other corporate transactions take place under and in accordance with applicable state law to dispose of those Debtors, then the Class 9 Subsidiary Interests shall be disposed of as part of such transactions.

3.4 Special Provision Regarding Unimpaired Claims. Except as otherwise explicitly provided in this Plan, nothing shall affect, diminish or impair the Debtors' or the Reorganized Debtors' rights and defenses, both legal and equitable, with respect to any Unimpaired Claims, including, but not limited to, legal and equitable defenses to setoffs or recoupments against Unimpaired Claims.

3.5 Intercompany Claims and Interests. Notwithstanding anything to the contrary contained in this Plan, Intercompany Claims held by one Debtor against another Debtor and Subsidiary Interests shall be Unimpaired and shall remain in full force and effect on and after the Effective Date.

ARTICLE IV

ACCEPTANCE OR REJECTION OF THE PLAN

4.1 Acceptance by an Impaired Class. In accordance with Section 1126(c) of the Bankruptcy Code and except as provided in Section 1126(e) of the Bankruptcy Code, an Impaired Class of Claims shall have accepted this Plan if this Plan is accepted by the Holders of

at least two-thirds (⅔) in dollar amount and more than one-half (½) in number of the Claims of such Class that have timely and properly voted to accept or reject this Plan.

4.2 Presumed Acceptances by Unimpaired Classes. Classes 1, 2 and 9 are Unimpaired by this Plan. Under Section 1126(f) of the Bankruptcy Code, Holders of such Claims are conclusively presumed to accept this Plan, and thus the votes of the Holders of such Claims will not be solicited.

4.3 Presumed Rejections by Impaired Classes. Class 8 is Impaired by this Plan and will not receive or retain any property under the Plan. Under Section 1126(f) of the Bankruptcy Code, Holders of such Interests are conclusively presumed to reject this Plan, and thus the votes of the Holders of such Interests will not be solicited.

4.4 Summary of Classes Voting on this Plan. As a result of the provisions of Sections 3.1, 3.2 and 3.3 of this Plan, only the votes of Holders of Claims in Classes 3, 4, 5, 6 and 7 will be solicited with respect to this Plan.

4.5 Non-Consensual Confirmation. If any Impaired Class fails to accept this Plan by the requisite statutory majorities, the Debtors reserve the right (i) to confirm this Plan by a "cram-down" of such non-accepting Class pursuant to Section 1129(b) of the Bankruptcy Code and (ii) to propose any modifications to this Plan and to confirm this Plan as modified, without re-solicitation, to the extent permitted by the Bankruptcy Code.

ARTICLE V

MEANS FOR IMPLEMENTATION OF THE PLAN

5.1 Non-Substantive Consolidation. Except as provided in Sections 2.2(c), (d), (e), (f) and (g), and 3.2(c), (d), (e), (f) and (g), the Plan is a joint plan that does not provide for substantive consolidation of the Debtors' Estates, and, on the Effective Date, the Debtors' Estates shall not be deemed to be substantively consolidated for purposes hereof. Except as specifically set forth herein, nothing in this Plan or the Disclosure Statement shall constitute or be deemed to constitute an admission that any one of the Debtors is subject to or liable for any claim against any other Debtor.

5.2 Reorganized Sea Launch Securities.

(a) Issuance of New Common Stock. As of the Effective Date, Reorganized Sea Launch shall issue or authorize for issuance an aggregate of one million five hundred thousand (1,500,000) shares of New Common Stock as further specified in the Articles of Incorporation. The Existing Creditor Equity Amount shall be distributed to the Creditor Trust. If required by the New Investor to effectuate the transformation of Reorganized Sea Launch into a Swiss corporation, the Creditor Trust shall be deemed to be the sole shareholder of Sea Launch immediately prior to the New Investment. Unless otherwise provided in the Plan or agreed, each Holder of an Allowed Claim in Classes 4, 5 and 7 will receive, in consideration of

the satisfaction of such Claim, its Pro Rata share of the Creditor Trust Equity Interests on account of the Customer Equity Recovery as to Class 4 and the Partner Equity Recovery as to Classes 5 and 7. The New Investor, in consideration of the New Investment Amount, shall receive the Investor Equity Amount of the New Common Stock. The New Common Stock shall not be registered under the Securities Act of 1933, as amended, or any equivalent statute under applicable Swiss law, and shall not be listed for public trading on any securities exchange. Distribution of such New Common Stock shall be made to the Creditor Trust by delivery of one or more certificates representing such shares as described herein or made by means of book-entry exchange as provided in Section 6.5 herein. The Articles of Incorporation will set forth the rights and preferences under the New Common Stock. As of the Effective Date, except as otherwise provided for herein, all Sea Launch Equity Interests shall be cancelled, and the obligations of the Debtors under any stockholder agreements, registration rights agreements, repurchase agreements and repurchase arrangements, or other instruments or documents evidencing or creating any obligations of the Debtor with respect to such Sea Launch Equity Interests, shall be rejected and discharged; provided, however, that notwithstanding the foregoing, such rejection and discharge of the Debtors' obligations pursuant to this subsection shall not affect or impair the existence, validity and enforceability of any such stockholders agreement, registration rights agreement, repurchase agreement and repurchase arrangement, or other such instrument or document, or any rights, claims, or defenses thereunder, with respect to and among non-Debtor entities. As of the Effective Date, all Sea Launch Equity Interests that have been authorized to be issued but that have not been issued shall be deemed cancelled and extinguished without any further action of any party.

(b) Issuance of Preferred Stock. Unless Energia agrees to a different treatment, as of the Effective Date, in consideration of the satisfaction of Allowed Partner Currency Control Claims held by Energia, Reorganized Sea Launch shall issue to Energia $28,800,000 in Preferred Stock. The Articles of Incorporation and the Shareholders Agreement will set forth the rights, obligations and preferences under the Preferred Stock. Distribution of such Preferred Stock shall be made to Energia by delivery of one or more certificates representing such shares as described herein or made by means of book-entry exchange as provided in Section 6.5 herein.

(c) Reorganized Sea Launch Shareholders Agreement. As of the Effective Date, the New Investor Energia and the Creditor Trust shall enter into (or be deemed to enter into as provided below) the Reorganized Sea Launch Shareholders Agreement. The Reorganized Sea Launch Shareholders Agreement shall be binding on all parties regardless of whether such parties execute the Reorganized Sea Launch Shareholders Agreement. Registration rights, if any, including any registration rights agreement,

"tag along" or "bring along" agreements, will be included in the Plan Supplement and shall be in form and substance acceptable to the Committee.

5.3 Continued Corporate Existence and Vesting of Assets in the Reorganized Debtors. As of the Effective Date, to the extent required by the New Investment Agreement, the Reorganized Debtors shall continue to exist as separate corporate entities or partnerships in accordance with the applicable law in the respective jurisdictions in which they are incorporated or organized and pursuant to their respective certificates, articles of incorporation and by-laws or partnership agreements in effect prior to the Effective Date, except to the extent such certificates, articles of incorporation and by-laws or partnership agreements are to be amended or extinguished pursuant to the terms of this Plan and the New Investment Agreement. Notwithstanding anything to the contrary in this Plan, the Reinstated Claims against a particular Debtor or Reorganized Debtor shall remain the obligations solely of such Debtor or Reorganized Debtor following the Effective Date and shall not become obligations of any other Debtor or Reorganized Debtor by virtue of this Plan, the Chapter 11 Cases, or otherwise. Except as otherwise provided in this Plan, on and after the Effective Date, all property of the Estates of the Debtors, including all Causes of Action (including Creditor Trust Actions unless expressly assigned to the Creditor Trust) and any property acquired by the Debtors or the Reorganized Debtors under or in connection with this Plan, shall vest in the Reorganized Debtors free and clear of all Claims, liens, charges, other encumbrances and Interests. On and after the Effective Date, the Reorganized Debtors may operate their businesses and may use, acquire and dispose of property and compromise or settle any Claims without supervision of or approval by the Bankruptcy Court and free and clear of any restrictions of the Bankruptcy Code or the Bankruptcy Rules, other than restrictions expressly imposed by this Plan or the Confirmation Order. Without limiting the foregoing, the Reorganized Debtors may pay the charges that they incur on or after the Effective Date for professionals' fees, disbursements, expenses or related support services without application to the Bankruptcy Court.

5.4 Corporate Governance, Directors, Officers and Corporate Action.

(a) Certificates or Articles of Incorporation. As of the Effective Date, the revised Articles of Incorporation of Reorganized Sea Launch, as included in the Plan Supplement, as may be further modified at or prior to the hearing on Confirmation of the Plan, shall go into effect and shall, to the extent permissible under Swiss law (i) include, among other things, a provision in accordance with applicable Swiss law, prohibiting the issuance of non-voting equity securities; and (ii) authorize the issuance of the New Common Stock. On or prior to the Effective Date, Sea Launch shall make such filings in the State of Delaware and the Federal Republic of Switzerland as shall be necessary or desirable to provide for the effectiveness on the Effective Date of the revised Articles of Incorporation. In addition, on or about the Effective Date, the certificates, articles of incorporation and by-laws and partnership agreements of the Affiliate Debtors shall be amended as necessary to satisfy the provisions of this Plan and the Bankruptcy Code. After the Effective Date, the Reorganized Debtors may amend and restate their certificates, articles of

incorporation and by-laws or partnership agreements as permitted by applicable law.

(b) Directors and Officers of the Reorganized Debtors. Subject to any requirement of Bankruptcy Court approval pursuant to Section 1129(a)(5) of the Bankruptcy Code, on the Effective Date, the existing initial directors shall be designated by the New Investor to be disclosed in the Plan Supplement. Each such director and officer shall serve from and after the Effective Date pursuant to the terms of the Articles of Incorporation for Reorganized Sea Launch and applicable Swiss law. Thereafter, the Articles of Incorporation and the Reorganized Sea Launch Shareholders Agreement shall govern the designation or election of directors. In addition, the boards of directors of the other Reorganized Debtors shall be comprised of members of the board of directors of Reorganized Sea Launch, or such other persons as are designated by the board of directors of Reorganized Sea Launch. Pursuant to Section 1129(a)(5), the Debtors will disclose, as part of the Plan Supplement, but which shall be filed within three (3) Business Days of the Confirmation Hearing, the identity and affiliations of any person proposed to serve on the initial board of directors of Reorganized Sea Launch, and to the extent such person is an insider other than by virtue of being a director, the nature of any compensation for such person. Each member of the current board of directors of each of the Debtors will be deemed to have resigned on the Effective Date or such earlier date as may be required to effectuate the Plan. In the event it is determined by New Investor that the transformation of Reorganized Sea Launch into a Swiss corporation requires an intervening board of directors with at least one Swiss resident serving as a director, Kjell Karlsen shall serve as one of two directors along with an initial Swiss resident director designated by the New Investor.

(c) Corporate Action. As of the Effective Date, the adoption of the revised Articles of Incorporation or similar constituent documents, the selection of directors and officers for Reorganized Sea Launch and the other Reorganized Debtors, and all other actions contemplated by this Plan and the New Investment Agreement, including all actions required to be taken by the board of directors of the Debtors or the Reorganized Debtors (or their partners) shall be authorized and approved in all respects, or shall have otherwise occurred (subject to the provisions of this Plan). All matters provided for in this Plan and the New Investment Agreement involving the corporate or partnership structure of the Debtors or the Reorganized Debtors, and any corporate action required by the Debtors or the Reorganized Debtors in connection with this Plan, shall be deemed to have timely occurred in accordance with applicable law and shall be in effect, without any requirement of further action by the security holders or directors of the Debtors or the Reorganized Debtors. On the Effective Date, the appropriate officers of Reorganized Sea Launch and/or the other

Reorganized Debtors and members of the boards of directors of Reorganized Sea Launch and/or the other Reorganized Debtors are authorized and directed to issue, execute and deliver the agreements, documents, securities and instruments contemplated by this Plan and the New Investment Agreement in the name of and on behalf of Reorganized Sea Launch and/or the other Reorganized Debtors.

5.5 Cancellation of Liens. Except as otherwise provided herein, on the Effective Date, any Lien securing any Secured Claim (other than a Lien securing a Secured Claim that is Reinstated pursuant to Section 3.2) hereof shall be deemed released and the Holder of such Secured Claim shall be authorized and directed to release any collateral or other property of any Debtor (including any cash collateral) held by such Holder and to take such actions as may be requested by the Debtors (or the Reorganized Debtors, as the case may be) to evidence the release of such Lien, including the execution, delivery, and filing or recording of such releases as may be requested by the Debtors (or the Reorganized Debtors, as the case may be).

5.6 Exit Financing. On the Effective Date, without any requirement of further action by security holders or directors of the Debtors or the Reorganized Debtors, the Reorganized Debtors shall be authorized and directed to enter into the Exit Financing Credit Agreement, as well as any notes, guarantees, documents or agreements in connection therewith, including, without limitation, any documents required in connection with the creation or perfection of Liens securing the obligations under the Exit Financing.

5.7 SLEIP. Following the Effective Date, Reorganized Sea Launch and, if necessary, the Creditor Trust, will be deemed to have adopted all obligations owing under the SLEIP, and shall perform such obligations when and as due in the manner provided in this Plan, provided further that nothing contained in Section 3.2(d) shall be deemed to limit the amounts payable under the SLEIP.

5.8 Creditor Trust.

(a) Formation and Funding. On or before the Effective Date, the Debtors and/or the Reorganized Debtors shall (i) take all steps necessary or appropriate to form, create and establish the Creditor Trust, (ii) transfer, deliver, and assign to the Creditor Trust the Creditor Trust Assets, including the proceeds of the Creditor Trust Actions against Holders of Claims in Class 7, and (iii) prosecute certain of the Creditor Trust Actions, including the Creditor Trust Actions against Holders of Claims in Class 7. Also on the Effective Date, the Reorganized Debtors shall cause the transfer of the Creditor Trust Cash Deposit to the Creditor Trust. Immediately upon its formation, the Creditor Trust shall issue the Creditor Trust Equity Interests as provided in this Plan. Subsequent to the Effective Date, the Reorganized Debtors shall take all steps necessary or appropriate to comply with the Creditor Trust Agreement.

(b) Purposes and Powers of the Creditor Trust. The Creditor Trust will be organized for the purposes of holding the Existing Claim Equity Amount

for the benefit of the Holders of the Creditor Trust Equity Interests and receiving such proceeds of the Creditor Trust Actions which are Creditor Trust Assets and, to the extent required by the New Investor as part of the transformation of Reorganized Sea Launch into a Swiss corporation, act as the intermediate sole shareholder with no objective or authority to continue or engage in the conduct of a trade or business. In particular, the Creditor Trust shall: (i) make distributions to holders of the Creditor Trust Equity Interests; and (ii) take such steps as are reasonably necessary to accomplish such purposes, all as more fully provided in, and subject to the terms and provisions of, the Creditor Trust Agreement, including prosecutions of the Creditor Trust Actions for the purposes of effectuating distributions to Holders of Claims in Class 4, to the extent necessary. The Creditor Trust shall be a party to the Shareholder Agreement required by the New Investment Agreement and the Exit Financing Commitment Letter.

(c) Management of the Creditor Trust. Pursuant and subject to the Creditor Trust Agreement, the affairs of the Creditor Trust shall be managed by a single Creditor Trust Manager who shall be designated as provided in the Creditor Trust Agreement. The Creditor Trust Manager shall be subject to removal and replacement as and to the extent provided in the Creditor Trust Agreement. Pursuant to the Creditor Trust Agreement, decisions regarding the administration of the Creditor Trust exclusively shall be made by the Creditor Trust Manager.

(d) Hiring of Employees and Retention of Professionals. As provided in the Creditor Trust Agreement, the Creditor Trust Manager shall be authorized to hire employees and retain and engage such professionals as may be necessary to carry out the purposes and powers of the Creditor Trust.

(e) Transfers of Creditor Trust Equity Interests. Transfers of the Creditor Trust Equity Interests (including any restrictions or prohibitions of the same) shall be governed by the Creditor Trust Agreement.

(f) Dissolution. Pursuant to the Creditor Trust Agreement, the Creditor Trust shall dissolve after the expiration of the Reorganized Sea Launch Shareholder Agreement, unless otherwise agreed by the holders of a majority of the Creditor Trust Equity Interests.

5.9 Additional Transactions Authorized Under this Plan. On or prior to the Effective Date, the Debtors shall be authorized to take any such actions as may be necessary or appropriate to Reinstate Claims or render Claims not Impaired, as provided for under this Plan.

ARTICLE VI

PROVISIONS GOVERNING DISTRIBUTIONS

6.1 Distributions for Classes 3, 4, 5, 6 and 7 Claims. Unless the Holder of a Class 3, 4, 5, 6 or 7 Claim agrees to a different distribution date or except as otherwise provided herein or as ordered by the Bankruptcy Court, distributions to be made on account of Claims in Classes 3, 4, 5, 6 and 7 shall be made on the Initial Distribution Date and shall continue thereafter on such subsequent distribution dates as the Distribution Agent determines to be appropriate in its discretion. Notwithstanding the date on which any distribution of Creditor Trust Equity Interests is actually made to a Holder of a Claim in Class 4, 5 or 7 as of the date of the distribution such Holder shall be deemed to have the rights of a holder of such securities distributed as of the Effective Date. Any payment or distribution required to be made under this Plan on a day other than a Business Day shall be made on the next succeeding Business Day.

6.2 Interest on Claims. Except as otherwise specifically provided for in this Plan, the Confirmation Order or other order of the Bankruptcy Court (including, without limitation, the Final DIP Order), or required by applicable bankruptcy or non-bankruptcy law, post-petition interest shall not accrue or be paid on any Claims (other than Secured Claims), and no Holder of a Claim (other than the Holder of a Secured Claim) shall be entitled to interest accruing on or after the Petition Date on any Claim.

6.3 Distributions by Disbursing Agent. Other than as specifically set forth in this Plan, the Disbursing Agent shall make all distributions required to be made under this Plan. Reorganized Sea Launch and/or the other Reorganized Debtors may act as Disbursing Agent or may employ or contract with other entities to assist in or make the distributions required by this Plan.

6.4 Delivery of Distributions and Undeliverable or Unclaimed Distributions. The following terms shall govern the delivery of distributions and undeliverable or unclaimed distributions with respect to Claims.

(a) *Delivery of Distributions in General*. Subject to Bankruptcy Rule 9010, all distributions to Holders of Claims in Classes 3, 4, 5, 6 and 7 shall be made at the addresses set forth in the Debtors' books and records unless such addresses are superseded by proofs of claim or transfers of claim filed pursuant to Bankruptcy Rule 3001.

(b) *Undeliverable and Unclaimed Distributions*.

(i) Holding and Investment of Undeliverable and Unclaimed Distributions. If the distribution to any Holder of a Claim in Class 3, 4, 5, 6 or 7 is returned to Reorganized Sea Launch, the other Reorganized Debtors or the Disbursing Agent as undeliverable or is otherwise unclaimed, no further distributions shall be made to such Holder unless and until the Reorganized Debtors or the

Disbursing Agent is notified in writing of such Holder's then current address.

(ii) Failure to Claim Undeliverable Distributions. Any Holder of a Claim in Class 3, 4, 5, 6 or 7 that does not assert a claim pursuant to this Plan for an undeliverable or unclaimed distribution within one (1) year after the Effective Date shall be deemed to have forfeited its claim for such undeliverable or unclaimed distribution and shall be forever barred and enjoined from asserting any such claim for an undeliverable or unclaimed distribution against the Debtors or their Estates or the Reorganized Debtors or their property. In such cases, any Cash for distribution on account of such claims for undeliverable or unclaimed distributions shall become the property of the Reorganized Debtors free of any restrictions thereon and notwithstanding any federal or state escheat laws to the contrary. Any Creditor Trust Equity Interests held for distribution on account of such Claim shall be canceled and of no further force or effect. Nothing contained in this Plan shall require any Disbursing Agent, including, but not limited to, the Reorganized Debtors, to attempt to locate any Holder of an Allowed Claim.

6.5 Record Date for Distributions. The record date for distributions under this Plan shall be the Distribution Record Date.

(a) The Reorganized Debtors and the Disbursing Agent will have no obligation to recognize the transfer of, or the sale of any participation in, any Claim in Class 3, 4, 5, 6 or 7 that occurs after the close of business on the Distribution Record Date, and will be entitled for all purposes herein to recognize and distribute only to those Holders of Claims in Classes 3, 4, 5, 6 and 7 that are Holders of such Claims, or participants therein, as of the close of business on the Distribution Record Date. The Reorganized Debtors and the Disbursing Agent shall be entitled to recognize and deal for all purposes under this Plan with only those record holders stated on the official claims register as of the close of business on the Distribution Record Date.

(b) Distributions of Creditor Trust Equity Interests to Holders of Claims in Classes 4, 5 and 7 may in the discretion of the Disbursing Agent be made by means of book-entry exchange through the facilities of DTC in accordance with the customary practices of DTC, as and to the extent practicable.

6.6 Allocation of Plan Distributions Between Principal and Interest. Except as otherwise expressly provided in this Plan, to the extent that any Claim entitled to a distribution under this Plan is comprised of indebtedness and accrued but unpaid interest thereon, such distribution shall, for all income tax purposes, be allocated to the principal amount of the Claim

first and then, to the extent that the consideration exceeds the principal amount of the Claim, to the portion of such Claim representing accrued but unpaid interest.

6.7 Means of Cash Payment. Payments of Cash made pursuant to this Plan shall be in U.S. dollars and shall be made, at the option and in the sole discretion of Reorganized Sea Launch or the other Reorganized Debtors, by (a) checks drawn on or (b) wire transfer from a bank selected by Reorganized Sea Launch or the other Reorganized Debtors. Cash payments to foreign creditors may be made, at the option of Reorganized Sea Launch or the other Reorganized Debtors, in such funds and by such means as are necessary or customary in a particular foreign jurisdiction.

6.8 Sources of Cash for Plan Distributions. Except as otherwise provided in this Plan or the Confirmation Order, all Cash necessary for the Reorganized Debtors to make payments pursuant to this Plan, including executory contract cure payments, if any, may be obtained from existing Cash balances, revenue generated from the operations of the Debtors and the Reorganized Debtors, from the New Investment Amount or from any available proceeds of the Exit Financing Credit Agreement. The Reorganized Debtors may also make such payments using Cash received from their subsidiaries through the Reorganized Debtors' consolidated cash management systems.

6.9 Withholding and Reporting Requirements. In connection with this Plan and all distributions thereunder, Reorganized Sea Launch and the other Reorganized Debtors shall comply with all withholding and reporting requirements imposed by any federal, state, local or foreign taxing authority, and all distributions hereunder shall be subject to any such withholding and reporting requirements. The Reorganized Debtors shall be authorized to take any and all actions that may be necessary or appropriate to comply with such withholding and reporting requirements. All persons holding Claims shall be required to provide any information necessary to effect information reporting and the withholding of such taxes. Notwithstanding any other provision of this Plan, (a) each Holder of a Claim in Class 3, 4, 5, 6 or 7 that is to receive a distribution on or after the Effective Date pursuant to this Plan shall have sole and exclusive responsibility for the satisfaction and payment of any tax obligations imposed by any Governmental Unit, including income, withholding and other tax obligations, on account of such distribution and (b) no distribution of any Cash or securities shall be made to or on behalf of such Holder pursuant to this Plan unless and until (i) such Holder has made arrangements satisfactory to the Reorganized Debtors for the payment and satisfaction of such tax obligations, and/or (ii) the Holder has made satisfactory arrangements for reimbursement of any Tax Withholding Advance.

6.10 Setoffs. Reorganized Sea Launch and the Reorganized Debtors may, pursuant to Section 553 of the Bankruptcy Code or applicable nonbankruptcy laws, but shall not be required to, set off against any Claim, the payments or other distributions to be made pursuant to this Plan in respect of such Claim, or claims of any nature whatsoever that the Debtors or the Reorganized Debtors may have against the Holder of such Claim; provided, however, that neither the failure to do so nor the allowance of any Claim hereunder shall constitute a waiver or release by the Reorganized Debtors of any such claim that the Debtors or the Reorganized Debtors may have against such Holder.

6.11 Fractional Shares. No fractional shares of New Common Stock shall be distributed. When a fractional share would otherwise be called for, the actual issuance shall reflect a rounding up (in the case of more than .50) of such fraction to the nearest whole share of New Common Stock or a rounding down of such fraction (in the case of .50 or less than .50) to the nearest whole share of New Common Stock. The total number of shares of New Common Stock to be distributed pursuant to the Plan shall be adjusted as necessary to account for the rounding provided for herein.

6.12 Exemption from Securities Law. The issuance of the New Common Stock pursuant to the terms of this Plan shall be exempt from any federal and state securities laws registration requirements to the fullest extent permitted by Section 1145 of the Bankruptcy Code.

ARTICLE VII

TREATMENT OF EXECUTORY CONTRACTS, UNEXPIRED LEASES AND PENSION AND RETIREMENT PLANS

7.1 Assumption of Executory Contracts and Unexpired Leases. On the Effective Date, all executory contracts or unexpired leases of the Debtors will be deemed rejected in accordance with, and subject to, the provisions and requirements of Sections 365 and 1123 of the Bankruptcy Code, except to the extent provided in the New Investment Agreement and listed by the Debtors in a Plan Supplement as a contract to be assumed and assigned to Energia Logistics, unless such executory contract or unexpired lease (i) was previously assumed or rejected by the Debtors pursuant to an order entered by the Bankruptcy Court, (ii) previously expired or terminated pursuant to its own terms, or (iii) is the subject of a pending motion to assume or reject. Entry of the Confirmation Order by the Bankruptcy Court will constitute approval of such rejections and assumptions pursuant to Sections 365(a) and 1123 of the Bankruptcy Code. If an executory contract is deemed rejected by the Confirmation Order, then the non-debtor party to such executory contract shall have, pursuant to the Notice Of Entry Of Bar Date Order Establishing Deadlines For Filing Proofs Of Claim Against The Debtors, thirty (30) days from the entry of the Confirmation Order to file a proof of claim for any alleged rejection damages, as set forth in the Notice. Each executory contract and unexpired lease assumed pursuant to this Article VII shall revest in and be fully enforceable by the respective Reorganized Debtor in accordance with its terms, except as modified by the provisions of this Plan, or any order of the Bankruptcy Court authorizing and providing for its assumption, or applicable federal law.

7.2 Cure of Defaults of Assumed Executory Contracts and Unexpired Leases. Any monetary amounts by which each executory contract and unexpired lease to be assumed is in default shall be satisfied, pursuant to Section 365(b)(1) of the Bankruptcy Code, by (i) payment of the default amount in Cash on the Effective Date, (ii) deferred payments described in the Plan as cure payments, or (iii) on such other terms as the parties to each such executory contract or unexpired lease may otherwise agree, consistent with the terms of the New Investment Agreement. In the event of a dispute regarding (a) the amount of any cure payments, (b) the ability of the Reorganized Debtors or any assignee to provide "adequate assurance of future performance" (within the meaning of Section 365 of the Bankruptcy Code) under the contract or lease to be assumed or (c) any other matter pertaining to assumption, the cure payments required by Section 365(b)(1) of the Bankruptcy Code shall be made following the entry of a Final Order

resolving the dispute and approving the assumption. Pending the Bankruptcy Court's ruling on such motion, the executory contract or unexpired lease at issue shall be deemed assumed by the Debtors unless otherwise ordered by the Bankruptcy Court.

7.3 Post-Petition Contracts and Leases. All contracts, agreements and leases that were entered into by the Debtors or assumed by the Debtors after the Petition Date shall be deemed assigned by the Debtors to the Reorganized Debtors or to an affiliate of the New Investor in accordance with the terms of the New Investment Agreement on the Effective Date.

7.4 Retiree Benefits, and Pension and Retirement Plans. In furtherance of, and without in any way limiting Section 7.5 of the Plan, from and after the Effective Date, the Debtors shall assume the obligation and shall continue to make the payment of all retiree benefits (if any), as that term is defined in Section 1114 of the Bankruptcy Code, at the level established pursuant to Section 1114(e)(1)(B) or (g), at any time prior to the Confirmation Date, for the duration of the period (if any) that the Debtors are obligated to provide such benefits. Notwithstanding anything in this Plan to the contrary, the Pension and Retirement Plans shall become obligations of the Reorganized Debtors and shall otherwise be unaffected by confirmation of this Plan, and any Claims arising under the Pension and Retirement Plans shall not be discharged or released or otherwise affected by this Plan or by these proceedings.

7.5 Compensation and Benefit Programs. Except as otherwise expressly provided in Article VII or any other provisions of this Plan including the New Investment Agreement (and except as may otherwise be agreed between an employee and the Board of Directors of the Reorganized Debtors), the Reorganized Debtors shall continue to perform their obligations under all compensation and benefit plans, policies and programs of the Debtors applicable to their current and former employees (but excluding any employment or severance contracts). Except as expressly set forth in the New Investment Agreement, nothing herein shall restrict the rights of the board of directors of the Reorganized Debtors to change or modify any such policy, plan or program in accordance with its terms, except as set forth in the SLEIP.

ARTICLE VIII

PROVISIONS FOR RESOLVING DISPUTED CLAIMS AND DISPUTED INTERESTS

8.1 Objections to and Estimation of Claims. Except as set forth in Section 8.2 of the Plan, only the Debtors or the Reorganized Debtors may object to the allowance of any Claim, including, without limitation, any Administrative Expense Claim. After the Effective Date, the Reorganized Debtors shall be accorded the power and authority to allow or settle and compromise any Claim without notice to any other party, or approval of, or notice to the Bankruptcy Court. In addition, the Debtors or the Reorganized Debtors may, at any time, request that the Bankruptcy Court estimate any contingent or unliquidated Claim pursuant to Section 502(c) of the Bankruptcy Code regardless of whether the Debtors or Reorganized Debtors have previously objected to such Claim.

8.2 Objections to Claims in Class 7. Only the Creditor Trust may object to the allowance of any Claim in Class 7. After the Effective Date, the Creditor Trust shall be accorded the power and authority to allow or settle any Creditor Trust Action against the holder of any

Claim in Class 7 without notice to any other party, or approval of, or notice to the Bankruptcy Court.

8.3 No Distributions Pending Allowance. Notwithstanding any other provision in this Plan, no payments or distributions shall be made with respect to all or any portion of a Disputed Claim unless and until all objections to such Disputed Claim have been settled or withdrawn or have been determined by Final Order and the Disputed Claim, or some portion thereof, has become an Allowed Claim.

8.4 Distributions on Account of Disputed Claims Once They Are Allowed. To the extent that a Disputed Claim ultimately becomes an Allowed Claim, distributions (if any) shall be made to the Holder of such Allowed Claim in accordance with the provisions of this Plan. As soon as practicable after the date that the order or judgment of the Bankruptcy Court allowing any Disputed Claim becomes a Final Order, the Disbursing Agent shall provide to the Holder of such Claim the distribution (if any) to which such Holder is entitled under this Plan as of the Effective Date, without any interest to be paid on account of such Claim.

8.5 Reinstated Claims. Notwithstanding anything contained herein to the contrary, nothing shall affect, diminish or impair the Debtors' or the Reorganized Debtors' rights and defenses, both legal and equitable, with respect to any Reinstated Claim, including, but not limited to, legal and equitable defenses to setoffs or recoupments against Reinstated Claims.

ARTICLE IX
CONFIRMATION AND CONSUMMATION OF THE PLAN

9.1 Conditions to Confirmation. The Plan shall not be confirmed unless and until the following conditions shall have been satisfied or waived in accordance with Section 9.3 of this Plan:

(a) The most current version of the Plan Supplement and the Plan Documents shall have been Filed.

(b) The board of directors shall have adopted such resolutions and taken any other actions necessary so that the Plan and the transactions contemplated hereunder may be consummated.

(c) The Bankruptcy Court shall have estimated the total amount of all Section 1446 Claims at no more than $250,000.

(d) That the form of the Confirmation Order to be entered by the Bankruptcy Court, which shall include an express finding of good faith on the part of the Debtors and the New Investor, shall be acceptable to the New Investor in form and substance.

9.2 Conditions to Effective Date. The Plan shall not become effective and the Effective Date shall not occur unless and until the following conditions shall have been satisfied or waived in accordance with Section 9.3 of this Plan:

(a) The Confirmation Order confirming this Plan shall have been entered by the Bankruptcy Court and shall not have been stayed.

(b) The final version of the Plan Supplement and all of the schedules, documents, and exhibits contained therein (including the Plan Documents) shall have been Filed without prejudice to the Reorganized Debtors' rights under the Plan to alter, amend, or modify certain of the schedules, documents, and exhibits contained in the Plan Supplement in accordance with the terms hereof.

(c) All other documents and agreements necessary to implement this Plan on the Effective Date, including, but not limited to the Plan Supplement and the Plan Documents, shall have been duly and validly executed and delivered by all parties thereto

(d) All other actions, documents, and agreements determined by the Debtors to be necessary to implement the Plan shall have been effected or executed.

(e) The Exit Financing Credit Agreement and the New Investment Agreement and all related documents provided for therein or contemplated thereby shall have been duly and validly executed and delivered by all parties thereto, all conditions precedent thereto shall have occurred or shall have been satisfied or waived in the manner provided therein.

(f) The entire proceeds of the New Investment Amount shall be made available to the Reorganized Debtors to fund distributions under the Plan.

(g) All of the Conditions Preceding the Effective Date set forth in the Exit Financing Commitment Letter shall have occurred or have been waived by the New Investor.

(h) All DIP Facility Claims shall have been paid in full and in Cash or converted to New Common Stock at the election of the DIP Lender, or the Debtors shall have provided reasonably satisfactory evidence that such Claims shall be paid from the proceeds of the Exit Financing.

(i) Prior to or at the Hearing on the Disclosure Statement, the Bankruptcy Court shall have entered an order that the "Right to Match" provision of, SLS DIP Financing Agreement has been fully offered by the Debtors and shall be of no further force and effect, and such order shall not have been stayed.

(j) All corporate actions required to be taken by Article VII of this Plan shall have been taken.

(k) Any material alteration to, or interpretation of, any term or provision of this Plan by the Bankruptcy Court shall have been acceptable to the Debtors and the New Investor.

(l) The Articles of Incorporation and By-Laws and the amended certificates, articles of incorporation or partnership agreements of the Debtors, as necessary, shall have been adopted and filed with the applicable authorities of the relevant jurisdictions of incorporation or organization and shall have become effective in accordance with the corporate laws of such jurisdictions.

(m) All authorizations, consents, certifications, approvals, rulings, no-action letters, opinions or other documents or actions required by any law, regulation or order to be received or to occur in order to implement this Plan on the Effective Date shall have been obtained or shall have occurred unless failure to do so will not have a material adverse effect on Reorganized Sea Launch.

(n) All conditions set forth in the New Investment Agreement shall have been satisfied or waived in the manner provided therein.

(o) All conditions to Confirmation have been satisfied and remain true, unless expressly waived by the Debtors and the New Investor.

9.3 Waiver of Conditions. Except to the extent that the consent of the New Investor may be required, each of the conditions set forth in Section 9.1 and 9.2 of this Plan, with the exception of those conditions set forth in subsection (j), may be waived in whole or in part by the Debtors, without any notice to the Bankruptcy Court or parties in interest and without the need for a hearing.

9.4 Effect of Non-Occurrence of Conditions to Effective Date. If each of the conditions specified in Section 9.1 and Section 9.2 has not been satisfied or waived in the manner provided in Section 9.3, then upon motion to the Bankruptcy Court and entry of an appropriate Order: (i) the Confirmation Order shall be vacated and of no further force or effect; (ii) no distributions under the Plan shall be made; (iii) the Debtors and all Holders of Claims and Interests in the Debtors shall be restored to the status quo ante as of the day immediately preceding the Confirmation Date as though the Confirmation Date had never occurred; and (iv) all of the Debtors' obligations with respect to the Claims and Interests shall remain unaffected by the Plan and nothing contained herein shall be deemed to constitute a waiver or release of any Claims by or against the Debtors or any other person or to prejudice in any manner the rights of the Debtors or any person in any further proceedings involving the Debtors, and the Plan shall be deemed withdrawn. Upon such occurrence, the Debtors shall file a written notification with the Bankruptcy Court and serve it upon such parties as the Bankruptcy Court may direct.

ARTICLE X

EFFECT OF PLAN CONFIRMATION

10.1 Binding Effect. Except as otherwise provided in Section 1141(d)(3) of the Bankruptcy Code and subject to the occurrence of the Effective Date, on and after the Confirmation Date, the provisions of this Plan shall bind any Holder of a Claim against, or Interest in, the Debtors and such Holder's respective successors and assigns, whether or not the Claim or Interest of such Holder is Impaired under this Plan and whether or not such Holder has accepted this Plan.

10.2 Exculpation and Releases.

(a) Exculpation. From and after the Effective Date, the Released Parties shall neither have nor incur any liability to, or be subject to any right of action by, any Holder of a Claim or Interest, or any other party in interest, or any of their respective employees, representatives, financial advisors, attorneys, or agents acting in such capacity, or affiliates, or any of their successors or assigns, for any act or omission in connection with, relating to, or arising out of, the Chapter 11 Cases, formulating, negotiating or implementing this Plan, the solicitation of acceptances of this Plan, the pursuit of approval of the Disclosure Statement and confirmation of this Plan, the confirmation of this Plan, the Plan Documents, the consummation of this Plan or the administration of this Plan or the property to be distributed under this Plan, or the restructuring transactions contemplated hereunder; provided, however, that the foregoing provision shall not apply to an act or omission that is determined by a Final Order of the Bankruptcy Court to have constituted willful misconduct or gross negligence. Any of the Released Parties shall be entitled to rely, in all respects, upon the advice of counsel with respect to their duties and responsibilities under the Plan.

(b) Releases by the Debtors. As of the Effective Date, for good and valuable consideration, the adequacy of which is hereby confirmed, the Debtors and Reorganized Debtors in their individual capacities and as debtors-in-possession on behalf of each of the Debtors' Estates will be deemed to release and forever waive and discharge all claims, obligations, suits, judgments, damages, demands, debts, rights, causes of action and liabilities whether liquidated or unliquidated, fixed or contingent, matured or unmatured, known or unknown, foreseen or unforeseen, then existing or thereafter arising, in law, equity or otherwise against the Released Parties, that are based in whole or part on any act, omission, transaction, event or other occurrence taking place on or prior to the Effective Date in any way relating to the Debtors, the Reorganized Debtors, the Chapter 11 Cases, this Plan or the Disclosure Statement, or any document or agreement related thereto; provided, however, that the foregoing provision shall not apply to an act or omission that is determined by a Final Order of the

Bankruptcy Court to have constituted willful misconduct or gross negligence.

(c) Releases by Holders of Claims and Interests. As of the Effective Date, to the fullest extent permitted by law, each Holder of a Claim or Interest that does not otherwise elect in accordance with voting on this Plan, shall in consideration for the obligations of the Debtors and the Reorganized Debtors under this Plan and the Cash, the securities, including the Call Option under the Exit Financing Commitment Letter, the New Investment Agreement and the Reorganized Sea Launch Shareholders Agreement, contracts, instruments, releases and other agreements or documents to be delivered in connection with this Plan, be deemed to have forever released, waived and discharged all claims, demands, debts, rights, causes of action or liabilities, whether liquidated or unliquidated, fixed or contingent, matured or unmatured, known or unknown, foreseen or unforeseen, then existing or thereafter arising, in law, equity or otherwise, relating to the Debtors, the Reorganized Debtors, the Chapter 11 Cases, this Plan or the Disclosure Statement, the Plan Documents, or the restructuring transactions contemplated thereby, existing as of the Effective Date or thereafter that are based in whole or part on any act, omission, transaction event, or other occurrence taking place on or prior to the Effective Date, against the Released Parties. Any Holder of a Claim or Interest who does not elect to offer the Releases described in this paragraph, to the extent receiving any securities pursuant to the Plan, shall not be entitled to any direct or indirect benefits from the Call Option under the Exit Financing Commitment Letter and New Investment Agreement.

(d) Injunction Related to Exculpation and Releases. All Persons that have held, hold or may hold any liabilities released or exculpated pursuant to this Section 10.2 will be permanently enjoined from taking any of the following actions against any Released Party or its property on account of such released liabilities: (i) commencing, conducting or continuing in any manner, directly or indirectly, any suit, action or other proceeding of any kind; (ii) enforcing, levying, attaching, collecting or otherwise recovering by any manner or means, directly or indirectly, any judgment, award, decree or order; (iii) creating, perfecting or otherwise enforcing in any manner, directly or indirectly, any lien; (iv) except as provided herein, asserting any setoff, right of subrogation or recoupment of any kind, directly or indirectly, against any obligation due a Released Party; and (v) commencing or continuing any action, in any manner, in any place that does not comply with or is inconsistent with the provisions of this Plan.

(e) Survival of Indemnification Obligations. The obligations of the Debtors to indemnify any past and present directors, officers, agents, employees and representatives, pursuant to certificates or articles of incorporation, by-laws, contracts and/or applicable statutes, in respect of all actions, suits and proceedings against any of such officers, directors, agents, employees

and representatives, based upon any act or omission related to service with or for or on behalf of the Debtors, shall not be discharged or Impaired by, and shall survive, confirmation or consummation of this Plan and shall be assumed by the other Reorganized Debtors.

(f) Discharge of Claims and Termination of Interests. Except as otherwise provided herein or in the Confirmation Order, all consideration distributed under this Plan shall be in exchange for, and in complete satisfaction, settlement, discharge and release of, all Claims and Interests (other than Unimpaired Claims under this Plan) of any nature whatsoever against the Debtors or any of their Estates, assets, properties or interest in property, and regardless of whether any property shall have been distributed or retained pursuant to this Plan on account of such Claims and Interests. Upon the Effective Date, the Debtors shall be deemed discharged and released under Section 1141(d)(1)(A) of the Bankruptcy Code from any and all Claims and Interests (other than Unimpaired Claims), including, but not limited to, demands and liabilities that arose before the Effective Date, and all debts of the kind specified in Section 502(g), 502(h) or 502(i) of the Bankruptcy Code, and the Sea Launch Equity Interests.

(g) Preservation of Rights of Action and Settlement of Causes of Action. Except as otherwise provided in this Plan, the Confirmation Order, or in any document, instrument, release or other agreement entered into in connection with this Plan, in accordance with Section 1123(b) of the Bankruptcy Code, the Debtors and their Estates shall retain the Causes of Action. The Reorganized Debtors, as the successors in interest to the Debtors and the Estates, may enforce, sue on, settle or compromise (or decline to do any of the foregoing) any or all of the Causes of Action.

(h) Release of Boeing and Aker by Holders of Claims and Interests. Subject to Bankruptcy Court approval of Boeing Aker UCC Settlement Agreement (as such term is defined below), as of the Effective Date, to the fullest extent permitted by law, each Holder of a Claim or Interest that does not otherwise elect in accordance with voting on this Plan, shall, in consideration for Boeing and Aker agreeing to the Boeing Aker UCC Settlement Agreement, be deemed to have forever released, waived and discharged all claims, demands, debts, rights, causes of action or liabilities, whether liquidated or unliquidated, fixed or contingent, matured or unmatured, known or unknown, foreseen or unforeseen, then existing or thereafter arising, in law, equity or otherwise, relating to the Debtors, the Reorganized Debtors, the Chapter 11 Cases, this Plan or the Disclosure Statement, the Plan Documents, or the restructuring transactions contemplated thereby, existing as of the Effective Date or thereafter that are based in whole or part on any act, omission, transaction event, or other occurrence taking place on or prior to the Effective Date, against Boeing and Aker, provided that nothing in such agreement shall contradict Section 10.5 of the Plan.

10.3 Injunction.

(a) Except as otherwise provided in this Plan or the Confirmation Order, from and after the Effective Date all Persons who have held, hold or may hold Claims (other than Unimpaired Claims under this Plan) against or Interests in the Debtors, are (i) permanently enjoined from taking any of the following actions against the Estate(s), or any of their property, on account of any such Claims or Interests and (ii) permanently enjoined from taking any of the following actions against any of the Debtors, the Reorganized Debtors or their property on account of such Claims or Interests: (A) commencing or continuing, in any manner or in any place, any action, or other proceeding; (B) enforcing, attaching, collecting or recovering in any manner any judgment, award, decree or order; (C) creating, perfecting or enforcing any lien or encumbrance; (D) asserting any right of setoff, subrogation or recoupment of any kind and (E) commencing or continuing, in any manner or in any place, any action that does not comply with or is inconsistent with the provisions of this Plan; provided, however, that nothing contained herein shall preclude such persons from exercising their rights pursuant to and consistent with the terms of this Plan.

(b) By accepting distributions pursuant to this Plan, each Holder of an Allowed Claim will be deemed to have specifically consented to the injunctions set forth in this Section 10.3.

10.4 Term of Bankruptcy Injunction or Stays. All injunctions or stays provided for in the Chapter 11 Cases under Section 105 or 362 of the Bankruptcy Code, or otherwise, and in existence on the Confirmation Date, shall remain in full force and effect until the Effective Date.

10.5 Exception to Releases. Nothing in the Plan, including, but not limited to, Sections 10.2 and 10.3 of the Plan, Confirmation Order, or any other document in connection with such documents shall release or discharge the claims, if any, of The Boeing Company, Boeing Commercial Space Company, Kvaerner Sea Launch Limited, Kvaerner Sea Launch U.S., Inc., Aker Maritime Finance AS, Kvaerner AS, Aker ASA, S.P. Korolev Rocket and Space Corporation Energia, KB Yuzhnoye, and PO Yuzhny Mashinostroitelny Zavod Production Association, against entities other than the Debtors; provided, however, that nothing contained in this Section 10.5 shall constitute an acknowledgement by any party of any right or fact with respect to any claims.

ARTICLE XI

RETENTION OF JURISDICTION

Pursuant to Sections 105(c) and 1142 of the Bankruptcy Code and notwithstanding entry of the Confirmation Order and the occurrence of the Effective Date, the Bankruptcy Court will retain exclusive jurisdiction over all matters arising out of, and related to, the Chapter 11 Cases and this Plan to the fullest extent permitted by law, including, among other things, jurisdiction to:

(a) allow, disallow, determine, liquidate, classify, estimate or establish the priority or secured or unsecured status of any Claim or Interest, including the resolution of any request for payment of any Administrative Expense Claim or Priority Tax Claim and the resolution of any objections to the allowance or priority of Claims or Interests;

(b) grant or deny any applications for allowance of compensation or reimbursement of expenses authorized pursuant to the Bankruptcy Code or this Plan for periods ending on or before the Effective Date;

(c) resolve any matters related to the assumption or assumption and assignment of any executory contract or unexpired lease to which any Debtor is a party or with respect to which any Debtor or Reorganized Debtor may be liable and to hear, determine, and, if necessary, liquidate any Claims arising therefrom;

(d) ensure that distributions to Holders of Allowed Claims are accomplished pursuant to the provisions of this Plan;

(e) decide or resolve any motions, adversary proceedings, contested or litigated matters and any other matters and grant or deny any applications involving the Debtors that may be pending on the Effective Date;

(f) enter such orders as may be necessary or appropriate to implement or consummate the provisions of this Plan and all contracts, instruments, releases and other agreements or documents created in connection with this Plan, the Disclosure Statement or the Confirmation Order;

(g) resolve any cases, controversies, suits or disputes that may arise in connection with the consummation, interpretation, or enforcement of this Plan or any contract, instrument, release or other agreement or document that is executed or created pursuant to this Plan, except to the extent expressly provided otherwise in such agreement or document, or any entity's rights arising from or obligations incurred in connection with this Plan or such documents, except to the extent expressly provided otherwise in such agreement or document;

(h) approve any modification of this Plan before or after the Effective Date pursuant to Section 1127 of the Bankruptcy Code or approve any modification of the Disclosure Statement, the Confirmation Order or any contract, instrument, release or other agreement or document created in connection with this Plan, the Disclosure Statement or the Confirmation Order, or remedy any defect or omission or reconcile any inconsistency in any Bankruptcy Court order, this Plan, the Disclosure Statement, the Confirmation Order or any contract, instrument, release or other agreement or document created in connection with this Plan, the

Disclosure Statement or the Confirmation Order, in such manner as may be necessary or appropriate to consummate this Plan;

(i) hear and determine all applications for compensation and reimbursement of expenses of Professionals under this Plan or under Sections 338, 330, 331, 363, and 503(b) of the Bankruptcy Code, which shall be payable by the Debtors only upon allowance thereof pursuant to the order of the Bankruptcy Court;

(j) issue injunctions, enter and implement other orders, or take such other actions as may be necessary or appropriate to restrain interference by any entity with consummation, implementation or enforcement of this Plan or the Confirmation Order;

(k) hear and determine causes of action by or on behalf of the Debtors or the Reorganized Debtors arising prior to the Effective Date;

(l) hear and determine matters concerning state, local and federal taxes in accordance with Sections 346, 505 and 1146 of the Bankruptcy Code;

(m) enter and implement such orders as are necessary or appropriate if the Confirmation Order is for any reason or in any respect modified, stayed, reversed, revoked or vacated, or if distributions pursuant to this Plan are enjoined or stayed;

(n) determine any other matters that may arise in connection with or relate to this Plan, the Disclosure Statement, the Confirmation Order or any contract, instrument, release, or other agreement, or document created in connection with this Plan, the Disclosure Statement or the Confirmation Order;

(o) enforce all orders, judgments, injunctions, releases, exculpations, indemnifications and rulings entered in connection with the Chapter 11 Cases;

(p) hear and determine all matters related to (i) the property of the Estates from and after the Confirmation Date and (ii) the activities of the Reorganized Debtors;

(q) hear and determine disputes with respect to compensation of the Reorganized Debtors' professional advisors;

(r) hear and determine such other matters as may be provided in the Confirmation Order or as may be authorized under the Bankruptcy Code; and

(s) enter an order closing the Chapter 11 Cases.

ARTICLE XII

MISCELLANEOUS PROVISIONS

12.1 Surrender of Instruments. As a condition to participation under this Plan the Holder of a note, debenture or other evidence of indebtedness of the Debtors that desires to receive the property to be distributed on account of a Class 3, 4, 5, 6 or 7 Claim based on such note, debenture or other evidence of indebtedness shall surrender such note, debenture or other evidence of indebtedness to the Debtors, or their designee (unless such Holder's Claim will be Reinstated by this Plan, in which case such surrender shall not be required), and shall execute and deliver such other documents as are necessary to effectuate this Plan; provided, however, that if a claimant is a Holder of a note, debenture or other evidence of indebtedness for which no physical certificate was issued to the Holder but which instead is held in book-entry form pursuant to a global security held by DTC or other securities depositary or custodian thereof, then such Holder shall be deemed to have surrendered such Holder's note, debenture or other evidence of indebtedness upon surrender to Sea Launch of such global security by DTC or such other securities depositary or custodian thereof. Except as otherwise provided in this section, if no surrender of a note, debenture or other evidence of indebtedness occurs and a claimant does not provide an affidavit and indemnification agreement, in form and substance satisfactory to the Debtors, that such note, debenture or other evidence of indebtedness was lost, then no distribution may be made to any claimant whose Claim is based on such note, debenture or other evidence of indebtedness thereof. The Debtors shall make subsequent distributions only to the persons who surrender the securities for exchange (or their assignees) and the record holders of such securities shall be those holders of record as of the Effective Date.

12.2 Post-Confirmation Date Retention of Professionals. Upon the Effective Date, any requirement that professionals employed by the Reorganized Debtors comply with Sections 327 through 331 of the Bankruptcy Code in seeking retention or compensation for services rendered after such date will terminate, and the Reorganized Debtors will be authorized to employ and compensate professionals in the ordinary course of business and without the need for Bankruptcy Court approval.

12.3 Bar Date for Certain Administrative Expense Claims. All applications for final allowance of fees and expenses of professional persons employed pursuant to orders entered by the Bankruptcy Court and on account of services rendered prior to the Effective Date, shall be filed with the Bankruptcy Court and served upon counsel for each of the Reorganized Debtors', the Committee, the New Investor and the Fee Auditor at the addresses set forth in Section 12.12 of this Plan no later than forty-five (45) days after the Effective Date. Any such claim that is not filed within this time period shall be discharged and forever barred. Objections to any application for allowance of Administrative Expense Claims described in this Section 12.3 must be filed within thirty (30) days after the filing thereof, as may be extended by the Bankruptcy Court upon request of the Reorganized Debtors.

12.4 Effectuating Documents and Further Transactions. Each of the Debtors and the Reorganized Debtors is authorized to execute, deliver, file or record the Plan Documents and such other contracts, instruments, releases and other agreements or documents and take such

actions as may be necessary or appropriate to effectuate, implement and further evidence the terms and conditions of this Plan and any notes or securities issued pursuant to this Plan.

12.5 Corporate Action. Prior to, on, or after the Effective Date (as appropriate), all matters expressly provided for under this Plan that would otherwise require approval of the shareholders or directors of one (1) or more of the Debtors or the Reorganized Debtors shall be deemed to have occurred and shall be in effect prior to, on, or after the Effective Date (as appropriate) pursuant to the applicable general corporation law of the states or foreign jurisdictions in which the Debtors or the Reorganized Debtors are incorporated without any requirement of further action by the shareholders or directors of the Debtors or the Reorganized Debtors, including all actions required to be taken by the board of directors of the Debtors or the Reorganized Debtors, as applicable, in Section 5.4(c) and Article VII of this Plan.

12.6 Exemption from Transfer Taxes. Pursuant to Section 1146(a) of the Bankruptcy Code, (a) the issuance, transfer or exchange of notes or equity securities under this Plan; (b) the creation of any mortgage, deed of trust, lien, pledge or other security interest; (c) the making or assignment of any lease or sublease; or (d) the making or delivery of any deed or other instrument of transfer under this Plan, including, without limitation, merger agreements, agreements of consolidation, restructuring, disposition, liquidation or dissolution, deeds, bills of sale, and transfers of tangible property, will not be subject to any stamp tax or other similar tax.

12.7 Payment of Statutory Fees. All fees payable pursuant to Section 1930 of Title 28 of the United States Code, as determined by the Bankruptcy Court at the Confirmation Hearing, shall be paid on the Effective Date.

12.8 Amendment or Modification of this Plan. Subject to Section 1127 of the Bankruptcy Code and, to the extent applicable, Sections 1122, 1123 and 1125 of the Bankruptcy Code, the Debtors may alter, amend or modify this Plan, the Plan Supplement or the Plan Documents at any time prior to or after the Confirmation Date but prior to the substantial consummation of this Plan. A Holder of a Claim that has accepted this Plan shall be deemed to have accepted this Plan, the Plan Supplement, and the Plan Documents, in each case, as altered, amended or modified, if the proposed alteration, amendment or modification does not materially and adversely change the treatment of the Claim of such Holder.

12.9 Severability of Plan Provisions. If, prior to the Confirmation Date, any term or provision of this Plan is determined by the Bankruptcy Court to be invalid, void or unenforceable, the Bankruptcy Court will have the power to alter and interpret such term or provision to make it valid or enforceable to the maximum extent practicable, consistent with the original purpose of the term or provision held to be invalid, void or unenforceable, and such term or provision will then be applicable as altered or interpreted. Notwithstanding any such holding, alteration or interpretation, the remainder of the terms and provisions of this Plan will remain in full force and effect and will in no way be affected, Impaired or invalidated by such holding, alteration, or interpretation. The Confirmation Order will constitute a judicial determination and will provide that each term and provision of this Plan, as it may have been altered or interpreted in accordance with the foregoing, is valid and enforceable pursuant to its terms.

12.10 Successors and Assigns. This Plan shall be binding upon and inure to the benefit of the Debtors, and their respective successors and assigns, including, without limitation, the Reorganized Debtors. The rights, benefits and obligations of any entity named or referred to in this Plan shall be binding on, and shall inure to the benefit of, any heir, executor, administrator, successor or assign of such entity.

12.11 Revocation, Withdrawal or Non-Consummation of the Plan. Except to the extent otherwise provided in the Exit Financing Commitment Letter and the New Investment Agreement, the Debtors reserve the right to revoke or withdraw this Plan as to any or all of the Debtors prior to the Confirmation Date and to file subsequent plans of reorganization. If the Debtors revoke or withdraw this Plan as to any or all of the Debtors or if confirmation or consummation of this Plan as to any or all of the Debtors does not occur, then, with respect to such Debtors, (a) this Plan shall be null and void in all respects, (b) any settlement or compromise embodied in this Plan (including the fixing or limiting to an amount certain any Claim or Class of Claims), assumption or rejection of executory contracts or leases affected by this Plan, and any document or agreement executed pursuant to this Plan shall be deemed null and void and (c) nothing contained in this Plan shall (i) constitute a waiver or release of any Claims by or against, or any Interests in, such Debtors or any other Person, (ii) prejudice in any manner the rights of such Debtors or any other Person or (iii) constitute an admission of any sort by the Debtors or any other Person.

12.12 Notice. All notices, requests and demands to or upon the Debtors or the Reorganized Debtors to be effective shall be in writing and, unless otherwise expressly provided herein, shall be deemed to have been duly given or made when actually delivered or, in the case of notice by facsimile transmission, when received and telephonically confirmed, addressed as follows:

Sea Launch Company, L.L.C.
2700 Nimitz Road
Long Beach, CA 90802
Facsimile: (562) 499-4755
Attn: Brett Carman

with a copy to:

Dennis J. Connolly
Matthew W. Levin
Alston & Bird LLP
1201 West Peachtree Street
Atlanta, GA 30309-3424
Atlanta, Georgia 30309-3424
Facsimile: (404) 881-7777

Counsel to Debtors and Debtors in Possession

and if to the Committee, to:

Tyson M. Lomazow
Milbank, Tweed, Hadley & McCloy LLP
1 Chase Manhattan Plaza
New York, NY 10005-1413
Facsimile: (212) 822-5367
New York, New York 10005-1413

Counsel to the Committee

and if to the New Investor, to:

Claude D. Montgomery
Lee P. Whidden
SALANS LLP
Rockefeller Center
620 Fifth Avenue
New York, New York 10020-2457
Facsimile: (212) 632-5555

Counsel to Energia Overseas

and if to the Fee Auditor, to:

Bobbi Ruhlander
Warren H. Smith & Associates, P.C.
325 N. St. Paul Street, Suite 1250
Dallas, Texas 75201
Facsimile: 214-722-0081

12.13 Governing Law. Except to the extent that the Bankruptcy Code, the Bankruptcy Rules or other federal law is applicable, or to the extent that an exhibit or schedule to this Plan or the Plan Documents provide otherwise, the rights and obligations arising under this Plan shall be governed by, and construed and enforced in accordance with the laws of the State of Delaware, without giving effect to the principles of conflicts of law of such jurisdiction.

12.14 Tax Reporting and Compliance. The Reorganized Debtors are hereby authorized, on behalf of each of the Debtors, to request an expedited determination under Section 505 of the Bankruptcy Code of the tax liability of the Debtors for all taxable periods ending after the Petition Date through, and including, the Effective Date.

12.15 Operating Reports and U.S. Trustee Fees. Post-confirmation, the Reorganized Debtors shall continue to file such operating reports as are required by the Bankruptcy Code and Rules, and shall continue paying such U.S. Trustee fees as are owed, until such time as the Chapter 11 Cases are closed.

12.16 Exhibits. All Exhibits to this Plan and the Plan Documents are hereby incorporated herein and made a part of this Plan as if set forth in full herein.

12.17 Filing of Additional Documents. On or before substantial consummation of this Plan, the Reorganized Debtors and the Debtors shall File such agreements and other documents as may be necessary or appropriate to effectuate and further evidence the terms and conditions of this Plan.

12.18 Reservation of Rights. Except as expressly set forth herein, this Plan shall have no force and effect unless the Bankruptcy Court has entered the Confirmation Order. The filing of this Plan, any statement or provision contained in this Plan, or the taking of any action by the Debtors with respect to this Plan shall not be and shall not be deemed to be an admission or waiver of any rights of the Debtors with respect to the Holders of Claims and Interests.

Dated: Long Beach, California
June 21, 2010

Respectfully submitted,

SEA LAUNCH COMPANY, L.L.C.
SEA LAUNCH LIMITED PARTNERSHIP
(for themselves and on behalf of the Affiliate Debtors, as Debtors and Debtors-in-Possession)

By: 

Kjell Karlsen
President and General Manager

ALSTON & BIRD LLP
Dennis J. Connolly
Matthew W. Levin
1201 West Peachtree Street, N.E.
Atlanta, Georgia 30309-3424
Telephone: (404) 881-7940
Facsimile: (404) 881-7777

- and -

YOUNG CONAWAY STARGATT & TAYLOR, LLP
Joel A. Waite (No. 2925)
Kenneth J. Enos (No. 4544)
The Brandywine Building
1000 West Street, 17th Floor
P.O. Box 391
Wilmington, Delaware 19801-0391
Telephone: (302) 571-6600
Facsimile: (302) 571-1253

Counsel to the Debtors and Debtors in Possession

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PUBLICATIONS

GPS BEHAVING BADLY: DISPUTES INVOLVING CAYMAN EXEMPTED LIMITED PARTNERSHIPS

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Private equity managers domicile their closed-ended funds in the Cayman Islands using the exempted limited partnership structure for two main reasons: tax efficiency and the flexibility to define the rights and obligations of the fund's stakeholders in contract with minimal legislative interference. When it comes time to liquidate or restructure these funds, complications can often arise due to the novel nature of these partnership structures. Recent first instance and appellate decisions in the Cayman Islands have clarified how these partnerships are to be liquidated and restructured. This article summarises those decisions and offers some practical points for how investors can best protect their positions when they invest in these structures.

PRIMARY CONTACT



Lorinda Peasland
Partner: Hong Kong

T +852 2905 5761
E lpeasland@applebyglobal.com



Lorinda Peasland

DISCUSSION POINTS

- Defining characteristics of a Cayman Islands exempted limited partnership
- The Limited Partnership Agreement – key provisions
- What happens upon the expiry of a closed-ended fund's term How does liquidation work
- Dealing with recalcitrant liquidators
- Restructuring of Cayman Islands exempted limited partnerships

REFERENCED IN THIS ARTICLE

- Exempted Limited Partnership Act (2021 Revision)
- In the matter of ECM Straits Fund I, LP (unreported, 20 December 2022).
- In the matter of One Thousand and One Voices Africa Fund I, LP (In Voluntary Liquidation) (unreported, 9 May 2024).
- Kuwait Ports Authority v Port Link GP Ltd FSD 236 of 2020 (unreported, 25 November 2021).
- Kuwait Ports Authority et al v Port Link GP Ltd et al (unreported, CICA (Civil) Appeals Nos. 002 and 003 of 2022, 20 January 2023).
- Kuwait Ports Authority & Ors v Port Link GP Ltd & Ors FSD 236 of 2020 (unreported, 25 May 2023, Parker J).
- Neoma Manager (Mauritius) Limited, in its capacity as the manager of Neoma Private Equity Fund IV LP v Abraaj ABOF IV SPV Limited & Ors (FSD 322 of 2020, FSD 141 of 2021 and FSD 52 of 2022, unreported, 10 March 2023).

INTRODUCTION

The Cayman Islands exempted limited partnership (ELP) is the preferred offshore investment vehicle for closed-ended private equity (PE) funds. Investors choose the Cayman Islands due to its tax neutral status, flexible structuring options and strong common law legal system. With the value of PE deals rebounding in recent months, post-pandemic choppiness has given way to a stronger recovery trendline, and general partners (GPs) of Cayman ELPs have been turning their attention towards opportunities further up the risk curve.

The surge in PE deal volume will incite a collective sigh of relief from M&A lawyers – but what about the funds whose assets have been locked up and their valuations battered by persistently high inflation, supply chain issues and geopolitical tensions over recent years GPs are coming up with creative solutions to unlock liquidity – such as GP-led secondaries and continuation vehicles – but the historical conduct of GPs in their management of PE funds as fiduciaries is coming under increasing scrutiny and resulting in disputes. In this article, we will look at some recent, real-world examples of alleged GP misconduct and offer some practical advice as to how limited partners (LPs) can protect their investments in Cayman ELPs.

ELPS

Although recently described by the Honourable Sir Michael Birt as the 'new kid on the block', [1]ELPs were introduced into Cayman Islands law back in 1991, making the 'new kid' 33 years old! It is likely that the Honourable Justice's remarks were prompted instead by the continuous iteration of the Exempted Limited Partnership Act (ELPA), which has been amended 21 times since its introduction to ensure that it continues to accommodate the business needs of PE funds in evolving market conditions.

An ELP is a partnership that is registered under the ELPA. The principal advantages of a Cayman ELP are the partnership pass-through tax treatment (the Cayman Islands has no corporate, income, capital gains or any other taxes applicable to an ELP conducting offshore business) and the flexibility to define the entire relationship between the parties in a contract typically called a limited partnership agreement (LPA) with minimal statutory constraints. There are almost 40,000 active ELPs registered with the Cayman Islands General Registry,[2]collectively deploying billions of US dollars of investable capital.

Unlike a company, an ELP has no separate legal personality.[3] It cannot sue or be sued. It also cannot own property in its own right; instead, the property of the ELP is held on statutory trust by the GP for the benefit of the LPs, in accordance with the terms of the LPA.[4] Any debt or obligation incurred by the GP in the conduct of the business of the ELP is a debt or obligation of the ELP.[5] The business of the ELP is conducted solely by the GP, which will enter into all contracts, deeds and other legal instruments on behalf of the ELP. LPs are not permitted to play any active role in the business of an ELP.

ELPs are formed by at least one GP entering into a partnership agreement with at least one LP. [6]The GP is typically a Cayman Islands exempted company. In a closed-ended fund structure, the LPs will also typically be Cayman Islands exempted companies, created as special purpose vehicles for the LPs' investment in the ELP.

LPA

The LPA is a contract that outlines the manner in which the ELP will conduct its business, together with the applicable rights and obligations of the GP and the LPs. In the context of a closed-ended PE fund, the essential commercial terms of the LPA are generally as follows.

FUND SIZE, CAPITAL ALLOCATION AND DURATION

The LPA will set out the total amount of capital that the GP can raise from the LPs, together with the respective capital contribution required by each LP and the time in which those capital contributions must be made. The LPA will also define the duration of the fund, make provision for the extension of the duration of the fund by consent and outline how the ELP will be dissolved once the term of the fund comes to an end.

DISTRIBUTIONS

The LPA will specify the order, timing and proportion in which distributions will be made to the LPs and the GP. This will typically be set out in the form of a distribution waterfall, which will prioritise the return of capital to the LPs and then make allowance for a preferred return of the fund's investment profits to the LPs (typically crafted as a hurdle rate setting out a minimum return that the fund must achieve for investors before the GP receives any performance fee). It is also not uncommon to see provisions providing for a GP catch-up, which will allocate distributions to the GP after the hurdle rate has been achieved to incentivise the GP to outperform. Provision will also be made for a management fee to be paid to the GP.

INVESTMENT OBJECTIVE AND RESTRICTIONS

The LPA will define the fund's investment objective and set out investment restrictions, which may be defined by reference to classifications such as asset class, jurisdiction, leverage, liquidity, concentration or perceived risk.

VALUATION

There will often be a mechanism set out in the LPA for the valuation of the assets of the fund and the frequency with which valuations are to be performed. The valuation of the fund's assets may then have a bearing on how and when distributions are made to the LPs.

INVESTMENT COMMITTEE

The LPA may make provision for the appointment of an investment committee or other form of advisory board, to assist the GP in the management of the fund. It is important to note that the participation of any one or more of the LPs on such committee or advisory board is one of a very limited number of safe harbours set out in the ELPA that operate as an exception to the overriding principle that LPs are not permitted to play any active role in the business of an ELP.[7]

DUTIES OF GPS OF CAYMAN ELPS

The duties and liabilities of a GP of a Cayman ELP are defined by

- the ELPA;
- the (non-exempted) limited partnership law of the Cayman Islands, along with broader company and trusts law, some of which applies directly and some of which is helpful by analogy for novel situations that arise in the ELP context;
- the terms of the relevant LPA; and
- the rules of equity and of common law applicable to partnerships insofar as they have not been amended by Cayman statutory provisions.[8]

FIDUCIARY DUTIES OF GPS OF CAYMAN ELPS

GPs of Cayman ELPs have a fiduciary duty to the fund and to the LPs. The primary fiduciary duty is the duty of loyalty and good faith, which requires GPs to act in the best interests of the fund and its LPs,[9]and to avoid any conflict of interest that could compromise the GP's ability to do so.[10]The ELPA does not provide any specific guidelines or guardrails in this respect; rather, the extent of the duty is determined by common law.

Section 19(1) of the ELPA provides that

"A general partner shall act at all times in good faith and, subject to any express provisions of the partnership agreement to the contrary, in the interests of the exempted limited partnership."

Cayman law does not go as far as Delaware law in permitting an LPA to exclude entirely a GP's duties to act in the interests of the ELP. At an absolute minimum, a GP of a Cayman LP must act in good faith for the benefit (although potentially not in the best interests) of the ELP; it must not act fraudulently; it must not act in bad faith or wilfully engage in misconduct; and it must not seize a commercial opportunity of the ELP for its own benefit.

DUTIES OF CARE AND SKILL APPLICABLE TO GPS OF CAYMAN ELPS

GPs of a Cayman ELP owe broadly the same (but not exactly the same) duties of care and skill as would be owed by a director of a Cayman Islands company.[11] Following modern common law authority, this duty comprises both an objective and a subject test for the standard of care and skill that a GP of an ELP would be required to exercise. The applicable test in the company context would be that of

"A reasonable diligent person having both (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as are carried out by that

director in relation to the company, and (b) the general knowledge, skill and experience that that director has.[12]"

GPs of a Cayman ELP are expected to acquire and maintain a sufficient knowledge and understanding of the fund's business to enable them to properly discharge their duties as managers and custodians of the fund's assets.[13]

Unlike ordinary partnerships and in contrast to the position of GPs, LPs of Cayman ELPs owe no fiduciary duties either to the ELP itself or to fellow partners in the ELP.[14]

It is important to note that an ELP is not a company, nor is it a conventional partnership. While the principles that apply in the corporate, trust and partnership contexts are instructive by analogy, when assessing the liability of a GP, the Cayman Court is likely to apply a sui generis test bespoke to the ELP structure.

LIQUIDATION, RESTRUCTURING AND FRAUD – ELP CLAIMS IN THE CAYMAN ISLANDS

Disputes in the context of closed-ended funds tend to have a prolonged gestation period. This is because LPs have minimal involvement in the day-to-day business of a fund and, therefore, tend to rely on material generated by the GP to ascertain the fund's performance. Further, the fixed-term nature of a closed-ended fund permits the GP considerable time to make up for any losses potentially attributable to its (mis)management of the fund's assets. In recent years, we have seen a proliferation of claims and cross-claims across ELP structures, typically arising from the alleged misconduct of the GP or the alleged mismanagement by the GP of the fund's assets. The following are examples from recent years where GPs of Cayman ELP structures (sometimes in their capacity as voluntary liquidator) have been accused of breaching their fiduciary duties or their duties of care and skill and contentious disputes have arisen.

THE CASE OF THE DISAPPEARING GP

The LPA of an ELP will set out the procedure for the liquidation of a fund once its term has come to an end. Conventionally, that will involve the GP placing the fund into a voluntary liquidation process, with the GP to act as the liquidator. The GP will pay the fund's creditors, pay any liquidation expenses it has incurred, make a final distribution of any remaining assets and then make the necessary filings to bring the legal existence of the ELP to an end.

But what happens if, part way through the liquidation process, the GP ceases to perform its duties Even worse, what happens when the GP is struck off the register of companies, effectively abandoning the partnership and leaving the LPs with no clear ability to conclude the fund's

liquidation. This was the unfortunate position that the sole LP of ECM Straits Fund I, LP found itself in, where following a breakdown in the relationship between the GP's executive board the GP ceased to perform its role as GP and voluntary liquidator of the fund.

The provisions of the LPA and the ELPA, read together, were such that it was not possible for the LP to effect the appointment of an alternative voluntary liquidator to the fund itself, because such appointment would require the affirmative vote of the GP. This was problematic, because it left the LP in the unenviable position of not being able to receive its final distribution. The LP was left out of pocket, with no apparent recourse available either through statute or by reliance on the contractual terms set out in the LPA.

As is often the case, equity stepped in to save the day. In the same way that a company can be wound up when a court considers it is 'just and equitable' to do so, an ELP can be wound up on the application by a partner, creditor or liquidator and directions made as to the conduct of the liquidation as the court considers to be just and equitable in the circumstances.[15] In the case of ECM Straits Fund, the court had little difficulty in agreeing with the LP that there was a clear need to bring the liquidation of the fund under the supervision of the court in circumstances where the GP was either unable or unwilling to perform its duties as voluntary liquidator. Further, the court agreed that it had jurisdiction to grant the replacement liquidators the powers necessary to conduct the liquidation, which in this case meant the power to deal with the fund's assets in accordance with the terms of the LPA, and ultimately for the benefit of the LP.

THE GP THAT HOLDS THE LPS HOSTAGE

In the recent case In the matter of One Thousand and One Voices Africa Fund I, LP (In Voluntary Liquidation),[16] the GP of a Cayman ELP had been appointed as voluntary liquidator of the fund by resolution of the fund's LPs. There followed a serious breakdown in the relationship between the GP and the LPs, which culminated in the presentation of a petition by one of the LPs for the appointment of independent voluntary liquidators to the fund.

Strikingly for a matter that had progressed all the way to a contested court hearing, a full 97 per cent of the fund's stakeholders were in favour of the appointment of independent voluntary liquidators. In an ordinary commercial context, the wishes of the financial stakeholders reign supreme, and certainly in the case of a private company, the shareholders' choice of voluntary liquidator is respected

"[W]hen the fund is contemplating the cessation of business and a voluntary winding-up…the starting assumption should be that where the majority of the participating shareholders nominates a suitable voluntary liquidator, their wishes should be acceded to…[17]"

But in this case, and notwithstanding the overwhelming opposition, the GP did not wish to be replaced as voluntary liquidator. The reasons for the GP's recalcitrance were never fully ventilated

in open court. It may have been motivated by fees, professional pride or a desire to avoid scrutiny of its conduct of the GP role in the preceding years. No findings of fact were made in the judgment, although reference was made to allegations that the GP had apparently rotated through five separate auditors in as many years, and that the GP may have been subject to an ongoing US Securities and Exchange Commission investigation into allegedly fraudulent conduct.

So intent was the GP on remaining the fund's liquidator that upon becoming aware of the petition seeking its replacement, it then took steps to remove the petitioner as LP of the fund before opening up a new litigation front, filing proceedings in New York seeking to enjoin the petitioner from proceeding in the Cayman Islands on the basis that the LP was seeking to 'surreptitiously circumvent the clear venue provision' in the LPA in favour of the courts of the state of New York. [18]

In any event, the court was deeply unimpressed by the GP's conduct and, in what can fairly be described as a scathing judgment, granted the LP the relief it sought by appointing independent voluntary liquidators to the fund.

The message here is clear while LPs have no entitlement to participate in the management of a fund structured as an ELP during its term, in the event that the GP assumes the role of liquidator, they have the right to demand that an alternative voluntary liquidator be appointed in the GP's place if they are unsatisfied with the GP's conduct of the liquidation. This is a point that GPs must take note of. In the past year, we have become aware of a number of situations where GPs have outright refused to commence the process of liquidation of a fund once its term has expired, in circumstances where the fund has underperformed and the LPs will not receive a return of their capital contribution in full, meaning the hurdle rate will not be achieved and there will be no 'cut' for the GP. Instead, the GP effectively holds the LPs hostage, refusing to make any distributions or otherwise proceed with the liquidation unless the LPs agree to revise the commercial terms of the LPA. Although we are not aware of any of those matters going to court (yet), it is tolerably clear that the Cayman courts would take an extremely dim view of such a GP's conduct, and would have little hesitation in making an order for the appointment of an alternative liquidator, using the just and equitable gateway in section 36(3)(g) of the ELPA, and also making a costs order in favour of the applicant LP, potentially on the indemnity basis. We expect to see more challenges in this space and potentially other service providers or funders coming in to balance the inequality and provide the LPs with a much-needed solution in this sphere, or at least a better seat at the table.

LPs contemplating the winding-up of an ELP in such circumstances should take care to carefully review the LPA to determine whether there is a non-petition clause that could effectively debar the presentation of a petition (and, equally, GPs should consider at the drafting stage whether it would be in the best interests of the fund for such a provision to be incorporated). Modern authority in the Cayman Islands has confirmed that a non-petition clause is effective in the context of an ELP,[19] but only if it drafted with exacting precision.[20]

THE GP THAT WITHHOLDS TRUE AND FULL INFORMATION ABOUT THE FUND FROM THE LPS

LPs of an ELP are not entitled to participate in the day-to-day operations and business of an ELP. In practice this means they would only be privy to information about such operations if provided by the GP voluntarily.

Section 22 of the ELPA seeks to address that information imbalance, and provides that

"Subject to any express of implied term of the partnership agreement, each limited partner may demand and shall receive from a general partner true and full information regarding the state of the business and financial condition of the exempted limited partnership."

The scope of an LPs' entitlement to true and full information was tested in a recent case for summary judgment as part of broader litigation involving the collapse of the Abraaj group, a PE syndicate in the Middle East that at its height had approximately US$13 billion of reported assets under management.[21]Appleby acts for the fourth to sixth defendants in these significant and multifaceted proceedings.

In these proceedings, the defendant LPs succeeded in their argument that an LP's entitlement to documents under section 22 of the ELPA is a broad one. The court found that

- what is required to fulfil the obligation to provide 'true and full information' will vary from case to case depending on the circumstances, meaning the test is essentially a functional one;[22]
- all materials and advice provided to the ELP from, for example, its managers or advisers, should, in principle, also be available to the LPs so far as they relate to the business of the partnership;[23]
- the LPs' entitlement to documents pursuant to section 22 of the ELPA is broader than that afforded through the usual discovery process, because section 22 requires production of 'true and full' information, not just 'documents',[24] and discovery is restricted to matters in issue in a specific litigated action, whereas section 22 disclosure extends to any matters regarding the state of the business and financial condition of the ELP;[25]and
- it is no defence to a request for section 22 disclosure for the GP to argue that it would be required to expend significant time and resources in responding to the request.[26]

The decision[27] serves as a timely reminder of the breadth of the information disclosure obligations of a GP to LPs and sets out a range of helpful clarifications as to the lengths to which GPs must go to comply with requests made pursuant to section 22 of the ELPA.

THE GP ACCUSED OF DEFRAUDING ITS LPS

The Port Fund LP is the subject of ongoing litigation in the Cayman Islands (in which Appleby is involved), in which two Kuwaiti state entities, in their capacity as LPs of the fund, have brought proceedings focusing on the alleged misfeasance, fraud and breach of duty of (among other parties) the GP of the fund. As part of that litigation, the LP plaintiffs have pleaded, among others

- individual direct claims against the GP; and
- derivative claims against the GP and other defendants on behalf of the ELP.

One of the primary allegations at issue in the proceedings is that the GP had made payments to third-party service providers as part of a fraudulent scheme to expropriate money from the fund. Total losses are said to exceed US$100 million.

A decision on the GP's culpability for the fraud itself is still some years away. However, the interlocutory litigation in the meantime has led to the delivery of rulings on novel points of law that are very relevant to stakeholders in Cayman ELPs.

LPs may, in limited circumstances, bring derivative claims for and on behalf of an ELP

Section 33 of the ELPA provides that

"Subject to subsection 33(3), legal proceedings by or against an exempted limited partnership may be instituted by or against any one or more of the general partners only, and a limited partner shall not be a party to or named in the proceedings.

...

"A limited partner may bring an action on behalf of an exempted limited partnership if any one or more of the general partners with authority to do so have, without cause, failed or refused to institute proceedings."

As part of the broader dispute, the GP (which at the time was under the control of independent directors with no connection to the alleged fraud) had determined, upon advice, that the claims identified by the LPs lacked merit and that to pursue those claims would not be in the best interests of the fund. The LPs responded by bringing an application to bring the claims derivatively in the name of the ELP. The defendants, in turn, applied to strike out the derivative claims on the basis that they were not permitted under the ELPA. At first instance,[28] the Grand Court dismissed the defendants' strike-out applications, permitting the LPs to proceed with their derivative action. The effect of the first instance ruling was to set a relatively low bar for LPs seeking to bring claims on behalf of a fund.

The judgment was appealed, and in a 2023 ruling as part of the broader litigation, the Court of Appeal of the Cayman Islands struck out the derivative claims against the GP, including on the basis that the LPs already had an alternative remedy available to them in the form of their direct claims, and that the fund itself had suffered no loss separate and distinct to the loss suffered by the LPs directly. A revised test for derivative actions in the context of ELPs has emerged in the process, with the Court of Appeal confirming that LPs have, in very exceptional circumstances similar to those that would apply to derivative claims brought by shareholders on behalf of companies in the corporate context, the right to bring claims for and on behalf of an ELP.[29] The judgment (which itself is now under appeal to the Judicial Committee of the Privy Council, with final judgment yet to be delivered) makes a number of important findings that are relevant to PE investors in ELP structures in the Cayman Islands[30]

- a plaintiff seeking to proceed derivatively in the name of an ELP does not have to first seek the leave of the court, as is the case with shareholder derivative actions in the company context;[31]
- the question of a plaintiff's entitlement to proceed derivatively must be addressed at an early stage, either by way of a strike-out application or alternatively by asking the court to determine the matter as a preliminary issue;
- on a strike-out application in the ELP context, the defendant does not bear the onus of satisfying the strike-out threshold; rather

"The court must decide, on the basis of the material before it, whether the likelihood of the general partner having failed or refused to institute proceedings without cause is sufficient to lead the court to conclude that a derivative action should be permitted in the interests of justice. In reaching this evaluative conclusion, the Court will no doubt have regard, inter alia, to the strength of the evidence that the general partner has failed or refuse to institute proceedings without cause, the strength of the underlying claim which is sought to be brought and the likelihood and nature of any injustice if the derivative claim is not permitted;[32]"

and

- the court retains an overriding discretion to decline to permit a derivative claim brought by LPs in the name of an ELP to continue, even if the requirements of the section 33(3) gateway in the ELPA have been met.

RECEIVERS CAN BE APPOINTED TO AN ELP

One of the many complexities that arose in the broader case was that due to a lack of funding, the directors and other office-holders of the GP had resigned, leaving the GP incapable of acting despite its involvement (as both claimant and defendant) in the proceedings. To remedy this governance void, the plaintiffs filed an application seeking the appointment of receivers and

managers over the assets of the GP, to manage the litigation on its behalf in accordance with the LPs' instructions, with funding to be provided by the LPs.

The application was novel. Receivers had never been appointed to a Cayman ELP. The jurisdictional basis of the application required the court to be persuaded (which it was, without any real difficulty) that it had the same power for the appointment of equitable receivers as vested in the English High Court pursuant to section 37(1) of the Senior Courts Act 1981.[33] The application was also strongly opposed by the defendants, who argued that the true motivation of the plaintiffs was to hijack the GP's conduct of the litigation, and that the court should instead grant the alternative, and more conventional, remedy of appointing an independent, special purpose liquidator to the GP to ensure it was properly able to defend itself in the proceedings.

Ultimately, the court granted the plaintiffs' application.[34] The court was satisfied that it was just and convenient to approving receivers

"for the purpose of ensuring that there is a professional, independent, and impartial office holder in place who will regularly report to the Court and … ensure the interests of the General Partner in the litigation are monitored, protected and advanced appropriately."

While acknowledging the defendants' concerns that the plaintiffs had ulterior motives in seeking to install receivers, the court determined that the appointment of receivers would ensure that 'the General Partner's interests will be advanced on an objective, reasonable, and independent basis free from the improper influence by any of the protagonists in the litigation'.[35]

The court determined that the alternative approach, being the appointment of liquidators, was not appropriate as it would sound the 'death knell' to the GP[36] and that as a remedy of last resort, it was not 'appropriate, necessary or desirable' at the time that the judgment was handed down.[37] In a later twist of events, after the hearing of the application but before the judgment was handed down, the Second Defendant placed the GP in a voluntary liquidation process in his capacity as the GP's ultimate beneficial owner, leading to the rather strange situation where both receivers and liquidators have been appointed to the GP. Given the entrenched position of the litigants, it seems likely that we will see further interlocutory manoeuvres before a final ruling is handed down on the substantive question of the alleged fraud of the GP.

RESTRUCTURING OF CAYMAN ELPS

Although this article has focused largely on the conduct of GPs in the context of the liquidation of Cayman ELPs, in the restructuring context it is important to note that the Cayman Islands' relatively new restructuring officer regime[38] applies not only to companies but also to ELPs. This means that GPs of ELPs can seek the appointment of restructuring officers who can thereafter

seek the sanctioning of a compromise or arrangement between the partnership and its LPs or its creditors.

PRACTICAL POINTERS FOR LPS OF CAYMAN ELPS

Most closed-ended PE funds structured as Cayman ELPs successfully achieve their investment objective and are duly liquidated at the end of the term by their GPs. The cases discussed in this article are exceptions to the norm. Disagreements and disputes between the LPs of a fund and its GP are not uncommon though, and it is important that LPs are aware of their right and powers, particularly in the liquidation context. To that end, we offer the following practical pointers in parting

- Information is power. If a dispute arises with the GP, consider forcing the disclosure of documents (pursuant to the information disclosure provisions of the LPA or section 22 of the ELPA, or both) as an initial pre-litigation step. Many GPs would rather make a concession to the LPs than risk any wrongdoing being publicly exposed.
- The contract is key. The flexibility afforded by the ELP structure, where the parties' rights and obligations are prescribed almost exclusively in the LPA, is often cited as one of the greatest advantages of a Cayman ELP but it can also create issues where gaps or ambiguous provisions leave the partners unsure as to their respective positions. Draft with precision. Provisions in relation to liquidation, distribution and clawback are critical. Also important are provisions dealing with the removal/replacement of the GP should there be a breakdown in the relationship between the various partners.
- How and where will the partners resolve any dispute Consider the use of tiered dispute clauses, requiring the sparring partners to attempt to conciliate their differences before they are entitled to file proceedings. Also be mindful of how any dispute resolution clause mandating arbitration might interact with the entitlement of an LP to petition in the Cayman Islands for the winding-up of the ELP on the just and equitable basis. Check for non-petition causes in the LPA.
- Do not delay. A closed-ended fund will typically include mandatory/affirmative language in the LPA to the effect that the GP shall be appointed as liquidator and shall liquidate the fund upon the expiry of the term. If the GP delays or prevaricates in the liquidation of the fund, LPs should write to the GP in short order, drawing the GP's attention to its duties and to the consequences of inaction.

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[1] In the matter of Aquapoint LP v Xiaohu Fan CICA (Civil) Appeal No. 14 of 2022 (4 October 2023) at [77].

[2] Partnership Statistics – Cayman Islands General Registry (https://www.eregistry.ky/partnerships-registerpartnerships-statistics).

[3] This is one of many important differences between Cayman ELPs and Delaware ELPs (DELPs) that many readers will be familiar with. DELPs have their own distinct legal personality, pursuant to section 17-201(b) of the Delaware Revised Uniform Limited Partnership Act.

[4] Section 14(1) of the ELPA.

[5] Sections 4(2) and 20 of the ELPA.

[6] Section 4(2) of the ELPA.

[7] Section 20(2) of the ELPA.

[8] This includes rulings on equity and common law from the courts of England & Wales and other common law jurisdictions, which will be persuasive, although not binding, on determinations made by the Cayman Islands Courts. The Judicial Committee of the Privy Council, sitting in London, is the highest court of appeal of the Cayman Islands.

[9] Section 4(3) of the ELPA. Subject to any express provision in the LPA to the contrary. The LPA may demand a higher standard of care, but it may not dilute the obligation of the GP to act in good faith.

[10] Kuwait Ports Authority v Port Link GP Ltd FSD 236 of 2020 (RPJ) (unreported, 25 November 2021).

[11] It would not, however, be correct to say that the duties are identical. It is best to treat director duties as a helpful analogy, rather than a binding precedent in the ELP context.

[12] Re D'Jan of London Limited [1994] 1 BCLC 561.

[13] Re Barings PLC, Secretary of State for Trade and Industry v Baker (No 5) [1999] BCLC 433, 439 and applied in the Cayman Islands in Weavering Macro Fixed Income Fund Limited (in liquidation) v Stefan Peterson and Hans Ekstrom [2011] 2 CILR 203.

[14] Section 19(2) of the ELPA.

[15] Section 36(3)(g) of the ELPA. Previously considered by the Court in In Re Xio Diamond Ltd (unreported, FSD 256 of 2019, 30 April 2020), in which the Court held that the provision was

analogous to section 129 of the Cayman Islands Companies Act, but that section 129 did not apply to the winding-up of ELPs pursuant to section 36.

[16] (Unreported, 9 May 2024).

[17] Re Asia Private Credit Fund [2020] (I) CILR 134 at [99] per Field JA.

[18] At [46] of the judgment.

[19] Re Rhone Holdings, LP (Appeal No. 21 of 2015, Cause No. FSD 119 of 2015).

[20] In the matter of KES Power Limited (Cause No. 192 of 2023 (NSJ), 31 May 2024).

[21] Neoma Manager (Mauritius) Limited, in its capacity as the manager of Neoma Private Equity Fund IV LP v Abraaj ABOF IV SPV Limited & Ors (FSD 322 of 2020, FSD 141 of 2021 and FSD 52 of 2022, unreported 10 March 2023). See also Dorsey Ventures Limited v XIO GP Limited (FSD 38 of 2018, unreported 22 October 2018) and In the matter of Gulf Investment Corporation v The Port Fund LP [2020] (2) CILR Note 6.

[22] At [75](c) of the judgment.

[23] At [62](v) of the judgment.

[24] At [34] of the judgment.

[25] At [41] of the judgment.

[26] At [75](j) of the judgment.

[27] Which is subject to an ongoing appeal as of the time of writing.

[28] Kuwait Ports Authority & Another v Port Link GP Ltd. & Ors (FSD 236 of 2020, unreported, 25 November 2021, Parker J).

[29] Section 33(3) of the ELPA.

[30] Kuwait Ports Authority et al -v- Port Link GP Ltd et al, Unreported, CICA (Civil) Appeals Nos. 003 and 003 of 2022, 20 January 2023.

[31] Per O. 15, r.12A of the Grand Court Rules.

[32] At [118].

[33] Pursuant to section 11 of the Grand Court Act (2015 Revision), albeit this was not entirely without precedent, with the same point having been considered previously in Y v R (Mangatal J, 9 January 2018).

[34] Kuwait Ports Authority & Ors v Port Link GP Ltd. & Ors FSD 236 of 2020 (unreported, 25 May 2023, Parker J).

[35] At [111] of the judgment.

[36] At [126] of the judgment.

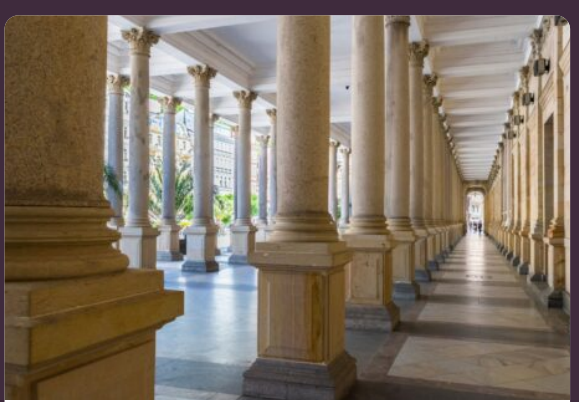
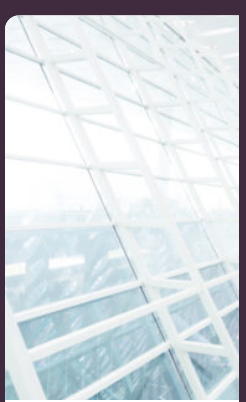
[37] At [128] of the judgment.

[38] Set out in Part V of the Companies Act.

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ITEM NO. 185

JA-71

Schemes of Arrangement in the Cayman Islands.

When a company faces serious financial pressure, timing and structure are everything. Whether you're dealing with creditor demands, managing distressed investment vehicles, or seeking to avoid formal liquidation, a scheme of arrangement under the Cayman Islands Companies Act can offer a flexible, court-approved solution.

At KSG Attorneys, we advise companies, creditors, general partners, and insolvency practitioners on the full range of restructuring options available under Cayman law. A scheme of arrangement allows a company to compromise or restructure its liabilities with creditors or shareholders, with the approval of the court and affected stakeholders. Often used to avoid liquidation or facilitate group reorganisations, schemes are now more accessible than ever, including for exempted limited partnerships under the new restructuring officer regime.

With schemes now used more frequently, and with greater emphasis on international recognition, the Cayman Islands has become a leading forum for sophisticated restructuring strategies.

Whether you are considering a standalone scheme or a coordinated international process, our team has the technical insight and litigation strength to guide you through every stage.

Contact our restructuring lawyers today to explore whether a scheme of arrangement is the right tool for your situation.

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strength to guide you through every stage.

Contact our restructuring lawyers today to explore whether a scheme of arrangement is the right tool for your situation.

Why Choose KSG Attorneys?

When a company is facing financial pressure, selecting the right legal advisors can be the difference between a successful restructure and an uncontrolled collapse. At KSG Attorneys, we are known for delivering effective, commercially focused legal advice on restructuring matters in the Cayman Islands.

Our team has extensive experience advising companies, creditors, general partners, and insolvency professionals on all aspects of schemes of arrangement. We represent clients across a range of industries, including investment funds, financial institutions, and multinational corporate groups. Whether acting for a company seeking to avoid liquidation, a creditor evaluating a proposed compromise, or a professional appointed to supervise the process, we provide the legal insight and strategic direction required to achieve workable outcomes.

We understand how to structure proposals that meet Cayman legal requirements while anticipating recognition and enforcement challenges abroad. Our approach is collaborative, rigorous and always aligned with our client's objectives.

At KSG, we combine deep legal knowledge with practical, results-driven advice. We understand the stakes, and we work quickly and precisely to protect your position and deliver a path forward.

GET IN TOUCH

What is a Scheme of Arrangement?

A scheme of arrangement is a court-supervised restructuring mechanism under section 86 of the Cayman Islands Companies Act (As Revised). It allows a company to enter into a binding compromise or arrangement with its creditors or shareholders, or specific classes of them, with the approval of the court and a statutory majority of stakeholders.

Schemes are best known as a tool for financial restructuring, but they are highly adaptable and are frequently used for broader corporate purposes. They can be deployed to:

- **Restructure or reschedule debt**, reducing financial pressure on the company
- **Reorganise group structures**, including intra-group arrangements
- **Implement mergers or take-private transactions**, with court approval providing certainty
- **Formalise pre-pack arrangements**, where stakeholders have already agreed terms

Unlike formal insolvency proceedings, a scheme of arrangement leaves the directors in control of the company throughout the process. If additional protection is required, the scheme may be paired with provisional liquidation or the appointment of a restructuring officer, which introduces a moratorium on creditor actions.

Once approved by the Cayman court and by the required majority of creditors or members, a scheme becomes binding on all affected parties, including those who oppose it or do not vote. This certainty and enforceability are what make schemes such a powerful alternative to informal restructurings.

The Schemes of Arrangement Process

The Cayman Islands scheme of arrangement process is supervised by the Grand Court. It follows a series of structured steps, each designed to ensure fairness, transparency, and legal certainty.

1. Preparing the Proposal

The process begins with the company, or in the case of an exempted limited partnership, its general partner, preparing a detailed proposal that sets out the terms of the compromise or arrangement. At this stage, advisors play an essential role in identifying the correct classes of creditors or members. Each class must have sufficiently similar legal and economic interests, as improper classification can prevent the court from approving the scheme.

2. Convening Hearings and Stakeholder Meetings

Once classes are determined, the company applies to the Grand Court for permission to convene meetings of the affected stakeholders. At these meetings, creditors or members vote on the proposal. Approval requires:

- For **creditor schemes**: a majority in number representing at least 75% in value of those present and voting (the “headcount test”).
- For **member schemes**: only a 75% approval in value is required, as the headcount test has been abolished.

3. Court Sanction

If the required thresholds are met, the proposal returns to the court for a sanction hearing. The court considers whether the process

has been properly conducted, whether the classification of creditors and members was appropriate, and whether stakeholders were given a genuine opportunity to consider the proposal. The court does not interfere with the commercial merits unless there is evidence of unfairness.

4. Binding Effect

Once sanctioned, the scheme becomes binding on all stakeholders within the approving classes, including those who opposed it or did not vote. The company is then free to implement the terms of the arrangement, with the assurance that the scheme is enforceable.

Although more streamlined than formal insolvency proceedings, a scheme of arrangement requires careful preparation and expert legal oversight to succeed at every stage.

The Restructuring Officer Regime

The restructuring officer regime is a recent addition to the Cayman Islands Companies Act (As Revised), designed to give companies in financial difficulty a formal pathway to protection while they pursue a scheme of arrangement or other restructuring.

Under this regime, a company can petition the Grand Court for the appointment of one or more restructuring officers. This can be done by the directors alone, without the need for:

- A winding up petition;
- Shareholder approval; or
- Express authority in the company's articles of association.

From the moment the petition is filed, the company benefits from an automatic moratorium on unsecured creditor claims. This breathing space allows management and advisors to focus on the restructuring, free from the threat of disruptive legal action.

The scope of the restructuring officer's powers is determined by the court's appointment order, making the role highly flexible. Depending on the case, the officer may take on an advisory role, oversee negotiations, or exercise more direct control. Importantly, secured creditors generally remain entitled to enforce their security unless specifically restricted by the court.

This regime significantly enhances the usefulness of schemes of arrangement in the Cayman Islands. By combining the flexibility of a scheme with the protection of a moratorium, it provides companies with a powerful tool to preserve value, address creditor concerns, and implement restructuring proposals without resorting to liquidation.

At KSG Attorneys, we guide companies and stakeholders through every stage of the restructuring officer process, ensuring that applications, appointments, and subsequent court procedures are handled with precision and efficiency.

Schemes for Exempted Limited Partnerships

A major recent development in Cayman Islands restructuring law is the extension of schemes of arrangement to exempted limited partnerships (ELPs). Historically, only companies could propose a scheme. Now, under the restructuring officer regime, general partners of ELPs can also seek court approval for a compromise or arrangement with creditors or limited partners.

This change is particularly significant because ELPs are the most common vehicle for investment funds and private equity structures in the Cayman Islands. With access to schemes, general partners can now restructure or protect fund structures through a court-supervised process, without entering liquidation.

The process for ELPs mirrors that for companies: the general partner applies to appoint restructuring officers, which:

- Triggers an automatic moratorium on unsecured creditor claims;
- Provides time and stability to promote a restructuring plan; and
- Creates a pathway for court-sanctioned compromises with creditors or limited partners.

Once approved by the relevant classes of stakeholders and sanctioned by the court, the scheme becomes binding on all parties, including dissenting limited partners or creditors.

Although still a relatively new option, schemes for ELPs are expected to become increasingly common in fund restructurings, distressed exits, and investor disputes. At KSG Attorneys, we are well-positioned to advise general partners, limited partners, and fund administrators on how to use this tool effectively and in compliance with Cayman law.

Cross-Border Restructuring and Recognition

Schemes of arrangement in the Cayman Islands are frequently used in cross-border restructurings, particularly where a company has creditors or assets in multiple jurisdictions. The Cayman framework provides a court-supervised process that delivers certainty and can be recognised internationally, making it a practical choice for corporate groups and investment structures.

To support a restructuring, companies often seek the appointment of provisional liquidators or restructuring officers. This step provides immediate protection from unsecured creditor claims in the Cayman Islands and creates the breathing space required to promote a scheme. Where appropriate, a foreign-qualified professional may also be appointed alongside Cayman officers to ensure smooth coordination with courts and advisors overseas.

Cayman schemes are increasingly recognised in major financial centres and have a track record of being upheld by foreign courts. Their adaptability and cost-effectiveness have made them a popular alternative to more expensive and time-consuming restructuring

regimes abroad. They are particularly effective for groups with offshore structures, diverse creditor bases, and multi-layered financing arrangements.

At KSG Attorneys, we have significant experience guiding clients through schemes that require cross-border recognition. We work seamlessly with international counsel, insolvency practitioners and stakeholders to ensure that schemes promoted in the Cayman Islands are capable of being enforced abroad, protecting value and delivering commercially sound outcomes.

Advising Creditors, Companies and Stakeholders

At KSG Attorneys, we advise a wide spectrum of clients involved in schemes of arrangement, each with their own priorities and challenges. Our role is to provide clarity, safeguard legal rights, and ensure the process delivers workable outcomes for all parties.

We regularly act for:

- **Companies and general partners** seeking to implement a scheme. We provide end-to-end support, from assessing viability and advising on class composition, to preparing documentation and representing clients in court. Our focus is on structuring proposals that minimise dissent, meet statutory thresholds, and withstand the scrutiny of the Cayman court.
- **Creditors** evaluating a proposed scheme. We analyse how the arrangement affects creditor rights, recovery prospects, and voting entitlements. Where necessary, we represent creditors during negotiations, scheme meetings, and sanction hearings to ensure their position is properly considered.
- **Insolvency professionals and restructuring officers** responsible for overseeing implementation. We guide practitioners through Cayman

law and court procedure, assist with drafting scheme documents, and provide support in managing disputes or compliance matters.

Across all stakeholder groups, our objective is the same: to protect our clients' legal position, reduce unnecessary risk, and achieve effective, enforceable results.

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From Our Clients



"Excellent service. Prompt response and excellent communication. I would recommend to absolutely use this firm!"

KSG Client
Grand Cayman

Contact Our Schemes of Arrangement Lawyers Today

If you are considering a scheme of arrangement or need guidance on any restructuring matter under Cayman Islands law, our team at KSG Attorneys is here to help. As a leading Cayman Islands law firm, we provide comprehensive legal support to companies, creditors, general partners and insolvency professionals facing financial challenges, offering clarity and confidence in situations where the stakes are high.

Our Insolvency & Restructuring Lawyers combine technical expertise with commercial awareness, ensuring that every scheme is carefully structured, compliant with Cayman law, and capable of achieving practical results. Whether your priority is to protect a business from liquidation, secure creditor recoveries, or manage the intricacies of fund or partnership structures, we deliver advice that is both strategic and solutions-focused.

We work closely with clients at every stage of the process, from assessing viability through to court sanction and implementation. With a proven track record in restructurings, we are trusted by local and international stakeholders alike to provide steady guidance and strong advocacy when it matters most.

To learn more about how we can assist with a scheme of arrangement, contact KSG Attorneys today. Our dedicated restructuring lawyers are ready to listen, advise, and deliver the outcome you need with precision.

Key Contacts



James Kennedy

Managing Partner

jameskennedy@ksglaw.ky



Kai McGriele

Partner

kaimcmriele@ksglaw.ky

FAQs

What happens if a class of creditors rejects the scheme?

A Cayman scheme requires approval by each affected class. If any class does not achieve the required statutory majority, being a majority in number representing 75% in value of those voting, the scheme cannot proceed. Early class analysis and through preparation are essential to avoid this outcome.

Can a scheme of arrangement be used without going into liquidation?

How does the restructuring officer regime improve the scheme process?

Can secured creditors be bound by a scheme?

Are Cayman schemes recognised internationally?

How long does a scheme of arrangement take in the Cayman Islands?

Who can propose a scheme of arrangement?

What types of corporate situations benefit most from a scheme?

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Contact us today and let us know how we can help you with your business and financial matters. Our experts are ready to assist you.

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4th Floor, One Capital Place
136 Shedden Road, George Town
PO Box 2255
Grand Cayman KY1-1107
Cayman Islands

345-949-0003

admin@ksglaw.ky

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ITEM NO. 186

JA-72

MAPLES GROUP

UPDATE

Good News for Debtors Seeking Access to the Cayman Islands Restructuring Regime

The Cayman Islands Government has confirmed that the long awaited reforms to Cayman Islands restructuring laws will now come into effect on 31 August.

Debtors seeking to restructure their debt in the Cayman Islands, with the protection of a stay on unsecured creditor action, will be able to do so without needing to file a winding up petition. While the Cayman Islands has always been receptive to international restructurings, the prior position was that, debtors seeking the protection of a restructuring stay in the Cayman Islands had to file a winding up petition and seek the appointment of provisional liquidators. Although the current regime has been effective in practice, filing a winding up petition in order to restructure is counterintuitive and unpalatable for some debtors.

The new regime, provides for a new stand-alone global restructuring stay on unsecured creditor action, outside the winding up procedure. The debtor will apply to the Cayman Islands court (the "Court") for the appointment of restructuring officers who, while the company's management will ordinarily be left in control of the company, will help facilitate a restructuring. A global stay will arise immediately upon filing the application, similar to a Chapter 11 or administration stay, and the restructuring takes place within the breathing space created by the stay. How the restructuring is implemented is flexible and could involve a consensual deal with creditors, a Cayman Islands scheme of arrangement or a restructuring proceeding in another jurisdiction (for example, Chapter 11 in the United States or an English or Hong Kong scheme of arrangement).

These new proceedings, while retaining all that is positive with the prior law, significantly enhance the Cayman Islands restructuring regime by:

- Removing the need to file a winding up petition in order to obtain a stay on creditor action.
- Providing for the stay (although not the appointment of restructuring officers) to arise automatically on filing the Court papers without the need for any Court hearing (in the prior law the moratorium only kicked in on the appointment of the provisional liquidators).
- Providing that, as a matter of Cayman Islands law, the stay will have extraterritorial effect.
- Including provisions which provide the potential for Cayman Islands schemes of arrangement to compromise debt governed by English law (an important consideration in light of challenges arising from Brexit) thereby broadening the circumstances in which Cayman Islands restructuring proceedings may provide the best fit.

The restructuring moratorium does not change important creditor protections under Cayman Islands law. There remains no stay in any Cayman Islands insolvency or restructuring proceeding on the enforcement of security by

secured creditors. Further, specific legislative provisions have been included to ensure that the Cayman Islands remains a preeminent jurisdiction for bankruptcy remote finance vehicles.

Restructuring Moratorium – FAQs

What is the restructuring moratorium?

The restructuring moratorium is a stand-alone regime where a company (including, in certain circumstances, a foreign company) can apply to the Court for the appointment of restructuring officers. On the filing of the application, the company obtains a moratorium (stay) on legal proceedings being continued or commenced by unsecured creditors against the company. This results in breathing space for a company that is in financial distress to pursue a restructuring. The restructuring moratorium is also available to exempted limited partnerships ("ELPs") and limited liability companies ("LLCs").

The restructuring moratorium can be used in support of a scheme of arrangement, a formal foreign restructuring proceeding (such as Chapter 11) or to explore a consensual deal with creditors. The moratorium has been crafted with flexibility in mind; flexibility to meet the needs of the stakeholders and the circumstances of the company in question.

The Court will decide whether or not to appoint restructuring officers. Creditors and, in certain circumstances, shareholders have the ability to be heard on, among other things, as to whether or not restructuring officers should be appointed. If the Court decides to appoint restructuring officers, the moratorium will continue.

The application should be heard within 21 days of being filed, but if the company needs the assistance of restructuring officers urgently, an interim appointment is possible pending the hearing of the application.

In what circumstance is it expected that the restructuring moratorium will be used most frequently?

We expect the moratorium to be used most frequently in restructuring the debt of a Cayman Islands incorporated holding or finance company. This should particularly be the case where the governing law of the debt is New York, but the moratorium may be relevant where the debt is governed by other laws (for example, English law). See the section on international recognition below.

Further, where a company is incorporated in a jurisdiction which does not have a restructuring regime that works for the required debt restructuring, it will be possible to: (i) register the company as a foreign company in the Cayman Islands; and (ii) if required, potentially relatively easily, shift certain aspects of the company's activities to the Cayman Islands, to enable the company to take advantage of the restructuring moratorium and utilise a Cayman Islands scheme of arrangement.

Will the moratorium prevent secured creditors from enforcing their security or exercising contractual rights of set-off or netting?

No. The key policy elements of freedom of contract and the creditor friendly nature of the jurisdiction are not affected.

Will the moratorium prevent counterparties from exercising their contractual rights, for example in relation to capital call rights and related issuance of shares?

No. The moratorium will not affect the ability to exercise contractual rights (unless legal

proceedings are required to exercise the contractual rights).

Will the moratorium have extra-territorial effect?

As a matter of Cayman Islands law, yes. In practice, this means that the moratorium will bite on parties who are subject to the jurisdiction of the Cayman Islands Courts – this includes, among others, Cayman Islands incorporated entities and partnerships (for example, companies, LLCs and ELPs). Therefore, creditors who are incorporated in the Cayman Islands (such as hedge funds) will, as a matter of Cayman Islands law, be caught by the moratorium. However, whether the moratorium is recognised and enforceable in foreign jurisdictions is a question of the relevant foreign law – see further below in relation to international recognition.

Who can apply to the Court to appoint restructuring officers?

Only the company can apply. This is because, as a matter of policy, the company will need to be on board with the restructuring. The company's involvement is not optional and an involuntary filing by a creditor to drag a company to the table is not possible.

What criteria must be satisfied in order to appoint restructuring officers and obtain the moratorium?

The test remains the same as under the prior regime. The company must: (i) be unable or likely to become unable to pay its debts; and (ii) intend to present a compromise or arrangement to its creditors.

The first limb is a cash flow test which includes an element of futurity - how far into the future the Court can look is highly fact specific.

The second limb has a low bar, for example, there is no need for a company to have a formulated (or even partially formulated) restructuring plan. The low bar enables a company to obtain the protection of a moratorium in the embryonic stages of a restructuring and negotiate with creditors within that safety net. There must though be a genuine intention to explore a restructuring and evidence to demonstrate this.

Must the proceedings to implement the restructuring take place in the Cayman Islands?

No. There is no requirement that any restructuring of the company's debts takes place in the Cayman Islands. As well as a Cayman Islands scheme of arrangement, the restructuring moratorium can be used to support any other restructuring proceeding in any other jurisdiction or an informal work-out with creditors. Flexibility to obtain the best result for stakeholders is a fundamental driving force behind the new law and the Cayman Islands is not territorial as to the jurisdiction in which the restructuring is implemented.

Who can be restructuring officers?

Restructuring officers will be independent Court-appointed fiduciaries who will supervise the restructuring process. A restructuring officer must be a qualified insolvency practitioner and will be an officer of the Court. A foreign insolvency practitioner may be appointed as a restructuring officer but there must always be one Cayman Islands practitioner appointed.

What role does the restructuring officer play?

The Court has complete flexibility as to the role the restructuring officer plays. For example, the restructuring officer can play a light role, leaving

the management to continue day-to-day operations (effectively a debtor in possession proceeding), while the restructuring officer provides an independent, focused and specialist oversight role in the company's restructuring. This can involve vetting a restructuring plan which has been formulated, providing an independent and impartial voice in negotiations with creditors or assisting the company in coming up with a restructuring plan from the ground up. At the other end of the spectrum, there may be circumstances where it is appropriate to divest the management of their powers with the restructuring officer taking over management and performing a much more active role (although it is envisaged that such circumstances are likely to be rare in practice).

Who pays for the restructuring officer?

The remuneration and expenses of a restructuring officer will ordinarily be paid out of the assets of the company. If the company goes into liquidation the expenses and remuneration of the restructuring officer will come ahead of the expenses and remuneration of any provisional or official liquidators.

The Court is given the power to make provision for the payment of liabilities incurred and falling due during the period in which the restructuring officer is appointed.

What protections are there for creditors?

There are a number of protections built in for creditors (and other stakeholders):

- As mentioned above, secured creditors rights are not affected by either the filing of an application to appoint restructuring officers or the appointment of restructuring officers. As a matter of Cayman Islands law, secured creditors remain entitled to enforce valid and enforceable security interests.

- An application to appoint restructuring officers will be advertised both domestically and, if relevant, internationally. The application is therefore on notice to all stakeholders. While the moratorium (stay) applies from filing, creditors are free to apply to the Court to lift the moratorium.

- Creditors have the right to be heard on an application to appoint restructuring officers and to nominate their own restructuring officers instead of those nominated by the company (for example, if the creditor has concerns about the independence of the company's nomination).

- A creditor may seek leave of the Court to present a winding up petition (either before or after restructuring officers are appointed). This recognises that a creditor may, for example, not want to keep kicking the can down the road and opt for liquidation instead. Procedural mechanisms exist to ensure that the two applications, which have competing end goals are coordinated (the competing end goals being, on the one hand, to rescue the company and, on the other hand, to end the life of the company). The Court will make the decision on whether the company should be given the opportunity to pursue a restructuring or be liquidated. The Court has regularly demonstrated that it will give a potential restructuring a chance to breathe and that it, ordinarily, regards liquidation as a remedy of last resort. We expect these principles to continue to apply in the context of an application to appoint restructuring officers.

- Creditors have, at any point in time after the appointment of restructuring officers, the right to apply to the Court to remove and

replace the restructuring officers or vary or discharge the order appointing restructuring officers.

- Shareholders have the same rights as above; although the extent that shareholders views will be given weight will heavily depend on whether the shareholders are in the money.

International Recognition

International recognition will depend on the relevant jurisdiction's law in which recognition and assistance is sought. However, in relation to jurisdictions that have implemented the Model Law on cross-border insolvency, from the Cayman Islands law perspective, the expectation is that recognition and assistance will be available. This is because the appointment of restructuring officers does not contain any substantive differences which impact on recognition from the previous restructuring provisional liquidation model. Restructuring provisional liquidation proceedings were routinely recognised in Model Law jurisdictions (including, importantly, in the United States under Chapter 15).

New York Law-Governed Debt

Where the debt to be restructured is New York law governed (as is currently common in Cayman Islands based debt restructurings), Chapter 15 recognition will continue to be a key component of any restructuring. This is because, among other things: (i) it allows for a moratorium within the territorial jurisdiction of the United States on the enforcement of security; and (ii) where the restructuring is effected through a Cayman Islands scheme of arrangement, the recognition and enforcement of the terms of the scheme.

English Law-Governed Debt

The restructuring moratorium includes separate provisions permitting a restructuring officer to propose a scheme of arrangement – these provisions mirror the current scheme legislation that is part of Cayman Islands company law. This means that Cayman Islands law will have two sets of scheme provisions – one specifically for restructuring officers within the insolvency law (a restructuring officer scheme) and general provisions available more widely. The reason for the specific restructuring officer scheme is to open up the possibility of compromising English law debt through a Cayman Islands scheme of arrangement. The fact that the scheme provisions sit within the wrapper of the restructuring moratorium should allow such a scheme to fall within certain English legislative provisions allowing for the recognition and enforcement of insolvency and restructuring proceedings commenced in specified countries (of which the Cayman Islands is one).

Can the company's directors apply for the appointment of restructuring officers without authority in the company's articles of association or a shareholder resolution?

Yes. The rule in the Cayman Islands that a director is unable to file a winding up application on behalf of the company without authority to do so in the articles of association or from shareholders does not apply to an application to appoint restructuring officers.

Is there any change to the fact that the directors cannot engage the winding up jurisdiction on behalf of the company without permission to do so in the articles of association or from shareholders?

Yes. The default position for companies incorporated **after the commencement of the new law** is to allow directors to file a winding up

application on behalf of the company without needing the authority to do so in the articles of association or from shareholders. This prevents the situation where directors need to file for liquidation proceedings but, without cooperation from a friendly creditor, are unable to do so. The default position will be that directors will be able to make the filing on behalf of the company.

However, the articles of association may expressly remove or modify the directors' authority to present a winding up petition on the company's behalf. Providing this opt out is important for the Cayman Islands structured and asset finance industry, where bankruptcy remoteness is key from both the stakeholder and rating agency perspective.

For companies incorporated **prior to the commencement of the new law**, the position remains the same. Directors will require permission in the articles of association or from shareholders to file a winding up petition. In order to avoid the need to conduct a large-scale review of current companies' articles of association, it was decided that there should be no retrospective change to the law.

Are there any other important changes to the restructuring laws?

Yes, in relation to schemes of arrangement which require a shareholder vote the requirement for a majority in number (the often referred to head count test) of each class of shareholders present and voting at the relevant meeting will be removed. The approval threshold will be 75% by value of those shareholders voting at the relevant meeting. This avoids an issue which can occur where an overwhelming majority of shareholders by value approve the restructuring but a large number of small shareholders do not.

Can a company still apply to the Court to appoint provisional liquidators?

Yes, although the legislative provisions allowing a company to apply to appoint provisional liquidators for the purpose of pursuing a restructuring will be repealed; a company may still apply to appoint provisional liquidators. The Court may appoint provisional liquidators if it considers it appropriate to do so.

Dispute Resolution & Insolvency Partners Caroline Moran and Nick Herrod from the Group's law firm, Maples and Calder, led the legislative reform project and worked closely with the industry, the judiciary and Government in delivering the enhanced regime.

Further Information

If you would like further information, please reach out to your usual Maples Group contact or any of the persons listed below.

Cayman Islands

Aristos Galatopoulos
+1 345 814 5241
aristos.galatopoulos@maples.com

James Eldridge
+1 345 814 5239
james.eldridge@maples.com

Caroline Moran
+1 345 814 5245
caroline.moran@maples.com

Nick Herrod
+1 345 814 5654
nick.herrod@maples.com

Hong Kong

John Trehey
+852 2971 3014
john.trehey@maples.com

Aisling Dwyer
+852 3690 7449
aisling.dwyer@maples.com

Nick Stern
+852 3690 7494
nick.stern@maples.com

London

Christian La-Roda Thomas
+44 20 7466 1648
christian.la-rodathomas@maples.com

July 2022
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This update is intended to provide only general information for the clients and professional contacts of the Maples Group. It does not purport to be comprehensive or to render legal advice.

ITEM NO. 187

JA-73

Cayman Islands Schemes of Arrangement now available for Exempted Limited Partnerships using the Restructuring Officer Regime



Mar 25, 2024

Advisory

KEY TAKEAWAYS:

- Exempted limited partnerships in the Cayman Islands can now use schemes of arrangement via the restructuring officer regime
- General partners can appoint restructuring officers to seek court-approved compromises with creditors or limited partners
- It's predicted exempted limited partnerships will soon use this mechanism for financial restructurings and corporate transactions

A Cayman Islands scheme of arrangement is a court approved compromise or

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creditors or shareholders (or classes thereof).

A scheme of arrangement is frequently used to implement a financial restructuring by varying or cramming in the rights of the relevant creditors and/or shareholders of a company but may also be used to complete corporate transactions such as a group restructuring or reorganisation, acquisitions, mergers and take-private transactions.

Traditionally, the Cayman Islands Companies Act has only afforded companies the ability to make an application to the Court under section 86 for the sanctioning of a scheme of arrangement. However, with the introduction of the new restructuring officer regime in Part V of the Companies Act, which also applies to exempted limited partnerships, general partners of exempted limited partnerships are now able to seek the appointment of restructuring officers who can then seek the sanctioning of a compromise or arrangement between the partnership and its creditors and/or limited partners.

With the increasing use of the restructuring officer regime in the Cayman Islands, it is only a matter of time before the first exempted limited partnership utilises it to sanction a scheme of arrangement. If you require legal advice on any offshore restructuring related issues, or any other Cayman Islands or BVI legal issues, please contact any of the following individuals on the Insolvency and Dispute Resolution team.

Dispute Resolution Insolvency & Restructuring

Cayman Islands

KEY CONTACTS



Luke Petith

Partner / Dubai

T / +971 4 363 7926

M / +971 54 492 3553

E / Email Luke Petith

View profile



Brett Basdeo

Partner / Hong Kong

T / +852 2596 3393

M / +852 9732 6361

E / Email Brett Basdeo

View profile



Cate Barbour

Senior Counsel / Dubai

T / +971 4 363 7917

M / +971 50 821 7338

E / Email Cate Barbour

View profile

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ITEM NO. 188

JA-74

Neutral Citation Number: [2025] CIGC (FSD) 124

Cause No: FSD 2025-0146 (JAJ)
and Cause No: FSD 2025-0151 (JAJ)

IN THE GRAND COURT OF THE CAYMAN ISLANDS
FINANCIAL SERVICES DIVISION

BETWEEN:

(1) UNICORN BIOTECH VENTURES ONE LTD
(in its capacity as general partner of RIGMORA BIOTECH INVESTOR ONE LP)

(2) UNICORN BIOTECH VENTURES TWO LTD
(in its capacity as general partner of RIGMORA BIOTECH INVESTOR TWO LP)

Plaintiffs

-and-

ATP III GP, LTD
(in its capacity as general partner of ATP Life Science Ventures, L.P.)

Defendant

Appearances:	**Mr Andrew Scott KC of counsel instructed by Mr Liam Faulkner, Mr Hugo Farmer and Ms Yuan Wen of Campbells LLP for the Plaintiffs / Petitioners**
	Mr Andrew Ayres KC of counsel instructed by Ms Shelley White, Ms Laure Astrid Wigglesworth and Ms Rebecca Mosely of Walkers (Cayman) LLP for the Defendant / Respondent
Before:	**The Honourable Justice Jalil Asif KC**
Heard:	**17 December 2025**
Ex tempore judgment delivered:	**17 December 2025**
Finalised judgment approved:	**22 December 2025**

Civil procedure—vacation of trial—effect of defendant filing for Chapter 11 bankruptcy protection in the United States on conduct of proceedings before the Grand Court—case management considerations

- -

JUDGMENT

- -

1. This writ action and winding up petition are listed before me today for a combined pre-trial review in advance of a trial in both matters due to commence on 12 January 2026. This hearing has been fixed in the calendar since October 2025 and was intended to be used to address any last-minute issues concerning preparation for the trial.

2. As in previous hearings before me, the limited partners who are the Plaintiffs / Petitioners have been represented by Mr Andrew Scott KC, supported by Mr Liam Faulkner, Mr Hugo Farmer and Ms Yuan Wen of Campbells LLP, and the Defendant / Respondent general partner has been represented by Mr Andrew Ayres KC, supported by Ms Shelley White, Ms Laure Astrid Wigglesworth and Ms Rebecca Mosely from Walkers (Cayman) LLP. I will refer to the parties respectively as the LPs and the GP.

3. In the last two weeks there have been two substantial developments, the first of which will have a significant effect on the intended progress of the trial; the second of which has largely derailed it. The first is that on 5 December 2025, just over 10 business days ago, Chancellor McCormick in Delaware gave judgment in the parallel proceedings between the parties dealing with certain issues about the GP's entitlement to make capital calls from the LPs, rejecting parts of the GP's case. This is likely to have consequences for the conduct of the winding up petition before the Grand Court, in particular Mr Scott argues that it will significantly simplify the question whether a winding up order should be made. If the trial before the Grand Court were to proceed, there would also be arguments about the extent to which any findings by Chancellor McCormick might be binding on the parties in respect of their disputes before the Grand Court. However, the parties have always known that that would be the case.

4. Secondly, and more significantly, on 9 December 2025, the GP and certain other linked entities sought Chapter 11 bankruptcy protection in the United States including, as part of that protection, a worldwide automatic stay of proceedings in any other jurisdiction.

5. The GP's intention to seek Chapter 11 protection was not foreshadowed in any way either to the LPs or to the Grand Court. Indeed on 8 and 9 December 2025, at the same time that the GP and Quinn Emanuel, its lead attorneys in the US proceedings, must have been preparing the GP's Chapter 11 filings (including a lengthy declaration of Dr Seth Harrison, the controller of the GP), Walkers were dealing with the Grand Court and the Court of Appeal in relation to the GP's intended expedited appeal against an Order I had made on 1 December 2025 concerning a privilege issue regarding discovery. In their dealings with Campbells, the Grand Court and the Court of Appeal on 8 and 9 December 2025, Walkers expressly represented that the GP did not intend the appeal to disrupt the trial fixed for 12 January 2026. There is no suggestion that Walkers were aware of the GP's intended Chapter 11 filing in the United States, which would be wholly contradictory to the representations made by them.

6. Thus, it is now clear that, for the second time within less than 3 weeks, the GP and Quinn Emanuel have not informed Walkers of important matters relevant to the proper conduct of the Cayman proceedings, with the result that the position has been actively misrepresented to the Court. This is extremely unsatisfactory and is to be deprecated.

7. Of a piece with this, it is also extremely regrettable that a partner in Quinn Emanuel considered it appropriate to write directly to an associate at Campbells on 11 December 2025 threatening all kinds of personal consequences as a result of Campbells' indication to the Grand Court on 10 December 2025 that they considered that the PTR should proceed, contrary to Walkers' request to vacate it, so that the Court could be properly informed of developments in Delaware and consider what consequences they had for the matters before the Grand Court. Quinn Emanuel asserted in the letter that the communication to the Grand Court was itself a violation of the automatic stay under Chapter 11. This is in marked contrast to the submissions on behalf of the GP at an oral hearing before the Delaware bankruptcy judge on 15 December 2025, where the transcript of the hearing that is before me records that an attorney from Quinn Emanuel orally submitted in relation to the PTR today:

> *"[…] on the specific issue of the Wednesday hearing. It is a pretrial conference. There is no dispute that the lawyers in the Cayman Islands should apprise the Court as to the goings on here. That is not -- I don't think there is any dispute that that can and should happen. In fact, we did inform the Court of the filing of the case and the judge did indicate that he wants to have counsel there to, at least, give him an update as to what is going on here. That makes all the sense in the world."*

Bullying correspondence of the kind exemplified by Quinn Emanuel's letter dated 11 December 2025, whilst it might be acceptable in the United States (although I doubt that), is completely unacceptable in the Cayman Islands. I do not want to see similar conduct in any matters that come before me by any American law firms involved in the background, still less by any local attorneys.

8. The PTR hearing before me today has focused on the consequences of the GP's filing of the Chapter 11 proceedings in the United States and the impact of the automatic stay under American law on what is happening and due to happen before the Grand Court.

9. It seems to me that the first point is the obvious one that the trial cannot proceed on 12 January 2026 and must be vacated. That is for two reasons. First, because neither of the parties are able to take steps to prepare for that trial whilst the Chapter 11 proceedings are live. Whilst the Chapter 11 stay is not directly enforceable in the Cayman Islands and no application has been made to recognise the Chapter 11 proceedings here, the GP and all the partnership assets are based in the United States. Thus, even if either of the parties were to take steps to try to progress the matters before the Grand Court, there would probably be arguments in Delaware that they are in contempt, with potentially severe consequences for them and for all of the partnership's assets. So, I do not criticise either party for taking the view that the January trial cannot realistically proceed.

10. I note that the LPs are seeking or intend to seek in Delaware, first, to dismiss the Chapter 11 proceedings as an abuse, and secondly, an order waiving or disapplying the automatic stay so that a slimmed down trial, taking into account Chancellor McCormick's recent judgment, can proceed before the Grand Court later in January 2026. Those motions in Delaware have not yet been briefed or determined and it appears unlikely that they will be determined until sometime during January 2026 at the earliest, which is also inconsistent with the ability to proceed with the intended trial on 12 January 2026.

11. The second reason why it seems to me that the trial cannot and should not proceed on 12 January 2026 is that the LPs' position is that the effect of the GP's Chapter 11 filing is that the partnership is now in voluntary liquidation under Cayman law. So, a number of the issues that were going to be fought out in the 12 January trial are likely no longer to be live issues and will probably not need to be determined by the Court. I therefore have no hesitation concluding that the trial fixed to commence on 12 January 2026 should be vacated.

12. The second question is whether the Court should fix a date in January or February 2026 for hearing a streamlined version of the substantive winding up petition presented by the LPs, which is the LPs' position, or whether, as the GP argues, the Court should simply await developments in Delaware and essentially take no further steps to move the Cayman disputes forward until clarity is obtained on the position in the United States.

13. I do not find the GP's position to be a particularly attractive one. The parties have throughout sought to advance the resolution of the disputes between them both in Delaware and in the Grand Court on an expedited basis. My own view is that an orderly separation of the GP from the LPs needs to occur sooner rather than later to avoid the continuation of these obviously corrosive disputes between the parties on each side. It does not seem to me to be productive or a beneficial use of the parties' time and resources for this dispute to drag on for any longer than absolutely necessary. The only people who are profiting from this dispute at the moment are the lawyers on each side.

14. I therefore conclude that I should fix a date for the trial of what the LPs have called the "paragraph 10(b) issues" for the week commencing 2 February 2026. If, for any reason, events in Delaware do not progress on a schedule that allows the parties to prepare for and conduct that hearing, then the parties can apply to me in mid to late January with a view to adjourning the trial and moving it perhaps into March 2026. But it seems to me that it is far better that I allocate that time and give the parties a date to be working towards now so that my calendar does not fill up in the intervening period. If I did not do so, and the parties were to come back to me in mid to late January 2026 following a decision by the Delaware judge on either the dismissal of the Chapter 11 proceedings or a carve out for the Grand Court proceedings from the automatic stay, the likelihood is that the earliest date that I could then give them would not be until the middle to the end of March, and perhaps even into April 2026.

15. I am inclined to accept Mr Scott's submission that Chancellor McCormick's findings and the fact of the Chapter 11 filing in the United States, and their consequences under the limited partnership agreement and Cayman Islands law, have the result that it ought not to be necessary any longer to get into the question whether the LPs have lost trust and confidence in the GP's ability to manage the partnership. It seems to me that Mr Scott is right to say that the issue for the Court, or at least a preliminary issue for the Court, is the question whether there has been a loss of substratum, which on its own would justify the making of a winding-up order without the necessity to get into the questions of loss and of trust and confidence.

16. It seems to me that two days should be sufficient for the Court to determine the paragraph 10(b) issues, which are largely matters of law and construction of the limited partnership agreement. To the extent that there is likely to be any need to consider questions of fact, they are likely to be relatively circumscribed in their scope. I note in passing, and with some admiration, that Chancellor McCormick was able to hear the Delaware trial in two days. I appreciate that there are significant differences in the procedural approach of the US courts to the conduct of trials compared to the approach of the Grand Court, but I think that with goodwill and cooperation on both sides it ought to be feasible to have a hearing of the more limited nature proposed by the LPs within a two-day time estimate.

17. I agree with Mr Ayres on behalf of the GP that it will be necessary for the LPs to make amendments to their winding up petition so that it is clear precisely what their case is, both for the GP and also for the Court when it comes to deal with the hearing of the petition. It also seems to me that Mr Scott is correct that the appropriate procedural way to characterise the hearing in February 2026 is that it will be a trial of preliminary issues, so that if, for any reason, I determine that the partnership's substratum has not been lost, then the LPs have the ability to come back and to argue the loss of trust and confidence points at a later stage, if there is any real appetite on either side for the matter to proceed beyond February 2026.

18. However, having said that, I will not make an order at this stage imposing any procedural timeline for the preparation of amended pleadings because I am conscious that there may well be arguments that the parties are unable to take any such substantive steps whilst the stay under Chapter 11 applies to them.

19. I understand that the matter is before the Delaware judge this afternoon. It does seem to me that, at the very least, it would be of real utility for the Delaware judge to authorise the preparation of amended pleadings on both sides in order to re-state what are the issues that the Grand Court will need to determine in due course. It also seems to me that it would be of real utility for the Delaware judge, as soon as possible, to determine that the limited issues that the LPs wish to put before the Grand Court for determination should be excluded from the scope of the automatic stay so that a determination on those issues can be made. A decision on those points is likely to be of real benefit to the parties and also to the Delaware court if the Chapter 11 proceedings are not dismissed and continue.

20. For what it is worth, I will conclude by saying that I generally take the view that the conduct of the winding up of a Cayman exempted limited partnership, and by whom that winding up ought to be carried out, are more appropriately questions for the Grand Court to determine supported by Chapter 15 recognition in due course, rather than by Chapter 11 proceedings. It is for the Delaware judge to take whatever view of that indication that she wishes to take.

21. It also occurs to me, without the benefit of full argument, but as a preliminary view, that the proposal for capital restructuring and the introduction of new investors, which is adverted to by Dr Harrison in his declaration in support of the Chapter 11 proceedings, appears at first blush to be outside the proper scope of the GP's powers based on the limited partnership agreement which is binding upon the GP, and also having regard to applicable Cayman law on what a GP's obligations are in the context of a winding-up of a Cayman exempted limited partnership.

Dated 17 December 2025



THE HONOURABLE JUSTICE JALIL ASIF KC
JUDGE OF THE GRAND COURT

ITEM NO. 189

JA-75



Neutral Citation Number: [2025] CIGC (FSD) 106

Cause No: FSD 2025-0151 (JAJ)

IN THE GRAND COURT OF THE CAYMAN ISLANDS
FINANCIAL SERVICES DIVISION

IN THE MATTER OF THE EXEMPTED LIMITED PARTNERSHIP ACT (2025 REVISION), THE COMPANIES ACT (2025 REVISION) AND THE PARTNERSHIP ACT (2025 REVISION)

AND IN THE MATTER OF ATP LIFE SCIENCE VENTURES, L.P.

Appearances:	**Mr Andrew Scott KC of counsel instructed by Mr Liam Faulkner, Mr Hugo Farmer, Ms Yuan Wen and Mr Jordie Fienberg of Campbells LLP for the Petitioner** **Mr Andrew Ayres KC of counsel instructed by Ms Shelley White and Ms Rebecca Moseley of Walkers for ATP III GP, Ltd**
Before:	**The Honourable Justice Jalil Asif KC**
Heard:	**31 October 2025**
Ex tempore judgment delivered:	**2 November 2025**
Finalised judgment approved:	**6 November 2025**

Exempted limited partnership—winding up on just and equitable basis—application of CWR O.3, r.12(1)(a) or (b) to winding up of exempted limited partnership—whether court can order petition to proceed against partnership or against general partner, with partnership as subject matter

- -

JUDGMENT

- -

1. This is my judgment on a novel point that has arisen in the course of a directions hearing in connection with this just and equitable winding up petition, which concerns an exempted limited partnership formed under the Exempted Limited Partnership Act.

2. The essential background is that the exempted limited partnership in this case operates in the life sciences or biotech space. The Petitioners are limited partners in the partnership and have contributed around 98% of the capital of the partnership. Dr Seth Harrison, a successful life sciences entrepreneur, has driven the research and development of the products and the portfolio companies developing them. He has contributed approximately 2% of the partnership's capital. There are a number of other limited partners who are said to have acquired minor partnership interests in the exempted limited partnership, apparently as employee incentives.

3. The general partner of the partnership, ATP III GP, Ltd, is a limited company owned and controlled or directed by Dr Harrison.

4. In recent months, the relationship between the individuals behind the Petitioners and Dr Harrison has broken down. I do not need to go into the reasons for that for the purposes of this judgment, but they have given rise to three sets of proceedings between the parties in which their disputes are being decided:

   4.1 a contractual dispute being tried in Delaware;

   4.2 a writ action commenced in the Cayman Islands, and seeking declaratory relief regarding the validity, or otherwise, of certain steps taken by the general partner in relation to capital calls; and

   4.3 these winding up proceedings.

5. In the winding up proceedings, the Petitioners seek the winding up of the partnership on the just and equitable basis. They assert that they have lost all confidence in Dr Harrison and the general partner. This is said to be due to:

   5.1 alleged mismanagement, prejudicial conduct, and a lack of probity in the conduct of the partnership's affairs.

   5.2 alleged conflicts of interest affecting the general partner through Dr Harrison's interest in it, and breach of fiduciary duty by the general partner;

   5.3 a loss of substratum in that the general partner is set on continuing to fund non-performing portfolio companies, contrary to the limited partners' legitimate expectation for the operation of the partnership; and

   5.4 a need for an investigation of the partnership's affairs.

6. Dr Harrison, and through him the general partner, strenuously disputes the Petitioners' claims and is determined to contest the allegations that have been made against them.

7. Due to the potential effect of the dispute on the ongoing operation and management of the portfolio companies, this winding up petition and the writ action have both been advanced on a compressed timetable and are due to be tried together in early January 2026, having been filed in early June 2025.

8. The issue that has arisen in the course of the summons for directions concerns how the petition is to be contested. The Petitioners seek an order under CWR O.3, r.12, as modified by section 36(3) of the Exempted Limited Partnership Act, that the petition be treated as an inter partes proceeding between the Petitioners and the general partner. The Petitioners say that that reflects the substance of the dispute.

9. The general partner resists such an order and contends that the petition should continue between the Petitioners and the exempted limited partnership. The importance of this point is the cost consequences that follow under CWR O.24, r.8. Section 36(3) of the Exempted Limited Partnership Act provides that:

> *"(3) Except to the extent that the provisions are not consistent with this Act, and in the event of any inconsistencies, this Act shall prevail, and subject to any express provisions of this Act to the contrary, the provisions of Part V of the Companies Act (2021 Revision) and the Companies Winding Up Rules, 2018 shall apply to the winding up of an exempted limited partnership and for this purpose —*
>
> *(a) references in Part V to a company shall include references to an exempted limited partnership;*
>
> *(b) the limited partners shall be treated as if they were shareholders of a company and references to contributories in Part V shall be construed accordingly, except that the application of the provisions shall not cause a limited partner to be subject to any greater liability than that limited partner would otherwise bear under this Act, but for the application of this paragraph;*
>
> *(c) references in Part V to a director or officer of a company shall include references to the general partner of an exempted limited partnership;"*

10. Part 3 of CWR O.3 concerns petitions presented by contributories, which, by virtue of section 36(3) of the Exempted Limited Partnership Act, is the analogue for the current situation.

11. CWR O.3, r.12 requires that at the hearing of the summons for directions, the court shall give directions as appropriate in respect of certain specified matters, including:

> *"(a) whether or not the company is properly able to participate in the proceeding or should be treated merely as the subject-matter of the proceeding;*
>
> *(b) whether the proceeding should be treated as a proceeding against the company or as an inter partes proceeding between one or more members of the company as petitioners and the other member or members of the company as respondents;"*

12. CWR O.24, r.8(2) states:

> *"(2) In the case of a contributory's winding up petition under Order 3, Part III, the general rules are that —*
>
> *(a) if the Court has directed that the company itself is properly able to participate in the proceeding, the general rule is that the costs of a successful petitioner be paid out of the assets of the company; or*
>
> *(b) if the Court has directed that the winding up petition be treated as an inter partes proceeding between one or more members of the other members or members of the company as respondents, the general rule is that none of the costs should be paid out of the assets of the company and the unsuccessful parties should pay the costs of the successful party, such costs to be taxed on the standard basis unless agreed."*

13. I interpose here that there is an obvious error in CWR O.24, r.8(2)(b). The wording *"between one or more members of the other members or members of the company as respondents"* makes no grammatical sense. By comparison with CWR O.3, r.12(b) it appears that two errors have crept into the drafting of CWR O.24, r.8(2)(b). The first is that the words *"company as petitioners and the"*

has been omitted after *"between one or more members of the"*. Secondly, an *"s"* has been wrongly added to *"member"* on the second occasion that it is used in subparagraph (b). In my judgment, I should treat CWR O.24, r.8(2)(b), as if it read:

> *"(b) if the Court has directed that the winding up petition be treated as an inter partes proceeding between one or more members of the* [company as petitioners and the] *other member*[**s**] *or members of the company as respondents, the general rule is that none of the costs should be paid out of the assets of the company and the unsuccessful parties should pay the costs of the successful party, such costs to be taxed on the standard basis unless agreed."*

Counsel agreed in the course of argument with this proposition and construction of CWR O.24 r.8(2)(b).

14. To resume my summary of the Rules, CWR O.24, r.8(2) thus determines the prima facie allocation of the costs of defending the petition, as between the petitioner on one side and the company or members of the company other than the petitioner, as appropriate, on the other.

15. The Petitioners in this case argue that this provision also applies to a winding up of an exempted limited partnership. Applying section 36(3)(a) and (b) of the Exempted Limited Partnership Act, they say that *"members of the company"* in the Companies Winding Up Rules becomes *"members of the exempted limited partnership"* and the members of an exempted limited partnership are the limited partners and the general partners together. Thus, the Petitioners say, there is a direct read over without any need to strain the statutory language. The court should therefore make an order on the summons for directions determining that the petition should proceed as a claim between the Petitioners and the general partner, with the exempted limited partnership as the subject matter of the petition.

16. The Petitioners support that approach to the construction of the Companies Winding Up Rules by arguing that the purpose of CWR O.24, r.8(2) is to apply the legal costs principle, namely that a company's money should not be spent on disputes between shareholders.

17. The Petitioners say that that principle applies wherever the real contest is between parties other than the company itself, for example between its members. The Petitioners say that the reason why that principle is engaged in the context of just and equitable winding up proceedings is because, as stated by Segal J in Re Uphold Limited (unreported, 16/02/23), just and equitable proceedings are:

> *"42. […] grounded on a dispute between the shareholder petitioner and those in control of the company where those in control have behaved in a way that is fundamentally inconsistent […]*

> *with the basis on which the shareholder subscribed for or purchased his / her shares so as to justify the termination of the corporate relationship. It is usually the case that those accused of misconduct should pay for the costs of defending the petition"*

18. The Petitioners argue it would be contrary to the legal costs principle for the general partner to use assets of the partnership, which are held overwhelmingly for the benefit of the Petitioners, to defend the petition by which the Petitioners seek to impugn the general partner's own conduct and other fiduciary failings. The Petitioners say this would effectively have the result that the Petitioners would end up funding both the pursuit of the claim and also its defence.

19. The general partner disputes the Petitioners' stance, based on the wording of section 36(3) of the Exempted Limited Partnership Act. The general partner submits that the Petitioners' approach is not permitted by section 36(3) of the Exempted Limited Partnership Act, so that I do not have jurisdiction to make the order sought by the Petitioners. The general partner's argument is as follows.

    19.1 The general partner says that by virtue of section 36(3)(a) and (b), *"company"* is to be read as *"exempted limited partnership"* and *"contributories"*, in other words, shareholders or members, is to be read as *"limited partners"*.

    19.2 The general partner argues that the reference in section 36(3)(c) to the general partner being assimilated to the position of a director of the company means that the general partner is <u>not</u> to be treated as a *"member"* for the purpose of CWR O.3, r.12, and CWR O.24, r.8.

    19.3 The general partner says in paragraph 16 of its skeleton argument:

> *"16. The choices under (a) and (b) are interdependent, and there are only two options: either (i) the Partnership is properly able to participate, and the proceeding should be treated as being against the Partnership; or (ii) the proceedings is an inter partes proceedings between different limited partners, and the Partnership is merely the subject-matter."*

    19.4 The general partner adds that the fact that there is a binary choice is clear from the structure of CWR O.24, r.8 which mirrors and follows the structure of CWR O.3, r.12.

    19.5 Therefore, the general partner argues, the only question that the court needs to ask is whether the proceedings should be treated as being between different limited partners, or as between limited partners and the exempted limited partnership itself.

20. The general partner submits that the Petitioner's construction requires that the meaning of *"members of the company"* in the Company Winding Up Rules sometimes means limited partners and sometimes means all of the partners in the exempted limited partnership, which the general partner submits indicates that the Petitioners' construction must be wrong.

21. The general partner says that Segal J's comments in *Re Uphold* are simply not relevant, as that case concerned the situation of a company, not an exempted limited partnership.

22. In response to the Petitioner's reliance on the legal costs principle, the general partner argues that there is no room for an argument based on principle where the Exempted Limited Partnership Act expressly requires the court to read the Companies Winding Up Rules in a particular way.

23. Relying on a dictum of Segal J in *Re China Shanshui Cement Group Limited* [2021] 1 CILR 253 at paragraph 39, the general partner submits that:

> *"39. A critical question is whether the company can show that it has a real interest independent of its shareholders in defending the petition (does the company have a separate interest to protect?). As Foster, J. said in* Freerider *(ibid., at para. 45), the court must decide whether the company has any independent interest in the dispute."*

In this case, I have to read *"company"* as *"limited partnership"*.

24. Finally, the general partner argues that even if the court has discretion to make an order under CWR O.3, r.12, the court should not exercise that discretion on the facts of this case. The general partner says that the exempted limited partnership has an independent interest in defending itself and continuing to exist because it has assets built up over many years that generate financial benefits for its limited partners, including 14 limited partners other than the Petitioners. Although that must be the case for many partnerships where disputes arise.

25. I agree with the Petitioners that the legal costs principle is an important one. As explained by Harman J in *Re A Company, ex parte Johnson* [1991] BCC 234, which was a case concerning an unfair prejudice petition under section 459 of the English Companies Act of 1985:

> *"The train of authority being well established, it seems to me quite clear that, if it is shown that directors of a company have been causing the company's money to be spent on financing the resistance either to a "pure" section 459 petition or, according to Plowman J in* Re A &BC Chewing Gum *and myself in* Re Hydrosan*, in financing the company's resistance to a member's winding-up petition based on the just and equitable ground, the court should prevent such*

> *expenditure. Such expenditure is a misfeasance, there is no excuse for it in law and it is not a question of an arguable case being raised showing that it might be right to permit misfeasances. Misfeasances are not matters that are permitted by the courts and there is no question of an arguable case at all."*

26. The Petitioners referred me to *Re Cybernaut Growth Fund LP* (unreported, 11/09/13), where the question of making an order under CWR O.3, r.12, and O.24, r.8 in respect of the winding up of an exempted limited partnership was dealt with by consent. Both parties before me accepted that, whilst it thus provides an example of a case where an order was made, the ability of the court to do so was not in issue and was not considered by either of the judges before whom the matter was listed. In my view, it therefore does not advance the argument.

27. In *Re Freerider Ltd* [2009] CILR 604, Foster J at paragraph 42 rejected the submission that what is now CWR O.3, r.12, was *ultra vires* the Insolvency Rules Committee because it was a legislative change or addition to the provisions of Part V of the Companies Act. He concluded that CWR O.3 r.12 is procedural in nature, giving effect to the legal costs principle, which he considered to be well established in law. In particular, he said, at paragraph 20:

> *"20. It is in this overall context that it seems to me the IRC are empowered by s.155(1)(a) of the Companies Law to make rules, in particular to enable the court giving directions to determine in its discretion in the particular circumstances which parties should most appropriately participate in winding-up proceedings brought under the Companies Law. In my view in the light of this, the relevant provisions of O.3, r.11(2)(a) and (b)* [now O.3, r.12(2)(a) and (b)] *are essentially procedural in nature and are directly related also to the provisions which the IRC is empowered to make and has properly made in relation to the costs of petitions. I do not think there can be any doubt that the IRC is empowered to make such costs rules.*
>
> *21. I also consider that it is probable that the members of the IRC were aware, or were made aware, of the English authorities in which the courts there have either restrained a company from active participation or refused a company permission to participate actively in a winding-up petition on the just and equitable basis and/or a petition under s.459 of the Companies Act 1985 and/or to do so at the expense of the company, when the reality is that the proceedings are in essence a dispute between shareholders and not a dispute with the company itself. […] Wickens, V.C. said* [in *Pickering v. Stephenson*] *(L.R. 14 Eq. at 340):*
>
> > *'It seems to me that where a quasi partnership of this sort is divided into a majority and minority who differ on a question of internal administration, and litigation results from the difference, it is contrary to the spirit of the partnership to pay the expense of the litigation out of the general fund; and that this is independent of the question whether the majority is overwhelming or a bare majority.'"*

28. At paragraph 32, Foster J commented that the provisions of CWR O.3 r.12 are a mechanism to enable the court to determine at an early stage whether the legal costs principle is engaged. He said:

> *"32. I would comment in passing that the provisions of O.3, r.11(2)(a) and (b) of the Companies Winding Up Rules may perhaps be seen as a sort of mechanism of the kind referred to by Lindsay, J. in that they will enable determination by the court at any early stage in the proceedings by way of directions of whether or not it is procedurally appropriate and desirable, in the particular circumstances, for the company concerned to participate in the petition proceedings or whether it should be treated simply as the subject-matter."*

29. The Petitioners submit at paragraph 48 of their skeleton argument:

> *"48. In the context of petitions for the just and equitable winding up of an ELP it is often the case that: (i) the dispute is grounded on the general partner's conduct of the partnership's affairs and (ii) the general partner (and the general partner alone) has the ability to access and deploy partnership assets towards funding a defence of the petition. There is no reason for the Legal Costs Principle not to apply in that context to prevent a general partner from deploying partnership assets (i.e. trust assets) towards defending allegations of misconduct against it."*

30. In my view, that understates the position. Given the statutory roles of the general partner and the limited partners, as provided for by the Exempted Limited Partnership Act, namely that the limited partners have no role in the management of the exempt limited partnership and do not owe any duties to the partnership or to the other limited partners; whereas the general partner is responsible for the management of the exempted limited partnership and does owe fiduciary and other duties to the limited partners, it is hard to see how a just and equitable petition would ever involve parties other than one or more limited partners on one side and the general partner, and possibly an intermeddling limited partner, on the other.

31. This points against the general partner's submission that the proper construction of CWR O.3 r.12 is that it is directed at limited partner on limited partner disputes. This is because it is extremely difficult to contemplate circumstances giving rise to a just and equitable petition in which the dispute would arise between the limited partners and would arise in such a way that it does not involve the general partner, given that no duties owed are owed by limited partners to each other and limited partners have no roles in management, and that the general partner is the entity that owes duties to each limited partner and is responsible for management of the partnership.

32. In addition, I consider there is a conceptual flaw in the argument that the petition should proceed as a dispute between limited partners and the exempted limited partnership. This is because an exempted limited partnership does not have any separate legal personality from the limited partners and the general partner. Neither side appears fully to have grappled with the consequences of this in the arguments that they have advanced before me.

33. By referring to the exempted limited partnership throughout as being the appropriate respondent to the petition, in the absence of separate legal personality, the effect of the general partner's position is that the Petitioners should both pursue the petition and at the same time be respondents to the petition. That is neither legally nor procedurally possible. It would necessarily involve obvious and irreconcilable conflicts of interest for the Petitioners. It also flies in the face of section 33(1) of the Exempted Limited Partnership Act, which provides that:

> *"(1) Subject to subsection (3), legal proceedings by or against an exempted limited partnership may be instituted by or against any one or more of the general partners only, and a limited partner shall not be a party to or named in the proceedings."*

Subsection (3) deals with the situation where a general partner has failed to bring proceedings against a third party and a limited partner in those circumstances wishes to pursue that claim on behalf of the exempted limited partnership. So that subsection is irrelevant for the purpose of the debate before me.

34. If, as I consider must be correct, the exempted limited partnership cannot itself be a respondent to a just and equitable petition brought by a limited partner, and that only the general partner and any intermeddling limited partners can be the respondents, then it also follows that CWR O.24 r.8(a) cannot be operative as against an exempted limited partnership because the court will not and cannot direct that the exempted limited partnership itself can participate in the proceeding. This is because the exempted limited partnership does not have separate legal personality and the petitioning limited partner cannot also be a respondent. Thus, the respondents to a just and equitable petition can only be the general partner and any limited partners who have intermeddled or who wish to take an active role in defending the petition.

35. In principle, therefore, whilst I accept that there is substantial force in the Petitioners' argument that the legal costs principle should apply equally to just and equitable petitions in the context of the winding up of an exempted limited partnership, just as it applies to companies, I find it impossible to apply the manifestation of it in the CWR, given the legal nature of an exempted limited partnership and the consequences of that nature on the operation of the CWR as regards exempted limited partnerships.

36. In my judgment, this is a situation covered by the opening words of section 36(3) of the Exempted Limited Partnership Act, namely, *"except to the extent that the provisions are not consistent with*

this Act and in the event of any inconsistencies, this Act shall prevail." The Exempted Limited Partnership Act, which creates the legal structure of an exempted limited partnership, has created an animal that does not fit within the application of the relevant rules of the CWR. The provisions of CWR O.3, r.12, and O.24, r.8, in my judgment, are therefore inconsistent with the Exempted Limited Partnership Act, and the Exempted Limited Partnership Act must prevail.

37. I therefore accept that the Court cannot make an order under CWR O.3, r.12(a) or (b) in this case, although not for the reasons advanced by the general partner.

38. It also follows from my conclusion that the joint position of counsel in *Re Cybernaut Growth Fund LP* that the court can apply CWR O.3, r.12 in the context of an exempted limited partnership was incorrect, and that *Re Cybernaut Growth Fund LP* should not be treated as authority for that proposition.

39. As required by section 33(1) of the Exempted Limited Partnership Act, the petition must continue as between the Petitioners and the general partner.

40. Mr Ayres submitted that it is important not to confuse the question of the prima facie liability for costs, which in my judgment will always be with the general partner, and the general partner's right to indemnity under the limited partnership agreement governing the partnership for the costs it has incurred. I agree with Mr Ayres on this point. There is clearly going to be a dispute in this case whether the general partner is entitled to indemnity from the exempted limited partnership's assets for the costs of defending the just and equitable petition and also the Delaware and Cayman writ proceedings.

41. I do not intend to prejudge the outcome of that debate, which will turn upon the wording of the limited partnership agreement. However, it does seem fairly plain that the real disputes are between the two Petitioners on one side and the general partner on the other. This does not appear to be a case where the exempted limited partnership has its own position to put forward, even if that were legally and procedurally possible, which I do not consider it is for the reasons I have already set out.

42. If any of the other limited partners wish to participate in the proceedings, that is a matter for them. Their position as limited partners can be put forward by them as respondents if they have a different interest to advance although, given the procedural position of these proceedings and the approaching trial, any limited partners who wish to do so should make an application to be joined urgently.

43. Finally, I record that Mr Ayres was at pains to say that the general partner does not accept the Petitioners' criticisms, either of the general partner or of Dr Harrison, and that I should avoid forming a view that there is a "good" side and a "bad" side of the court. Mr Ayres said that the general partner and Dr Harrison are very keen to vindicate the position of the general partner.

44. I acknowledge that that is Dr Harrison's and the general partners' position. However, it seems to me that there is a real danger that the general partner is failing to heed the words of Kawaley J in *One Thousand and One Voices Africa Fund I LP* [2024] 1 CILR 371 at paragraphs 30 to 34. The learned judge said:

> *"30. […] The petitioner's case, in a nutshell, amounts to this. It would be inconsistent with elementary principles of winding-up law for the court not to replace the general partner when it has unarguably lost the trust and confidence of 97% of the economic stakeholders of the ELP, no matter what the reasons may be. There is no need for the court to consider the merits of the original complaints laid against the GP. That position appears to be an unassailable one.*
>
> *31. Section 36(13) of the Act confers an unfettered discretion on the court. […] The very fact that the GP does not apparently accept the fundamental principle that in a liquidation the wishes of the majority stakeholders prevail (assuming the opposition to the petition is maintained) appears to demonstrate the need for a fresh appointment.*
>
> *32. Unfortunately, the opposition to the present petition has an all too familiar ring. The best way for a manager who has lost the confidence of the investors to demonstrate their probity is to step aside, demonstrating confidence that their impugned management of the fund will be vindicated by independent scrutiny. Instead, the importance of their continuing at the helm is apparently given priority over the wishes of the investors, and the recalcitrant manager claims to know better than the investors where their best commercial interests lie. Regrettably, whatever unique expertise the scorned manager truly possesses, the distinct impression is created that the determination to cling to office is motivated by self-interest at best, or the desire to forestall independent investigation into suspect dealings at worst.*
>
> *33. In the instant case it is admittedly extremely plausible that the GP's Mr. Jordaan has specialist knowledge of and unique contacts with the businesses the ELP has invested in. The appointment of independent liquidators would not necessarily preclude his expertise being deployed if this was demonstrably in the best interest of the investors as a whole."*

45. It is difficult not to observe the strong similarity between that case and this one on the material that I have seen so far but, as I have indicated, these are all matters that Dr Harrison, through the general

partner, wishes to contest. No doubt at the trial I will hear argument and evidence on both sides of the court in relation to the allegations that are made against Dr Harrison and the general partner by the Petitioners and the counter-allegations that are made by Dr Harrison and the general partner against the Petitioners, and I will make a final decision on the basis of the evidence and argument that I hear on that occasion. However, in doing so, both parties are likely to continue to incur very substantial costs that will have to be paid by the various parties, depending on the costs orders that are made.

46. As to the costs of arguing this issue before me, Mr Ayres contended that the general partner was the winner, albeit for different reasons than he had argued, and should have its costs. Mr Farmer addressed me on costs for the Petitioners and argued that costs should be reserved, which would be the usual outcome on a summons for directions.

47. I have concluded that the general partner has effectively been the winner on this particular issue; the Petitioners raised the specific issue of making an order under CWR O.3, r.12 and have not obtained what they were seeking, and it is right that general partner should have its costs of arguing this point on the summons for directions, to be taxed on the standard basis if not agreed. I do not consider it is appropriate to reserve the costs to the hearing of the petition.

Dated 2 November 2025



THE HONOURABLE JUSTICE JALIL ASIF KC
JUDGE OF THE GRAND COURT

ITEM NO. 190

JA-76

Neutral Citation Number: [2025] CIGC (FSD) 124

Cause No: FSD 2025-0146 (JAJ)
and Cause No: FSD 2025-0151 (JAJ)

IN THE GRAND COURT OF THE CAYMAN ISLANDS
FINANCIAL SERVICES DIVISION

BETWEEN:

(1) UNICORN BIOTECH VENTURES ONE LTD
(in its capacity as general partner of RIGMORA BIOTECH INVESTOR ONE LP)

(2) UNICORN BIOTECH VENTURES TWO LTD
(in its capacity as general partner of RIGMORA BIOTECH INVESTOR TWO LP)

Plaintiffs

-and-

ATP III GP, LTD
(in its capacity as general partner of ATP Life Science Ventures, L.P.)

Defendant

Appearances:	**Mr Andrew Scott KC of counsel instructed by Mr Liam Faulkner, Mr Hugo Farmer and Ms Yuan Wen of Campbells LLP for the Plaintiffs / Petitioners**
	Mr Andrew Ayres KC of counsel instructed by Ms Shelley White, Ms Laure Astrid Wigglesworth and Ms Rebecca Mosely of Walkers (Cayman) LLP for the Defendant / Respondent
Before:	**The Honourable Justice Jalil Asif KC**
Heard:	**17 December 2025**
Ex tempore judgment delivered:	**17 December 2025**
Finalised judgment approved:	**22 December 2025**

Civil procedure—vacation of trial—effect of defendant filing for Chapter 11 bankruptcy protection in the United States on conduct of proceedings before the Grand Court—case management considerations

- -

JUDGMENT

- -

1. This writ action and winding up petition are listed before me today for a combined pre-trial review in advance of a trial in both matters due to commence on 12 January 2026. This hearing has been fixed in the calendar since October 2025 and was intended to be used to address any last-minute issues concerning preparation for the trial.

2. As in previous hearings before me, the limited partners who are the Plaintiffs / Petitioners have been represented by Mr Andrew Scott KC, supported by Mr Liam Faulkner, Mr Hugo Farmer and Ms Yuan Wen of Campbells LLP, and the Defendant / Respondent general partner has been represented by Mr Andrew Ayres KC, supported by Ms Shelley White, Ms Laure Astrid Wigglesworth and Ms Rebecca Mosely from Walkers (Cayman) LLP. I will refer to the parties respectively as the LPs and the GP.

3. In the last two weeks there have been two substantial developments, the first of which will have a significant effect on the intended progress of the trial; the second of which has largely derailed it. The first is that on 5 December 2025, just over 10 business days ago, Chancellor McCormick in Delaware gave judgment in the parallel proceedings between the parties dealing with certain issues about the GP's entitlement to make capital calls from the LPs, rejecting parts of the GP's case. This is likely to have consequences for the conduct of the winding up petition before the Grand Court, in particular Mr Scott argues that it will significantly simplify the question whether a winding up order should be made. If the trial before the Grand Court were to proceed, there would also be arguments about the extent to which any findings by Chancellor McCormick might be binding on the parties in respect of their disputes before the Grand Court. However, the parties have always known that that would be the case.

4. Secondly, and more significantly, on 9 December 2025, the GP and certain other linked entities sought Chapter 11 bankruptcy protection in the United States including, as part of that protection, a worldwide automatic stay of proceedings in any other jurisdiction.

5. The GP's intention to seek Chapter 11 protection was not foreshadowed in any way either to the LPs or to the Grand Court. Indeed on 8 and 9 December 2025, at the same time that the GP and Quinn Emanuel, its lead attorneys in the US proceedings, must have been preparing the GP's Chapter 11 filings (including a lengthy declaration of Dr Seth Harrison, the controller of the GP), Walkers were dealing with the Grand Court and the Court of Appeal in relation to the GP's intended expedited appeal against an Order I had made on 1 December 2025 concerning a privilege issue regarding discovery. In their dealings with Campbells, the Grand Court and the Court of Appeal on 8 and 9 December 2025, Walkers expressly represented that the GP did not intend the appeal to disrupt the trial fixed for 12 January 2026. There is no suggestion that Walkers were aware of the GP's intended Chapter 11 filing in the United States, which would be wholly contradictory to the representations made by them.

6. Thus, it is now clear that, for the second time within less than 3 weeks, the GP and Quinn Emanuel have not informed Walkers of important matters relevant to the proper conduct of the Cayman proceedings, with the result that the position has been actively misrepresented to the Court. This is extremely unsatisfactory and is to be deprecated.

7. Of a piece with this, it is also extremely regrettable that a partner in Quinn Emanuel considered it appropriate to write directly to an associate at Campbells on 11 December 2025 threatening all kinds of personal consequences as a result of Campbells' indication to the Grand Court on 10 December 2025 that they considered that the PTR should proceed, contrary to Walkers' request to vacate it, so that the Court could be properly informed of developments in Delaware and consider what consequences they had for the matters before the Grand Court. Quinn Emanuel asserted in the letter that the communication to the Grand Court was itself a violation of the automatic stay under Chapter 11. This is in marked contrast to the submissions on behalf of the GP at an oral hearing before the Delaware bankruptcy judge on 15 December 2025, where the transcript of the hearing that is before me records that an attorney from Quinn Emanuel orally submitted in relation to the PTR today:

> *"[…] on the specific issue of the Wednesday hearing. It is a pretrial conference. There is no dispute that the lawyers in the Cayman Islands should apprise the Court as to the goings on here. That is not -- I don't think there is any dispute that that can and should happen. In fact, we did inform the Court of the filing of the case and the judge did indicate that he wants to have counsel there to, at least, give him an update as to what is going on here. That makes all the sense in the world."*

Bullying correspondence of the kind exemplified by Quinn Emanuel's letter dated 11 December 2025, whilst it might be acceptable in the United States (although I doubt that), is completely unacceptable in the Cayman Islands. I do not want to see similar conduct in any matters that come before me by any American law firms involved in the background, still less by any local attorneys.

8. The PTR hearing before me today has focused on the consequences of the GP's filing of the Chapter 11 proceedings in the United States and the impact of the automatic stay under American law on what is happening and due to happen before the Grand Court.

9. It seems to me that the first point is the obvious one that the trial cannot proceed on 12 January 2026 and must be vacated. That is for two reasons. First, because neither of the parties are able to take steps to prepare for that trial whilst the Chapter 11 proceedings are live. Whilst the Chapter 11 stay is not directly enforceable in the Cayman Islands and no application has been made to recognise the Chapter 11 proceedings here, the GP and all the partnership assets are based in the United States. Thus, even if either of the parties were to take steps to try to progress the matters before the Grand Court, there would probably be arguments in Delaware that they are in contempt, with potentially severe consequences for them and for all of the partnership's assets. So, I do not criticise either party for taking the view that the January trial cannot realistically proceed.

10. I note that the LPs are seeking or intend to seek in Delaware, first, to dismiss the Chapter 11 proceedings as an abuse, and secondly, an order waiving or disapplying the automatic stay so that a slimmed down trial, taking into account Chancellor McCormick's recent judgment, can proceed before the Grand Court later in January 2026. Those motions in Delaware have not yet been briefed or determined and it appears unlikely that they will be determined until sometime during January 2026 at the earliest, which is also inconsistent with the ability to proceed with the intended trial on 12 January 2026.

11. The second reason why it seems to me that the trial cannot and should not proceed on 12 January 2026 is that the LPs' position is that the effect of the GP's Chapter 11 filing is that the partnership is now in voluntary liquidation under Cayman law. So, a number of the issues that were going to be fought out in the 12 January trial are likely no longer to be live issues and will probably not need to be determined by the Court. I therefore have no hesitation concluding that the trial fixed to commence on 12 January 2026 should be vacated.

12. The second question is whether the Court should fix a date in January or February 2026 for hearing a streamlined version of the substantive winding up petition presented by the LPs, which is the LPs' position, or whether, as the GP argues, the Court should simply await developments in Delaware and essentially take no further steps to move the Cayman disputes forward until clarity is obtained on the position in the United States.

13. I do not find the GP's position to be a particularly attractive one. The parties have throughout sought to advance the resolution of the disputes between them both in Delaware and in the Grand Court on an expedited basis. My own view is that an orderly separation of the GP from the LPs needs to occur sooner rather than later to avoid the continuation of these obviously corrosive disputes between the parties on each side. It does not seem to me to be productive or a beneficial use of the parties' time and resources for this dispute to drag on for any longer than absolutely necessary. The only people who are profiting from this dispute at the moment are the lawyers on each side.

14. I therefore conclude that I should fix a date for the trial of what the LPs have called the "paragraph 10(b) issues" for the week commencing 2 February 2026. If, for any reason, events in Delaware do not progress on a schedule that allows the parties to prepare for and conduct that hearing, then the parties can apply to me in mid to late January with a view to adjourning the trial and moving it perhaps into March 2026. But it seems to me that it is far better that I allocate that time and give the parties a date to be working towards now so that my calendar does not fill up in the intervening period. If I did not do so, and the parties were to come back to me in mid to late January 2026 following a decision by the Delaware judge on either the dismissal of the Chapter 11 proceedings or a carve out for the Grand Court proceedings from the automatic stay, the likelihood is that the earliest date that I could then give them would not be until the middle to the end of March, and perhaps even into April 2026.

15. I am inclined to accept Mr Scott's submission that Chancellor McCormick's findings and the fact of the Chapter 11 filing in the United States, and their consequences under the limited partnership agreement and Cayman Islands law, have the result that it ought not to be necessary any longer to get into the question whether the LPs have lost trust and confidence in the GP's ability to manage the partnership. It seems to me that Mr Scott is right to say that the issue for the Court, or at least a preliminary issue for the Court, is the question whether there has been a loss of substratum, which on its own would justify the making of a winding-up order without the necessity to get into the questions of loss and of trust and confidence.

16. It seems to me that two days should be sufficient for the Court to determine the paragraph 10(b) issues, which are largely matters of law and construction of the limited partnership agreement. To the extent that there is likely to be any need to consider questions of fact, they are likely to be relatively circumscribed in their scope. I note in passing, and with some admiration, that Chancellor McCormick was able to hear the Delaware trial in two days. I appreciate that there are significant differences in the procedural approach of the US courts to the conduct of trials compared to the approach of the Grand Court, but I think that with goodwill and cooperation on both sides it ought to be feasible to have a hearing of the more limited nature proposed by the LPs within a two-day time estimate.

17. I agree with Mr Ayres on behalf of the GP that it will be necessary for the LPs to make amendments to their winding up petition so that it is clear precisely what their case is, both for the GP and also for the Court when it comes to deal with the hearing of the petition. It also seems to me that Mr Scott is correct that the appropriate procedural way to characterise the hearing in February 2026 is that it will be a trial of preliminary issues, so that if, for any reason, I determine that the partnership's substratum has not been lost, then the LPs have the ability to come back and to argue the loss of trust and confidence points at a later stage, if there is any real appetite on either side for the matter to proceed beyond February 2026.

18. However, having said that, I will not make an order at this stage imposing any procedural timeline for the preparation of amended pleadings because I am conscious that there may well be arguments that the parties are unable to take any such substantive steps whilst the stay under Chapter 11 applies to them.

19. I understand that the matter is before the Delaware judge this afternoon. It does seem to me that, at the very least, it would be of real utility for the Delaware judge to authorise the preparation of amended pleadings on both sides in order to re-state what are the issues that the Grand Court will need to determine in due course. It also seems to me that it would be of real utility for the Delaware judge, as soon as possible, to determine that the limited issues that the LPs wish to put before the Grand Court for determination should be excluded from the scope of the automatic stay so that a determination on those issues can be made. A decision on those points is likely to be of real benefit to the parties and also to the Delaware court if the Chapter 11 proceedings are not dismissed and continue.

20. For what it is worth, I will conclude by saying that I generally take the view that the conduct of the winding up of a Cayman exempted limited partnership, and by whom that winding up ought to be carried out, are more appropriately questions for the Grand Court to determine supported by Chapter 15 recognition in due course, rather than by Chapter 11 proceedings. It is for the Delaware judge to take whatever view of that indication that she wishes to take.

21. It also occurs to me, without the benefit of full argument, but as a preliminary view, that the proposal for capital restructuring and the introduction of new investors, which is adverted to by Dr Harrison in his declaration in support of the Chapter 11 proceedings, appears at first blush to be outside the proper scope of the GP's powers based on the limited partnership agreement which is binding upon the GP, and also having regard to applicable Cayman law on what a GP's obligations are in the context of a winding-up of a Cayman exempted limited partnership.

Dated 17 December 2025



THE HONOURABLE JUSTICE JALIL ASIF KC
JUDGE OF THE GRAND COURT

ITEM NO. 191

JA-77

FILED UNDER SEAL



Neutral Citation Number: [2026] CIGC (FSD) 5

Cause No: FSD 2025-0146 (JAJ)
and Cause No: FSD 2025-0151 (JAJ)

IN THE GRAND COURT OF THE CAYMAN ISLANDS
FINANCIAL SERVICES DIVISION

BETWEEN:

(1) UNICORN BIOTECH VENTURES ONE LTD
(in its capacity as general partner of RIGMORA BIOTECH INVESTOR ONE LP)

(2) UNICORN BIOTECH VENTURES TWO LTD
(in its capacity as general partner of RIGMORA BIOTECH INVESTOR TWO LP)

Plaintiffs

-and-

ATP III GP, LTD
(in its capacity as general partner of ATP Life Science Ventures, L.P.)

Defendant

Appearances:	**Mr Andrew Scott KC of counsel instructed by Mr Liam Faulkner, Mr Hugo Farmer, Ms Yuan Wen, and Mr Jordie Fienberg of Campbells LLP for the Plaintiffs**
	Mr Andrew Ayres KC of counsel instructed by Mr Rupert Bell, Ms Shelley White and Ms Laure Astrid Wigglesworth of Walkers (Cayman) LLP for the Defendant
Before:	**The Honourable Justice Jalil Asif KC**
Heard:	**28 November 2025**
Decision communicated	**1 December 2025**
Judgment:	**27 January 2026**

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JUDGMENT

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A. Introduction

1. There are two actions before the Court, which have been case managed and have proceeded in tandem. The purpose of this judgment is to determine a summons filed by the Defendant in each action raising an issue as to whether the Defendant is able to claim privilege over certain documents, which are agreed to be relevant to the issues in the two actions, or can otherwise prevent the Plaintiffs from using the documents at the trials of these two matters.

2. I communicated my decision to the parties on 1 December 2025 that the Defendant cannot maintain a claim to privilege in respect of the documents in question and that they are available for use by the Plaintiffs in the actions before the Grand Court. I now return to this matter to provide my reasons for that decision. This apparently simple question has a relatively complex factual and procedural background, which I must set out for context.

3. I also record that the conduct of the Defendant's onshore attorneys at law in this matter has fallen seriously below that which I am entitled to expect from them, as I explain later in this judgment.

B. Relevant background

B.1 The proceedings before the Grand Court and in Delaware and their genesis

4. The first of the two actions before the Grand Court is a writ action commenced by the Plaintiffs on 2 June 2025 with Cause No. FSD 2025-0146. The second is a winding up petition, with the Plaintiffs as petitioners, presented on 6 June 2025 on the just and equitable basis with Cause No. FSD 2025-0151. In addition, there is an ongoing action in Delaware commenced on 30 May 2025 by the Defendant in the Grand Court proceedings against the Plaintiffs in these proceedings.

5. The Delaware proceedings have been assigned to Chancellor McCormick, who ordered that the Delaware trial should be expedited. The evidentiary hearing took place on 16 and 17 October 2025, the parties filed their written closing arguments from late October to mid November 2025 and, at the time of the oral argument before me on the Defendant's summonses, the parties were awaiting judgment in that action. Chancellor McCormick subsequently handed down her judgment on 5 December 2025, after I had communicated my decision on the Defendant's summonses to the

parties on 1 December 2025. I have not reviewed or considered the content of Chancellor McCormick's judgment in the course of preparing this judgment.

6. The trials of the Grand Court actions were fixed to commence on 12 January 2026, i.e. just over 7 months from the date of issue and some six weeks from the date when I heard the Defendant's summonses. As I have indicated in earlier judgments in these matters, the procedural timetable has been significantly compressed and the procedural steps to be taken by the parties have been streamlined in order to achieve the 12 January 2026 trial date.

7. However, on 17 December 2025, I had to vacate the trial due to the Defendant filing for Chapter 11 bankruptcy protection in the United States of America on 9 December 2025. Whilst there is no automatic recognition in the Cayman Islands of a Chapter 11 filing in the USA or of the stay upon other proceedings flowing from such a filing, the reality was that the parties were unable to continue to prepare the matter for trial in light of that filing.

8. All three proceedings arise out of the collapse of the personal relationships between the individuals involved in an exempted limited partnership formed under Cayman Islands law ("**the Fund**"). The Fund has a single general partner entity, which is the Defendant in the writ action and the subject of the winding up petition. I will refer to the Defendant as the GP. The dispute is between the main investors in the Fund and the GP. The two Plaintiff investors are vehicles for Dr Dmitri Rybolovlev, a Cypriot national of Russian origin. The sole director of the GP, Dr Seth Harrison, is an entrepreneur responsible for developing a number of portfolio companies in which the Fund has interests, each of which is involved in the life sciences industry. Dr Harrison, his family trust and certain employees comprise the other members of the Fund. It is common ground that the Plaintiffs have contributed roughly 98% of the Fund's capital and that the Fund is currently worth at least US $2.4 billion. As the other limited partners in the Fund are not taking part in the proceedings, I will refer to the Plaintiffs as the LPs.

9. The relationships between the partners in the Fund are governed by a limited partnership agreement, which has gone through multiple amendments and revisions ("**the LPA**").

10. On 15 May 2025, in the course of discussions regarding the Fund's capital requirements, the LPs wrote to the GP indicating that they did not consider that it was in the Fund's best interests to allocate further funding to certain early-stage portfolio companies, which they said had failed to meet required milestones. They stated that they understood that the GP held a similar view, based on the GP's proposal to reallocate the investments budgeted for those early-stage companies to other portfolio companies. The LPs continued that if the GP disagreed then it should provide a detailed explanation of its position. The LPs confirmed that they intended to comply with the requirements of the LPA and would be cooperative if the GP could demonstrate that the LPA permitted the GP to call for further funding. The LPs requested that, if the GP agreed with the LPs' position, then the GP should put forward proposals to salvage value from the early-stage portfolio companies in question. In addition, the LPs indicated that they would consider approving new budgets for the portfolio companies that appeared to be commercially viable if they were provided with certain information.

11. As I have indicated, the GP commenced the Delaware proceedings on 30 May 2025. In that action, the GP claims that the LPs' email dated 15 May 2025 was a repudiatory breach of the LPA.

12. On 30 May and 1 June 2025, the GP made a large number of capital calls demanding payment by the LPs of a total of over US $101 million, with payment required within 14 days. The LPs say that they have contributed all the capital to the Fund that they are required to contribute and that the capital calls were made by the GP to try to engineer a default by the LPs under the terms of the LPA. The LPs say this is because the GP has alleged that the LPA gives the GP power to confiscate up to 50% of a limited partner's interest and to re-allocate it to other limited partners where a default has occurred and certain other steps have been taken. The LPs believe that the GP was manoeuvring to put itself in a position to exercise that power against the LPs and in favour of the other limited partners in the Fund, including Dr Harrison's family trust. Interests in the Fund worth up to about US $1.2 billion could potentially be transferred away from the LPs to other limited partners if the LPs were in default of the LPA and the other steps required under the LPA were taken.

13. Against that background, the LPs commenced the writ action in the Grand Court on 2 June 2025, which was the first working day after 30 May 2025, seeking declarations that they are not in default of the LPA. By the winding up proceedings, commenced on 6 June 2025, the LPs seek an order that

the Fund be wound up on the just and equitable basis, primarily on the ground that they have lost all trust and confidence in Dr Harrison and, through him, in the GP as general partner of the Fund.

B.2 The Consent Orders for discovery in the Grand Court actions

14. On 12 June 2025, the LPs filed an summons in the writ action seeking an interim injunction to restrain the GP from taking any steps to enforce any of the provisions in the LPA premised on a default by the LPs in making the disputed capital calls and from making any further capital calls other than with the LPs' consent. The summons was listed before me on notice on 20 June 2025, when I granted an injunction substantially in the terms sought by the LPs.

15. The two Grand Court matters came back before me on 1 August 2025: (a) on the return date of the injunction; (b) on summonses filed by the GP to stay each of the Grand Court actions in favour of the Delaware action; and (c) on summonses for directions filed in each action by the LPs. Both parties were represented at the hearing by experienced leading counsel: the LPs by Mr Andrew Scott KC, who continues to appear for the LPs, and the GP by Ms Sue Prevezer KC, who has been replaced since that hearing by Mr Andrew Ayres KC. Ms Prevezer, on behalf of the GP, sought to vary the terms of the injunction and also sought an order that the LPs fortify their undertaking in damages, both of which I refused. The parties agreed that the GP would withdraw its summonses to stay the Grand Court actions, with costs reserved. The parties indicated that they had agreed directions to enable the trials of the Grand Court actions to be heard on 12 January 2026 and that they would prepare a draft order for directions in each action. The directions would necessarily require a streamlined process to enable all of the essential procedural steps to be taken in time for a trial on that date.

16. On 12 August 2025, the parties provided the Court with a draft consent order for directions in each action, which were in essentially the same terms. I circulated revised draft orders the same day and the parties provided their comments on 20 August 2025. I made some further minor revisions to the draft consent orders and the parties indicated their agreement to those revisions. I therefore finalised and signed the Consent Orders on 20 August 2025 but dated the Orders as of 1 August 2025 to reflect that that was when the parties had reached their agreement in principle on the terms of the Consent Orders.

B.3 The draft discovery protocol

17. The Consent Orders refer to a discovery protocol, which is to be agreed by the parties. Campbells LLP, the LPs' Cayman attorneys, circulated an initial draft discovery protocol on 4 July 2025. As I explain later in this judgment, there does not appear to have been any active discussion on the content of this draft protocol before the directions hearing on 1 August 2025. The issues regarding discovery were advanced in correspondence between the parties during July and August 2025 instead.

18. On 2 September 2025, Walkers (Cayman) LLP, the GP's Cayman attorneys, produced a superseding draft discovery protocol. In harmony with the Consent Orders, this document is explicitly in two parts, addressing first the question of the admissibility and use of the discovery in the Delaware action for the purposes of the Grand Court actions, and then the treatment of additional discovery in the Grand Court actions. Campbells provided their comments on the new draft discovery protocol on 4 September 2025. Following the developments in Delaware regarding discovery between 2 and 8 September 2025, discussed in the following section of this judgment, the GP sought to make further revisions to the draft protocol on 12 September 2025. Discussions between the parties continued during September and October 2025. The protocol was eventually agreed on 29 October 2025, but incorporating a provision that the court would determine the issue of privilege under Cayman law raised by the GP's summonses.

B.4 Relevant procedural steps in the Delaware proceedings

19. In the Delaware proceedings, the parties agreed a stipulation dated 21 July 2025 regarding confidentiality of discovery materials. This was made an order of the Delaware Court on the same date, with one clarification or modification ordered by the Chancellor. The confidentiality stipulation addresses the use of confidential documents and information from the Delaware proceedings in the Grand Court actions, amongst other things. The stated effect of the confidentiality stipulation is that the parties are permitted to use any discovery material from the Delaware proceedings in the Grand Court actions provided that they use reasonable efforts to agree or to obtain orders from the Grand Court preserving the confidentiality of documents similarly to the protections in the confidentiality stipulation. The parties are agreed that the terms of the discovery protocol will satisfy the requirement for equivalent confidentiality provisions to apply.

20. On 30 July 2025, two days before the directions hearing before me on 1 August 2025, the GP indicated that it was claiming privilege in Delaware in respect of approximately 15,000 documents. The LPs disputed the GP's claim to privilege, in particular for documents pre-dating 15 May 2025, which apparently numbered about 14,500 of the 15,000 documents. The LPs asserted that, as 98% limited partners in the Fund, they were within any applicable privilege for any period when the GP shared a "mutuality of interest" with the Fund, i.e. when there was no adversity between the GP and the LPs. Given that the GP's case in the Delaware action is that the relationship between the parties broke down following receipt of the LPs' letter dated 15 May 2025, the LPs asserted that there was mutuality of interest at all times before that date.

21. The parties were unable to resolve the privilege issue by agreement. On 17 August 2025, the LPs filed a Motion to Compel, which challenged the GP's claim to privilege in respect of documents of various kinds that pre-dated 15 May 2025 and sought an order for discovery of the 15,000 documents. In its opposition to the Motion to Compel, the GP did not contest the "mutuality of interest" approach to the question of privilege.

22. On 2 September 2025, Chancellor McCormick ruled on the LPs' Motion to Compel. On the basis of the parties' mutual interest in the Fund before 15 May 2025, the Chancellor ordered that the parties select a special discovery magistrate to conduct a review of 100 documents selected by the LPs from the GP's list of privileged documents. She continued that if the special discovery magistrate were to conclude that the GP had improperly withheld more than 30 of those documents, then she would grant the discovery sought by the LPs, subject to an exceptions process.

23. The LPs rely on a note prepared by an independent Delaware law firm, Bayard P.A., as expert evidence on Delaware procedure and practice. The note explains that the mechanism that I have set out in the previous paragraph is commonly used by the Delaware courts, and that it is well established that improper claims to privilege in Delaware can result in the loss of privilege. This is particularly so in expedited proceedings, where the parties are expected to take extra care in preparing their privilege log correctly in the first instance. The LPs submit that the only unusual feature of Chancellor McCormick's order was the generosity of the 30% error rate in favour of the GP: the note suggests that the Delaware court tends to allow a 10% error rate. Although it was not in the form normally required for expert evidence, the substance of this evidence was not challenged

by the GP. I take the evidence into account insofar as it assists in understanding this procedural step in the progress of the Delaware proceedings, but it does not have any wider impact on my decision on the GP's summonses.

24. The parties appointed an independent lawyer to act as special discovery magistrate in Delaware. The parties agreed with the special discovery magistrate on 3 September 2025 that he would conduct a two-step analysis of the sampled documents:

24.1 the magistrate would assess whether the document was privileged and, if not, it should be produced;

24.2 for putatively privileged documents, the magistrate would assess whether there was adversity between the GP and the LPs in respect of the document and, if not, then the document should be produced.

25. The magistrate conducted his review and reported on 3 September 2025 that 60 of the 100 documents had been improperly withheld, with 8 of them not being privileged at all and there being no adversity between the GP and the LPs in relation to 52 of them.

26. The GP filed an application with the Chancellor on 3 September 2025 to clarify whether the LPs had waived production of certain categories of documents. On 5 September 2025, the GP sought to raise a number of exceptions to production with the Chancellor, arguing that the magistrate had misapplied Delaware law regarding mutuality of interest. On 8 September 2025, the Chancellor rejected the GP's applications and ordered that the GP produce all 15,000 documents. I will adopt the GP's description of these documents as the Compelled Documents for convenience; it does not indicate that I accept Mr Ayres' argument that the GP should be treated as having been compelled to produce the documents in question for the purpose of deciding whether the GP has lost any privilege in the documents under Cayman law.

27. The GP did not appeal the Chancellor's decisions of 2 or 8 September 2025 and produced the Compelled Documents in the Delaware action over the period between 8-15 September 2025. The GP designated most of the Compelled Documents as either "Confidential Discovery Material" or "Highly Confidential Discovery Material" in accordance with the mechanism set out in the confidentiality stipulation. However, the GP did not seek any other protection from the Delaware

court regarding the Compelled Documents and their use in the Delaware proceedings, or in the Grand Court actions.

B.5 The LPs' application to appoint provisional liquidators

28. On 17 September 2025, the LPs filed a summons in the Grand Court winding up proceedings seeking to appoint provisional liquidators in respect of the Fund. The LPs relied on 10 documents from the Compelled Documents to support the relief sought by the summons. Walkers wrote on 21 September 2025 complaining about the LPs' intended reliance on those documents, asserting that they remained highly confidential and privileged, and could not be used in the Grand Court proceedings. They demanded that the LPs withdraw the summons.

29. Following further applications in Delaware, the LPs did withdraw the summons to appoint provisional liquidators, with some reluctance. Nevertheless, the LPs maintained that they were fully entitled to use the Compelled Documents within the Grand Court actions.

B.6 The GP's summonses

30. The GP filed the summonses on 2 October 2025 in response to the LPs' application to appoint provisional liquidators over the Fund. However, following the LPs' withdrawal of that summons, the GP continues to pursue the relief sought due to the wider implications for the use of the Compelled Documents within the Grand Court actions, and particularly at the trials.

31. The GP's summonses seek the following relief:

    31.1 a declaration that the 10 documents relied upon by the LPs to support their summons to appoint provisional liquidators are privileged under Cayman law;

    31.2 a declaration that the GP has not waived privilege in any of the Compelled Documents (including the 10 documents relied upon by the LPs) by their production in the Delaware action or by the Consent Orders dated 1 August 2025;

    31.3 a declaration that the LPs cannot use or rely in the Grand Court actions on any of the Compelled Documents which are privileged under Cayman law;

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31.4 a declaration that the LPs cannot use or rely in the Grand Court actions on any privileged information that they have obtained from the Compelled Documents which are privileged under Cayman law;

31.5 return, destruction and/or redaction of the Compelled Documents by Campbells;

31.6 orders that certain of the evidence filed in respect of the GP's summonses be sealed;

31.7 if any relief is granted, then an order that the Grand Court trials be heard by a different judge; and

31.8 costs.

B.7 The evidence on the GP's summonses

32. The evidence relied upon in respect of the GP's summons in the writ action is set out below. In each case, the same or corresponding evidence was relied upon in the winding up proceedings:

32.1 the first affirmation and exhibit PB-1 of Patrik Blöchlinger, the LPs' Chief Legal Officer, affirmed on 22 September 2025 in support of the LPs' application to appoint provisional liquidators over the Fund, redacted to remove references to the content of the 10 documents;

32.2 the first affidavit and exhibit DF-1 of Daniel Finkelman, the GP's general counsel, sworn on 3 October 2025, also redacted to remove references to the content of the 10 documents;

32.3 the second affirmation and exhibit PB-2 of Patrik Blöchlinger affirmed on 4 November 2025; and

32.4 the second affidavit and exhibit DF-2 of Daniel Finkelman, the GP's general counsel, sworn on 17 November 2025, again redacted in certain respects.

33. Shortly before the hearing of the GP's summonses on 28 November 2025, the parties agreed that they should each be permitted to adduce some further evidence of recent developments in the Delaware proceedings. That further evidence was put before me in the following forms:

33.1 the second affidavit and exhibit JF-2 of Jordie Fienberg, an attorney at Campbells, sworn on 25 November 2025; and

33.2 the signed approved draft affidavit and exhibit AB-1 of Andrew Berdon, the lead partner at Quinn Emanuel Urquhart & Sullivan, the GP's primary on-shore attorneys, dated 27 November 2025.

34. Mr Fienberg's evidence was sworn: (a) to support the LPs' case that the GP has lost any privilege in respect of four documents that are referred to in the publicly filed version of the LPs' post-trial brief in the Delaware action; (b) to put forward that the GP's attorneys had had the opportunity to request redactions to the publicly filed version of the LPs' post-trial brief but did not do so; and (c) to state that Mr Berdon had referred to and made submissions on one of the documents during his own oral closing arguments in Delaware, implicitly confirming that the GP has waived any privilege or no longer relies upon privilege in relation to those documents.

35. Mr Berdon's signed approved draft affidavit dated 27 November 2025 was prepared to answer Mr Fienberg's evidence and to argue that the LPs had breached the confidentiality stipulation embodied in the order of the Delaware Court dated 21 July 2025 and other sealing rulings of Chancellor McCormick by referring to the four documents in the public version of its post-trial brief. It also made other allegations regarding the LPs' conduct in relation to the Delaware proceedings. Mr Berdon swore his affidavit in the same form as his signed approved draft on 2 December 2025. I will therefore refer to it in this judgment as his affidavit, although it was in unsworn form before me on 28 November 2025.

C. The parties' positions on the GP's summonses

C.1 The GP's arguments

36. Mr Ayres commenced his oral submissions by stating that the GP is no longer seeking the relief in paragraph 1(a) of the GP's summonses, namely a declaration that the 10 documents that the LPs had sought to rely upon in support of their application to appoint provisional liquidators are privileged. He says that the focus of the GP's summonses has shifted as a result of the LPs abandoning their application to appoint provisional liquidators. Instead, the GP only seeks a declaration that it has not waived privilege under Cayman law or lost confidentiality in respect of the Compelled Documents as against the LPs, whether by their production to the LPs in Delaware or by the Consent Orders dated 1 August 2025 in the Grand Court actions, and consequential relief. Mr

Ayres argues that any question whether particular documents are privileged should be determined on another occasion, once the GP has carried out a privilege review of the Compelled Documents applying Cayman law. By taking this position, the GP seeks to avoid having to deal with the third of the LPs' arguments, which I summarise in the following section of this judgment.

37. Mr Ayres summarises the GP's case as being that there has been no waiver of privilege under Cayman law in respect of the Compelled Documents, and that the limited loss of confidentiality resulting from the production of the Compelled Documents does not prevent the GP from continuing to assert privilege against the LPs. He argues that:

37.1 The issues raised by the GP's summonses are governed by Cayman law, as the law of the forum: _____ [2016] 2 CILR 353 at [6]-[9].

37.2 Privilege under Cayman law has not been lost:

(a) the fact that privilege may have been lost in another jurisdiction does not affect whether it applies under Cayman law: at 5.42; citing _____ _____ [1999] 3 All ER 154 and [1999] FSR 641, per Aldous LJ at 167;

(b) because the Compelled Documents were produced pursuant to an order of the Delaware court, their production does not have the necessary voluntary character to give rise to a waiver of privilege under Cayman law: _____ _____ [2004] EWCA Civ 1064, per Mummery at [35];

(c) properly construed, the 1 August 2025 Consent Orders do not amount to any waiver of privilege or consent to the use of the Compelled Documents in the Grand Court actions;

(d) the GP's position on the effect of the Consent Orders is supported by the surrounding context, in particular the terms of the draft discovery protocol; and

(e) the position was made clear by the GP's revisions to the draft discovery protocol on 12 September 2025.

37.3 The LPs' case that any confidentiality regarding the Compelled Documents has been lost is misconceived. But, if there were any loss of confidentiality in respect of the Compelled Documents, then it was only as regards the LPs, or their legal advisors only for documents marked "Highly Confidential Discovery Material", and does not prevent the GP from asserting privilege under Cayman law against the LPs.

37.4 In relation to the four Compelled Documents that are referenced by the LPs in the publicly filed version of their post-trial brief in Delaware, and the Compelled Documents referred to by the GP, Mr Ayres submitted orally, based on Mr Berdon's affidavit that:

(a) the LPs have wrongfully breached the confidentiality stipulation in the Delaware proceedings and should not be permitted to rely upon their own breaches of privilege and confidentiality in Delaware to argue before the Grand Court that the GP has lost the ability to claim privilege in relation to those documents under Cayman law; and

(b) any references to the four Compelled Documents by the GP in the GP's own post-trial brief was inadvertent and is in the course of being removed, and therefore should not be treated as supporting a conclusion that the GP has waived privilege or confidentiality.

C.2 The LPs' response

38. Mr Scott's argument on behalf of the LPs is that both the Delaware confidentiality stipulation and the Consent Orders permit the LPs to use the Compelled Documents in the Grand Court actions.

39. Mr Scott complains that because of the GP's last-minute abandonment of its claim for a declaration that the 10 documents relied on by LPs on their application to appoint provisional liquidators are privileged, there is no remaining foundation for the GP's application to prevent the LPs from deploying those documents.

40. In addition, Mr Scott argues that the GP could never assert privilege over any of the Compelled Documents against the LPs. He says that the GP's position is that it obtained legal advice on behalf of the Fund in the period up to 15 May 2025 and paid for it, properly, from Fund assets. He says that the LPs do not accept that factual case: but having adopted this position, the GP cannot properly assert any privilege in documents containing such legal advice, including the Compelled Documents, against the LPs. That is because any privilege would be that of the Fund rather than the GP personally, and the Fund includes the LPs as members. The LPs are therefore entitled to see documents for which they have paid or are to be treated as having paid. Mr Scott says that the position would be otherwise only if the GP could show that it obtained and paid for the relevant legal advice in its personal capacity, but that is not the GP's case.

41. Even if the Compelled Documents might be privileged as regards other persons, Mr Scott says that they cannot be privileged against the LPs following their production in the Delaware proceedings and applying the confidentiality stipulation and the Consent Orders. The LPs should therefore be able to deploy the Compelled Documents at trial subject only to making appropriate arrangements to sit in camera as necessary where documents designated as Confidential Discovery Material or Highly Confidential Discovery Material are being discussed.

42. Mr Scott argues that the issue for determination on the GP's summonses is not whether the Compelled Documents are privileged, which Mr Ayres has conceded the GP is not arguing now, but whether the GP can properly prevent the LPs under Cayman law from deploying the Compelled Documents in the Grand Court actions. He says that this raises three questions:

42.1 can the GP show that the Compelled Documents are privileged – which the GP is not willing or able to prove now;

42.2 can the GP show that it personally is the beneficiary of the privilege, and not the Fund – which would require the GP to argue the opposite of the factual case that it puts forward regarding the circumstances in which any privileged Compelled Documents were created; and

42.3 did the LPs receive the Compelled Documents subject to an equitable duty of confidence that prevents use of the documents – which the GP cannot prove given the circumstances in which the Compelled Documents were produced in Delaware.

43. As to the third issue, Mr Scott identified the relevant circumstances of production as being that the Compelled Documents were produced:

43.1 pursuant to the confidentiality stipulation, which expressly provides that they can be used in the Grand Court actions;

43.2 in the context of the Consent Orders that expressly permit documents produced in the Delaware proceedings to be used in the Grand Court actions;

43.3 following the contested Motion to Compel, as a result of which the Delaware court determined that the GP could not assert privilege in respect of the Compelled Documents; and

43.4 without the GP seeking to appeal the decision of Chancellor McCormick or to obtain any order from the Chancellor limiting or preventing the use of the Compelled Documents in the Grand Court actions.

44. In addition, Mr Scott complains that the GP is seeking to "kick the can" of determining the privilege status of the Compelled Documents with a view to disrupting or delaying progress towards the trials, and preventing the trials from proceeding on 12 January 2026, as ordered. Mr Scott says that this is consistent with the GP's previous attempts to derail the trials.

D. Analysis

D.1 The applicable law

45. I accept the general propositions of law advanced by Mr Ayres that privilege is to be determined according to the law of the forum and that there are strong public policy considerations underpinning the availability of legal professional privilege. In _____ [1996] AC 487 at 507, Lord Taylor described legal professional privilege as:

> *"[…] much more than an ordinary rule of evidence […] It is a fundamental condition on which the administration of justice as a whole rests."*

46. I also accept Mr Ayres' submission that the rationales for legal professional privilege are the twin public policies of the promotion of the rule of law and facilitating access to justice: _____ _____ [2005] 1 AC 610 per Lord Scott at [34].

47. I agree with Mr Ayres that the loss of privilege in another forum does not necessarily prevent privilege being asserted in proceedings before the Grand Court. Finally, I accept that if a party is compelled to give disclosure of documents in another forum, that does not necessarily result in a voluntary waiver of privilege, so that the party may still be able to rely on privilege in other contexts.

D.2 The effect of the confidentiality stipulation in Delaware

48. In my judgment, the answer to the dispute between the parties is provided by the terms of the confidentiality stipulation, which was made an order of the Delaware court on 21 July 2025, and the Consent Orders made by this Court dated 1 August 2025.

49. Paragraph 1 of the confidentiality stipulation defines "Discovery Material" to cover a wide range of documents of various kinds, including deposition testimony, exhibits and transcripts, responses to requests for admissions and to interrogatories, and discovery provided within the Delaware proceedings.

50. Paragraph 1 includes definitions of two sub-categories of Discovery Material, namely "Confidential Discovery Material" and "Highly Confidential Discovery Material". The definition of Confidential Discovery Material is Discovery Material that contains non-public, confidential, personal, business, strategic, proprietary or commercially sensitive information, which has not become part of the public record. It therefore requires that the document in question retains an element of confidentiality. Highly Confidential Discovery Material takes the concept one step further in that the designation is available in respect of Confidential Discovery Material that, if disclosed other than subject to the requirements of the confidentiality stipulation, is substantially likely, in the good faith and reasonable belief of the person producing the document, to cause injury to them.

51. In summary, paragraph 7 of the confidentiality stipulation provides that Confidential Discovery Material can be shared with the parties and their internal management involved in conducting the litigation; their attorneys-at-law and service providers assisting with the conduct of the litigation; factual and expert witnesses, but only to the extent necessary for them to give their evidence; persons already familiar with the content of the document, whether as author, addressee, recipient, custodian etc; court staff; mediators etc; and others explicitly authorised by the Delaware court. Implicitly, Confidential Discovery Material cannot be shared publicly.

52. Paragraph 8 of the confidentiality stipulation addresses Highly Confidential Discovery Material. It further limits the dissemination allowed by paragraph 7 of the confidentiality stipulation by excluding the parties themselves and their internal management (other than in-house counsel) from the persons who may view the material.

53. The effect of the confidentiality stipulation in relation to Confidential Discovery Material and Highly Confidential Discovery Material generally is therefore to preserve, so far as reasonably possible and consistently with the proper resolution of the Delaware proceedings, the existing confidentiality in such materials. This is subject to the rider ordered by Chancellor McCormick when she made the

confidentiality stipulation an order of the Delaware court, namely that to the extent that there is any conflict between the confidentiality stipulation and Court of Chancery Rule 5.1, Rule 5.1 shall take precedence.

54. Paragraph 4 of the confidentiality stipulation provides, so far as relevant, as follows:

> *"4. Confidential Discovery Material and Highly Confidential Discovery Material can only be used for purposes of this Litigation and cannot be used for any other purpose […]. Notwithstanding anything to the contrary in this Stipulation, and without prejudice to any party's discovery obligations in the Cayman Actions (as defined below), any party may use Confidential Discovery Material and Highly Confidential Discovery Material, including deposition transcripts designated as Confidential or Highly Confidential, in the proceedings pending before the Financial Services Division of the Grand Court of the Cayman Islands […] Cause No. FSD 146 of 2025, and […] Cause No. FSD 151 of 2025 […] so long as such party uses reasonable efforts to obtain confidentiality protections in the Cayman Action that are substantially equivalent to those in the Stipulation..[…]"*

55. The effect of paragraph 4 of the confidentiality stipulation is therefore that all Discovery Material, including Confidential Discovery Material and Highly Confidential Discovery Material, can be used within the Grand Court proceedings provided that the parties use reasonable efforts to obtain similar confidentiality protections as those which apply in Delaware under the confidentiality stipulation.

56. Notably, paragraph 18 of the confidentiality stipulation expressly records that:

> *"18. Entering into this Stipulation, producing or receiving Discovery Material (regardless of its designation), agreeing to produce or receive Discovery Material (regardless of its designation), or otherwise complying with the terms of this Stipulation, does not:*
>
> *a. Prejudice any right of any Party to (i) seek production of documents or information; (ii) object to the production of documents or information; […]*
>
> *[…]*
>
> *e. Operate as a waiver of any Privilege."*

Thus, the confidentiality stipulation does not affect the ability of the parties to pursue disputes before the Chancellor as to the adequacy of the discovery provided in Delaware and to assert privilege in the Delaware action over particular documents, as occurred in respect of the Compelled Documents.

57. In these circumstances, in my judgment, at the time that they agreed the terms of the confidentiality stipulation on 21 July 2025, the parties must have proceeded on the basis that any issues of privilege in respect of discovery in Delaware would be raised before and decided by the Delaware court.

D.3 The effect of the Grand Court Consent Orders

58. To recap, it was at the hearing before the Grand Court on 1 August 2025 that the parties indicated that they had agreed directions in principle leading to a trial commencing on 12 January 2026. This was two days after the GP had claimed privilege in Delaware in respect of the Compelled Documents. When addressing the Court on the withdrawal of the GP's summonses to stay the Grand Court proceedings and in respect of the agreement reached as to directions, Ms Prevezer stated (at page 60, line 9 of the transcript):

> *"[…] the agreements being reached by the parties, is that we will file a defence to the petition by 20 August, and we can draw up an order for Your Lordship that the discovery in Delaware stands as the discovery in Cayman, I think that gets moving on 13 August, that any additional discovery requests, all requests have to be made by 3 September and delivered by 24 September […]"*

59. The draft consent orders were prepared in the period between 4 and 20 August 2025, and the Consent Orders were finalised on 20 August 2025, although dated 1 August 2025. Throughout this period, the GP and the LPs were well aware that the GP was seeking to claim privilege in Delaware in respect of the Compelled Documents, and for most of this period they also knew that the LPs were challenging that claim. This is relevant background context.

60. So far as it addresses discovery, the Consent Order in the writ action is in the following terms:

> *"3. Nothing in this Order shall vary or modify any existing rights of the parties to demand, receive or inspect documents.*
>
> *4. The parties shall give discovery in accordance with GCR O.24, as modified by this Order.*
>
> *5. The following documents from the proceedings with case no. 2025-0607-KSJM before the Court of Chancery in the State of Delaware ("the Delaware Proceedings") shall be deemed to have been disclosed in this cause, shall be admissible and may be relied upon at trial:*
>
> *a) all documentary discovery given by the Plaintiffs and the Defendant;*
>
> *b) deposition testimony, exhibits and transcripts;*
>
> *c) responses to written discovery requests;*
>
> *d) responses to interrogatories; and*
>
> *e) responses to requests for admissions.*
>
> *6. By 4:00 pm on 5 September 2025, the parties may request discovery and/or inspection of any additional categories of discoverable documents that have not been disclosed in the Delaware Proceedings. For the avoidance of doubt, these requests may include requests for discovery and inspection of documents that were withheld in the Delaware Proceedings for reasons that would not justify their withholding from discovery and inspection in the Cayman Islands.*

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7. *By 4:00 pm on 26 September 2025, the parties shall exchange Lists of Documents and shall give inspection contemporaneously in accordance with the terms of a discovery protocol to be agreed by the parties.*
8. *Documents disclosed in FSD 151 of 2025 (JAJ) shall be deemed also to have been disclosed and to be admissible in this cause and vice versa.*
9. *By 4:00 pm on 3 November 2025 any party requiring inspection of a document in its original form shall give notice to the disclosing party and the disclosing party shall make such document available for inspection at the offices of its Cayman Islands' attorneys (or such other agreed place) within 21 days of such notice (or at such later time as is agreed).*
10. *Subject to GCR O.24, r.22 and to paragraph 8 of this Order, all documents disclosed or deemed to be disclosed in this cause shall be subject to the implied undertaking of confidentiality."*

The paragraphs of the Consent Order in the winding up proceedings concerning discovery mirror these paragraphs. The date when exchange of Lists of Documents was due was subsequently extended by the parties by consent to 30 October 2025.

D.4 The discussions regarding the draft discovery protocol

61. The origin of the wording in paragraph 5 of the Consent Order set out above, that the listed items from the Delaware action , is a letter from Walkers dated 17 July 2025. Walkers' letter was written against the background of the draft discovery protocol circulated by Campbells LLP on 4 July 2025, but which the parties appear thereafter largely to have ignored. The last sentence of the extract from Walkers' letter set out below makes clear that Walkers' letter was drafted with the impending agreement of the confidentiality stipulation in Delaware well in mind. Walkers said in their letter dated 17 July 2025:

> *"(b) Our client proposes that the parties agree that the discovery made in the Delaware Proceedings stand as the discovery in both the Writ Action and Petition. […]*
>
> *(c) Following completion of discovery in the Delaware Proceedings, we would propose that the parties have the opportunity to request discovery of specific categories of document in the Writ Action and the Petition, to the extent that the parties consider that there are any relevant documents for those proceedings that have not been previously discovered in the Delaware Proceedings. This would be an efficient and cost-effective way of dealing with discovery, where otherwise the parties would be required to re-produce many of the same documents that have previously been produced in the Delaware Proceedings. With that in mind, we understand that the parties' US counsel are currently liaising in relation to the terms of a confidentiality protocol which would, inter alia, allow the parties to deploy documents discovered in the Delaware Proceedings in each of the Writ Action and the Petition."*

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62. Campbells replied on 23 July 2025, two days after the confidentiality stipulation was agreed and approved by the Chancellor in Delaware, that Walkers' proposal was agreed in principle, with certain reservations. Walkers wrote back on 25 July 2025 that:

> *"(a) we agree that documents that have been discovered in the Delaware Proceedings be immediately deemed as discovered in the Writ Action and Winding Up Petition on 13 August 2025. This will mean that neither party is required to produce these documents or request inspection of the same;*
>
> *(b) with regard to the confidentiality provisions in your proposed discovery protocol (enclosed with your letter of 4 July 2025), whilst we consider the parties still need to agree the exact terms of a discovery protocol, we agree that the parties should be able to agree terms regarding confidentiality within that protocol that meet the condition in the Delaware Protocol;*
>
> *(c) we propose that the parties should endeavour to agree a discovery protocol (including terms as to confidentiality), although we do not think this requires a formal Court order. We are content to begin by providing our comments on your draft protocol following the hearing on 1 August 2025, in the event that the proceedings are not stayed;*
>
> *(d) we agree that where a document has been withheld from discovery and inspection in the Delaware Proceedings for reasons that would not justify the withholding of discovery and inspection in the Cayman Islands, it will be open to one of the parties to seek production/inspection of that document in the Writ Action or Winding Up Petition;*
>
> *(e) we consider that the parties' requests for additional categories of document will need to be subject to a deadline in order to ensure the other party has sufficient time to search for and review those documents. […]*
>
> *(f) we consider that it will be most practical, with regard to lists and inspection of documents, that the parties agree that they be permitted to file identical lists of documents in respect of the two sets of proceedings given that many documents will be relevant to both of the proceedings and it would be inefficient, given the tight timeframe for discovery, for the parties to spend time determining whether some documents be disclosed in just one of the proceedings or both of them;"*

63. Walkers do not indicate in their letters of 17 or 25 July 2025 that they are asserting or intending to assert or reserve any right of the GP to withhold documents in the Grand Court actions where those documents have been produced in the Delaware proceedings; nor do they suggest that the parties should be entitled to raise issues of privilege under Cayman law in respect of documents disclosed in the Delaware proceedings and in the Grand Court actions as a result. This was the position going into the Grand Court hearing on 1 August 2025.

64. Nothing was said in Court on 1 August 2025 by Ms Prevezer on behalf of the GP to indicate that there was any intention on the GP's part to qualify the position regarding the status of and use of the Delaware discovery within the Grand Court proceedings, as set out in Walkers' letter dated 25 July 2025. To the contrary, her position, as recorded in the agreed transcript of the hearing, was that

, reflecting Walkers' statement in the same terms in their letter dated 17 July 2025.

65. The next working day following the hearing on 1 August 2025 was 4 August 2025. On that day, Campbells sent a draft consent order to Walkers for their comments, which included the deeming wording regarding the Delaware discovery that I have set out earlier in this judgment and which appears again in the following paragraph of this judgment. That wording remained unchanged through the various drafts of the Consent Orders that followed and was carried into the final version of the Consent Orders.

66. The Consent Orders distinguish between: (a) discovery which has been given in the Delaware proceedings, which ; and (b) additional discoverable documents relevant to the Grand Court actions, for which detailed mechanisms are set out in the draft discovery protocol concerning their handling and management. It is clear to me from the terms of the documents that at the time that the Consent Orders were prepared, finalised and made by the Court, the parties intended, as the Consent Orders state, that documents in the specified classes that were disclosed in Delaware would be deemed to have been disclosed in each of the Grand Court actions, would be admissible and could be relied upon at the trials in the Grand Court actions. There is no qualification in the Consent Orders to allow the parties to raise issues of privilege under Cayman law in respect of the Delaware discovery material. This is to be contrasted with the position regarding additional discovery that would be made specifically within the Grand Court proceedings only, where the parties were expressly permitted to raise issues of privilege.

67. Objectively, this makes good sense. The Delaware action concerns the GP's claim that the LPs are in repudiatory breach of the LPA; whereas the issues in the winding up proceedings are wider, including whether the LPs can show a basis for their assertion that they have lost all trust and confidence in Dr Harrison and, through him, in the GP as general partner of the Fund. This will necessarily require a review of the GP's management of the Fund, which is not necessary in the Delaware action. Treating the discovery in Delaware as disclosed and admissible in the Grand Court proceedings has the obvious benefit of saving time, effort and cost by avoiding the need to repeat the discovery process in relation to the Delaware discovery documents and applying GCR O.24 only

in relation to additional discovery required for the Grand Court proceedings. It is also consistent with the parties' desire to advance the procedural progress of the Grand Court actions as rapidly as reasonably possible to achieve the trial date of 12 January 2026 in that it significantly reduces the work required on discovery and hence the time to be taken by that process.

D.5 The GP's arguments that it has not waived privilege under Cayman law for the Grand Court proceedings

68. Mr Ayres seeks to row back on the position regarding the effect of the Consent Orders on two grounds. The first is by reference to the initial draft discovery protocol circulated by Campbells on 4 July 2025. He draws my attention to paragraph 30 of that draft, which follows a heading and is in the following terms:

> *"30. Nothing in this Protocol will prevent a Party from withholding documents from inspection by the other Parties on the basis of any applicable Cayman Islands law."*

Mr Ayres argues that this was still the only draft discovery protocol in existence throughout the period up to 2 September 2025 and, he submits, it indicates that the parties intended throughout that period that privilege under Cayman law could still be raised in respect of documents disclosed in Delaware and brought into the Grand Court actions.

69. I do not accept that submission. I consider that the correspondence between Walkers and Campbells in July 2025 that I have already set out demonstrates that the parties had moved on from the approach of Campbells' draft discovery protocol by no later than 25 July 2025 and before the Consent Orders were made. The draft discovery protocol circulated by Campbells is a relatively basic document that proceeds on the basis that all discovery will take place under Cayman law and in accordance with GCR O.24. There is no evidence of any discussion of the content of the draft discovery protocol before the hearing on 1 August 2025. Instead, the correspondence proceeds on the basis that there will be the bifurcated approach to discovery in Delaware and in the Cayman Islands that I have described. I therefore consider that, by no later than 25 July 2025, the provisions in Campbells' draft discovery protocol regarding privilege had been superseded as regards the treatment of any Delaware discovery materials and the draft discovery protocol is not relevant to the determination of the proper effect of the Consent Orders in that respect.

70. The second ground on which Mr Ayres argues that the GP is still able to raise issues of privilege in respect of discovery in Delaware is based on the revisions to Walkers' draft discovery protocol which Walkers proposed on 12 September 2025. These seek to introduce the ability of the parties to raise privilege under Cayman law in respect of documents disclosed in Delaware, whatever their treatment in Delaware. Mr Ayres argues that the LPs cannot conceivably have relied upon any of the Compelled Documents by this date, because the Compelled Documents had only been produced starting from 8 September 2025, and so it is not unfair for the GP on 12 September 2025 to limit any waiver of privilege that had taken place. Mr Ayres relies on a judgment of the Hong Kong Court of Appeal to support the proposition that the GP could clarify or confirm the purpose for which the Compelled Documents were produced, and any limitations on that production, as late as 12 September 2025: _____ [2012] HKCA 153.

71. Citic was a company listed on the Hong Kong Stock Exchange. Following the financial crisis in 2008, Citic was under investigation by the Securities and Futures Commission in Hong Kong ("**the SFC**") as to the reasons why it had delayed publication of a substantial profit warning indicating it anticipated losses of HK $15 billion. Pursuant to a statutory notice, Citic provided the SFC with a number of documents including six documents that it asserted were subject to legal professional privilege, which was not disputed in the proceedings. Some weeks later, the SFC queried with Citic's solicitors the extent to which privilege in the documents had been waived. Citic's solicitors responded on 26 November 2008 that privileged was waived for the sole purpose of the SFC investigation.

72. In March 2009, the Hong Kong Police commenced a criminal investigation into Citic's conduct. Citic discovered that the SFC had provided copies of the privileged documents to the Hong Kong Ministry of Justice to obtain legal advice and that the Hong Kong police wished to view the privileged documents. Citic commenced the proceedings seeking orders for the return of the privileged documents on the basis that Citic had waived privilege for the limited purpose of the SFC investigation only and that the Ministry of Justice did not have lawful authority to retain them; and a declaration that, if the Ministry of Justice did have lawful authority to retain the documents, then the Ministry could not disclose them to any third party, including the Hong Kong Police.

73. The judge at first instance dismissed Citic's claim. He concluded that when Citic provided the documents to the SFC, it had not expressly or impliedly imposed any condition on that disclosure,

so that there was a full waiver of privilege by Citic. He also held that there was a case that the documents had been created to further a fraudulent scheme, and so they were not privileged for that reason in any event.

74. The Hong Kong Court of Appeal disagreed with the judge's decisions on both issues. The Court of Appeal carried out an extensive survey of the law on privilege to determine whether the concept of a partial waiver of privilege is part of the law of Hong Kong, which it concluded it is. Mr Ayres relies in particular on paragraph 76 of the judgment of Hartmann JA, with whom the other members of the Court of Appeal agreed, to support his argument that the GP was able on 12 September 2025 to limit the scope of its waiver of privilege in respect of the Compelled Documents, even though that was after production had taken place. Hartmann JA said:

> *"76. The solicitors' letter of 26 November 2008 was afforded little weight at first instance. On the evidence, however, there appears to be nothing to suggest that at about the time the letter was drafted Citic knew of any police investigation or had reason to believe that one was about to be launched and, regretting its earlier full waiver of privilege, was seeking to claw back at least some partial privilege in the documents in order to avoid them falling into the hands of the police. Citic's general counsel and the company's legal advisers may of course have had a change of heart concerning surrender of the documents to the SFC but there is nothing to suggest that. Accordingly, I must disagree with the judge at first instance. I am satisfied on the probabilities that the letter is not to be seen as a tactical device but as a simple statement of what Citic had always considered to be the basis upon which privilege in the documents had been waived several weeks earlier. As such, I am satisfied that the contents of the letter stating Citic's understanding that waiver of privilege had not been absolute must be given due weight."*

75. I do not accept Mr Ayres' analysis of ____. In my judgment, the Hong Kong Court of Appeal did not conclude that it is possible for a party subsequently to qualify the extent of a waiver of privilege that has already occurred. Instead, the Court of Appeal in paragraph 76 of its judgment found on the evidence and on a balance of probabilities that Citic had always intended that its waiver of privilege should be limited to the SFC. The relevance of the solicitors' subsequent letter was simply that it provided confirmatory evidence of Citic's intention that the documents had been produced.

76. It is therefore necessary to consider the evidence in this case to determine whether on 12 September 2025 the GP was expressing a position it had always taken or was seeking to adopt a new position regarding privilege.

77. I have already set out the relevant discussions between the GP and the LPs before 1 August 2025. On 21 August 2025, Campbells chased Walkers for their input on the draft discovery protocol and re-attached a copy of the draft that they had circulated on 4 July 2025. Walkers responded to Campbells on 22 August 2025. Their letter included the following:

> *"In circumstances where the documents from the Delaware proceedings will be deemed to have been disclosed in the Cayman proceedings, we consider that the Cayman discovery protocol should, as far as possible […] align with the protocols agreed in Delaware […].*
>
> *We appreciate that the draft protocol you shared reflects certain alignment with the Delaware protocols. However, we have identified a few material differences that we consider need to be reconciled with the Delaware Protocols to ensure the Cayman discovery properly adopts, and does not cut across, the Delaware discovery and the provisions of the Delaware Protocols, but at the same time is compliant with Cayman Islands law. In particular, we are concerned to ensure that, at the very least, (i) production format, (ii) privilege claims and logs, and (iii) treatment of confidential documents are as consistent as possible between the Delaware and Cayman proceedings. If we do not do so, then unnecessary costs will likely be incurred and there may be confusion and uncertainty as a result of the inconsistency.*
>
> *[…]*
>
> *Additionally, we consider that the Cayman protocol should include the parties' agreement(s) concerning the practical considerations relating to how the Delaware discovery will be dealt with in Cayman – for example, whether the Delaware discovery is required to be re-listed and re-produced and whether the parties in Cayman adopt the bates numbering used in Delaware, etc."*

78. Walkers' letter does not express anywhere any intention that either party should be able to raise issues of privilege under Cayman law in respect of documents disclosed in Delaware and therefore deemed to be disclosed in the Grand Court actions. To the contrary, Walkers' letter expressly indicates that the GP's intention was

and that the treatment of privilege and confidentiality was to be

, all to avoid unnecessary costs, confusion and uncertainty. Such statements contradict the suggestion that the GP intended at this time that the parties could raise issues of privilege under Cayman law in respect of documents disclosed in the Delaware proceedings and brought into the Grand Court actions by that route.

79. Walkers provided their own draft discovery protocol on behalf of the GP on 2 September 2025. This adopts the bifurcated approach to discovery, differentiating between Delaware discovery, which automatically comes into the Grand Court actions, and additional discovery for the Grand Court actions, which was not within the discovery in Delaware. Paragraph 3 of the draft discovery protocol states:

> *"3. Pursuant to the Directions Orders, the Parties are to give discovery in accordance with Order 24 of the Grand Court Rules (2023 Revision) (the "GCR"), as modified by the Directions Orders, including, inter alia, that:*
>
> *(a) all documentary discovery given by the Parties in proceedings with case no. 2025-0607-KSJM before the Court of Chancery in the State of Delaware (the "Delaware Proceedings") shall be deemed to have been disclosed in the Cayman Proceedings, shall be admissible and may be relied upon at trial (see paragraph 5 of the Directions Order in the Writ Proceedings and paragraph 6 of the Directions Order in the Petition Proceedings (the "Delaware Discovery")); […]"*

80. Part I of the draft discovery protocol then addresses the treatment of the Delaware discovery while Part II addresses additional Cayman discovery. Part I provides:

> *"7. The Parties agree, pursuant to the terms of the Discovery Orders, that the Delaware Discovery is to be deemed to have been discovered in the Cayman Proceedings and is admissible and may be relied upon at trial in the Cayman Proceedings.*
>
> *8. Accordingly, the Parties shall not be required to:*
>
> *(a) include the Delaware Discovery in the Parties' respective List of Documents to be exchanged in the Cayman Proceedings;*
>
> *(b) re-produce any documents already disclosed as part of the Delaware Discovery; and*
>
> *(c) prepare any separate privilege log beyond those already provided in the Delaware Proceedings, save for any documents solely subject to discovery in the Cayman Proceedings, over which any party claims privilege for the purposes of the Cayman Proceedings.*
>
> *[…]*
>
> *11. The Delaware Discovery shall not be subject to the requirements of this Protocol and the following Delaware Protocols (and any further agreements between the Parties) shall continue to govern the Delaware Discovery […]"*

81. The GP's draft discovery protocol therefore proceeds on the basis that all discovery from Delaware is to be admissible and can be used at the trial of the Grand Court actions. The GP's draft discovery protocol contemplates that discovery for the Grand Court proceedings may be wider than discovery in the Delaware proceedings and, to that extent, provides in paragraph 8(c) for the possibility that privilege might be asserted over documents disclosed in the Grand Court proceedings only.

82. In addition to the broad deeming wording in paragraph 7 of the draft discovery protocol that I have already considered in relation to the Consent Orders, there are additional features of these paragraphs of the GP's draft discovery protocol that I consider to be inconsistent with an intention on the part of the GP that the parties would be able to raise issues of privilege under Cayman law in respect of the Delaware discovery. The first is that the parties are not required to include the Delaware discovery in their Lists of Documents. The List of Documents is where any claim to privilege

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under Cayman law would be made, by including such documents within Schedule 1, part 2. By excluding the requirement to list the Delaware discovery, it follows that the GP was also excluding the parties' ability to identify documents within the Delaware discovery in respect of which they wish to claim privilege. Secondly, the exclusion of a requirement to prepare any separate privilege log beyond those provided in Delaware, except for the additional Cayman discovery, contradicts the suggestion that the GP intended at this time that privilege under Cayman law should be a live issue in respect of the Delaware discovery.

83. Part I of the draft discovery protocol continues relevantly in paragraphs 16 and 17, which state:

> *"16. Any documents subject to a claim of privilege in the Delaware Proceedings shall maintain their designation as privileged (subject to any waiver of privilege or a finding against a claim of privilege by the Delaware court), and the Parties shall not be required to review such documents for Relevance in the Cayman Proceedings.*
>
> *17. If a document the subject of a claim of privilege in the Delaware Proceedings is inadvertently discovered in the Cayman Proceedings, the inadvertent production shall in no way prejudice or otherwise constitute a waiver of, or estoppel as to, any claim of privilege […]"*

84. It is clear from these paragraphs that on 2 September 2025:

84.1 the GP's intention was that issues of privilege as regards documents that were disclosed in Delaware were to be determined under Delaware law – hence the provision in paragraph 16 of the draft discovery protocol that privileged documents would carry over that status into the Grand Court actions; and

84.2 a finding by the Delaware court against a claim of privilege would also be carried over to the Grand Court to determine the privilege status of Delaware disclosed documents.

It is significant, in my view, that the GP's draft discovery protocol did not make any provision for the parties to be able to claim privilege under Cayman law in respect of documents disclosed in Delaware and brought into the Grand Court actions as a result. This omission is inconsistent with Mr Ayres' suggestion that that was the GP's intention at this time.

85. Campbells provided their comments on Walkers' draft discovery protocol on 4 September 2025. Campbells did not suggest any changes to paragraphs 3, 7, 8 and 11, which are therefore to be taken as agreed. Due to some other suggested revisions, paragraphs 16 and 17 in Walkers' draft protocol became paragraphs 15 and 16 in Campbells' response. Campbells did not suggest any revisions to

(new) paragraph 16 but did propose some relevant changes to (new) paragraph 15, as follows, with revisions from the previous version shown by underlining and strike-out:

> *"~~16.~~15. Any documents subject to a claim of privilege in the Delaware Proceedings shall maintain their designation as privileged ~~(subject to any~~ , unless there is a waiver of privilege and/or a finding against a claim of privilege by the Delaware court and/or a finding against a claim of privilege by the Court~~)~~, and the Parties shall not be required to review such documents for Relevance in the Cayman Proceedings. Any dispute as to whether a document is privileged shall be resolved by the Court in accordance with Cayman Islands law."*

By their proposed amendment to this paragraph, Campbells were contemplating that documents that are privileged for the purposes of the proceedings in Delaware might nonetheless be determined by the Grand Court not to be privileged under Cayman law. However, they were not suggesting that documents that are not privileged in Delaware might be ordered to be privileged under Cayman law for the purpose of the Grand Court proceedings. Thus, Campbells' proposed revisions are consistent with the overall position regarding privilege that I have already described.

86. There was then a short hiatus whilst the GP's claim to privilege over the Compelled Documents was being considered in Delaware by Chancellor McCormick and the special discovery master. It was only following the decision in Delaware against the GP's ability to claim privilege in respect of the Compelled Documents that the GP first sought to introduce the issue of privilege under Cayman law in the draft discovery protocol as regards the Delaware discovery. Walkers circulated a further revised draft of the discovery protocol on 12 September 2025. This draft also did not make any changes to paragraphs 3, 7 and 8, but it did seek to make a significant change to paragraph 15 (renumbered as paragraph 16 again), with the revisions from the previous version once more shown by underlining and strike-out:

> *"~~15.~~16. Any documents subject to a claim of privilege in the Delaware Proceedings shall maintain their designation as privileged, unless there is a waiver of privilege and/or a finding against a claim of privilege by the Delaware court and/or a finding against a claim of privilege by the Court)~~,~~. For the avoidance of doubt, any Party may apply to the Court seeking that a document is privileged and shall not be relied upon notwithstanding the treatment of that document in Delaware. ~~and the Parties shall not be required to review such documents for Relevance in the Cayman Proceedings.~~ Any dispute as to whether a document is privileged shall be resolved by the Court in accordance with Cayman Islands law."*

87. This was clearly a fundamental change in the intended treatment of the Delaware discovery, which sought to reverse the effect of the Consent Orders. It also contradicts paragraph 3(a) of the draft

discovery protocol, which Walkers had originally drafted and had not sought to revise, and which was agreed by Campbells for the LPs. Unsurprisingly, Campbells' response on 25 September 2025 was to delete Walkers' proposed addition to paragraph 16 of the draft discovery protocol.

88. In my view, the further drafts of the discovery protocol that were circulated during October 2025 do not assist, as the difference between the parties regarding the treatment of the Delaware discovery had crystallised by then and the drafts simply record that there is disagreement between them.

89. I consider that it is clear from the correspondence and the various drafts of the discovery protocol, as well as the Consent Orders, that the GP did change its position on the question of privilege on or shortly before 12 September 2025. I find it did so as a direct response to the Chancellor's ruling in Delaware that the Compelled Documents were not privileged and would have to be disclosed in Delaware, and that the Compelled Documents would therefore automatically be admissible in and available to be used at the trials of the Grand Court actions unless the GP sought to put the privilege genie back into the bottle.

D.6 Did the LPs deliberately breach privilege and confidentiality in the public version of their post-trial brief in Delaware?

90. As I have already recorded, the definition of Discovery Material in the confidentiality stipulation is very broad. Paragraphs 2 and 3 of the confidentiality stipulation address the applicability of the confidentiality stipulation as follows:

> *"2. This Stipulation governs the handling of Discovery Material by or among any Party or non-Party to this Litigation, except to the extent Discovery Material is filed with the Court.*
>
> *3. This Stipulation does not govern the filing of Discovery Material with the Court. Only Court of Chancery Rule 5.1 governs the filing of Discovery Material with the Court."*

Paragraphs 2 and 3 therefore include an important carve out that the confidentiality stipulation does not apply where any document containing Discovery Material is filed with the Delaware court and that Court of Chancery Rule 5.1 will apply in that situation instead.

91. When approving the confidentiality stipulation and making it an order of the Delaware court on 21 July 2025, Chancellor McCormick additionally ordered:

"To the extent of any conflict between this order and Court of Chancery Rule 5.1, Rule 5.1 will control."

92. Thus, it appears from the provisions that I have set out that the handling of any document filed at court in Delaware, including post-trial briefs, is governed, not by the confidentiality stipulation, but by Court of Chancery Rule 5.1. This is reinforced by the Chancellor's order when she approved the confidentiality stipulation and made it an order of the Delaware court.

93. Mr Scott provided me with a copy of Court of Chancery Rule 5.1 during oral argument at the hearing on 28 November 2025. Court of Chancery Rule 5.1, so far as relevant, provides as follows:

> *"**(a) General Principles of Public Access.***
>
> *[…]*
>
> *(3) Papers filed with the Register in Chancery ("Filed Documents") must be available to the public, except as provided in this rule.*
>
> *[…]*
>
> ***(b) Confidential Information.***
>
> *(1) Public access to a Filed Document may be limited only if the Filed Document contains Confidential Information.*
>
> *[…]*
>
> ***(d) Making a Confidential Filing.***
>
> *(1) A person may make a Confidential Filing if the person believes that the paper contains Confidential Information.*
>
> *(2) A person must make a Confidential Filing if the person believes that another person would contend that the paper contains Confidential Information.*
>
> *[…]*
>
> ***(e) Notice of Confidential Filing.***
>
> *(1)* Obligation to Give Notice. *After making a Confidential Filing, the filer must use best efforts to give notice to any person who has designated information in the Confidential Filing as Confidential Information or who the filer believes could have a legitimate interest in designating information in the filing as Confidential Information.*
>
> *(2)* Notice to a Person Who Has Appeared. *If the person has appeared, the filer must provide the notice to the person's attorney […]*
>
> *[…]*
>
> *(4)* Contents of the Notice. *The notice must refer to this rule and include a proposed public version of each Confidential Filing for which a public version is required. The proposed public version may redact information that the filer believes constitutes Confidential Information or that the filer believes another person would contend constitutes Confidential Information. The notice must identify the date and time by which this rule requires the recipient of notice to identify any additional information for redaction.*
>
> *[…]*

> *(6)* Designating Confidential Information for Redaction in Response to Notice.
>
> *(A) Any recipient of notice may designate additional information for redaction if the person believes in good faith that the information qualifies as Confidential Information or that another person would contend that it qualifies as Confidential Information.*
>
> *(B) The recipient of notice must identify any additional information for redaction within the time period set by this rule.*
>
> *[…]*
>
> *(7)* Timing of Notice and Designation of Confidential Information for Redaction.
>
> *[…]*
>
> *(B) […] the filer should give notice contemporaneously with the Confidential Filing and must give notice not later than 3:00 p.m. two days after the filing. Any recipient must designate any additional information for redaction by 3:00 p.m. on the fifth day after the filing.*
>
> ***(f) Filing a Public Version.***
>
> *(1)* Public Version Required. *A public version is required for every Confidential Filing, except for an exhibit or lodged deposition.*
>
> *(2)* Timing of Public Version. *The filer must file a public version of every Confidential Filing that was the subject of a Rule 5.1(e) notice the day after the deadline for designating additional information for redaction. The public version must contain the redactions in the proposed public version and any additional information designated for redaction in response to the notice unless the filer and a person receiving notice agree to make fewer redactions."*

94. In the absence of evidence from an independent expert on Delaware law and practice, I am conscious that I should be cautious in interpreting Court of Chancery Rule 5.1. Nevertheless, the provisions of Rule 5.1(e) setting out the mechanism and timeline by which a litigant should take steps to redact confidential information contained in a proposed public filing and should give notice to other parties to allow them to make further redaction proposals are clear, simple and straightforward on their face, and are easy to understand. In short, the filer must give notice to the other parties at the same time as filing the document on a confidential basis, and the other parties have 5 days to respond with any further redaction requests (or to agree to omit redactions). The filer must then file a publicly accessible version of the document the following day.

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95. The use of confidential discovery material in open court is addressed in paragraph 25 of the confidentiality stipulation as follows:

> *"25. If any Confidential Discovery Material or Highly Confidential Discovery Material is used in open court during any proceeding or introduced into evidence as a trial exhibit, the material loses its confidential status and becomes part of the public record, unless the*

> *Producing Person applies for and obtains an order from the Court specifically maintaining the confidential status of the material. Before any court proceeding where Confidential Discovery Material or Highly Confidential Discovery Material will be used, the Parties must confer in good faith on procedures to protect the confidentiality of any of the Confidential Discovery Material or Highly Confidential Discovery Material."*

96. In a section of his affidavit entitled , Mr Berdon asserts:

> *"28. Notably absent from Fienberg 2 is that the fact that the Rigmora LPs inclusion of quotations or detailed descriptions of the Four Documents in their publicly filed post-trial brief was in breach of the parties' Confidentiality Stipulation and the Delaware Court's sealing rulings.*
>
> *29. As outlined above, in preparing public versions of post-trial submissions, the parties were expected to apply redactions consistent with the Delaware Court's sealing ruling. In other words, the onus to maintain the confidentiality of the documents which were designated Highly Confidential applies equally to both parties. Contrary to that position, the Rigmora LPs did not seek to redact the relevant portions of the public version of their post-trial brief and thereby breached the Confidentiality Stipulation.*
>
> *30. Although Quinn Emanuel did not, when reviewing the Rigmora LPs' post-trial brief, take notice of the relevant material and ask Rigmora's US counsel to apply the appropriate redactions, that oversight was entirely inadvertent and was a result of the extreme time pressure under which my firm was required to file its post-trial reply brief, which was due a mere 3 business days after receipt of the Rigmora LPs' PTRB (which was 64 pages in length).*
>
> *31. Having now become aware of this matter, Quinn Emanuel have written to the Rigmora LPs' US-counsel, Richards Layton & Finger, P.A. ("RLF") who serves as Delaware Counsel for Debevoise & Plimpton ("Debevoise"), on 26 November notifying them of the breach of the Confidentiality Stipulation and the Sealing Order and have requested that Debevoise promptly file a corrected public version of their post-trial brief with the offending passages redacted (the "**QE Email**") **[AB-1/1]**, […]"*

97. The email exhibited by Mr Berdon is from Ms Shannon Doughty, an associate in Quinn Emanuel's Wilmington office. It was sent at 6:03 pm on 26 November 2025 to a number of attorneys at Richards Layton & Finger LLP, who were acting for the LPs, and was sent or copied to attorneys at Quinn Emanuel and at Ross Aronstam & Moritz LLP acting for the GP but not, apparently, Mr Berdon. The email is in the following terms:

> *"Counsel:*
>
> *[…] it has come to our attention that when Rigmora filed the public version of its post-trial brief, it failed to redact certain portions of its brief that referred to or quoted ATP's Highly Confidential Documents that the Court had ordered at trial should be treated as 'under seal' and closed the Courtroom accordingly, specifically JX-2153, 2178, 2155, 2138. While we had originally hoped that this was just an oversight on behalf of Rigmora, it now appears that Rigmora is attempting to use their own failure to comply with the Court's ruling as justification to claim a waiver of privilege in the Cayman.*

> *The Court's sealing order is unambiguous and required Rigmora to shield ATP's Highly Confidential Information from public dissemination. ATP therefore requests that Rigmora remedy the erroneous disclosures in the public version of its post-trial brief by filing the attached corrected version in its place. […]"*

98. During oral argument on 28 November 2025, the LPs handed up a clip of correspondence relevant to the assertions made by Mr Berdon that I have set out and to Ms Doughty's email.

99. First is an email from Mr Zachary Greer, an associate at Richards Layton & Finger, the Delaware attorneys for the LPs, which was sent at 8:16 pm on 26 November 2025 in response to Ms Doughty's email sent 2 hours 13 minutes earlier. Despite its subject matter, timing and obvious relevance, this email was not discussed and nor was it exhibited by Mr Berdon when he approved and signed his affidavit and exhibit on 27 November 2025. Mr Greer's email appears to provide a complete answer to the complaints made in Ms Doughty's email that was exhibited by Mr Berdon. It states:

> *"Shannon*
>
> *ATP, after having the opportunity to propose redactions, expressly confirmed that it had no redactions to Defendant's Post-Trial Brief before it was filed publicly.*
>
> *In accordance with Court of Chancery Rule 5.1(e), on November 12, Defendants provided ATP with the opportunity to propose any redactions it had to Defendants' Post-Trial Brief which was filed under seal. In accordance with Rule 5.1, we let ATP know that it had until 3:00 PM ET on November 17 to propose any redactions it saw fit under the rule. Counsel for ATP responded on November 17 saying, 'I'll be sending a few redactions shortly. Apologies for the delay' See attached email thread. Defendants provided ATP with additional time and waited for confirmation as to its proposed redactions.*
>
> *On November 18, Plaintiff responded, 'Apologies for the delay, Plaintiff does not have any redactions.' See attached email thread. Later that day, Defendants filed a public version of their Post-Trial Brief as approved by ATP. Plaintiff has not raised this issue since, including during oral argument with the Court on November 21 (nor could it given that Defendants complied with Rule 5.1 and filed the public version of their brief in accordance with ATP's instructions and as required by Rule 5.1). ATP cannot now seek to seal Defendants' brief for perceived tactical gain in the litigation between the parties in the Cayman Islands. […]"*

100. The emails to which Mr Greer referred were also provided to me by the LPs. Again, none of these emails were discussed or exhibited by Mr Berdon when he approved and signed his affidavit and exhibit on 27 November 2025 despite their obvious relevance. They show the following:

100.1 At 2:53 pm on 12 November 2025, Mr Greer sent to a number of attorneys at Quinn Emanuel and Ross Aronstam & Moritz LLP (not apparently including Mr Berdon) a proposed public version of the LPs' post-trial brief. As required, Mr Greer stated that he was doing so pursuant to Court of Chancery Rule 5.1. He continued:

> *"If you wish to designate any information as confidential, please provide proposed redactions by November 17 at 3pm. If no additional information is designated for redaction, we will file the attached proposed public version on November 18."*

100.2 At 3:02 pm on 17 November 2025, after the time imposed by Court of Chancery Rule 5.1(e)(7)(B) and specified by Mr Greer for any response had expired, Morgan Harrison of Quinn Emanuel replied to Mr Greer's email, not copying other attorneys at Quinn Emanuel or Ross Aronstam & Moritz LLP, saying:

> *"Hi Zack*
> *I'll be sending a few redactions shortly. Apologies for the delay.*
> *Thank you*
> *Morgan"*

100.3 At 10:00 am on 18 November 2025 Ms Harrison replied again to Mr Greer's email of 12 November 2025, copying a number of attorneys at Quinn Emanuel and Ross Aronstam & Moritz LLP (but not apparently including Mr Berdon), as follows:

> *"Hi Zack*
> *Apologies for the delay. Plaintiff does not have any redactions.*
> *Thank you*
> *Morgan"*

These emails thus contradict the argument made in Ms Doughty's email and espoused by Mr Berdon in his affidavit that the LPs had acted wrongfully in including references to the four documents in the public version of their post-trial brief.

101. Mr Berdon's description of the GP's failure to request additional redactions in relation to the references to the four documents as being an that was , and that it was due to Quinn Emanuel having only 3 business days to review the LPs' post-trial brief is very difficult to reconcile with the following points:

101.1 Court of Chancery Rule 5.1(e)(7)(B) provides a period of 5 days for any responsive requests for redaction, without limiting that period to business days, whatever the length of the document that requires review. Quinn Emanuel therefore always knew that they would have 5 days from receipt to carry out their review of the public version of the LPs' post-trial brief to determine whether to request any additional redactions.

101.2 In fact, the LPs gave the GP six days to respond with any additional proposed redactions to the public version of its post-trial brief. There is nothing to suggest that the LPs would not have

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provided yet more time, if the GP requested it. Quinn Emanuel did not request any additional time, if they required longer to complete their review of the LPs' post-trial brief.

101.3 The clear inference to be drawn from Ms Harrison's emails of 17 and 18 November 2025 is that Quinn Emanuel gave active thought to the question of additional redactions of the public version of the LPs' post-trial brief and determined that they did not wish to request any further redactions.

101.4 That Quinn Emanuel gave active thought to the question of additional redactions is also supported by the fact that Quinn Emanuel included unredacted references to the documents in question in the GP's own post-trial brief, whilst redacting other text.

101.5 Given the GP's continued focus at the trial on seeking to preserve the possibility of arguing before the Grand Court that the relevant documents remained privileged, which I address later in this judgment, it is very hard to credit that the decision not to request any further redactions in the public version of the LPs' post-trial brief was an entirely inadvertent oversight, as Mr Berdon asserts.

101.6 The number of partners apparently working on this matter at Quinn Emanuel and at Ross Aronstam & Moritz also cannot be reconciled with the suggestion that the decision not to request any further redactions in the public version of the LPs' post-trial brief was an entirely inadvertent oversight.

101.7 Given Mr Berdon's role as lead partner with overall control of the Delaware litigation on behalf of the GP and that he had expressly raised during the trial the question of protecting possible privilege under Cayman law, as recorded in the transcript at page 120 set out later in this judgment, any suggestion that he was not aware of and was not a participant in the decision not to request any further redactions to the public version of the LPs' post-trial brief is equally difficult to credit.

102. Having regard to the emails from Mr Greer that I have discussed, I wholly reject the GP's argument, put forward by Mr Berdon in his affidavit, that the LPs breached the terms of the confidentiality stipulation and did so in order to bolster their case before the Grand Court that the GP has waived privilege in respect of the documents in question. Moreover, it appears likely on the material that I have seen that at the time that it completed its post-trial brief and engaged in oral argument, the GP had decided it no longer intended to assert privilege in respect of the documents that Mr Berdon

referenced, however I do not need to reach a conclusion on that particular point in light of my other findings on the substance of the GP's summonses.

D.7 Conclusion on the GP's summonses

103. For the reasons that I have set out, I conclude that the GP and the LPs agreed to waive any available privilege arguments under Cayman law in respect of documents disclosed in the Delaware proceedings. Instead, those documents were to be automatically disclosed, admissible and available to the parties to use in the Grand Court actions. This was the result of their agreement of: (a) the confidentiality stipulation in Delaware; and (b) the Consent Orders. As regards the discovery in the Delaware proceedings, the parties' approach was that all questions of privilege etc would be determined by the Delaware court under Delaware law. As recorded in the Consent Orders, the Delaware discovery and the other documents from the Delaware proceedings identified in the Consent Orders are to be deemed to have been disclosed in the Grand Court actions, are admissible and may be relied upon at trial. The GP therefore cannot prevent the LPs from using the Compelled Documents in the Grand Court proceedings provided that the LPs comply with the requirements applicable to Confidential Discovery Material and Highly Confidential Discovery Material that are set out in the confidentiality stipulation or make similar arrangements to protect wider dissemination of the documents in those categories. I therefore dismiss the GP's application for declarations and consequential relief in relation to the Compelled Documents.

104. I also dismiss the GP's application that its evidence in support of its summonses should be sealed save to the extent that redactions have already been applied to the affidavits and exhibits of Mr Blöchlinger and Mr Finkelman.

105. In addition, I reject the GP's argument that the LPs deliberately breached privilege and confidentiality in Delaware by referring to four of the Compelled Documents in the public version of their post-trial brief for the Delaware trial. I hold that the LPs gave appropriate notice to the GP that they intended to include unredacted references to those documents in the public version of their post-trial brief. Quinn Emanuel did not request any additional redactions, as they were entitled to do and could have done. It does not seem to me that there was anything inherently wrong in the LPs then filing the public version of their post-trial brief in the form approved by Quinn Emanuel,

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and the LPs' case is that they were obliged to do so in order to comply with Court of Chancery Rule 5.1.

106. Given my conclusions on the effect of the confidentiality stipulation and the Consent Orders, I do not consider it necessary to add further to this lengthy judgment by addressing in detail the questions whether, in principle, the loss of privilege in Delaware prevents privilege under Cayman law from being claimed; and whether the way in which the circumstances in which the GP disclosed the Compelled Documents in Delaware was or was not sufficiently voluntary in nature to give rise to or to prevent a voluntary waiver of privilege under Cayman law. Those issues simply do not arise on the conclusions that I have reached.

E. The misleading evidence filed on behalf of the GP

107. Before leaving this matter, it is necessary that I address the misleading evidence filed in support of the GP's summonses by Mr Berdon in his signed approved draft affidavit dated 27 November 2025. Unhappily, this judgment should be read with my judgment in _____ _____ [2025] CIGC (FSD) 124, which was delivered before this judgment but concerns events that occurred after the hearing of the GP's summonses on 28 November 2025. It provides my reasons for vacating the trial at the hearing on 17 December 2025 but also records my criticisms of the GP and Quinn Emanuel for actively misleading the Grand Court and the Court of Appeal in the period before that hearing regarding the GP's intention that the trial on 12 January 2026 should go ahead, and apparently Walkers as well, and for Quinn Emanuel's attempts to bully an attorney at Campbells. As I indicate in that judgment, it is extremely concerning that there have been two instances of Quinn Emanuel being involved in misleading the Grand Court within 3 weeks.

108. In the course of his oral submissions on 28 November 2025, Mr Scott criticised Mr Berdon's evidence in his affidavit in trenchant terms as being misleading in certain important respects. Mr Ayres and Walkers were in court and attorneys from Quinn Emanuel observed the hearing on 28 November 2025 remotely. Following the hearing on 28 November 2025, and notwithstanding the submissions by Mr Scott that Mr Berdon's draft affidavit was seriously misleading, Mr Berdon proceeded to swear his affidavit on 2 December 2025 in the form of the draft that he had approved on 27 November 2025.

109. For the reasons that I now set out, I conclude that Mr Scott's criticisms of Mr Berdon's evidence are justified.

110. As I have indicated earlier in this judgment, Mr Berdon describes himself in his affidavit as being the lead partner at Quinn Emanuel with conduct of the Delaware action on behalf of the GP. He is based in Quinn Emanuel's New York office. He is supported by a number of attorneys within Quinn Emanuel, including attorneys based in Quinn Emanuel's Wilmington, Delaware office. In addition to Quinn Emanuel, the GP is represented in the Delaware action by a number of partners and associates from Ross Aronstam & Moritz LLP, who are also based in Wilmington, Delaware and who hold themselves out as being experienced in litigating the most significant corporate and commercial disputes before the Delaware Court of Chancery. In the circumstances, it is appropriate to infer that the GP's legal team, including Mr Berdon, should be fully familiar with the appropriate practice and procedure before the Delaware Court of Chancery.

111. In addition, the GP is represented in the Cayman Islands by Mr Ayres and Walkers, both of whom are experienced in conducting litigation before the Grand Court and with the ethical requirements associated with being officers of the Court and attorneys at law in the Cayman Islands. I do not believe that either would knowingly have assisted in any attempt to mislead the Court.

112. I find that Mr Berdon's statements that the facts and matters set out in his affidavit which are within his knowledge are true and correct, and are true and correct to the best of his information and belief where they are not within his knowledge, are extremely questionable. I conclude that the content of Mr Berdon's affidavit is seriously misleading in several important respects, which are material to the argument put forward before me on behalf of the GP that the LPs deliberately breached the confidentiality regime in Delaware in order to assist them in resisting the GP's summonses, and also in respect of Mr Berdon's wider criticisms of the LPs' conduct in Delaware. I cannot see how Mr Berdon was not aware that his affidavit is seriously misleading.

E.1 The effect of the confidentiality stipulation

113. The confidentiality stipulation was signed by Mr Berdon, along with a number of his colleagues at Quinn Emanuel and by their co-counsel from Ross Aronstam & Moritz LLP. Mr Berdon must be taken

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to be familiar with its contents and with Chancellor McCormick's qualification that its application to the Delaware action is subject to Court of Chancery Rule 5.1 as regards documents filed at court.

114. In paragraphs 5 to 8 of his affidavit, Mr Berdon describes the effect of the confidentiality stipulation in the Delaware action. He asserts that:

> *"5. […] As the Rigmora LPs will be aware, the Confidentiality Stipulation governed not only the handling, review and use of designated materials during discovery, but also the manner in which such materials could be referenced in motion practice, at trial, and in any publicly filed submissions, including by requiring redaction or sealing where necessary to preserve the protections conferred.*
>
> *6. The confidentiality protections took on particular importance following the Delaware Court's 8 September 2025 order compelling production of the Privileged Documents […]*
>
> *7. More specifically, a number of the Privileged Documents in the Compelled Production which were plainly privileged and which contained sensitive material were designated by Quinn Emanuel as "Highly Confidential". Where the documents marked with Highly Confidential designations were to be relied upon at the trial, pursuant to the Confidentiality Stipulation, the parties were required to ask the Court to restrict access to the courtroom […]*
>
> *8. Consistent with the confidentiality regime, the parties were required, when preparing public versions of post-trial briefs, to respect the confidentiality of sealed documents and to ensure that highly confidential content was not placed into the public domain. In particular, where highly confidential material was to be cited, it was to be handled through targeted redactions and, where necessary, sealing. Indeed, as stated in Finkelman 1, the Confidentiality Stipulation was intended to preserve the protections over designated materials notwithstanding their disclosure to adversary counsel, and that nothing in the Delaware process effected privilege, including Cayman privilege, or confidentiality outside the confines of that case."*

115. These passages in Mr Berdon's affidavit are to be contrasted with the terms of paragraphs 2 and 3 of the confidentiality stipulation, which is exhibited by Mr Finkelman, and which I have already set out earlier in this judgment. Those paragraphs make clear that

is governed,

not by the confidentiality stipulation, as Mr Berdon asserts in paragraph 5 of his affidavit, but by Court of Chancery Rule 5.1, which Mr Berdon wholly fails to address in his affidavit. This is reinforced by the terms of the Chancellor's rider when she approved the confidentiality stipulation and made it an order of the Delaware court. I am forced to conclude that Mr Berdon's evidence on this aspect is plainly wrong. Further, his complete failure to address Court of Chancery Rule 5.1 in his evidence is inexplicable.

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116. Moreover, Mr Berdon's statement that the LPs that the confidentiality stipulation governs reference to confidential discovery material in publicly filed submissions is unjustified and is also wrong. There is no reason for the LPs to form that view because paragraphs 2 and 3 of the confidentiality stipulation and the Chancellor's endorsement all make plain that the applicable procedure in respect of documents filed at court is that set out in Court of Chancery Rule 5.1 and not the confidentiality stipulation.

E.2 The LPs' alleged objection to sealing of the courtroom during the Delaware trial

117. I have set out the terms of paragraph 25 of the confidentiality stipulation earlier in this judgment. Paragraph 25 deals with the use of confidential discovery material in open court.

118. In paragraph 7 of his affidavit, Mr Berdon states:

> *"7. […] Where […] documents marked with Highly Confidential designations were to be relied upon at the trial […] the parties were required to ask the Court to restrict access to the courtroom, with members of the public being required to leave the courtroom so as to preserve their confidentiality. Notwithstanding this stipulated agreement, the Rigmora LPs objected to the Partnership's timely request to seal the courtroom when Highly Confidential information was to be presented in court. The Court granted the Partnership's request over the Rigmora LPs' objection, noting that it would not be appropriate to have material which was plainly privileged referred to in open Court. […]"*

119. Mr Berdon picks up this point again in paragraph 10 of his affidavit, where he says:

> *"10. On the first day of the Delaware Trial, the Partnership moved to seal the Courtroom during the cross-examination of Dr Seth Harrison when the Rigmora LPs sought to use Highly Confidential documents that contained privilege communications (see October 16, 2025 Trial Transcript at 120:13-24 [DF-2/5]) in an effort to preserve the confidentiality of these documents. The Court granted the motion to seal the Courtroom and, in so doing, Chancellor McCormick stated 'I think the solution is to seal the courtroom and for you all to identify who in the courtroom is within the scope of privilege so that showing it doesn't blow privilege' (see Oct. 16 Tr. 126:10-13 [DF-2/11]) (the "Sealing Order")."*

120. The extracts from the transcript of the trial to which Mr Berdon refers are exhibited by Mr Finkelman; Mr Berdon does not himself exhibit any parts of the transcript. The extracts exhibited by Mr Finkelman disclose that it was Mr Berdon who was the advocate appearing for the GP during this part of the trial before Chancellor McCormick. At page 120, lines 13-24 of the transcript, Mr Berdon is recorded as interjecting in the cross-examination of Dr Harrison as follows:

> *"ATTORNEY BERDON: Your Honor, as Your Honor knows, there's been a roll-off production of otherwise documents that were claimed as privileged. And we would ask that they be treated as*

> *highly confidential in this proceeding because, even if used in this proceeding among the parties, they will still retain privilege in Cayman under Cayman law as long as they are not disclosed to the public.*
>
> *So we would ask that the courtroom be sealed during any questioning relating to otherwise privileged information that was in the roll-off production."*

121. Ms Shannon Selden of Debevoise & Plimpton, who was appearing for the LPs, responded to Mr Berdon's submission. In summary, she said that the LPs had sought to agree to de-designate the documents that she wished to put to Dr Harrison as highly confidential but had not received any response from the GP's attorneys; the GP's attorneys did not raise their concern about closing the courtroom in advance; and they had not sought an order from the court as required by paragraph 25 of the confidentiality stipulation. In other words, Ms Selden was being ambushed by the GP. The transcript at page 121, lines 1 to 23, exhibited by Mr Finkelman, is as follows:

> *"ATTORNEY SELDEN: Your Honor, paragraph 25 of the pretrial order governs the use of confidential or highly confidential information in this proceeding. It requires the parties to meet and confer in advance of trial, which defendants attempted to do. We asked plaintiffs to de-designate this material by letter dated September 29, by letter dated October 8, and by chaser email dated October 12.*
>
> *Plaintiffs have declined to engage with us with respect to the reduction in designation of that material, and did not raise this concern about closing the courtroom in advance.*
>
> *Paragraph 25 of the pretrial order further provides that if the parties are unable to reach agreement -- which we had very much hoped to do -- the parties seeking to maintain highly confidential information throughout trial should seek an order from the Court, which plaintiffs have not done in advance of trial.*
>
> *So we would ask, including for the interest of time, to be able to use this information, which we understand is subject to a privilege waiver publicly and with the witness."*

122. Mr Berdon responded that the GP had suggested a meet-and-confer to take place on 13 October 2025, three days before the trial was due to commence, which had not taken place. The transcript then sets out a discussion between Ms Selden and Chancellor McCormick regarding the LPs' objection to the documents in question continuing to be designated as "highly confidential", which the Chancellor pointed out was different from the question of privilege in the documents and was the point being raised by Mr Berdon. The transcript records the statement of the Chancellor at page 126, lines 10-13 quoted by Mr Berdon in his affidavit, but Mr Berdon omits from his quotation important context and the Chancellor's further comments. The full text of this part of the transcript at page 126, line 7 to page 127 line 2 is as follows:

> *"[THE COURT:] So I see the concern here. I don't know whether the document you're discussing now or about to show the witness falls into that category. But if it does, I think the solution is to seal the courtroom and for you all to identify who in the courtroom is within the scope of privilege*

> *so that showing it doesn't blow privilege. So I'm not sure how we do that now. Maybe you want to [take] a break and do it, or maybe you want to talk about it over the lunch break. Either way, I'm open to.*
>
> *ATTORNEY SELDEN: Thank you, Your Honor.*
>
> *I would suggest that, in the interest of time, we skip ahead and I'll proceed with questions that don't implicate those documents, and then we can discuss during the lunch break whether and how to seal the courtroom and who's within the scope of privilege.*
>
> *Would that be acceptable, Your Honor?*
>
> *THE COURT: That works, yes."*

123. Neither Mr Finkelman nor Mr Berdon exhibit the part of the transcript covering the period after the lunch break or refer in their affidavits to what happened when the Delaware court resumed hearing the trial after the lunch break. This part of the transcript was handed up by the LPs during oral argument before me on 28 November 2025. At page 137, lines 4 to 12, the transcript records the following exchange between the Chancellor and Ms Selden, when the hearing resumed:

> *"[THE COURT:] So what did you work out?*
>
> *ATTORNEY SELDEN: Good afternoon, Your Honor. We have consulted with plaintiff's counsel. We are happy to seal the courtroom. I apologize for any confusion. I didn't know plaintiff's counsel had wanted to do that before this morning, but we are happy to seal the courtroom.*
>
> *We have asked from our team anyone outside the privilege to leave. […]"*

124. Having considered the extracts from the transcript to which I have referred, it seems to me that:

124.1 Mr Berdon's statement in paragraph 7 of his affidavit that the GP had made a request to seal the courtroom is highly questionable in light of the GP's failure to make an application in advance of trial under paragraph 25 of the confidentiality stipulation and the apparent ambush of Ms Selden at trial during her cross-examination of Dr Harrison.

124.2 Mr Berdon's statement in paragraph 7 of his affidavit that the Chancellor granted the GP's request to seal the courtroom over the LPs' objection is simply wrong. The sealing of the courtroom was by consent, once Ms Selden had considered the GP's request over the lunch break. There was no question of the Chancellor ruling against the LPs, as stated by Mr Berdon. Moreover, given that Mr Berdon was the advocate who was appearing for the GP at the hearing, it is inexplicable how he could have made these errors and why he did not give a full explanation of events in his affidavit.

124.3 Of more concern, is that neither Mr Finkelman nor Mr Berdon referred at all to and did not exhibit a copy of page 137 of the transcript of the Delaware trial, which puts a completely

different complexion on how the debate regarding sealing the courtroom concluded. I do not understand why a full account of the hearing was not given in Mr Berdon's affidavit. I am driven to the conclusion that this was an attempt by Mr Berdon to mislead the Court as to the LPs' position and the Chancellor's response to it.

E.3 The GP's case that the LPs deliberately breached the confidentiality stipulation

125. In my judgment, there was a further attempt by Mr Berdon to mislead the Court, which is more serious. I have set out earlier in this judgment paragraphs 28-31 of Mr Berdon's affidavit entitled . I have also discussed earlier in this judgment the mischaracterisation by Mr Berdon of the effect of the confidentiality stipulation and the omission by Mr Berdon in his evidence of any reference to Court of Chancery Rule 5.1 and its relevance to the issues that he advances in his affidavit. The result is that Mr Berdon's repeated assertions in his affidavit that the LPs breached the confidentiality stipulation by referring to putatively privileged documents in the public version of their post-trial brief are simply wrong. The preparation of the post-trial briefs on each side was governed by Court of Chancery Rule 5.1, not by the confidentiality stipulation. It was, thus, not a that the LPs had breached the confidentiality stipulation, as stated by Mr Berdon in paragraph 28 of his affidavit.

126. I have also noted earlier in this judgment that Mr Berdon exhibited an email sent by Ms Doughty at 6:03 pm on 26 November 2025 without also exhibiting or even referencing in his affidavit the following other highly relevant contemporaneous emails between the parties' attorneys:

126.1 email sent at 2:53 pm on 12 November 2025 by Mr Greer circulating a proposed public version of the LPs' post-trial brief pursuant to Court of Chancery Rule 5.1 and seeking the GP's additional redactions by 3:00 pm on 17 November 2025;

126.2 email sent at 3:02 pm on 17 November 2025 by Ms Harrison, after the time specified in Rule 5.1 and by Mr Greer for any response had expired, indicating that Quinn Emanuel would provide a few redactions shortly;

126.3 email sent at 10:00 am on 18 November 2025 by Ms Harrison stating that the GP did not have any redactions; and

126.4 email from Mr Zachery Greer sent at 8:16 pm on 26 November 2025 in response to Ms Doughty's email, which rehearses the previous correspondence and appears to provide a complete answer to the complaints made in Ms Doughty's email.

127. Finally, I record that, in response to Mr Scott's oral submission that Mr Berdon's omission from his affidavit of copies of, or any reference to, the emails of 12, 17, 18 and 26 November 2025 was inexcusable, Mr Ayres was in the unhappy professional position of having to tell the Court at the hearing on 28 November 2025 that: (a) Mr Greer's email of 26 November 2025 ; and (b) neither he nor Walkers had seen or were aware of Mr Greer's email before it was put before the Court by the LPs.

128. It seems to me that Mr Ayres' concession that Mr Berdon should have exhibited the emails must apply with equal force to the emails of 12, 17 and 18 November 2025, and I infer that neither Mr Ayres nor Walkers were aware of those emails until the LPs produced them in court. If they had been aware of them, Mr Ayres would not have made the oral submissions that he did regarding the LPs' alleged deliberate breach of privilege or Walkers would not have permitted him to do so.

129. It is extremely concerning that Walkers and Mr Ayres were not informed of any of the emails of 12, 17, 18 and 26 November 2025 by the GP or Quinn Emanuel and that, as a result, Mr Ayres made oral submissions to the Court regarding the public version of the LPs' post-trial brief and its potential effect on the privilege issues on the basis that the matters stated in Mr Berdon's affidavit that I have identified are correct, when they are plainly not.

130. Mr Berdon's failure to exhibit or to refer to the emails of 12, 17, 18 and 26 November 2025 that I have discussed is highly concerning. The only apparent explanations for it are that it was gross incompetence in the preparation of his affidavit, of a kind that is very difficult to conceive would occur within a well-resourced firm of the stature of Quinn Emanuel, or that it was a deliberate attempt to mislead the court. I am driven to the latter conclusion, having regard to:

130.1 the timing of the email from Mr Greer sent on 26 November 2025: while Mr Berdon was not apparently copied into either Ms Doughty's email or Mr Greer's response, he was clearly provided with a copy of Ms Doughty's email in order to prepare his affidavit and it is inconceivable that he was not also provided with a copy of Mr Greer's response sent just over

two hours later or that he did not enquire whether a response to Ms Doughty's email had been received before approving his affidavit; it is also inconceivable that he did not review or ask to see the relevant correspondence preceding Ms Doughty's email;

130.2 Mr Berdon's role as lead partner on the Delaware action: it is equally inconceivable that Mr Berdon, as lead partner, was not aware of Mr Greer's earlier emails sending the draft public version of the LPs' post-trial brief and the substance of the responses to that sent by Ms Harrison, as well as the email exchange on 26 November 2025 between Ms Doughty and Mr Greer; and

130.3 the fact that, notwithstanding that Mr Scott made trenchant criticisms of Mr Berdon and Quinn Emanuel in his oral argument before me on 28 November 2025, and that attorneys from Quinn Emanuel observed the hearing remotely, there has been no communication from Mr Berdon, Quinn Emanuel or anyone on their behalf since that hearing, some 7 weeks ago, responding to Mr Scott's complaints or suggesting that Mr Berdon or Quinn Emanuel accept that there were any errors in Mr Berdon's affidavit: to the contrary, Mr Berdon proceeded to swear his affidavit on 2 December 2025 in the form of the draft that he had approved on 27 November 2025, in the face of the submissions by Mr Scott on 28 November 2025 that it was misleading in the ways set out above and despite Mr Ayres' concession that Mr Greer's email should have been exhibited.

131. If Mr Berdon were an attorney-at-law in the Cayman Islands, it is likely that he would face a disciplinary complaint in relation to these matters. As he is not, I simply record my extreme dissatisfaction with his conduct and that of Quinn Emanuel in the respects that I have set out.

E.4 Post-script

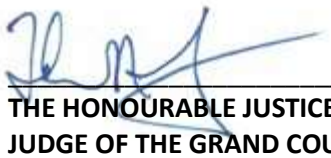
132. In the usual way, a draft of this judgment was circulated to the parties' attorneys for them to propose corrections to typographical and factual errors. In response, Walkers drew to my attention that Mr Berdon had sworn a second affidavit on 2 December 2025; that Campbells had objected to that evidence being filed; and that Walkers had then conceded that Mr Berdon's second affidavit would not be filed. Mr Berdon's second affidavit has not been filed. Walkers invited me to review it and the exhibit, and also the correspondence, which I have done. Mr Berdon's second affidavit exhibits Ms Doughty's email sent on 26 November 2025, Mr Greer's response that day, and two

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subsequent emails between the parties' US attorneys arguing about whether the LPs' public version of their post-trial brief breached any sealing orders in Delaware. Those two emails post-date the hearing before me on 28 November 2025. It does not exhibit any of the emails of the emails of 12, 17 or 18 November 2025 or the extract from the transcript of the hearing before the Chancellor after the lunch break.

133. Mr Berdon does not express any apology or explanation in his second affidavit for the omission of Mr Greer's email from the exhibit to his first affidavit. He does not provide any response to the detailed criticisms of his evidence made by Mr Scott at the hearing on 28 November 2025. In my judgment, Mr Berdon's second affidavit does not provide any reason for me to alter the findings that I have already made and the concerns I have expressed about his conduct.

Dated 27 January 2026



THE HONOURABLE JUSTICE JALIL ASIF KC
JUDGE OF THE GRAND COURT

ITEM NO. 192

JA-78

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

ATP III GP, LTD., in its capacity as General Partner of ATP Life Science Ventures, L.P.,	)	
Plaintiff,	)	
v.	)	C.A. No. 2025-0607-KSJM
RIGMORA BIOTECH INVESTOR ONE LP and RIGMORA BIOTECH INVESTOR TWO LP,	)	
Defendants.	)	

POST-TRIAL MEMORANDUM OPINION

Date Submitted: December 3, 2025
Date Decided: December 5, 2025

Michael A. Barlow, Shannon M. Doughty, Morgan R. Harrison, QUINN EMANUEL URQUHART & SULLIVAN LLP, Wilmington, Delaware; Garrett B. Moritz, Roger S. Stronach, A. Gage Whirley, ROSS ARONSTAM & MORITZ LLP, Wilmington, Delaware; Andrew M. Berdon, Rachel E. Epstein, Kathryn D. Bonacorsi, Jonathan M. Acevedo, Taylor L. Jones, Jenny Braun, QUINN EMANUEL URQUHART & SULLIVAN, LLP, New York, New York; Jessica T. Reese, John F. Ferraro, QUINN EMANUEL URQUHART & SULLIVAN, LLP, Boston, Massachusetts; *Counsel for Plaintiff ATP III GP, Ltd.*

Blake Rohrbacher, Daniel E. Kaprow, Christine J. Chen, Zachary R. Greer, Benjamin O. Allen, RICHARDS, LAYTON & FINGER, P.A, Wilmington, Delaware; Shannon Rose Selden, William H. Taft V, Zachary Saltzman, Natascha Born, Carl Micarelli, Sebastian Dutz, DEBEVOISE & PLIMPTON LLP, New York, New York; *Counsel for Defendants Rigmora Biotech Investor One LP and Rigmora Biotech Investor Two LP.*

McCORMICK, C.

The plaintiff is the general partner of a Cayman exempted limited partnership that holds a portfolio of Delaware life science companies. The plaintiff sued its limited partners to enforce capital calls, to force them to work in good faith to approve budgets for the portfolio companies, and to obtain declarations concerning the plaintiff's rights under the fund agreement. The funding freeze at issue here placed several of the portfolio companies at risk of insolvency, and so the court entered a highly expedited schedule leading to trial.

This post-trial decision orders specific performance of all but one of the capital calls and otherwise sides with the limited partners. The plaintiff's effort to force budget approvals rests on an implied contractual duty of good faith recognized under Cayman law, a duty that constrains the exercise of discretionary contractual rights when it is implied. Although Cayman law recognizes this implied duty, no court has implied the duty in the context of an exempted limited partnership. This court will not be the first. And the plaintiff's requested declarations that are ripe, which also implicate primarily Cayman law, do not relate to the capital call or budgeting issues that warranted expedition of this case. They relate mainly to issues pending parallel proceedings in a Cayman court. This court thus defers to the Cayman court on those issues.

That's a highly abbreviated summary of what follows. Given the precarious position of the affected portfolio companies, the court worked hard to issue this decision promptly.[1] Wasting no time on wordsmithing, this introduction foregoes an

[1] The plaintiff requested that the court issue this decision on or by December 5, 2025.

extensive and riveting account of the facts learned at trial—the deeply human story of a fund formed by two doctors-turned-businessmen motivated to develop drug therapies that improve human health, their many successful years of collaboration, the temporary surge in early stage biotech investment spurred by a global response to the pandemic, the geopolitical events and attendant adjustments to risk strategies that strained the parties' relationship, and the complex legal framework governing their dispute. Although the court streamlined the decision given the press of time, these details and more follow.

I. FACTUAL BACKGROUND

Trial took place on October 16 and 17, 2025. The record comprises 1,930 trial exhibits, live testimony from five fact witnesses and three expert witnesses, deposition testimony from four fact witnesses, and 57 stipulations of fact.[2] These are the facts as the court finds them after trial.

[2] This decision cites to: C.A. No. 2025-0607-KSJM docket entries (by docket "Dkt." number); trial exhibits (by "JX" number); the trial transcript, Dkts. 277–79 ("Trial Tr."); and stipulated facts set forth in the Parties' Stipulation and Pre-Trial Order, Dkt. 209 ("PTO"). The parties called the following fact witnesses: Yuri Bogdanov (Rigmora CEO), Seth Harrison (ATP Founder and Managing Partner), Spiros Liras (ATP Venture Partner), Dmitry Rybolovlev (Rigmora Founder), and Joseph Yanchik (ATP Venture Partner). The parties called the following expert witnesses: Ilonna Rimm (Rigmora Biotechnology Investing Expert), Mark Robbins (ATP Biotechnology Investing Expert), and Ilya Strebulaev (Rigmora Venture Capital Expert). The parties submitted the deposition transcripts of the live witnesses and called the following witnesses by deposition only: Michael Ehlers (ATP Chief Scientific Officer, Venture Partner, and Portfolio Company Officer & Director), William Engels (ATP CFO), Daniel Finkelman (ATP General Counsel), and Alexey Yakovlev (Rigmora CFO). Depositions transcripts are cited using the witnesses' last name and "Dep. Tr."

A. The Fund And The Limited Partnership Agreement

In 2012, Dr. Seth Harrison and Dr. Dimitry Rybolovlev formed Apple Tree Partners IV, L.P., which was later renamed to ATP Life Science Ventures, L.P., a Cayman Islands exempted limited partnership (the "Fund").[3]

Both Harrison and Rybolovlev were medical doctors. Harrison received his M.D. from Columbia Medical School[4] and worked as a surgeon at a New York City hospital for a year.[5] He then left the field of medicine to attend Columbia Business School.[6] After business school, in the 1990s, he joined a large venture capital firm and formed Apple Tree Partners I to hold his life-science investments.[7]

Rybolovlev received his medical degree in 1990 from Perm Medical Institute and practiced medicine for a year after.[8] He switched careers in the 1990s when the Soviet Union was privatizing.[9] Rybolovlev acquired stakes in multiple companies before consolidating his investments in the most successful, a fertilizer manufacturer named Uralkali.[10] Rybolovlev acquired voting control of Uralkali by 2000, instituted "western style" corporate governance mechanisms,[11] and took it public in 2007 on the

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[3] PTO ¶ 23.

[4] Trial Tr. at 7:22–8:1 (Harrison).

[5] *Id.* at 8:1–3 (Harrison).

[6] *Id.* at 8:2–16 (Harrison).

[7] *Id.* 8:13–21 (Harrison).

[8] *Id.* at 345:2–14 (Rybolovlev).

[9] *Id.* at 346:8–347:1 (Rybolovlev).

[10] *Id.* at 347:2–16 (Rybolovlev).

[11] *Id.* at 347:20–348:5 (Rybolovlev).

London Stock Exchange.[12] Rybolovlev sold his interests in Uralkali in 2010, personally earning around $5 billion through the transaction.[13]

Rybolovlev decided to invest the proceeds in companies addressing the "three major ways" in which, in his view, the future of "humanity will benefit the most": "health, . . . food, and entertainment."[14] He ultimately invested in a diverse array of companies intended to fulfill these goals, including a cellular-based meat producer and AS Monaco Football Club.[15] To promote human health, Rybolovlev met with fund managers in the U.S. "to find an optimal way to invest in biotech industry."[16] He ultimately determined to replicate the investment strategy that led to his success with Uralkali, creating a "family-owned pharma company" using the "apparatus" of "venture capital."[17]

In 2010, a biotech analyst at Merrill Lynch introduced Harrison to Rybolovlev.[18] Harrison liked Rybolovlev's investment strategy.[19] Harrison and Rybolovlev formed the Fund to invest in and develop biotechnology.[20]

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[12] *Id.* at 348:6–7 (Rybolovlev).

[13] *Id.* at 348:11–13 (Rybolovlev).

[14] *Id.* at 351:2–6 (Rybolovlev).

[15] *Id.* at 351:7–352:6 (Rybolovlev).

[16] *Id.* at 349:24–350:5 (Rybolovlev).

[17] *Id.* at 16:18–23 (Harrison); *id.* at 350:6–9 (Rybolovlev).

[18] *Id.* at 9:10–14 (Harrison).

[19] *Id.* at 350:14–17 (Rybolovlev).

[20] *Id.*; *id.* at 9:24–10:10 (Harrison); *id.* at 349:20–351:9 (Rybolovlev); JX-1 (LPA) at 3; JX-1574 ("Bloch Report") ¶ 15.

ATP III GP, Ltd. ("ATP") serves as the General Partner of the Fund, and Harrison is the manager of ATP.[21] The Fund's largest limited partners, contributing approximately 98% of the Fund's overall capital,[22] are Defendants Rigmora Biotech Investor One LP and Rigmora Biotech Investor Two LP, both owned by Rybolovlev's family trust.[23] The Rigmora entities are successors-in-interest to the original limited partners Blue Horizon Enterprise Ltd. and Ezbon International Ltd. (together with the Rigmora entities, "Rigmora").[24]

On November 1, 2012, the parties entered into the First Amended and Restated Limited Partnership Agreement (the "LPA"), which governs the Fund's operations.[25] The LPA is governed by the law of the Cayman Islands.[26] The parties have amended the LPA twenty-two times.[27]

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[21] PTO ¶¶ 13, 15.

[22] JX-1237 at 4 (contributions through 2024); JX 1302 at 3–5 (showing Defendants' combined contributions accounted for about 98% of the Fund's ~$2.309 billion of capital contributions as of December 31, 2024); PTO ¶¶ 57, 59–61, 63 (contributions in 2025); Trial Tr. at 469:11–22, 470:12–17 (Yakovlev) (explaining how to navigate JX-1237 and calculate total contributions); *id.* at 208:10–18 (Strebulaev). Harrison and Les Pommes have contributed $54.7 million combined. JX-1400 ¶ 44; Trial Tr. 11:16–12:5 (Harrison).

[23] PTO ¶¶ 17–20; *see also* Trial Tr. at 270:12–271:3, 271:13–15 (Bogdanov).

[24] PTO ¶ 18; *see also* Trial Tr. at 11:4–7, 25:10–17 (Harrison).

[25] LPA; *see also* PTO ¶¶ 24–25.

[26] LPA ¶ 18(g).

[27] JX-1–JX-6 (LPA and LPA Ams. 1–5); JX-8–JX-17 (LPA Ams. 6–15); JX-19 (LPA Am. 16); JX-89 (LPA Am. 17); JX-126 (LPA Am. 18); JX-132 (LPA Am. 19); JX-222 (LPA Am. 20); JX-480 (LPA Am. 20); JX-1068 (LPA Am. 22).

At issue here, the LPA provides a framework for making capital calls and approving budgets.[28] Also relevant to this litigation, the LPA contains an "Exculpation Provision" that protects ATP from liability for actions taken in good faith that are not willful fraud, willful misconduct, gross negligence, or an intentional and material breach of the LPA.[29] It as well contains a "Discretionary-Action Provision" that grants ATP the discretion to take action against any limited partner who breaches the LPA.[30] The LPA's "Global Default Provision" authorizes ATP as General Partner to declare a Limited Partner who failed to honor its capital call obligations a "Defaulting Partner," and outlines a set of remedies that ATP can elect to pursue.[31] Those remedies include imposing a "Default Charge" by reducing the limited partner's preferred units.[32]

B. The Historical Budgeting Process

The LPA authorizes the General Partner to call capital for "Projects approved by" the Limited Partners "in writing" and "in accordance with a budget therefor approved" by the Limited Partners.[33] The LPA thus granted Rigmora the right to approve budgets for projects before the General Partner can call capital for those projects.

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[28] LPA ¶ 5(a); LPA Am. 3 ¶ 3.

[29] LPA ¶ 2(g).

[30] *Id.* ¶ 18(g)(iv).

[31] *Id.* 5(c).

[32] *Id.*

[33] LPA Am. 3 ¶ 5(a)(iii).

Until late 2024, the process by which the parties agreed on budgets began with informal discussions among Rigmora's Chief Investment Officer (whoever occupied that position at the time), Harrison, and Rybolovlev.[34] For each new Series A investment, Harrison and Rybolovlev met—often in person, although Harrison lives in the United States and Rybolovlev lives in Switzerland—to discuss the opportunity, its prospects for commercial and scientific success, and funding needs.[35]

Rybolovlev personally approved every new investment informally.[36] Once he did so, ATP prepared a packet of materials to secure formal approval.[37] The packet included things like a CFIUS memorandum,[38] a request for formal budget approval,[39] and an investment memorandum.[40]

ATP employees drafted the investment memoranda,[41] which served as a "roadmap from the implementation of a project all the way to the delivery of value as measured by exits."[42] The investment memoranda included the investment thesis, the investment rationale, and an assessment of the quality of the company's

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[34] Trial Tr. at 14:1–24 (Harrison).

[35] *Id.* at 31:15–32:4, 33:5–10 (Harrison); *id.* at 349:9–14, 355:4–12 (Rybolovlev).

[36] *Id.*

[37] *Id.* at 32:19–33:4 (Harrison).

[38] JX-310 at 6–7.

[39] Trial Tr. at 31:15–33:4 (Harrison); *id.* at 355:9–18 (Rybolovlev).

[40] *Id.* at 32:19–33:4 (Harrison); *id.* at 245:13–17, 251:3–13 (Liras).

[41] *Id.* at 132:8–12 (Harrison).

[42] *Id.* at 241:21–24 (Liras).

founders.[43] The memoranda also contained performance milestones by which ATP could "measure progress against stated goals."[44]

As Harrison explained, milestones supplied a useful starting point in projecting a portfolio company's performance, but the initial milestones identified in the investment memoranda became less important in middle and later stages of the investment.[45] As the portfolio companies were "developing drugs from new technologies" and "working with teams of scientists of various stripes," their progress could not easily be predicted from the outset and they would often pivot if their initial strategy was not progressing well.[46]

In this litigation, Rigmora argues that the milestones served as conditions to Rigmora's obligation to fund approved budgets.[47] For this purpose, Rigmora cites to evidence reflecting the significance that ATP placed on milestones.[48] But that

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[43] *See, e.g.,* JX-150 at 8.

[44] Trial Tr. at 242:1–6 (Liras). They also included risk mitigation strategies, which could involve analyses of comparable companies to assess the novelty of the science and its potential value to patients and investors. *Id.* at 242:6–10 (Liras).

[45] Trial Tr. at 134:5–135:13 (Harrison).

[46] *Id.*

[47] JX-1579 ("Rimm Report") Figs. 5–11; *see also, e.g.*, JX-243 at 32 (Evercrisp) (dividing funding into "six milestone-driven tranches"); JX-114 at 1, 7, 32–33 (Apertor) (establishing $50m financing in "milestone-driven tranches"); JX-269 at 27 (Red Queen) (establishing tranches "based on milestones and progress").

[48] *See* Dkt. 269 ("Rigmora Post-Trial Br.") at 8, 28 (citing investment memoranda explaining the significant of milestones, JX-243 at 32, JX-309 at 4, JX-269 at 27; Ehlers's testimony that milestones were valuable for focusing the company's management and protecting investors, Trial Tr. at 403:20–404:2 (Ehlers); and Harrison's investment deck characterizing the Fund's investing practices as "[d]iscipline funding" consisting of "[m]ilestone-based tranches infused over time," JX-2280 at 6).

evidence reflects that ATP viewed milestones as important tools for managing the portfolio companies. No evidence suggests that anyone intended the performance milestones identified in the investment memoranda to serve as conditions to Rigmora's obligation to fund budgets that it approved. Harrison and Rybolovlev never discussed nor negotiated the milestones.[49] Rigmora lacked the substantive expertise to set or track performance milestones.[50] Only two of the approved budgets contained any express milestones, and they were based on corporate strategy metrics.[51] The fact that certain of the Rigmora approved budgets contained express milestones suggests that the parties did not intend to condition the other budgets on milestones contained in the investment memoranda.

After formal budget approval, the Fund would enter into Series A stock purchase agreements with the relevant portfolio companies.[52] ATP viewed the Series A commitments as key to recruiting top scientists and staff.[53] This is because most of the Fund's portfolio companies rely on funding from the Fund exclusively.[54]

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[49] *Id.* at 33:11–14 (Harrison).

[50] Bogdanov Dep. Tr. at 31:2–9; 45:23–46:10; 46:11–15; Blöchlinger Dep. Tr. at 37:17–25; Yakovlev Dep. Tr. at 30:23–31.

[51] *Id.* at 33:23–34:5 (Harrison); JX-1192 at 2.

[52] Trial Tr. at 34:19–35:2 (Harrison).

[53] JX-1174 at 2.

[54] Trial Tr. at 20:8–21:1 (Harrison).

C. Rigmora's Capital Commitments

Since the inception of the Fund, Rigmora agreed to multiple capital commitments. The LPA limits ATP's right to call capital to the maximum amount of money each limited partner, including Rigmora, committed to the Fund, which the LPA refers to as a limited partner's "Contingent Subscription."[55] Rigmora's commitments began with an initial commitment of $1.425 billion alongside the November 2012 LPA and were followed by additional commitments negotiated in connection with amendments to the LPA.

1. Rigmora Commits $1.425 Billion To Establish The Fund.

The parties agreed to capitalize the Fund with $1.5 billion initially.[56] Rigmora would supply $1.425 billion and Harrison would supply the remaining $75 million pursuant to a loan from Rigmora.[57] Rigmora made its initial capital commitments totaling $1.425 billion on November 1, 2012, under subscription agreements signed by Blue Horizon for $698.25 million and Ezbon for $726.75 million.[58] The

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[55] LPA ¶ 5(a)(i).

[56] Trial Tr. at 350:18–23 (Rybolovlev).

[57] PTO ¶¶ 26–27; Trial Tr. at 23:16–25:22 (testifying that Rigmora's total subscription at the time the parties executed the LPA was $1.425 billion when combining Blue Horizon's and Ezbon's subscriptions); JX-212 at 19–23; JX-213 at 19–23; JX-216 at 19–23; Trial Tr. at 25:18–26:3 (Harrison); *id*. at 354:12–19 (Rybolovlev); *see also* JX-1, Sch. D (describing Rigmora's financing of Harrison's capital contributions).

[58] JX-212 at 19–23 (signature pages); JX-213 at 19–23 (signature pages); Trial Tr. at 25:18–22 (Harrison).

subscription agreements were "[s]ubject to the terms and conditions set forth in . . . the [LPA]."[59]

Rigmora also agreed to "make such other capital contributions and payments to the Fund as provided for in the LPA, in the manner and at the times provided in the [LPA]," and to become "bound by the terms of the [LPA]."[60] ATP's right to call capital, in addition to being limited in amount to each partner's Contingent Subscription, was restricted to contractually specified purposes.

2. The Parties Amend The LPA To Create Investment Pools.

Amendment 13 to the LPA, dated February 4, 2019, introduced a Fund structure through which commitments, assets, and contributions would be allocated and tracked across separate "pools."[61] The aim of the pool concept was to segregate money so that profits on new investments would not leak to former Fund employees.[62] As Harrison explained, "we had old teams and new teams coming in that would found [sic] new deals. So we needed to segregate their deals in a pool out of fairness."[63] Pools also allowed the parties to increase capital commitments without having to establish new entities, thus avoiding potential know-your-customer roadblocks.[64]

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[59] JX-212 ¶ 1; JX-213 ¶ 1.

[60] *Id.*

[61] JX-15 (LPA Am. 13) ¶ 17(a).

[62] Trial Tr. at 27:11–28:9 (Harrison)

[63] *Id.* at 27:13–17 (Harrison).

[64] *Id.* at 27:11–28:9 (Harrison).

Amendment 13 established two pools: Pool A, which held the existing projects, and Pool B, which held the Fund's new projects.[65] Rigmora was responsible for funding 100% of capital called for Pool B.[66] Amendment 13 stated that expenses "directly attributable" to a particular pool would be allocated exclusively to that pool with other expenses apportioned between the pools based on the relative cost basis of the remaining assets in each pool.[67] Amendment 13 identified the "Management Fee" paid to Harrison, and the "Apple Tree Life Sciences, Inc. Fee, or "ATLS Fee" for Fund expenses incurred across the portfolio companies, as expenses attributable to both pools.[68]

Amendment 13 further provided that "separate and distinct records shall be maintained for each Pool, and capital contributions . . . shall also be accounted for separately on a Pool-by-Pool basis."[69]

3. Rigmora Commits An Additional $1 Billion.

Rigmora increased its commitment to the Fund as early-stage biotech investment surged in 2020 and 2021, spurred by the global response to the Covid-19

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[65] LPA Am. 13 ¶ 17(a).

[66] *Id.*¶ 17(b).

[67] *Id.* ¶ 17(d)).

[68] JX-9 (LPA Am. 7) Schedule A ¶ 3; JX-19 (LPA Am. 13) ¶ 17(d). ATLS is a wholly owned subsidiary of the Fund that covers Fund operational expenses like facility costs, leases, rents, and employee costs. JX-9 (LPA Am. 7) Schedule A ¶ 3; Trial Tr. at 17:17–18:4 (Harrison). The parties allocated the Management Fee and ATLS Fee between the pools according to fixed percentages. LPA Am. 20 ¶ 6.

[69] LPA Am. 13 ¶ 17(a).

pandemic.[70] Amendment 17 to the Limited Partnership Agreement, dated September 9, 2020, committed Rigmora to fund an additional $1 billion to be allocated between Pool B and a new Pool C.[71] Thereafter, Pool A would consist of Rigmora's original $1.425 billion capital commitment and all economics of the Fund not expressly allocated to Pools B or C. Pools B and C would split Rigmora's new $1 billion commitment.[72]

Amendment 17 further specified that Pool B would contain: Chinook Therapeutics U.S., Inc.; Nine Square Therapeutics Corporation; and Initial Therapeutics, Inc., along with a proportionate share of the Management Fee and ATLS Fee.[73] Pool C would contain Kynos Therapeutics Ltd and any new projects after the execution of Amendment 17, along with a proportionate share of the ATLS Fee and Management Fee.[74]

Each of these pools would be funded "exclusively" by Rigmora, and "[a]ll capital invested in the Pool C Projects . . . [would] be treated as contributed to [Pool C]."[75]

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[70] Trial Tr. at 362:7–12 (Rybolovlev); *see also id.* at 402:20–22 (Ehlers); JX-1579 ¶ 19.

[71] Trial Tr. at 29:1–19 (Harrison); JX-89 (LPA Am. 17).

[72] LPA Am. 17 ¶ 20(a)

[73] *Id.*

[74] *Id.*

[75] *Id.* ¶ 20(b).

After Amendment 17, the parties executed amended subscription agreements under which Blue Horizon and Ezbon committed to contributing $490 million and $510 million, respectively, to Pools B and C.[76]

In Amendment 19, dated November 27, 2020, the parties renamed Pools A, B, and C, as Pool ATP IV, Pool ATP V-1, and Pool ATP V-2, respectively.[77] In their testimony, the witnesses further shortened the Pool names to Pool IV, Pool V-1, and Pool V-2,[78] and this decision follows suit.

D. Amendment 20 To The Limited Partnership Agreement

In 2021, while investments in early-stage biotech companies still surged, the parties decided to restructure the economic rights and obligations surrounding an existing Pool IV project called Braeburn Inc. The Fund founded Braeburn in 2012 as "a Phase 1 company."[79] By 2021, it was "market[ing] a drug for opioid addiction" and had around "$300 million in sales revenue."[80] Pool IV held Braeburn, but the company was "capital intensive."[81] So Rybolovlev agreed to fund the capital commitments to Braeburn, and ATP agreed to "change[] . . . carry economics in favor of [Rybolovlev]."[82] To facilitate this arrangement, the parties amended the LPA to

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[76] Trial Tr. at 41:11–42:14 (Harrison); JX-99; JX-101.

[77] JX-132 (LPA Am. 19) ¶ 1; Trial Tr. at 28:22–24 (Harrison).

[78] *See, e.g.*, Trial Tr. at 40:19–23 (Harrison).

[79] Trial Tr. at 44:14–19 (Harrison).

[80] *Id.* at 44:13–21 (Harrison).

[81] *Id.* at 45:8–21 (Harrison).

[82] *Id.* at 45:8–24 (Harrison); LPA Am. 20 ¶ 21(b).

"segregate the investment in Braeburn."[83] Meanwhile, ATP had placed new executives in charge of existing projects.[84] This, coupled with changes at Braeburn, prompted a wholesale restructuring of Pool IV to allocate existing assets and liabilities to newly created pools and align managers' carried interests with their performance.[85]

In June 2021, the parties executed Amendment 20 to for this purpose.[86] Amendment 20 created two new pools.[87] The first, "Pool Braeburn," held Braeburn in a segregated fund for which Rigmora would be the exclusive source of capital.[88] The second, "Pool V-3," held seven companies formerly under Pool IV that "hadn't quite made it" and "would be managed by the members of our new team"[89]—Ascidian Therapeutics, Inc., Gala Therapeutics, Inc., Galary, Inc., Galvanize Therapeutics, Inc., Galaxy Medical, Inc., Intergalactic Therapeutics, Inc., and Marengo

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[83] *Id.* at 44:22–45:2 (Harrison).

[84] *Id.* at 46:6–15 (Harrison).

[85] LPA Am. 20 ¶¶ 21(a), 22(a) (describing Pools V-3 and Braeburn as "consist[ing] of the assets, liabilities, income, gains, losses and expenses associated with the Partnership's investments" in the relevant portfolio companies); Trial Tr. at 44:22–45:11 (Harrison) (Pool Braeburn created to change "carry economics" for investment in Braeburn); *id.* at 39:21–41:10, 46:6–15 (Harrison) (Pool V-3 set up to segregate economics for new managers).

[86] Trial Tr. at 44:11–46:15 (Harrison).

[87] LPA Am. 20 ¶¶ 21, 22.

[88] LPA Am. 20 ¶ 21; *id.* ¶ 21(b) (stating that capital shall be called from Rigmora "exclusively" and that "[n]o other Partner shall be required to contribute capital to or in respect of Pool Braeburn").

[89] Trial Tr. at 46:6–15 (Harrison).

Therapeutics, Inc.[90] Amendment 20 also reduced Rigmora's funding commitments to Pool IV.[91]

The parties dispute whether Rigmora agreed to increase its overall capital commitments through Amendment 20. Before Amendment 20, Rigmora had committed a total of $2.425 billion: $1.425 billion to Pool IV and $1 billion to Pools V-1 and V-2.[92] Of that amount, Rigmora had contributed approximately $1.3 billion[93] to Pool IV and $58.5 million to Pools V-1 or V-2.[94] Rigmora's commitments thus left around $1.067 billion in head room in its Contingent Subscription to achieve the then contemplated projects.[95] In this litigation, Rigmora argues that $1.067 billion was

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[90] LPA Am. 20 ¶ 22(a).

[91] LPA Am. 20 ¶ 24.

[92] PTO ¶ 30; JX-212 at 19–23 (Blue Horizon SA signature pages); -213 at 19–23 (Ezbon SA signature pages); LPA Am. 17 ¶ 20(a) (committing an additional $1 billion to Pools B and C); JX-99 ¶ 1; JX-101 ¶ 1; LPA Am. 19 ¶ 1 (renaming Pool A to Pool IV and Pools B and C to Pools V-1 and V-2 respectively).

[93] *See* JX-221, Tab "Capital Contributions – ATP IV," Cells D163, E163 (stating Ezbon and Blue Horizon contributed $662,918,351.14 and $636,921,696.00 to ATP IV respectively, which combined equals $1,299,840,047.14).

[94] *See id.*, Tab "Capital Calls – V-1 and V-2," Adding cells D23 and D47, the totals for Rigmora's contributions to V-1 and V-2, yields $58,486,530.

[95] As described in the legal analysis, immediately prior to Amendment 20's adoption, Rigmora committed $2.425 billion to the Fund. PTO ¶ 30; JX-212 at 19–23 (Blue Horizon SA signature pages); JX-213 at 19–23 (Ezbon SA signature pages); LPA Am. 17 ¶ 20(a); JX-99 ¶ 1; JX-101 ¶ 1; LPA Am. 19 ¶ 1. Rigmora's combined contributions to all pools immediately prior to Amendment 20's adoption was $1,358,326,577.14. JX-221, Tab "Capital Contributions – ATP IV," Cells D163, E163 (showing Rigmora's total contributions to Pool IV as $1,299,840,047.14); *id.*, Tab "Capital Calls – V-1 and V-2," Cells D23, D47 (showing Rigmora's total contributions to Pools V-1 and V-2 as $58,486,530). Subtracting Rigmora's capital contributions of $1,358,326,577.14 from its then current Contingent Subscription of $2.425 billion yields unfunded capital commitments of $1,066,673,422.86.

more than enough to accomplish anticipated projects. And the parties did not expressly amend the subscription agreements in connection with Amendment 20 as they had with prior LPA amendments.[96]

But Amendment 20 and communications leading up to it, all during the biotech boom, reflect that the parties anticipated unfunded commitments exceeding $1.067 billion, and total commitments from Rigmora exceeding $2.425 billion.

In May 2021, Harrison emailed a draft outline of the transaction to Rigmora's then-CEO and CIO Anna Kolonchina, who indicated Rigmora's assent to the outline a few days later.[97] The outline included a section titled "Remaining Unfunded Capital Commitments" of approximately $1.385 billion as follows: (1) $20 million for ATP IV; (2) $220 million for ATP V-1; (3) $664 million for ATP V-2; (4) $291 million for new Pool ATP V-3; and (5) $189.95 million for new Pool Braeburn.[98] Adding up Rigmora's obligation for those commitments (approximately $1.384 billion),[99] to its then-funded commitments ($1.3 billion) equals $2.684 billion.

On its face, Amendment 20 reflects a minimum in unfunded commitments of approximately $2.814 billion, more than those of the May 2021 outline.[100]

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[96] *See* PTO ¶¶ 26–27, 30 (listing amendments to subscription agreements).

[97] JX-195 at 1 (Kolonchina circulated a revised draft and stating it "make[s] sense to start drafting a long form" amendment).

[98] JX-195 at 4–5.

[99] Of that, Rigmora would be responsible for approximately $1.384 billion based on its agreement to fund 99.6028% of Pool IV and Pool V-3 and 100% of the remaining pools. JX-195 at 1, 4–5.

[100] LPA Am. 20.

Amendment 20 reflected anywhere from $304.6 to $309.2 million in contributions to Pool V-3[101] (more than the $291 million reflected in the outline). It also reflected a minimum of $189.9 million to Pool Braeburn plus a commitment to fund additional securities fees (thus likely more than the flat $189.9 million reflected in the outline).[102] Amendment 20 reduced the $1.425 billion commitment to Pool IV consistent with the email (subtracting approximately $92 million to even the

[101] As discussed in the legal analysis, to Pool V-3, Amendment 20 reflected a total commitment of $500 million. LPA Am. 20 ¶ 22(b). This included $189,544,660 in "deemed commitments" to the existing investments into the Pool V-3 companies and implied approximately $310.5 million in new commitments. *Id.* The new commitments expressly identify two new expenses totaling $305.8 million: $70,853,399 in previously approved, unfunded budgets and $235 million in additional commitments to those companies. *Id.* Amendment 20 further states that "Ezbon, Blue Horizon, Harrison, and Les Pommes shall contribute 50.7974%, 48.8054%, 0.1869%, and 0.2103%, respectively," to any unfunded remaining budgets. *Id.* Assuming the implied $310.5 million, then Rigmora would be required to contribute approximately $309.2 million. Assuming the expressly noted $305.8 million, then Rigmora would be required to contribute approximately $304.6 million. So Amendment 20 reflects anticipated additional capital commitments from Rigmora to Pool V-3 in a range of $304.6 million to $309.2 million.

[102] As discussed in the legal analysis, to Pool Braeburn, Amendment 20 reflected Rigmora's commitment of $189.9 million. LPA Am. 20 ¶ 21(a). Amendment 20 also committed Pool Braeburn to "any additional securities of Braeburn acquired by the Partnership after the date of Amendment 20" and fees and expenses related to Pool Braeburn. *Id.* ATP's former CFO Engels testified that the Braeburn later purchased $30.6 million in additional Series B shares for Braeburn and called approximately $9 million in expenses to Pool Braeburn. Engels Dep. Tr. at 355:3–15. The parties executed a settlement agreement in December 2024 to resolve a dispute that Rigmora initiated in Cayman. Trial Tr. at 71:5–10 (Harrison). Pursuant to that settlement, the parties waived the then-remaining $21.3 million in commitments to Pool Braeburn. Engels Dep. Tr. at 355:16–21; JX-1068 (LPA Am. 22); JX-1072.As Engels explained, these commitments "netted out to a total obligation of $208,355,000." Engels Dep. Tr. at 355:22–356:4. Even assuming that the parties did not know the precise costs of the additional securities, fees, and expenses at the time of executing Amendment 20, the Amendment anticipated $189.9 million in additonal funding to Braeburn.

commitment to the funds already contributed and adding the then-anticipated $20 million in fees)[103] but did not reduce the $1 billion commitment to Pools V-1/V-2.

And immediately following Amendment 20, ATP began calling committed capital from Rigmora and Harrison. On June 24, 2021, ATP transmitted a capital call to Rigmora for approximately $16.4 million, consisting of $2 million for Pool Braeburn, $1.6 million for Pool V-2, and $12.8 million in expenses charged to the pools, all split among Rigmora and Harrison in line with their commitment obligations to the pools.[104]

This capital call—and every call that followed—included as "Exhibit A" a tracker of the outstanding capital commitments.[105] The tracker included the amount of funds being called from each party on a pool-by-pool basis (including the breakdown of ATLS fees proportionately for each pool), and the amount of unfunded committed capital that would remain following the capital call.[106] Exhibit A to the June 2021 capital call evidenced a total remaining commitment of $1.447 billion.[107] Before this

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[103] The parties agreed to reduce Pool IV's remaining unfunded commitments from the initial $1.5 billion to approximately $20 million to be used to cover expenses, including the cost of litigating a then-ongoing portfolio company exit. JX-1061 (LPA Am. 20) ¶ 24. The actual cost of expenses related to that litigation, and what was ultimately paid into Pool IV after Amendment 20, totaled around $33.3 million. Engels Dep. Tr. at 321:20–322:22. Adding Rigmora's share of those costs to the amount Rigmora contributed to Pool IV prior to Amendment 20 equals $1,333,059,463.85. *See infra* § II.A.1.

[104] Trial Tr. at 47:10-48:3 (Harrison); JX-230 at 1–2.

[105] JX-230 at 4; Trial Tr. at 48:19–50:18 (Harrison).

[106] *Id.*

[107] JX-224 at 3.

litigation, no one at Rigmora (including then-CEO Kolonchina, who received these calls) ever objected to the accounting.[108]

E. Amendment 22 To The Limited Partnership Agreement

Biotech markets retrenched in 2022,[109] and Russia invaded the Ukraine early that year.[110] Rigmora's investment strategy and risk appetite changed after these events,[111] and the parties' relationship began to strain.[112] By 2023, Rigmora had started conditioning its capital contributions on budget reductions.[113] Braeburn had achieved commercial success.[114] The FDA approved Braeburn's drug Brixadi, transforming Braeburn into a commercial-stage company with multi-billion dollar potential.[115] In July 2021, Braeburn entered into a royalty purchase agreement with ATP which gave ATP a license to Braeburn's IP and the associated royalty

[108] Trial Tr. at 48:19–51:1 (Harrison); *id.* at 474:22–476:10 (Yakovlev) (testifying that he was "not . . . aware" of anyone at Rigmora challenging these records)

[109] *Id.* at 382:10–19 (Rybolovlev).

[110] *Id.* at 199:2–3 (Strebulaev).

[111] JX-463 at 2–3; Trial Tr. at 51:15–52:12 (Harrison). At trial, Rybolovlev denied that the invasion of Ukraine played a part in Rigmora's decision making. Trial Tr. at 352:20–353:3 (Rybolovlev).

[112] *See* Trial Tr. at 51:15–52:12 (Harrison).

[113] JX-698.

[114] PTO ¶¶ 48–50.

[115] *Id.*

payments.[116] And Rigmora demanded immediate distributions from Braeburn.[117] ATP refused the demand.[118]

Ultimately, ATP sued in the Cayman Islands to compel Braeburn distributions.[119] In that litigation, Rigmora previewed the defense it would make in this litigation. On October 10, 2024, Kolonchina filed an affidavit in the Cayman court.[120] The LPA authorizes the General Partner to request capital calls in "an amount equal to, *but not in excess of*" the "Contingent Subscriptions" as that term is defined in the LPA.[121] In an October 10, 2024 affidavit, Kolonchina stated, for the first time, that Rigmora's "combined Contingent Subscriptions are US$2.425 billion."[122] Because Rigmora had already funded $2.6 billion, in Rigmora's view, "it is therefore impossible" that Rigmora had outstanding Contingent Subscriptions.[123]

Rigmora did not stand on its newly formed legal defense in the Cayman litigation but instead agreed to meet its capital obligations.[124] The day that she filed her affidavit, Kolonchina stated in an email to ATP that Rigmora would pay a

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[116] JX-586 at 2,

[117] Trial Tr. at 67:9–68:14 (Harrison); PTO ¶¶ 51, 53.

[118] PTO ¶ 52.

[119] PTO ¶ 54; Dkt 57 ("Answer") ¶¶ 98, 100.

[120] JX-1002.

[121] LPA ¶ 5(a)(i) (emphasis added).

[122] JX-1002 ¶¶ 23–26.

[123] *Id.*

[124] JX-998 at 1.

pending capital call although it was "not obligated to do so."[125] By October 2024, Rigmora was explicitly disclaiming any obligation to respond to capital calls for budgets already approved in writing, insisting that further payments would be made only "on a voluntary basis."[126]

During this time, ATP portfolio companies were nearing the end of their Series A commitments and initial budgets, making new budgets critical.[127]

Harrison flew to Monaco and suggested to Rybolovlev that they settle the Cayman litigation.[128] This led to a "couple of days of meetings" where they "agreed to the basic outline of a settlement in order to continue to work together."[129] On December 20, 2024, the parties implemented the settlement terms through Amendment 22 to the LPA.[130]

Through Amendment 22, Rigmora agreed to "discuss" budgets for ATP portfolio companies in exchange for distributions from a newly secured Braeburn royalty valued at approximately $700 million.[131] Amendment 22 provides:

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[125] *Id.*

[126] *Id.*

[127] Trial Tr. at 72:6–73:10 (Harrison).

[128] *Id.* at 68:22–69:1 (Harrison).

[129] *Id.* at 68:24–69:4 (Harrison).

[130] *See* LPA Am. 22 ¶ 26; Trial Tr. at 275:6–21 (Bogdanov).

[131] LPA Am. 22 ¶¶21, 26. By this time, Braeburn was a successful public company and the Braeburn royalty reflected the Fund's share of the company's cash flows. Trial Tr. at 64:18–65:12 (Harrison). ATP removed the Braeburn royalty from the Fund into a separate entity, ATP LLC. *Id.* Amendment 22 allowed Rigmora to receive distributions from the Braeburn royalty. LPA Am. 22 ¶ 21.

> From and after the date of [Amendment 22], the General Partner and [Rigmora] shall discuss new budgets for the Partnership in accordance with the process set forth in this Agreement to allow it to invest in Ascidian Therapeutics, Inc., Aulos Bioscience, Inc., Nereid Bioscience, Incorporated, Nine Square Therapeutics Corporation and Replicate Bioscience, Inc. sufficient amounts to enable each of them to operate for a period of twelve months after the remaining unfunded amounts, if any, under their respective existing approved budgets are expected to have been fully utilized . . . .[132]

Amendment 22 noted, on its face, the projected dates by which each company would run out of cash: January 2025 for Aulos, February 2025 for Replicate, April 2025 for Nereid, May 2025 for Nine Square, and first quarter 2026 for Ascidian.[133]

At the same time, Amendments 22 created a "Royalty Financing" contingency. It stated that "[i]f any approval of a new budget is given by [Rigmora], *such approval shall be contingent upon* at least $300 million being realized (including through deemed distributions) by [Rigmora] on a sale or financing of its interest in ATP LLC."[134] Put differently, no budget for entities identified in Amendment 22 would be approved, and thus subject to capital calls, absent a Royalty Financing.

Harrison expected that the parties would work together to obtain the Royalty Financing.[135] These expectations were consistent with the terms of Amendment 22, which mandates that, in pursuing the financing, as well as approving budget proposals, each party would "do and perform, or cause to be done and performed, all

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[132] LPA Am. 22 ¶ 26.

[133] *Id.* ¶ 26.

[134] *Id.* ¶ 26 (emphasis added).

[135] Trial Tr. at 77:24–78:3 (Harrison).

such further acts and things . . . as any other party may reasonably request in order to carry out the intent and accomplish the purposes of this Amendment and the consummation of the transactions contemplated hereby."[136]

F. Rigmora's New Management Shifts Funding Priorities And Delays Budget Approvals.

In October 2024, Kolonchina left Rigmora,[137] and Rybolovlev promoted Yuri Bogdanov to CIO and co-CEO.[138] Rybolovlev had known Bogdanov for two decades.[139] Before Rigmora, Bogdanov had worked for Uralkali in Russia.[140] Prior to his elevation at Rigmora, Bogdanov worked as a special advisor for several years which entailed giving a "second opinion" and challenging management on investments and other matters.[141] Bogdanov was promoted due to his "general understanding" of Rigmora's operations.[142] But Rybolovlev identified drawbacks to his elevation. For one, "background i[n] auditing" made him "very, very, conservative."[143] Also, Bogdanov had no prior involvement in the Fund's company budgets nor any meaningful exposure to biotech.[144]

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[136] LPA Am. 22 ¶ Miscellaneous.

[137] Trial Tr. at 378:7–14 (Rybolovlev)

[138] *Id.* at 271:24–272:7 (Bogdanov).

[139] Trial Tr. at 273:20–274:1 (Bogdanov).

[140] *Id.*

[141] *Id.* at 272:14–20 (Bogdanov).

[142] Rybolovlev Dep. Tr. at 51:5–52:4.

[143] *Id.* at 50:17–51:3.

[144] Trial Tr. at 272:8–24, 316:24–13 (Bogdanov).

1. Bogdanov Proposes Drastically Reducing Rigmora's Investment In ATP.

Years before his elevation, Bogdanov was working as an investment analyst at Rigmora and recommended that Rigmora slash its investment in ATP.[145] By the fall of 2022, Rigmora's investment strategy and macroeconomic trends landed Rigmora in what Bogdanov described as a "liquidity crisis."[146] To address it, Bogdanov prepared an internal memorandum proposing a change in investment strategy.[147]

In the memorandum, Bogdanov observed that "two to three years ago" a crisis with similar characteristics had been "resolved by liquidating the private equity portfolio."[148] He warned that Rigmora's structure, with mainly "venture businesses (biotech [and] gaming) carries similar risks that had led to the current crisis: poorly predictable money inflows (divestments) and massive outflows (capital calls), which will grow exponentially if the divestments are delayed."[149]

Bogdanov's solution was straightforward: "The current cash gap can be closed by drastic reduction in venture investment (and particularly biotech) and divestiture."[150] Otherwise, Rigmora would remain trapped in "the same logic of

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[145] JX-446.

[146] *Id.*; *see also* Trial Tr. at 352:10–15 (Rybolovlev) (testifying that Rigmora did "not like to keep a lot of liquidity on hand" because "the money, whether it's cash, it has to work").

[147] JX-446; *see* Trial Tr. at 318:2–321:23 (Bogdanov).

[148] JX-446 at 1.

[149] *Id.*; Trial Tr. at 320:11–18 (Bogdanov).

[150] JX-463 at 2; Trial Tr. at 320:3–7 (Bogdanov).

shifting money from less risk (Private Equity Funds, real estate, boat) to more risky assets with 'fire extinguishing' from time to time" to resolve periodic emergency cash shortages.[151]

According to Bogdanov, Rigmora would "most importantly" re-encounter emergency cash shortages due to "guaranteed obligations on . . . biotech venture projects."[152] "Biotech ventures" referred to the Fund.[153] And although the Fund could be "a source of capital gains," it could not "serve as a reliable source of cash for funding [Rigmora's] regular needs."[154] If Rigmora were to exit its biotech investments, it would gain a "buffer" of at least $300 million—enough to mitigate Rigmora's liquidity crisis and achieve a "stable position" long term.[155] Bogdanov concluded that the way "to start moving towards the cash buffer" was "to drastically reduce ATP payments."[156]

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[151] JX-463 at 2; Trial Tr. at 320:19–24 (Bogdanov).

[152] JX-440 at 2 (emphasis added). This email was sent by Bogdanov's associate, but Bogdanov testified that he is "the author." Bogdanov Dep. Tr. 162:5–10.

[153] Trial Tr. at 320:8–10 (Bogdanov).

[154] JX-440 at 2.

[155] JX-446 at 1.

[156] JX-462 at 2 (emphasis added); Bogdanov Dep. Tr. at 174:14–21.

Bogdanov believed that Rigmora could achieve "drastic" payment reductions through "tight controls," including "clear rules for review and approval of new projects."[157] His "priority number one [was] to create the cash buffer."[158]

2. Bogdanov Delays Budget Approvals To Reduce Funding Commitments.

No one gave Bogdanov any "specific instructions" on his new priorities when he became CIO and co-CEO in late 2024.[159] All indications are that Bogdanov set his fall 2022 plans in motion and began implementing a shift toward reducing long-term investments and building a cash buffer by cutting funds to ATP.

Meanwhile, ATP was on the verge of crisis. That is what prompted Harrison to make settlement overtures to Rybolovlev, overtures that led to Amendment 22 and Rigmora's commitment to discuss new budgets. And ATP wasted little time after executing Amendment 22 before sending Rigmora proposed budgets.[160]

Bogdanov had negotiated Amendment 22 for Rigmora and remained ATP's point of contact.[161] On December 24, 2024, Harrison emailed Bogdanov budget requests for:[162] Auolos, "align[ing] with management's recommendation for the middle scenario of $28M"; Replicate, for "$11M"; and Nine Square, "with a budget

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[157] JX-462 at 2; Bogdanov Dep. Tr. at 173:16–22.

[158] JX-462 at 2.

[159] Trial Tr. at 342:20–343:3 (Bogdanov).

[160] JX-1079 at 1; Trial Tr. at 79:10–80:5 (Harrison).

[161] Trial Tr. at 271:24–272:7, 275:2–5 (Bogdanov).

[162] JX-1079 at 1.

request of $15M" (the "Budgeting Requests").[163] Harrison also explained that he had attached materials concerning budgets for: Nereid, which could merge with Marlinspike and "utilize Marlinspike's remaining budget" and therefore required no additional funds; and Ascidian, which would "require more discussion and time to understand" due to "contingent variables" expected to "emerge" in the coming year.[164]

Harrison provided a spreadsheet showing "expected tranching by quarter for 2025," plus access to data rooms with "supporting materials for the new budgets."[165] ATP had not historically provided this level of information when requesting budget approval.[166] Harrison testified at trial that ATP provided this information "to make sure [Rigmora] understood that after the settlement agreement we were being radically transparent."[167] Bogdanov forwarded Harrison's email to Rigmora's analyst, Zufar Iskhakov, exclaiming "Let's start. Merry Christmas!"[168] This seems like a positive response. Yet Bogdanov testified in deposition that he did not mean "let's start approving budgets."[169] And events that followed seem to suggest that he meant "let's start" imposing "tight controls."

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[163] *Id.*

[164] *Id.*

[165] *Id.*

[166] Trial Tr. at 80:18–81:7 (Harrison).

[167] Trial Tr. at 128:6–9 (Harrison).

[168] JX-1079 at 1.

[169] Bogdanov Dep. Tr. at 228:13–15.

Bogdanov prioritized Replicate, which Harrison had warned would "run out of cash by the third week of January."[170] Over the holidays, Bogdanov's team prepared a "list of the follow-up diligence questions,"[171] which Bogdanov sent to Harrison.[172]

Bogdanov testified that this was appropriate. He characterized the list as "basic diligence questions on the company's past performance" and "how the company executed its original plan."[173] The questions determine the "most important indicators before [] mak[ing] any decision on the new budget."[174]

Harrison, on the other hand, viewed Bogdanov's diligence questions as bizarre.[175] As he testified, Rigmora "already knew about" Replicate and had "approved the budget[.]"[176] Replicate had pivoted "from oncology to a rabies vaccine over the course of the fund's investment."[177] As Harrison explained: "this is a company that we founded I think in 2021 and on which we'd reported extensively, were the sole owner, and we had many, many, many conversations about with [Rybolovlev]."[178]

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[170] Trial Tr. at 291:11–16 (Bogdanov).

[171] *Id.* 291:17–20 (Bogdanov).

[172] JX-1107 at 1–5.

[173] Trial Tr. at 292:1–8 (Bogdanov).

[174] *Id.* at 292:9–15 (Bogdanov).

[175] Trial Tr. at 129:3–5 (Harrison).

[176] *Id.*

[177] *Id.* at 128:19–23 (Harrison); JX-1107 at 3.

[178] Trial Tr. at 82:23–83:3 (Harrison).

Rigmora's diligence requests ignored this history. Some of the requests were open-ended, seeking, for example, narratives explaining whether Replicate had "lost its differentiation," and how its "technology evolved over the past four years compared to its main peers."[179] When confronted on cross-examination about whether he knew if his diligence questions could "be answered in a reasonable amount of time," Bogdanov admitted: "I didn't know."[180]

Rigmora ultimately approved Replicate's budget.[181] But the budgeting experience for Replicate marked a departure from the parties' historically collaborative approach over the Fund's twelve-year history and, in that way, foretold events to come.

3. To Move Forward, Harrison Proposes Reallocating Committed Funds To Clinical-Stage Companies.

Additional meetings occurred in March 2025 in Monaco to discuss the budgeting efforts contemplated by Amendment 22, including Aulos, Ascidian, and Marengo.[182] Bogdanov continued to issue requests for extensive information in connection with the budgeting process.[183] And ATP continued responding to those requests.[184] The senior management teams for those budgets under review flew

[179] *Id.* at 130:4–16 (Harrison); JX-1107 at 3.

[180] *Id.* at 328:17–329:1 (Bogdanov).

[181] *Id.* at 87:4–17 (Harrison); *id.* at 295:13–18 (Bogdanov).

[182] *Id.* at 92:15–18 (Harrison).

[183] *Id.* at 293:3–19 (Bogdanov).

[184] *Id.* at 94:5–24 (Harrison); JX-1222 at 1.

overseas, as did consultant Bill Grossman, whom ATP engaged for Bogdanov's and Rybolovlev's benefit.[185]

The Monaco meetings, however, did not result in approved budgets for Aulos, Ascidian, or Marengo.[186] Nor had Rigmora made any progress toward Royalty Financing.[187] With the understanding that the only capital the Fund would receive from Rigmora would be capital called within approved budgets, Harrison proposed as a compromise that the parties reallocate funding to "move some of the clinical projects along."[188] He proposed reallocating some of the approved budget amounts from the preclinical companies to clinical companies.[189]

Harrison put the reallocation proposal forward although he believed that the preclinical projects had value.[190] He engaged Rigmora to "attempt to minimize any need for near-term cash funding."[191] He sought to neutralize Rigmora's "incessant refrain that it faced cash flow issues and that it either could not, or would not, meet the funding needs of the Pool V-1 and V-2 portfolio companies."[192]

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[185] Trial Tr. at 95:1–18 (Harrison). Grossman assessed courses of action for Aulos. *Id.* at 95:19–96:6. Eventually, Rybolovlev deferred to Harrison's expertise before agreeing, in Harrison's words, "we should do Aulos." *Id.* at 95:24–97:15 (Harrison).

[186] *Id.* at 97:16–18 (Harrison).

[187] *Id.* at 98:1–12 (Harrison).

[188] *Id.* at 97:19–98:20 (Harrison).

[189] *Id.* at 98:21–99:2 (Harrison).

[190] *Id.* at 101:19–102:7 (Harrison).

[191] JX-1336 at 1.

[192] *Id.*

4. In Response To A Hostile Reaction From Rigmora, Harrison Withdraws The Reallocation Proposal.

Rigmora did not agree to Harrison's reallocation proposal.[193] At first, Rigmora seemed receptive to the approach. On May 9, Harrison held a Zoom call with Bogdanov, Rybolovlev, and Anna Batarina, an ATP partner.[194] At this meeting Harrison provided a brief introduction and then offered a more formal presentation.[195] In response, Bogdanov and Rybolovlev said that a presentation would be unnecessary because it is moving in the right direction, and the next step would be to speak with Rigmora's lawyers.[196]

Harrison spoke with Rigmora's lawyers on May 12, 2025.[197] Harrison characterized the call as an "ambush."[198] In his view, the lawyers distorted the purpose and meaning behind his reallocation proposal, saying to Harrison "it's obvious that you think the preclinical companies are worthless, otherwise why would you have proposed this reallocation."[199] Harrison withdrew the proposal during the May 12 call.[200]

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[193] Trial Tr. at 99:3–6 (Harrison).

[194] *Id.* at 47:20–23, 99:7–15 (Harrison).

[195] *Id.*

[196] *Id.*

[197] *Id.* at 99:8–100:8 (Harrison).

[198] *Id.* at 100:18–21 (Harrison).

[199] *Id.* at 101:2–12 (Harrison).

[200] *Id.* at 305:2–20 (Bogdanov).

G. Rigmora Disclaims Any Outstanding Capital Commitments To ATP.

Rigmora ratcheted up the parties' level of conflict further on May 15, 2025, when Bogdanov emailed ATP an alarming communication (the "May 15 Email").[201]

In the email, Bogdanov declared that the Fund should cease further funding of seven preclinical companies, which he referred to as the "Early-Stage Companies," and which all had approved yet unspent budgets.[202] He claimed those companies had "no way for a path to commercial success," had "failed to meet the milestones set out in the investment memoranda on which [Rigmora's] initial funding was premised," and there was "no third party interest."[203] In describing the companies as dead-ends, the May 15 Email contorted the purpose of Harrison's reallocation proposal, misstating that Harrison "hold[s] a similar view" that "further funding of those Early-Stage Companies will waste the ATP Fund's assets."[204]

Although Rigmora had already approved budgets for the preclinical companies, Bogdanov invited a "detailed explanation" of why, despite the companies' supposed unworthiness, Rigmora should "contribute further capital" to the preclinical companies.[205] Bogdanov stated Rigmora's intent to "comply" with the LPA but

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[201] JX-1319 at 1.

[202] *Id.*

[203] *Id.*

[204] *Id.*

[205] *Id.*

conditioned its cooperation on whether ATP could "demonstrate that the LPA allows" ATP to call further capital.[206]

And although the parties had just spent months discussing budgets for the four clinical-stage companies, and ATP had called capital for those companies on December 24, 2024, Bogdanov conditioned any further funding for those companies on ATP's agreement to "wind down or liquidate the Early-Stage Companies."[207]

Bogdanov gave ATP an ultimatum: liquidate the preclinical companies with already approved budgets to obtain funding for companies during clinical trials. Rigmora stated that it would not even "consider" the budgets for clinical-stage companies until ATP agreed to release Rigmora from its obligations to meet capital calls for already-approved budgets and abandon existing investments through liquidation or wind down.

The May 15 Email demanded "objective information" to "facilitate the discussion" of any "new budgets"— ignoring the past five months' of data and erecting new hoops for ATP to jump through.[208]

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[206] *Id.*

[207] *Id.* Bogdanov did not address the two preclinical companies Nereid and Nine Square that had already expended their initial Series A funding. *See id.*

[208] *Id.*

In the penultimate sentence, the May 15 Email stated that Rigmora did "*not presently have any outstanding capital commitments to ATP Fund* and therefore has full discretion on whether to agree to fund any new investment proposals."[209]

H. ATP Calls Six Months Of Capital.

The May 15 Email ultimatum left ATP with very few options. ATP decided to lean on its contractual rights. On May 30 and June 1, the GP called $87.76 million in capital needed to maintain six months of research activity for ten companies—the seven preclinical companies as well as Replicate, Marengo, and Ascidian—and $19,371,099 in ATLS Fees and partnership expenses (the "Capital Calls").[210] The capital called and unfunded approved budgets are below:

[209] *Id*. (emphasis added).

[210] *See* JX-1387 at 1; JX-1388 at 1; JX-1390 at 1; JX-1391 at 1; JX-1393 at 1; JX-1394 at 1; JX-1395 at 1; JX-1396 at 1; JX-1397 at 1; JX-1398 at 1; JX-1415 at 1; *see also* Trial Tr. at 110:8–21 (Harrison) (testifying that the figures were keyed to estimates for six months of budgets, with the goal of permitting company survival and "following forward on . . . research plans"); *id.* at 392:8–11 (Rybolovlev) (corroborating Harrison's view that six-months' worth of money permits a company's "normal functioning").

Company	Pool	Capital Called	Unfunded Approved Budget[211]
Aethon	ATP V-2	$5,000,000	$8,000,000
Apertor	ATP V-2	$7,100,000	$19,400,000
Ascidian	ATP V-3	$6,000,000	$6,000,000
Deep Apple	ATP V-2	$9,000,000	$9,000,000
Evercrisp	ATP V-2	$7,000,000	$49,000,000
Initial	ATP V-1	$7,000,000	$19,880,000
Marengo	ATP V-3	$29,960,000	$29,960,000
Marlinspike	ATP V-2	$6,300,000	$36,275,000
Red Queen	ATP V-2	$6,400,000	$23,600,000
Replicate	ATP V-2	$4,000,000	$13,000,000
	TOTAL:	$87,760,000	$214,170,000

Except for Replicate, for which the GP issued a revised capital call on June 1, 2025, the Capital Calls were due on June 13.[212] The revised Replicate capital call was due June 16, 2025.[213] ATP issued Default Notices on June 17, 2025.[214] With ATLS Fees and the June 1 revision, the Capital Calls totaled $101,103,759. Rigmora has never contributed capital in response to any of the Capital Calls.[215]

I. ATP Files This Litigation.

Concurrently with sending the May 30 capital calls, ATP filed this suit.[216] The Verified Complaint (the "Complaint") asserts five Counts.

- In Count I, ATP claims that Rigmora breached the LPA and Amendments 17, 18, and 20 to the LPA, by refusing to engage in

[211] JX-1622.

[212] *See* JX-1387 at 1; JX-1388 at 1; JX-1390 at 1; JX-1391 at 1; JX-1393 at 1; JX-1394 at 1; JX-1395 at 1; JX-1396 at 1; JX-1397 at 1; JX-1398 at 1; JX-1415 at 1.

[213] JX-1415 at 1.

[214] *See, e.g.*, JX-1620.

[215] PTO ¶ 78.

[216] Dkt. 1, Verified Complaint ("Compl.") ¶¶ 23, 183–196.

substantive discussions of new budgets, imposing improper conditions to the occurrence of budget discussions, and repudiating any obligation to consider new budgets.

- In Count II, ATP claims that Rigmora breached or repudiated its obligations under the LPA to fund capital calls made consistent with the budgets it approved.
- In Count III, ATP claims that Rigmora breached its implied obligations under Cayman law to act rationally and in good faith in exercising discretionary rights (absent clear language to the contrary) by refusing to consider requests for new budgets for the Fund's clinical-stage portfolio companies.
- In Count IV, ATP seeks a declaration that the Global Default Provisions of the LPA warrant a Global Default penalty on Rigmora—not on a project-by-project or pool-by-pool basis, but across all of the Limited Partner's interests in the Fund.
- In Count V, ATP seeks a declaration that the Fund is entitled to exculpation, under Paragraph 2(g) of the LPA, for filing this action.

ATP moved to expedite proceedings due to the impending shutdown of several of the affected portfolio companies for lack of funding.[217] The court granted the motion to expedite over Rigmora's opposition and scheduled trial for September.[218]

J. Rigmora Files Competing Litigation In The Cayman Islands.

On June 2, Rigmora filed a Writ of Summons against ATP in the Grand Court of the Cayman Islands.[219] Rigmora resurrected its argument debuted in the prior Cayman litigation—that Rigmora committed $2.425 billion in Contingent Subscription, Rigmora has already made capital commitments in excess of that amount, and thus Rigmora is not required to fund any further capital calls under the

[217] Dkt. 1, Pl.'s Mot. to Expedite Proceedings ¶ 1.

[218] Dkt. 31; Dkt. 39 at 43:8–22.

[219] PTO ¶ 11.

LPA.[220] Four days later, Rigmora filed a Winding Up Petition against ATP in the same court (together with the Writ of Summons, the "Cayman Litigation").[221] Rigmora argued that it had lost trust and confidence in ATP due to ATP's "mismanagement and lack of probity[.]"[222] And Rigmora sought to accomplish through the Cayman court what Bogdanov had unilaterally demanded in the May 15 Email—a liquidation.

K. Forum Jockeying Ensues.

Through motion practice in the competing lawsuits, the parties fought bitterly over the dominance of their preferred forums. On June 9, 2025, Rigmora moved to dismiss ATP's claims and a motion to stay this proceeding pending the resolution of the Cayman Litigation. Three days later, Rigmora filed an ex parte summons in the Cayman Litigation seeking an injunction barring ATP from declaring Rigmora in default of the LPA or issuing any further capital calls.[223] ATP responded by moving to stay the Cayman Litigation.[224]

This court denied Rigmora's motion to dismiss or stay these proceedings, concluding that its motion relied on convenience defenses that it waived in the LPA, and that ATP's allegations supported a finding of irreparable harm to multiple

[220] JX-1416 ¶¶ 4–5.

[221] PTO ¶ 11.

[222] JX-1417 ¶ 4.

[223] JX-1434.

[224] JX-1446.

Delaware entities absent expedition.[225] The Cayman court entered Rigmora's requested injunction and scheduled trial for January 2026 (the "Writ Injunction").[226] And ATP withdrew its motion to stay the Cayman Litigation.[227]

The parties began a sprint to trial in both fora.[228] The parties engaged in further motion practice in these proceedings, filing a combined five motions to compel in one month.[229] This court continued the September trial to October based on Rigmora's claim that ATP's late-produced documents prejudiced its ability to prepare for trial.[230] When seeking a continuance, Rigmora stated that its trial team "may not be able to review [the documents] in time to integrate them into their preparations for the trial[,]" and that "[t]here's no question that there's been actual prejudice" to Rigmora.[231]

Rigmora used its newfound time secured by the continuance to return to the forum fight. Rigmora filed an emergency motion in the Cayman court based on the late-produced documents, seeking the appointment of provisional liquidators to take

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[225] Dkt. 56 at 51:10–52:18. The LPA contains provisions (i) selecting both Delaware and the Cayman Islands as the exclusive forums for related suits, and (ii) waiving all venue and forum non conveniens defenses as to suits filed in Delaware or the Cayman Islands.

[226] JX-1439 ¶¶ 1–2; JX-1446.

[227] JX-1533 ¶ 5.

[228] *Id.* ¶¶ 6, 16.

[229] *See* Dkts. 92, 113, 141, 143, 186.

[230] Dkt. 225.

[231] Dkt. 215 ¶ 7; Dkt. 238 at 13:3–4.

control of the Fund.[232] The Cayman court scheduled a hearing on the emergency motion for October 31.[233]

ATP responded to Rigmora's new advances in the Cayman Litigation by petitioning this court for an emergency status quo order that would prevent Rigmora from pursuing relief in the Cayman court pending resolution of this action.[234] After an initial hearing on the motion for a status quo order,[235] Rigmora agreed not to pursue a hearing on the emergency application in the Cayman court before October 31 and would provide notice to this court of any change in position.[236] The parties ultimately reached a resolution on the status quo order that involved Rigmora withdrawing its emergency application in the Cayman Litigation. [237]

The court held a two-day trial from October 16, 2025 through October 17, 2025.[238] The parties completed post-trial briefing on November 12, 2025, presented post-trial arguments on November 21, 2025, and submitted the Schedule of Evidence on December 3, 2025.[239]

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[232] Dkt. 232 (Pl.'s Mot. for Status Quo Order Br.) at 5–6.

[233] *Id.* at 3.

[234] *Id.*

[235] Dkt. 261.

[236] Dkt. 267 at 7:13–8:13.

[237] Dkt. 267 at 7:13–8:13.

[238] Dkt. 259.

[239] Dkt. 265 (ATP Post-Trial Opening Br.); Dkt. 262 (Rigmora Post-Trial Br.); Dkt. 272 ("ATP Post-Trial Reply Br."); Dkt. 282 (Schedule of Evidence).

L. The Current Status Of The Portfolio Companies

The Capital Calls and Budgeting Requests affect 13 portfolio companies—nine preclinical and four in clinical trials.[240]

The eight preclinical companies—Aethon, Apertor, Deep Apple, Evercrisp, Initial, Marlinspike, Nine Square, and Red Queen—have shown merit in addressing a major unmet therapeutic need. In some instances, initial research and data provided pivot points for the preclinical companies to refocus their efforts on unexpected, more fruitful avenues. ATP personnel, including Harrison and Venture Partner Spiros Liras, Ph.D., testified to these facts, which were further expounded upon by ATP's expert, Robbins Dr. Mark Robbins, Ph.D, J.D.,[241] whose analysis of the preclinical companies, individually and in aggregate, indicated "significant

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[240] *See* JX-1390 (Aethon May 30 Capital Call); JX-1391 (Apertor May 30 Capital Call); JX-1393 (Deep Apple May 30 Capital Call); JX-1394 (Evercrisp May 30 Capital Call); JX-1395 (Initial May 30 Capital Call); JX-1397 (Marlinspike May 30 Capital Call); JX-1398 (Red Queen May 30 Capital Call); JX-1387 (Ascidian May 30 Capital Call); JX-1396 (Marengo May 30 Capital Call); JX-1415 (Replicate June Capital Call). To recap, ATP initially sent a capital call for Replicate on May 30, 2025 for $13 million (JX-1399), but it later issued a revised and superseding capital call for $4 million on June 1. JX-1415. ATP sent the Budgeting Requests for Replicate, Ascidian, Aulos, and Nine Square to Rigmora in a December 24, 2024 email. JX-1079. ATP never sent Rigmora a formal Budgeting Request to increase Marengo's budget. Marengo's management first sought additional money from the Fund in its presentation to Rybolovlev and Bogdanov in Monaco on March 12, 2025. JX-1222, at 147. They requested the Fund commit an additional $75 million to Marengo above what it had already budgeted for the company. *Id.* But Rigmora did not approve the request coming out of the Monaco meetings. Trial Tr. at 97:16-18 (Harrison). Later, on May 19, four days after Bogdanov refused to provide further funding or consider additional budgets unless certain "Early Stage Companies" were wound down, ATP asked Rigmora to discuss (in good faith) and approve a new budget for Marengo. JX-1349. ATP then estimated Marengo's additional funding needs to be $63 million. *Id.*

[241] *See, e.g.,* Trial Tr. at 74:13–20 (Harrison); *id.* at 246:23–247:16 (Liras).

scientific and clinical potential."[242] ATP offered Robbins as an expert on pharmaceutical and biotechnology industry custom and practice to evaluate the scientific and clinical potential of the treatments being developed by the Portfolio Companies.

The four companies in clinical trials—Aulos, Ascidian, Marengo, and Replicate—are similarly promising.[243] ATP has placed each under the direction of a talented group of founders and leaders, including past biotech CEOs who have sold their companies to pharma giants like Bristol Myers Squibb and Amgen for billions of dollars,[244] holders of several patents,[245] and seasoned pharma executives and scientific leaders.[246] The clinical stage companies are all currently engaged in active clinical trials[247] and have generated interest from potential third-party collaborators.[248]

The negative impacts of a funding default for early-stage life sciences companies are severe. These impacts include "[t]alent loss," "[d]elayed, abandoned,

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[242] JX-1573 (Robbins Opening) ¶¶ 23(iv), 38; Trial Tr. at 183:13–23 (Robbins).

[243] Robbins Report ¶¶ 15, 124–159,

[244] *Id.* ¶ 125.

[245] *Id.* ¶¶ 133–134.

[246] *Id.* ¶ 155.

[247] *Id.* ¶¶ 126–128; 137–142; 149–150; 157.

[248] *Id.* ¶ 131 (Aulos' developing partnerships with Pfizer, Regeneron), ¶ 143 (Replicate's partnership with leading Brazilian pharma company, and negotiations with Novo Nordisk), ¶ 152 (Marengo in partnerships with Ipsen and Gilead), ¶ 158 (Ascidian partnership with Roche, and discussions with Lilly, Regeneron, and Bayer).

disrupted R&D," [d]ifficulty in restarting halted or delayed [] trials," "[d]ifficulty attracting future investments or partners, and [n]egative market perception in general."[249] The sudden discontinuation of funding can lead creditors to trigger bankruptcy proceedings and force a sale of the companies for "a fraction of their actual value."[250]

ATP has kept the affected portfolio companies alive during this litigation by scaling down operations with the goal of preserving "critical projects" and "key employees," and trying to operate with a skeleton crew without destroying the company.[251] This has involved "mov[ing] companies [] out of facilities, heavy negotiations with landlords, sales of capital equipment, consolidations, reduction of research programs," and terminating approximately 70% of employees across all companies.[252] One company has been forced to cede platform technology back to the source institution.[253] Despite entering survival mode at great expense to the companies, ATP does not "believe [the creditors] will hold off for much longer" and that the Fund is "likely to lose the assets."[254]

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[249] JX-1572 ("Rao Report") ¶ 67; *see also* Trial Tr. at 60:19–61:10 (Harrison); *id.* at 165:5–21 (Yanchik).

[250] Robbins Report ¶ 162; *see also* Trial Tr. at 165:17–21 (Yanchik).

[251] Trial Tr. at 113:14–114:12 (Harrison); *id.* at 163:21–23 (Yanchik); *id.* at 266:3–7 (Liras).

[252] *Id.* at 113:14–20 (Harrison); *id.* at 162:23–163:6 (Yanchik).

[253] *Id.* at 113:21–114:1 (Harrison).

[254] *Id.* at 163:3–6, 165:17–21 (Yanchik).

Operationally, the companies are in a form of "stasis" and could be revived upon receipt of funding.[255] But the window for revival is closing, because "whenever you stop a research organization, it starts to deteriorate."[256]

II. LEGAL ANALYSIS

In the Pretrial Order and in post-trial briefing, the parties narrowed their disputes to four issues. First, is ATP entitled to specific performance of the Capital Calls under the LPA? Second, did Rigmora breach a duty, implied by common law, to exercise its discretion to approve budgets in good faith?[257] Third, is ATP entitled to a declaration that it did not violate the LPA by bringing this action or that Rigmora is a Defaulting Partner as defined in the LPA? Fourth, is ATP entitled to attorney's fees and expenses incurred in connection with this lawsuit? ATP bears the burden of proof on each of its claims.[258]

A. Capital Calls

The parties' dispute over the Capital Calls centers on two parts of Paragraph 5(a) of the LPA: Paragraph 5(a)(i), which allows the GP to call capital in amounts up to but not "in excess of" the Limited Partners "Contingent

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[255] *Id.* at 163:17–165:4 (Yanchik); *see also id.* at 114:2–12 (Harrison).

[256] *Id.* at 164:18–167:2 (Yanchik).

[257] In the Pre-Trial Order, ATP sought a declaration that Rigmora waived or otherwise forfeited its voting and budget approval rights, but dropped this request after trial. *See generally* Dkt. 265 ("ATP Post-Trial Opening Br.").

[258] *See AB Stable VIII LLC v. Maps Hotels & Resorts One LLC*, 2020 WL 7024929, at *49 (Del. Ch. Nov. 30, 2020), *aff'd,* 268 A.3d 198 (Del. 2021).

Subscriptions";[259] and Paragraph 5(a)(ii), which requires that any capital call be for a purpose stated in the LPA.[260] The parties' competing positions raise two sets of issues: Under Paragraph 5(a)(i), were the Capital Calls in excess of Rigmora's unfunded Contingent Subscriptions? Under Paragraph 5(a)(ii), were the Capital Calls for contractually specified purposes? If the first set of issues go ATP's way, the court must also determine whether ATP is entitled to specific performance of the Capital Calls. To obtain specific performance, ATP bears the burden of showing the existence of terms that it seeks to enforce by clear and convincing evidence.[261]

This contract analysis is governed by Cayman law, consistent with the LPA.[262] The parties dispute the LPA's meaning. Under Cayman law, a court interprets a written contract according to "the intention of the parties by reference to what a reasonable person having all the background knowledge which would have been available to the parties would have understood them to be using the language in the

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[259] LPA ¶ 5(a)(i).

[260] LPA ¶ 5(a)(ii).

[261] Which party bears the burden of proof is a procedural question governed by Delaware law, but the nature of the burden is arguably a substantive issue governed by Cayman law. *See In re IBP, Inc. S'holder Litig.*, 789 A.2d 14, 53 (Del. Ch. 2001). Yet Rigmora cited Delaware law on the nature of the burden. *See* Rigmora Post-Trial Br. at 29 (citing *Vill. Prac. Mgmt. Co. v. West*, 342 A.3d 295, 321 (Del. 2025)). And ATP did not brief it, so this decision applies Delaware law.

[262] LPA ¶ 18(g)(i) (stating that the "terms and provisions" of the LPA "shall be construed under the laws of the Cayman Islands"); PTO ¶ 25. The elements to prove a breach are: (1) a valid contract, (2) a breach of that contract, and (3) damages arising from the breach. JX-1588 ("Phillips Report") ¶ 56 (citing *Chitty on Contracts* at [4-001] (35th ed. 2024); *accord Kuroda v. SPJS Hldgs.*, 971 A.2d 872, 883 (Del. Ch. 2009) (reciting the same elements for a claim of breach of contract under Delaware law)).

context to mean."[263] The goal is to "ascertain the objective meaning of the language which the parties have chosen to express their agreement."[264] The court employs "an iterative process by which each suggested interpretation is checked against the provisions of the contract and its commercial consequences are investigated."[265] But "[c]ommercial common sense is only relevant to the extent of how matters would or could have been perceived by the parties, or by reasonable people in the position of the parties, as at the date that the contract was made."[266]

1. Paragraph 5(a)(i) – Funding Commitments

Rigmora argues that Rigmora has committed $2.45 billion on an aggregate basis as the Contingent Subscription and contributed $2.69 billion, and that the Capital Calls are thus necessarily "in excess of" the Contingent Subscription.[267] ATP argues that Rigmora made over $545.5 million in unfunded commitments to the pools and over $2.85 billion in total commitments across all pools, leaving head room for the Capital Calls. ATP also argues that Rigmora's $2.69 billion calculation double-counted pools of funds that were transferred or reallocated, such that Rigmora's

[263] Bloch Report ¶ 23 (quoting *Arnold v. Britton*, [2015] UKSC 36 at [15]).

[264] Bloch Report ¶ 23 (quoting *Wood v. Capita* [2017] UKSC 24 at [10]); Phillips Report ¶ 61 (same).

[265] Bloch Report ¶ 25 (citing *Wood*, [2017] UKSC 24 at [12]).

[266] Bloch Report ¶ 24 (citing *Arnold*, [2015] UKSC at [19]; *see also* Phillips Report ¶ 60 (also citing *Arnold*, [2015] UKSC at [15], [17]–[21]).

[267] *See* Rigmora Post-Trial Br. at 32, 38–40.

actual contribution is $2.3 billion. In all events, therefore, there is head room to meet the Capital Calls.[268]

The parties' dispute on the meaning and application of Paragraph 5(a)(i) thus raises three sub-issues: What is the Contingent Subscription amount, $2.425 billion as Rigmora contends or over $2.85 billion as ATP argues? What has Rigmora contributed to date, $2.65 billion as Rigmora contends or $2.3 billion as ATP argues? And do the Capital Calls of $101,103,759 fall within any delta between the Contingent Subscription and Rigmora's contributions?

a. Rigmora's Contingent Subscription is $2.425 billion.

The parties dispute both how to calculate the Contingent Subscription (in the aggregate by Limited Partner or pool-by-pool) and Rigmora's total commitments. The threshold issue concerning how to calculate the Contingent Subscription is largely beside the point because ATP has not proven that Rigmora committed over $2.85 billion.[269] ATP reaches the $2.85 billion by adding and deducting the amounts reflected in Amendment 20 to the $2.425 in subscription agreements.

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[268] ATP Post-Trial Opening Br. at 8–9, 54–58; ATP Post-Trial Reply Br. at 13–14.

[269] It bears noting that Amendment 13 to the LPA seems to mandate a pool-by-pool approach. Under the heading "Separate Pools," it provided that "all of the Partnership's assets and liabilities shall be divided into two separate pools" and "separate and distinct records shall be maintained for each Pool, and capital contributions, distributions, income, gains, losses and expenses *shall also be accounted on a Pool-by-Pool basis*." JX-15 ("LPA Am. 13") ¶ 17(a) (emphasis added). ATP satisfied its obligation to track the Contingent Subscription amount on a Pool-by-Pool basis by circulating a detailed "tracker" of funded and unfunded commitments each time it issued a capital call. *See, e.g.*, JX-230; *see also* Trial Tr. at 48:19–49:21 (Harrison).

Broken down by Pool, beginning with Pool IV, recall that the parties initially contributed $1.5 billion to Pool IV and Rigmora contributed $1.425 billion of that amount.[270] In Amendment 20, the parties agreed to reduce the Pool IV commitment to the amount already contributed, plus expenses.[271] By Amendment 20, Rigmora had contributed $1,299,840.047.14 to Pool IV.[272] The parties originally anticipated $20 million in expenses but ultimately incurred around $33,351,890.42.[273] Adding

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[270] *See* PTO ¶¶ 26–27; JX-212 at 19 (Blue Horizon $698,250,000 subscription); JX-213 at 19 (Ezbon $726,750,000); JX-216 at 18 (Harrison $75 million subscription); JX-1, Sch. D.

[271] LPA Am. 20 ¶ 24.

[272] *See* JX-221, Tab "Capital Contributions – ATP IV," Cells D163, E163 (stating Ezbon and Blue Horizon contributed $662,918,351.14 and $636,921,696.00 to ATP IV respectively, which combined equals $1,299,840.047.14).

[273] It was $33,351,890.42 and Rigmora's 99.6028% of that amount was $33,219,416.71. *See* JX-224 at 3 (capital call for $320,590 of expenses for Pool IV); JX-382, at 3 (capital call of 4,749,982.91 in expenses for Pool IV); JX-318, at 3 (capital call for $1,960,789.97 in expenses for Pool IV); JX-487 at 3 (capital call for $8,435,798.52 in expenses for Pool IV); JX-568 at 3 (capital call for $4,000,000 in expenses for Pool IV); JX-585 at 3 (capital call for $280,790.62 in expenses for Pool IV); JX-609 at 3 (capital call for $5,000,000 in expenses for Pool IV); JX-652 at 3 (capital call for $5,200,000 in expenses for Pool IV); JX-718 at 3 (capital call for $1,500,000 in expenses for Pool IV); JX-740 at 3 (capital call for $ 368,717.64 in expenses for Pool IV); JX-823 at 3 (capital call for $874,363.01 in expenses for Pool IV); JX-878 at 3 (capital call for $299,903.33 in expenses for Pool IV); JX-1185 at 3 (capital call for $24,533.02 in expenses for Pool IV). The limited partners also received two capital calls in December 2024 seeking funds relating to the ATLS Fee for the first half of 2025, partnership expenses for the second half of 2024, and the 2024 ATVM management fee. JX-1075 at 3; JX-1086 at 5. The calls sought $375,354.80 from Pool IV and about $15 million across all pools. *See id.* Rigmora initially refused to fund those calls. JX-1085. ATP later discovered that it overcharged the ATLS Fee due to an accounting error and it returned $599,225.46. JX-1172. It is unclear how that refund was allocated across the various pools, but later records indicate that the December calls were reconciled to $336,502.41 for Pool IV. *See* JX-1237, Tab "Pool V-4 Total," Cell E152.

Rigmora's share of the fee to the amount contributed by Rigmora equals $1,333,059,463.85.

Pools V-1 and V-2 are straightforward. Rigmora contributed $1,000,000,000 to Pools V-1 and V-2 in September 2020 in connection with Amendment 17.[274]

Pool V-3 requires some math. According to ATP, Rigmora contribute $310 million to Pool V-3 through Amendment 20. ATP relies on new Paragraph 22(b) of Amendment 20, which provides that:

> ATP V-3 shall have capital commitments of $500,000,000, including without limitation (i) the $189,500,000 of capital deemed to have been contributed as provided below, (ii) the $70,853,399 of capital comprising the Prior Budgeted ATP V-3 Follow-on Investments and (iii) approximately $235,000,000 in investments anticipated to be made in new Portfolio Companies . . . .[275]

This language does not expressly reflect an additional $310 million capital commitment. To reach $310 million, ATP subtracts the "deemed" contributions of $189,544,660 from the total commitment of $500 million.[276] ATP ignores the $70,853,399 in previously approved unfunded budgets for Pool V-3 companies and $235 million, which add up to $305.9 million, not $310 million.

Last is Pool Braeburn. According to ATP, Rigmora contributed $189.9 million to Pool Braeburn through Amendment 20 and agreed to contribute capital sufficient

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[274] Trial Tr. at 29:1–19, 41:11–42:14 (Harrison); LPA Am. 17; JX-99; JX-101.

[275] LPA Am. 20 ¶ 22(b).

[276] *Id.* Here is the math: $500,000,000 – $189,544,660 = $310,455,340. Rigmora is responsible for 99.6028% of the capital contributions for Pool V-3. *See id.* So, Rigmora is responsible for $309,222,211.39 of the Pool V-3 commitments, which rounds up to $310 million.

to cover additional expenses, which Pool Braeburn ultimately incurred. ATP relies on new Paragraph 22(b) of Amendment 20, which provides that Pool Braeburn includes "$189,900,000 in unfunded previously approved budgets," as well as "additional securities of Braeburn acquired by the Partnership after the date of Amendment 20," and management fees and expenses discussed in the Amendment.[277] ATP adjusts the $189.9 million based on later events—ATP acquired $30.6 million in additional securities and was allocated $9 million in expenses, bringing the total commitment to $229.5 million.[278] Through Amendment 22, ATP distributed to Rigmora the royalty held in Pool Braeburn and thus Rigmora "no longer had an obligation to fund the remaining amounts on the royalty purchase agreement," which was $21.3 million.[279] ATP therefore "reduced the obligation to Pool Braeburn by that amount, which netted out to a total obligation $208,355,000."[280]

In summary, in a snapshot, here is how ATP builds to the "over $2.85 billion" figure:

Pool	**Rigmora's Commitment**
Pool IV	1,333,059,463.85
Pools V-1/V-2	1,000,000,000
Pool V-3	309,222,211.39
Pool Braeburn	208,335,616.81
Total	2,850,617,292.05

[277] LPA Am. 20 ¶ 21(a).

[278] Engels Dep. Tr. at 94:3–10; JX-1565, Cell G8.

[279] Engels Dep. Tr. at 355:22–356:3, 355:16–355:21.

[280] Engels Dep. Tr. at 356:2–4; ATP Post-Trial Reply Br. at 11, although by the court's math, it nets out to $208,200.

Rigmora takes issue with ATP's interpretation of Amendment 20 as a capital commitment. Rigmora advances three main arguments to that effect: Rigmora first appeals to the commercial context. Rigmora next argues that interpreting Amendment 20 as a subscription agreement is inconsistent with ATP's contemporaneous representations.[281] Rigmora last contends that Amendment 20 does not read like a subscription agreement and is not sufficiently clear and convincing in its terms to be treated like one.[282]

Rigmora's first argument based on the commercial context of Amendment 20 is misguided. Rigmora argues that Amendment 20 "was entered into less than a year after the $1 billion increase in the LPs' Contingent Subscriptions, when the Fund had over $1 billion in uncalled Contingent Subscriptions remaining."[283] According to Rigmora, "there was no need to increase the capital commitment when Amendment 20 was executed, no reason to think the parties did so, and no reason to think they would have done so without following the same formalities used to increase the Contingent Subscriptions a few months earlier."[284]

Rigmora's commercial-context argument, however, ignores the plain text of Amendment 20. As discussed above, on its face, Amendment 20 reflects a minimum in unfunded commitments of approximately $2.814 billion, far more than the $2.425

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[281] *Id.* at 35–36.

[282] *Id.* at 36–37.

[283] *Id.* at 37; *see* JX-1237 at 4 (schedule of capital activity).

[284] Rigmora Post-Trial Opening Br. at 37.

billion Rigmora conceded. This argument also ignores that biotech investment was booming in 2021 when the parties entered Amendment 20,[285] Rigmora had not yet entered what Bogdanov would later call a liquidity crisis,[286] Rybolovlev approved all of the budgets at issue in Amendment 20, and Rigmora was ATP's only source of capital.[287] If not Rigmora, who was expected to fund the approved budgets reflected in Amendment 20? This commercial context is *ATP's* strongest point.

Rigmora's second argument based on ATP's contemporaneous communications is neutral. Rigmora is correct that interpreting Amendment 20 as a subscription agreement runs contrary to many of ATP's contemporaneous representations.[288] Before the events that led to this litigation, ATP informed its banks, insurance companies, and portfolio-company landlords that its total committed capital was $2.5 billion, which is equal to Rigmora's $2.425 billion under their subscription agreements and Harrison and his family trust's $75 million.[289] And ATP's website for the Fund still lists its capital commitments as "$2.65 billion" as it has since 2020.[290] But other contemporaneous documents, like ATP's first post-Amendment 20

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[285] *See id.* at 7 ("[T]he biotech market peaked in 2020 and 2021, during the COVID pandemic[.]" (citing Trial Tr. at 402:20–22 (Ehlers))).

[286] *See* JX-446 at 1; Trial Tr. at 51:15–52:19 (Harrison).

[287] LPA Am. 20 ¶ 21.

[288] *See generally* Ehlers Dep. Tr. at 35:10–21.

[289] Trial Tr. at 460:12–461:3, 462:10–24, 463:13–464:16 (Engels); JX-834 (communicating to J.P. Morgan that "ATP has approximately $2.5 billion in committed capital").

[290] JX-128 (2020); JX-2128 (Sept. 8, 2025); *see also* About, Apple Tree Partners, https://www.appletreepartners.com/about (accessed Dec. 4, 2025).

capital call to the limited partners[291] and ATP's own accounting of capital contributions that it sent to Rigmora in March 2025,[292] suggests Rigmora did increase its Contingent Subscription through Amendment 20. These competing contemporaneous communications work neither for nor against either side. They suggest that ATP did not spend a lot of time worrying about the precise amount of Rigmora's total capital commitments in 2022. This is consistent with Harrison's testimony that the parties' enjoyed a collaborative relationship during that period.[293]

Rigmora's last argument based on the language of Amendment 20 is compelling. The parties did not execute any new or amended subscription

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[291] The first capital call issued shortly after the adoption of Amendment 20 shows unfunded capital commitments stood at $1,461,868,810 total across all limited partners and $1,460,556,241.39 for Rigmora alone. JX-224, at 3. This evidence supports ATP's position that Rigmora committed more capital through Amendment 20 as unfunded capital commitments immediately preceding Amendment 20 were $1.067 billion. *See supra* § I. D.

[292] *See* JX-1237; JX-1237, PX-513, Tab "Amendment Summary," Cells G8, N8, U8, AC8 (reflecting cumulative commitments across Pools V-1, V-2, Braeburn, V-3, and IV of 3,203,669,000.00). This accounting did not deduct deemed commitments from neither its contribution tabulations nor its tabulations on commitments, so they had no net effect on the limited partner's unfunded commitments. *See* JX-1237, PX-513, Tab "Pool V-3 Total," Cell B9 (including the $189,544,660 deemed contribution in Pool V-3's contributions); *id.*, Tab "Pool Braeburn Total," Cell B9 (including the $203,669,000 deemed contribution in Pool Braeburn's contribution's calculation); *id.*, Tab "Amendment Summary," Cells G8, N10, U8, AC9, AC11 (listing total capital commitments of $1,000,000,000 billion (Pools V-1 and V-2), $393,569,000 million (Pool Braeburn), $500,000,000 (Pool V-3), and $1,383,360,505.56 (Pool IV) for total commitments of $3,276,929,505.56 across all pools). The total commitments listed for Pools V-3 and Braeburn include the deemed commitments within Amendment 20, meaning their accounting in the capital contributions has no net effect on the amount of Rigmora's unfunded commitments. *See id.*, Tab "Amendment Summary," Cells N9, U11. Total commitments exceeding $3.2 billion indicates Amendment 20 increased Rigmora's Contingent Subscription.

[293] Trial Tr. at 51:21:52:4 (Harrison).

agreements with Amendment 20. And Amendment 20 does not expressly refer to the Contingent Subscriptions.[294] The absence of express language referencing Contingent Subscription stands in contrast to Amendments 17 and 18, which both explicitly refer to "Contingent Subscription."[295] This combination of factors is enough to suggest that the finer details of Rigmora's funding commitments were yet to be ironed out when the parties entered into Amendment 20.

Moreover, Amendment 20 does not make clear the amount of capital that Rigmora was to contribute. Amendment 20 does not expressly state that Rigmora commits to contributing its share of the $310 million to Pool V-3. Rather, ATP implies that number by deducting the "deemed contributions" from the contemplated $500 million.[296] Amendment 20 also does not state that Rigmora will contribute $208 million to Pool Braeburn. Rather, Amendment 20 states that Rigmora commits $189.9 million plus unspecified future expenses.[297]

In the end, ATP's interpretation of Amendment 20 leaves too much to interpretation. ATP must demonstrate the contractual terms that it seeks to specifically enforce by clear and convincing evidence.[298] ATP has not proven an overall Contingent Subscription amount of over $2.85 billion. Thus, regardless of

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[294] LPA Am. 20.

[295] LPA Am. 17; LPA Am. 18.

[296] *See* ATP Post-Trial Opening Br. at 10, 13–14.

[297] LPA Am. 20 ¶ 21.

[298] *West*, 342 A.3d at 321.

whether calculated in the aggregate or on a pool-by-pool basis, ATP has proven that Rigmora committed no more than $2.425 billion.

b. Rigmora has contributed no more than $2.3 billion.

Ultimately, ATP need not rely on Amendment 20 to secure the relief it seeks. Rigmora claims to have contributed over $2.69 billion to date, well in excess of the $2.425 billion in undisputed commitments. But the $2.69 billion figure double counts $390 million in "deemed contributions" reallocated through Amendment 20 from Pool IV to Pool V-3 and Pool Braeburn.[299]

Double counting "deemed contributions" of Amendment 20 is inconsistent with the purpose of Amendment 20 as recounted by Rigmora. According Rigmora, the purpose of Amendment 20 was to "reallocat[e] . . . an *existing* commitment from a different pool[.]"[300] Amendment 20 was "not a new commitment."[301] Put differently, the deemed contributions were not new contributions. Moreover, counting the deemed contributions twice against Rigmora's $2.425 billion Contingent Subscription would result in Rigmora committing less than $2.425 billion to the Fund.[302] There is no evidence, either in Amendment 20 or elsewhere, that the parties intended to

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[299] LPA Am. 20 ¶¶ 21(b) (stating initial deemed contributions for Pool Braeburn were $203,669,000 for Pool Braeburn and $189,544,660 for Pool V-3, which is $393,213,660; *see also* Rigmora Post-Trial Answering Br. at 38 n. 277, Ex. 1 (Strebulaev) at 2.

[300] Rigmora Post-Trial Br. at 36 (emphasis added).

[301] *Id.*; *see also id.* at 6 ("Amendment 20 created two new pools . . ." and "allocated *existing assets* and liabilities to them . . . ." (emphasis added)).

[302] LPA Am. 20 ¶¶ 21(b), 22(b) (stating initial deemed contributions $203,669,000 for Pool Braeburn and $189,544,660 for Pool V-3, which is $393,213,660 in deemed contributions total).

reduce the total amounts committed to the Fund through Amendment 20. As discussed above, the commercial context indicates the contrary.

Rigmora relies on a series of ATP communications documents to support its double counting theory.[303] Each of those documents were prepared for other purposes. Two of those documents show that ATP tabulated the limited partners' total capital commitments as more than $3.2 billion.[304] These are not figures that Rigmora stands behind.

Reducing Rigmora's $2.69 billion figure to eliminate double counting, Rigmora has contributed $2.3 billion to the Fund.

c. The Capital Calls do not exceed the difference between the Contingent Subscription and Rigmora's contributions.

ATP has proven that Rigmora committed $2.425 billion and contributed $2.3 billion. The difference is $125 million. Given Rigmora's overall contributions, there is sufficient room to fund the Capital Calls of totaling approximately $101.7 million.

2. Paragraph 5(a)(ii) – Funding Purposes

ATP issued the Capital Calls for ten portfolio companies: Aethon, Apertor, Deep Apple, Evercrisp, Initial, Marlinspike, Red Queen, and Replicate of Pools V-1

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[303] *See* Rigmora Post-Trial Br. at 39–40.

[304] JX-1237, PX-513, Tab "Amendment Summary," Tab "Amendment Summary," Cells G8, N10, U8, AC9, AC11 (reflecting cumulative commitments across Pools V-1, V-2, Braeburn, V-3, and IV of $3,276,929,505.56), JX-2000, Tab "Amendment Summary," Cells G8, N8, U8, AC8 (same).

and V-2, and Marengo and Ascidian of Pool V-3.[305] ATP issued these calls to provide six months of approved budget to carry forward research plans, partnership fees, and ATLS Fees.[306]

The LPA identifies partnership fees, ATLS Fees, and budgets expenses as appropriate purposes. Subsections 5(a)(ii)(A) through (C) state that "[u]nless otherwise approved by the holders of a majority of the Preferred Units in writing," the GP:

> may only call capital, as of any time, in amounts sufficient to enable the Partnership . . . to (A) pay Partnership . . . expenses then existing or reasonably anticipated to be incurred within the next six-month period, (B) pay other Partnership . . . non-discretionary items (such as taxes and tax distributions) and satisfy other Partnership . . . expenses and obligations incurred in the ordinary course of business, [and] (C) pay the Management Fee for the next 12-month period.[307]

Subsection 5(a)(ii)(E) authorizes the GP to call capital in amounts sufficient to "invest in Projects approved by the holders of a majority of the Preferred Units in writing in accordance with a budget therefor approved by such holders of Preferred Units."[308]

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[305] *See* JX-1387 at 1; JX-1388 at 1; JX-1390 at 1; JX-1391 at 1; JX-1393 at 1; JX-1394 at 1; JX-1395 at 1; JX-1396 at 1; JX-1397 at 1; JX-1398 at 1; JX-1415 at 1; *see also* JX-1622.

[306] Trial Tr. at 109:1–110:24 (Harrison); *see also* LPA Am. 13 ¶ 17(d).

[307] LPA Am. 3 ¶ 5(a)(ii)

[308] *Id.* Amendment 3 originally provided for an ATC board of directors and made certain distinctions depending on whether a project was "being run through ATC" or not. *Id.* at 1–2. Amendment 14 excised ATC, and with it the ATC board of directors, from the LPA. JX-16 at 5 (LPA Am. 14).

Rigmora concedes that the stated purpose of the Capital Calls is proper under the LPA. Aside from Replicate, Rigmora does not dispute that it approved budgets for the calls at issue or that the calls were within the approved budgets. Nor does Rigmora dispute that partnership expenses and ATLS Fees are proper purposes for capital calls or that those expenses were improperly calculated.

Rigmora instead advances three arguments to avoid its payment obligation. First, Rigmora argues that ATP cannot call capital because ATP acted in bad faith.[309] Second, Rigmora argues that the approved budgets called for tranched funding conditioned on milestones set out in investment memoranda, which served as conditions to Rigmora's funding obligations, and which the projects did not achieve.[310] Third, as to Replicate, Rigmora argues that Replicate budget was subject to contingency set out in Amendment 22 that the LPs realize at least $300 million from a sale or financing of their interest in the Braeburn royalty, which has not yet occurred.[311]

a. Bad Faith

Rigmora argues that ATP cannot call capital because it acted in bad faith when making the Capital Calls. The LPA permits the General Partner to call capital only for a purpose enumerated in Paragraph 5(a)(ii).[312] The Cayman Islands' Exempted Limited Partnership ("ELP") Act, as adopted by the LPA, requires the General

[309] Rigmora Post-Trial Br. at 44–47.

[310] *Id.* at 40–43.

[311] *Id.* at 43–44; LPA Am. 22 ¶ 26.

[312] LPA Am. 3 ¶ 5(a)(ii).

Partner to exercise its power to call capital in good faith in accordance with its fiduciary duties—which Cayman courts have held requires it to act in the interests of the Fund's limited partners.[313] Rigmora argues that, as a plaintiff seeking specific performance, ATP must prove by clear and convincing evidence that it satisfied the LPA's requirements for all calls and that they are consistent with the ATP's fiduciary duties under Cayman law.[314]

It is unclear whether Rigmora is correct in interpreting Cayman law to mean that a General Partner must prove fiduciary compliance as a condition to enforcing capital calls. Typically, a party relying on the absence of a condition to avoid a contractual obligation bears the burden of proving its absence.[315] But ATP did not challenge this legal assertion. And the accuracy of Rigmora's legal position does not alter the outcome in any event, because there is no factual basis to question ATP's good faith.

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[313] *See* JX-2019, ELP Act § 19(1) ("A general partner shall act at all times in good faith and . . . in the interests of the exempted limited partnership."); JX-1 at 2 (requiring parties to carry on the limited partnership "in accordance with the provisions of the" ELP Act); *id.* ¶ 18(g)(i) (LPA governed by ELP Act); JX-2073, *Kuwait Ports Authority v Port Link GP Ltd* [2023] 1 CILR 50 at [34(iii)]; JX-2074, *Re Aquapoint LP*, CICA (Civil) Appeal No. 0014 of 2022, [2023], at [67].

[314] Rigmora Post-Trial Opening Br. at 44–47; *see also* Bloch Report ¶ 83.

[315] *See generally S'holder Representative Servs. LLC v. Shire US Hldgs. Inc.*, 2020 WL 6018738, at *17 (Del. Ch. Oct. 12, 2020), *aff'd* 267 A.3d 370 (Del. 2021) (TABLE); *AB Stable VIII LLC v. Maps Hotels & Resorts One LLC*, 2020 WL 7024929, at *48–50 (Del. Ch. Nov. 30, 2020), *aff'd,* 268 A.3d 198 (Del. 2021).

Harrison testified that the Capital Calls were for the purpose of funding six months of operations.[316] ATP considered numerous scenarios, evaluating how much capital to call in order to continue funding operations.[317] Harrison ultimately based the size of the Capital Calls on the portfolio companies' research plans and the partnership's expenses.[318] He excluded his own Management Fee from the Capital Calls, so none of the money would be directed to him.[319] Harrison then realized that ATP overcalled capital for Replicate based on the approved budget and corrected that Capital Call on June 1.[320] Harrison's testimony was highly credible.

To argue bad faith, Rigmora states that ATP's "correspondence demonstrates that the capital calls were made at least in part to 'put pressure on' the [Limited Partners]."[321] Rigmora bases this assertion on a May 14, 2025 email among ATP's outside attorneys.[322] The email states: "The point of making the calls is to put pressure on [Rigmora], so let's put the pressure on [Rigmora]."[323] On its face, this statement is not alarming. Contractual rights can be a source of pressure. That does not mean exercising them is an act of bad faith. Moreover, a single line in a single email among outside counsel does not undermine the extensive evidence

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316 Trial Tr. at 110:12–16 (Harrison).

317 *Id.* at 152:7–153:14 (Harrison).

318 *Id.* at 110:17–24 (Harrison).

319 *Id.* at 111:4–10 (Harrison).

320 *Id.* at 109:24–110:5 (Harrison).

321 *Id.* at 45.

322 Dkt. 269 at 45 (citing JX-2155 at 2).

323 JX-2155 at 2.

demonstrating Harrison's sincere concerns about the financial health of the portfolio companies.

Rigmora's grab-bag of other arguments similarly fail. Rigmora argues that ATP delayed capital calls to maximize its litigation position.[324] But the evidence does not point to that conclusion. ATP recognized the portfolio companies' urgent need for funding and knew that Rigmora would immediately file suit in the Cayman Islands as soon as ATP issued capital calls.[325] Rigmora describes the calls as improper because ATP did not intend to distribute all the capital called to portfolio companies as required under the LPA.[326] But ATP withheld some capital to ensure that the funds would not be subject to attachment by creditors leaving the companies without funding to pay severance to employees.[327] Rigmora emphasized in briefing how the anticipated amount of capital calls evolved leading up to this lawsuit.[328] But the evidence reflects that ATP ran scenarios and considered calling capital sufficient to fund ongoing work at the portfolio companies for periods of weeks, three months, six months, and the end of calendar year 2025-2026.[329] None of this supports a finding that ATP acted in bad faith.

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[324] Rigmora Post-Trial Opening Br. at 45.

[325] *See* JX-2138 at 1–2.

[326] Rigmora Post-Trial Opening Br. at 45; LPA Am. 3 ¶ 5(a)(ii)(E).

[327] Yanchik Dep. Tr. 218:23–219:22.

[328] Dkt. 269 at 45-47.

[329] Trial Tr. at 152:5–19 (Harrison).

b. Milestones

Rigmora argues that the milestones set out in investment memoranda served as conditions to Rigmora's obligations to fund capital calls. No evidence supports this assertion.

As discussed above,[330] no evidence suggests that anyone intended the performance milestones identified in the investment memoranda to serve as conditions to Rigmora's obligation to fund budgets that it approved. Harrison and Rybolovlev never discussed nor negotiated the milestones.[331] Rigmora lacked the substantive expertise to set or track performance milestones.[332] Only two of the approved budgets contained any express milestones, and they were based on corporate strategy metrics.[333] The fact that certain of the Rigmora-approved budgets contained express milestones suggests that the parties did not intend to condition the other budgets on milestones contained in the investment memoranda. And although the Series A agreements of five companies (Marlinspike, Aethon, Aulos, Braeburn, and Replicate) originally contained milestone conditions, those conditions applied to the Fund's obligation to fund the companies, not the limited partners' obligation meet capital calls.[334]

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[330] *See supra* § I.B.

[331] *Id.* at 33:11–14 (Harrison).

[332] Bogdanov Dep. Tr. at 31:2–9, 45:23–46:10, 46:11–15; Blöchlinger Dep. Tr. at 37:17–25; Yakovlev Dep. Tr. at 30:23–25.

[333] *Id.* at 33:23–34:5 (Harrison); JX-1192 at 2.

[334] *See* JX-2201; Trial Tr. at 140:5–10 (Harrison); *see, e.g.*, JX-1329 at 64, 167, 441, 586.

Moreover, treating milestones in dated investment memoranda as a fixed condition to future funding misaligns the budgeting process with the commercial realities of biotech investing.[335] "[M]any very successful therapeutics have missed development milestones."[336] Apparent "misses" were often successful pivots that increased value. Deep Apple pivoted to obesity and secured a partnership worth up to $812 million with Novo Nordisk.[337] Apertor's pivot led to a "breakthrough publication" demonstrating "incredible" platform value, ultimately leading to delivering clinical candidates.[338] Information regarding portfolio companies' pivots were regularly reported to Rigmora in quarterly reports provided by ATP.[339]

Milestones were informative on many levels to Fund management. But Rigmora did not staff anyone with a scientific background. Rigmora went nearly thirteen years without requesting information about milestones.[340] Its interest in milestones surfaced as a defense strategy in this action, and an unsuccessful one. Rigmora cannot rely on the absence of milestone achievements to avoid its funding commitments.

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[335] Trial Tr. at 105:3–11 (Harrison); *see* JX-1583 ("Robbins Rebuttal") ¶ 26.

[336] Trial Tr. at 189:11–18 (Robbins).

[337] Robbins Rebuttal ¶ 27.

[338] Trial Tr. at 253:13–254:3 (Liras).

[339] *Id.* at 255:13–256:21, 257:2–259:1, 262:8–264:9 (Liras); *see, e.g.*, JX-0560.

[340] Trial Tr. at 332:1–333:2 (Bogdanov).

c. Replicate

Replicate is different. The Replicate budget was approved on February 12, 2025.[341] Replicate was one of the five companies addressed in Amendment 22. It is thus subject to the contingency set out in Amendment 22 stating that the LPs realize at least $300 million from a sale or financing of their interest in the Braeburn royalty.[342] Neither event has occurred. So Rigmora need not meet the call.

ATP advances a factual response to this outcome, but it is somewhat convoluted. According to ATP, when the parties executed Amendment 22 in December 2024, they expected the then-current, unfunded budget amounts for each of the five projects listed in the new Paragraph 26—including Replicate—to last for a matter of weeks. In the case of Replicate, the parties anticipated that the budget would run out in February 2025. Paragraph 26 of Amendment 22 thus called for the discussion of a new budget sufficient to enable Replicate to operate for a period twelve months after that.[343] ATP portrays the financing condition as inconsistent with the dire circumstances under which the parties executed Amendment 22.[344]

But the language of Amendment 22 is plain. It conditions Royalty Financing on budget approval, providing that "[i]f any approval of a new budget is given by the Subject limited Partner, *such approval shall be contingent upon* at least $300 million being realized (including through deemed distributions) by the Subject Limited

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[341] JX-1192.

[342] LPA Am. 22 ¶ 26.

[343] *Id.*

[344] ATP Post-Trial Reply Br. at 27–28; *see also* ATP Post-Trial Opening Br. at 29–31

Partner on a sale or financing of its interest in ATP LLC."[345] At the time, Rigmora indicated that it would not be difficult to obtain the Royalty Financing, and ATP expected that Rigmora would "do and perform, or cause to be done and performed, all such further acts and things . . . to carry out the intent and accomplish the purposes of this Amendment . . . ," including securing Royalty Financing.[346] Whether Rigmora honored this commitment is not before the court. But there is not Royalty Financing, so the Replicate budget is not approved, and ATP may not enforce Capital Calls for Replicate.

3. Specific Performance

A grant of specific performance "is a specialized form of mandatory injunction that requires a party to fulfill its contractual obligations."[347] Specific performance is appropriate when (1) a valid contract exists, (2) the plaintiff is ready, willing, and able to perform, (3) money damages are inadequate, and (4) the balance of equities tips in the plaintiff's favor.[348] To obtain specific performance, a plaintiff must prove these conditions by clear and convincing evidence.[349]

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[345] LPA Am. 22 ¶ 26 (emphasis added).

[346] LPA Am. 22 ¶ Miscellaneous.

[347] *26 Cap. Acq. Corp. v. Tiger Resort Asia Ltd.*, 309 A.3d 434, 464 (Del. Ch. 2023); *see also supra* n.260 (explaining why this decision applies Delaware law on the request for specific performance).

[348] *See Osborn ex rel. Osborn v. Kemp*, 991 A.2d 1153, 1158 (Del. 2010); *AbbVie Endocrine Inc. v. Takeda Pharm. Co. Ltd.*, 2021 WL 4059793, at *6 n.97 (Del. Ch. Sept. 7, 2021) ("It is elementary that the remedy of specific performance is designed to take care of situations where the assessment of money damages is impracticable[.]").

[349] *West*, 342 A.3d at 321.

As discussed above, ATP has proven by clear and convincing evidence that Rigmora must meet Capital Calls within approved portfolio company budgets and the Contingent Subscription with the exception of Replicate.[350] Rigmora must also fund calls issued for Fund expenses falling within those parameters.[351] Excluding Replicate, Rigmora's portion of those calls is $96,960,925.88. ATP also stands ready, willing, and able to perform.

Money damages are inadequate. The LPA sets out deadlines for meeting Capital Calls.[352] And timing matters. As discussed above, the negative impacts of a funding default for early-stage life sciences companies can be fatal.[353] The companies' research could ramp up again upon receipt of funding.[354] But they cannot stay in a holding pattern indefinitely.[355]

Further, a contractual provision stipulating the parties' preference of specific performance favors granting specific performance.[356] It is even more so when the agreement is between "sophisticated entities that bargained at arm's length."[357] In the LPA, sophisticated parties stipulated that damages for funding defaults "cannot

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[350] *See* JX-1 ¶ 5(a)(i).

[351] *See id.*

[352] LPA ¶ 5(a)(iii).

[353] Rao Report ¶ 67.

[354] *Id.* at 163:17–165:4 (Yanchik); *see also id.* at 114:2–12 (Harrison).

[355] *Id.* at 165:5–9, 166:6–167:2 (Yanchik).

[356] *See L-5 Healthcare P'rs, LLC v. Alphatec Hldgs., Inc.*, 2024 WL 3888696, at *7 (Del. Ch. Aug. 21, 2024).

[357] *See id.* (quoting *In re Cellular Tel. P'ship Litig.*, 2021 WL 4438046, at *72 (Del. Ch. Sept. 28, 2021)).

be estimated with reasonable accuracy."[358] This language supports a finding that damages would be inadequate.

Rigmora argues that ATP cannot seek specific performance of the capital calls for Ascidian, Aethon, Evercrisp, or Fund expenses because ATP has already used other Fund proceeds intended for other purposes to invest in the companies.[359] But rediverting funds to those companies was necessary to mitigate harm against them. The fact that ATP did so does not eliminate Rigmora's funding obligations.

On balance, the equities favor ATP. Rigmora has the funds available to meet the Capital Calls.[360] Moreover, the portfolio companies are developing treatments for serious medical conditions, including childhood blindness, various cancers, obesity, and neurodegenerative diseases. The public interest strongly favors preserving potentially life-saving research programs.[361]

For these reasons, ATP is entitled to specific performance of the Capital Calls excluding Replicate, or $96,960,925.88.

B. Budget Approvals

ATP claims that Rigmora breached its implied duties of good faith, honesty, and rationality when reviewing and denying the budgets circulated on December 24

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[358] JX-0001 at 25 (LPA ¶ 5(c)).

[359] Rigmora Post-Trial Br. at 47 (citing JX-2130 ¶¶ 17, 25 (listing payments for Ascidian, Aethon, Replicate, Evercrisp, and Fund expenses); PTO ¶ 64).

[360] Trial Tr. at 473:1–6 (Yakovlev).

[361] *Cf. Morabito v. Harris*, 2002 WL 550117, at *2 (Del. Ch. Mar. 26, 2002); *Bernard Pers. Consultants, Inc. v. Mazarella*, 1990 WL 124969, at *3 (Del. Ch. Aug. 28, 1990).

and for Marengo.[362] ATP does not root its claim in fiduciary obligations, nor could it. Section 19(2) of the ELP Act eliminated any fiduciary obligations, so Rigmora does not owe fiduciary obligations to the Fund.[363]

Rather, ATP's claim is based in contract law. Under English and Cayman common law, which govern this analysis,[364] a court may imply contract terms in one of two scenarios: when "the term must be necessary either to spell out what is so obvious that it goes without saying [the obviousness test] or to give business efficacy to the contract [the business-efficacy test]."[365]

ATP seeks to imply a specific set of obligations—to act honestly, rationally, and in good faith.[366] These implied duties, referred to as "*Braganza* duties" after the

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[362] ATP's claim first identified budgets for Marengo, Ascidian, and Aulos but it has since shifted to the budgets for Marengo, Aulos, Replicate, and Nine Square. *Compare* Compl. ¶ 179, *with* ATP Post-Trial Opening Br. at 66, 73.

[363] ELP Act § 19(2).

[364] LPA ¶ 18(g)(1) (stating that the "terms and provisions" of the LPA "shall be construed under the laws of the Cayman Islands, and Cayman law governs ATP's claim of breach"); PTO ¶ 25. Cayman courts view English cases as persuasive authority when Cayman law does not provide direct guidance. Phillips Report ¶¶ 19–20. Because no Cayman court has decided this issue, this opinion relies upon English authority when available.

[365] *USDAW v. Tesco Stores*, [2024] UKSC 28 at [102], available in the record as JX-2116; *see also Marks & Spencer v. BNP Paribas*, [2015] UKSC 72 at [20], available in the record as JX-2042; *Primeo Fund (In Official Liquidation) v. Bank of Bermuda (Cayman) Ltd.*, [2017] CILR 334 at [211], available in the record as JX-2056; *Cayman Shores v. Registrar of Lands*, [2021] (2) CILR 1 at [65]–[66], available in the record as JX-2120; Bloch Report ¶ 29.

[366] Phillips Report ¶ 75.

eponymous case, apply in certain circumstances when a party exercises a unilaterally conferred discretionary power under a contract.[367]

Braganza involved an employment contract between BP Shipping Ltd. and an employee who died mysteriously on one of its ships.[368] If the employee died by suicide, then BP Shipping had the discretion under the employment contract to deny his widow a contractual death benefit.[369] The company denied the widow the death benefit, and the widow sued for breach of an implied contractual term. The Supreme Court of the United Kingdom held that a party exercising a discretionary control of another's rights has an obligation to act "rationally (as well as in good faith) and consistently with its contractual purpose"[370] when a conflict of interest arises due to that control.[371] The court emphasized that the "conflict is heightened where there is a significant imbalance of power between the contracting parties."[372] To prevent abuse of discretion, the court will ensure the power is exercised in good faith and not arbitrarily, capriciously, or perversely.[373]

According to ATP, a court should imply *Braganza* duties when three factors are present: (1) the existence of a discretionary power granted to one party; (2) that

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[367] *Braganza v. BP Shipping Ltd.*, [2015] UKSC 17, at Headnote, [18]–[19], available in the record as JX-2102.

[368] *Id.*

[369] *Id.* at Headnote, [10]–[11].

[370] *Id.* at Headnote, [30].

[371] *Id.* at Headnote, [18].

[372] *Id.*

[373] *Id.* at Headnote, [30]–[31].

power's potential to harm the other party's interests; and (3) a conflict of interest where the decision-maker could exercise the power to benefit themselves at the other party's expense.[374] It is unclear whether English or Cayman courts apply the three-factor *Braganza* test for which ATP advocates. The case law supplied by the parties does not frame *Braganza* in this manner, nor does either side's expert in Cayman law. And the parties do not join issue on the precise requirements for implying contractual terms generally or *Braganza* duties specifically.[375]

It is clear, however, that contractual context matters in the analysis of whether to imply contractual terms.[376] In an effort to shortcut the analysis, Rigmora argues that a court can never imply *Braganza* duties in this specific context—on a limited partner of a Cayman exempted limited partnership.[377]

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[374] *Id.* at [18], [30].

[375] *See generally* ATP Post-trial Opening Br. at 66-76, Rigmora Post-Trial Br. at 48–60.

[376] *Braganza*, [2015] UKSC 17, at Headnote [31] ("But whatever term may be implied will depend on the terms and the context of the particular contract involved.").

[377] Rigmora Post-Trial Br. at 50–51 (citing *In re Torchlight Fund LP*, FSD 103 of 2015 (RMJ), 25 September 2018, at [1189]–[1190], available in the record as JX-2061). *Torchlight* is remarkable in a few ways. Justice Robin McMillan issued the decision *after* the parties settled the case. JX-2061.0002. He noted that "the Court was invited . . . to withdraw the Petition" in light of the settlement but had "independent discretion to decide whether to deliver its Judgment or not." *Id.* The Justice determined to deliver his Judgment in part because he believed that the two directors of the General Partner were improperly maligned by the allegations, which "the public is entitled to know." *Id.* He viewed issuing his determination a matter of "human rights as much as . . . as matter of commercial law." *Id.* He then issued a 366 page decision.

Rigmora's primary authority does not support a categorical exclusion. Rigmora relies primarily on *Torchlight Fund LP*, where a limited partner of a Cayman exempted limited partnership alleged the general partner owed *Braganza* duties when exercising a discretionary right to send a default notice to the limited partner without first consulting the limited partner.[378] In a brief discussion toward the end of a lengthy analysis, the Cayman court declined to impose *Braganza* duties.[379] The court first noted the relevance of Section 25(1) of the ELP Act, which limits court interference with remedies under partnership agreements.[380] Next, referencing Section 25(1), the court reasoned that:

> It is the view of this Court that those who enter into and participate in complex and sophisticated commercial arrangements must be taken to be fully aware of what they are doing and what the potential consequences may be. Not only are they bound in this case by the LPA but that LPA itself is further grounded in this instance by an express statutory provision [i.e., Section 25(1) of the ELP Act]. Therefore, taking into account the terms and context of this particular contract, the Court rules that the standard of review adopted in the judicial review of administration action [i.e., the implied duty] *does not apply nor does it have any relevance*.[381]

Rigmora interprets this passage to mean that a court can never imply a contractual duty of good faith under Cayman law where an express statutory

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[378] *In re Torchlight Fund LP*, FSD 103 of 2015 (RMJ), 25 September 2018, at [1189]–[1190], available in the record as JX-2061.

[379] *Id.* at [1180], [1182].

[380] *Id.* at [1188].

[381] *Id.* at [1189] (emphasis added).

provision already governs.[382] And that is a fair interpretation of *Torchlight*. But, unlike *Torchlight*, no express provision of the ELP Act governs here. Section 19(2) of the ELP Act eliminates general fiduciary obligations generally.[383] It does not eliminate implied contractual obligations. And the parties cite no statutory provision that governs a limited partner's discretion in approving budgets. *Torchlight*, thus, does not categorically prohibit this court from implying contractual duties of good faith into the LPA.

Torchlight, however, supports Rigmora's position in a more limited way. Fairly read, *Torchlight* stands for the proposition that a court will be reticent to imply *Braganza* duties in the ELP context because the power disparities that motivated *Braganza*—the power's potential to harm the other party's interest—are less present. *Braganza* involved a discretionary right wielded by a large multi-national corporation against its late employee's widow.[384] Other cases implying *Braganza* duties involve discretionary rights wielded by an insurance corporation against an insured.[385] The power disparities between the parties existed both at the time of contracting and at the time the counterparty exercised its discretionary right.[386]

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[382] Rigmora Post-Trial Br. at 51.

[383] ELP Act § 19(2).

[384] *Braganza*, [2015] UKSC 17 at [1189].

[385] *Equitas Ins. Ltd v Municipal Mut. Ins. Ltd* [2019] EWCA Civ [114]–[118], available in the record as JX-2047 (implying a term between insurers).

[386] *Braganza* does not provide clarity on the timing of when a court should assess these factors, and the parties did not specifically address this issue. Generally, "[t]he test for the implication of a *Braganza* duty is one of necessity[.]" *Horlick v Cavaco*, [2022] EWHC 2935 (KB) at [175] (citing *Equitas Ins. Ltd v. Municipal Mut. Ins. Ltd*,

The ELP context is different. As the *Torchlight* court observed: "those who enter into and participate in complex and sophisticated commercial arrangements must be taken to be fully aware of what they are doing and what the potential consequences may be."[387] And that is factually true here—both Rigmora and ATP are highly sophisticated, and the LPA was heavily negotiated. Moreover, the parties cite to no case in which applicable authorities have implied *Braganza* duties in the ELP context. And if a court is unwilling to impose implied contractual obligations on a general partner as in *Torchlight*, then it will be an exceptional case that the court imposes implied obligations on a limited partner.

This case is not the exception. Of the three *Braganza* factors identified by ATP, only two of the three are met. The LPA grants Rigmora the discretion to approve budgets. But the presence of other factors suggests that one cannot imply *Brananza* duties due to the existence of a discretionary right alone. And Rigmora's ability to reject budgets can impede ATP's right to call capital and operate the Fund. But it would be weird to describe the parties as conflicted concerning whether to call capital. It is true that Rigmora's liquidity issues changed its investment strategy. And a need for liquidity can provide a source of conflict in certain circumstances. But at the end

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[2019] EWCA Civ 718 at [150]–[151]). The tests for necessity are the business efficacy and obviousness tests. To satisfy those tests, a court will imply a term "in the way that the parties must have intended or reasonably expected it to work." *Equitas Ins. Ltd*, [2019] EWCA at [151]. This suggests that the court analyzes the *Braganza* factors ex ante. *See also* Bloch Report ¶ 24 (citing *Arnold*, [2015] UKSC at [19]) (explaining a court should interpret a contract "as at the date that the contract was made"). But, again, it is unclear. In this analysis, it does not matter.

[387] *Id.*

of the day, Rigmora owns over 98% of the Fund. Rigmora is thus highly interested in the success of its portfolio companies. And Rybolovlev's family-pharma goal, and desire to replicate his success at Uralkali, meant that he would ultimately consolidate funds behind only some of the portfolio companies and successful therapies. Rigmora's liquidity needs might have hastened that process. This, however, does not seem to be the type of conflict motivating *Braganza* duties.

Because the circumstances do not warrant implying *Braganza* duties, the analysis could end here. But, again, the parties did not neatly join issue on the relevant legal framework, and ATP analyzes the business efficacy and obviousness tests as well the *Braganza* factors. For completeness, so too does this decision.

In *USDAW v. Tesco Stores*, Lord Leggatt expounded on the business-efficacy and obviousness tests.[388] The business-efficacy test involves two steps. The court must first identify the relevant contractual purpose.[389] The court must then ask "whether the implication of a term is necessary to give effect to that purpose and prevent it from being defeated."[390] The implied term cannot conflict with existing provisions, and it must be "strictly necessary."[391]

Under the obviousness test, a court only implies a term if it is "so obvious it goes without saying."[392] The court must assess what reasonable people in the

[388] [2024] UKSC 28 at [106].

[389] *Id.*

[390] *Id.*

[391] *Id.*

[392] *Id.* at [102].

positions of the parties at the time would have agreed.[393] Actual intent does not matter.[394] Regarding detailed commercial contracts, "[a] term should not be implied . . . merely because it appears fair or merely because the court considers the parties would have agreed it if it had been suggested to them . . . [it] is a stringent test."[395]

Neither test is satisfied. Starting with the first step of the business-efficacy test, the LPA's purpose is facilitating investment in "in pharmaceutical medical device and other medically-related companies and business projects."[396] ATP seeks to imply a "good faith, honestly, and rationally" modifier to Rigmora's discretion to approve budgets.[397] Inserting that term, however, is not strictly necessary for effectuating the LPA's purpose because ATP and Rigmora share economic incentives to approve budgets. They relied on the existing provision for years, approving budgets without issue, and the Fund operated without incident. No implication is needed.

The obviousness test also fails. At the time of contracting, Rigmora contributed nearly all the Fund's capital. It thus makes sense that Rigmora secured the absolute discretion to reject budgets and negotiated for the ability to preserve its capital by blocking budgets. It is not so obvious or goes without saying that a reasonable

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[393] *Yoo Design Services v Iliv Realty Pte*, [2021] EWCA Civ 560 at [51], available in the record as JX-2113.

[394] *Id.*

[395] *Id.*

[396] LPA Am. 1 ¶ 1(c).

[397] ATP Post-trial Opening Br. at 66.

potential limited partner would have agreed to constrain its discretion to approve budgets.

Ultimately, none of the relevant tests support implying a good faith term. Because Rigmora had no implied duty to breach, ATP's claim fails.

C. Declaratory Relief

ATP also seeks two forms of declaratory relief: a declaration that ATP's filing of this action does not violate the Exculpation Provision and is consistent with the Discretionary-Action Provision of the LPA, and a declaration that parties have not amended the Global Default Provision.[398]

Declaratory relief "is appropriate only if there is an actual controversy between the parties."[399] The Delaware Supreme Court has articulated four prerequisites for to an "actual controversy":

> (1) It must be a controversy involving the rights or other legal relations of the party seeking declaratory relief; (2) it must be a controversy in which the claim of right or other legal interest is asserted against one who has an interest in contesting the claim; (3) the controversy must be between parties whose interests are real and adverse; (4) the issue involved in the controversy must be ripe for judicial determination.[400]

On the fourth factor specified by the high court, "[a] ripeness determination requires a commonsense assessment of whether the interests of the party seeking immediate

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[398] PTO ¶ 74(f); Dkt. 266, [Proposed] Order and Final Judgment ¶¶ 2(b), 2(d).

[399] *Dana Corp. v. LTV Corp.*, 668 A.2d 752, 755 (Del. Ch. 1995).

[400] *XL Specialty Ins. Co. v. WMI Liquid. Tr.*, 93 A.3d 1208, 1217 (Del. 2014) (quoting *Stroud v. Milliken Enters., Inc.*, 552 A.2d 476, 479–80 (Del. 1989)).

relief outweigh the concerns of the court in postponing review until the question arises in some more concrete and final form."[401] A dispute is ripe if "litigation sooner or later appears to be unavoidable" and "the material facts are static."[402] Ultimately, Delaware's approach to declaratory relief and ripeness leaves the determination to the discretion of the court.[403] "The [c]ourt may . . . properly decline to entertain a declaratory judgment claim where another remedy is available and would be more 'effective or efficient.'"[404]

1. The Exculpation And Discretionary-Action Provisions

ATP seeks a declaratory judgment that ATP's filing of this action was in good faith, falls within the Exculpation Provision, and was authorized under the

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[401] *XL Specialty*, 93 A.3d at 1217 (citation modified); *see also Nask4Innovation Sp. Z.o.o. v. Sellers*, 2022 WL 4127621, at *4 (Del. Ch. Sept. 12, 2022) ("In determining whether a dispute is ripe, the Court must take a practical view of all relevant facts and make a common-sense determination of whether adjudicating a dispute at present is a prudent use of judicial resources.").

[402] *XL Specialty*, 93 A.3d at 1217 (quoting *Julian v. Julian*, 2009 WL 29371212, at *3 (Del. Ch. Sept. 9, 2009)) (citation modified).

[403] *See Stroud v. Milliken Enters., Inc.*, 552 A.2d at 480 ("The reasons for not rendering a hypothetical opinion must be weighed against the benefits to be derived from the rendering of a declaratory judgment. This weighing process requires "the exercise of judicial discretion[.]"); *Horizon Pers. Commc'ns, Inc. v. Sprint Corp.*, 2006 WL 2337592, at *17 (Del. Ch. Aug. 4, 2006) ("The ripeness of a dispute is a matter entrusted to the discretion of the trial court." (quoting *UbiquiTel Inc. v. Sprint Corp.*, 2006 WL 44424, at *2 (Del. Ch. Jan. 4, 2006))) (citation modified).

[404] *Walton v. Walton*, 2025 WL 2555839, at *8 (Del. Ch. Sept. 2, 2025) (quoting *Reylek v. Albence*, 2023 WL 4633411, at *6 (Del. Super. July 19, 2023)); *see also Markusic v. Blum*, 2021 WL 2456637, at *4–5 (Del. Ch. June 16, 2021), *aff'd*, 284 A.3d 1017 (Del. 2022) (declining to issue declaratory judgment where concurrent litigation in another court would sufficiently address the controversy); *Burris v. Cross*, 583 A.2d 1364, 1370–76 (Del. Super. Ct. 1990) (same).

Discretionary-Action Provision.[405] ATP seeks this declaration in part because Rigmora argues in the Cayman Litigation that ATP filed this action in breach of its fiduciary duties.

Rigmora argues that ATP's claim under the Exculpatory Provision is unusual. Exculpatory provisions shield a covered person from liability for covered claims. And there is no ripe claim here, because Rigmora does not argue in this dispute that ATP breached its fiduciary duties.[406]

Rigmora has the better of the argument here; ATP's request for declaratory judgment is not suitable for resolution in this forum. Delaware law governs a gross negligence standard in the Exculpation Provision; but otherwise, Cayman law governs both the Exculpatory Provision and the Discretionary-Action Provision. Further, the underlying dispute around whether ATP's filing of this action constitutes

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[405] Compl. ¶ 196; PTO ¶ 74(f); LPA ¶ 2(g) ("To the fullest extent permitted by law, neither the General Partner nor any of its affiliates shall incur liability . . . provided that in any such case (i) the General Partner's or such affiliate's course of conduct was in good faith and (ii) such course of conduct did not constitute willful fraud, willful misconduct, gross negligence as determined under the laws of the State of Delaware without regard to otherwise governing principles of conflicts of law ("Gross Negligence") or an intentional and material breach of this Agreement on the part of the General Partner[.]"; LPA ¶ 18(g)(iv) ("In determining what action, if any, shall be taken against a Limited Partner in connection with such Limited Partner's breach of this Agreement, the General Partner shall seek to obtain a favorable result (as determined by the General Partner in its sole discretion . . . . To the fullest extent permitted by law, each Limited Partner hereby specifically agrees that, in the event such Limited Partner violates the terms of this Agreement, such Limited Partner shall not be entitled to claim that the Partnership or any of the other Partners are precluded, on the basis of any fiduciary or other duty arising in respect of such Limited Partner's status as such, from seeking any of the remedies permitted under this Agreement or applicable law.").

[406] Rigmora Post-Trial Br. at 61–62.

a breach of its fiduciary duties is central to Rigmora's Winding Up Petition in the Cayman Litigation.[407] As a commonsense matter, this court has little reason to resolve the issue, which was not a core dispute in this litigation.[408] The factual findings in this decision speak for themselves. And Cayman court is well positioned to assess their implications under Cayman law. Commonsense dictates reserving judgment on both of ATP's requests for declaratory relief concerning the Exculpatory and Discretionary-Action Provisions.

2. Global Default Provisions

ATP seeks a declaratory judgment concerning the Global Default Provision, although the nature of the ATP's requested declaration has evolved over the course of this litigation.

In its Complaint, ATP requested a declaration that Rigmora is "in breach of its funding and budget approval obligations sufficient to qualify as a Defaulting Partner."[409] ATP requested similar relief in the Pre-Trial Order.[410] The Writ Injunction, however, prohibits ATP from "taking any steps against [Rigmora] to enforce any purported default provisions" related to the May 30 and June 1 capital calls.[411] At trial, therefore, ATP withdrew any request contrary to the Writ

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[407] JX-1417 ¶ 26; ATP Post-Trial Reply Br. at 44.

[408] *See id.*

[409] *Markusic*, 2021 WL 2456637, at *5.

[410] PTO ¶ 74(a)(iv) (requesting a declaration that Rigmora "breached [its] obligations under the LPA to fund and approve budgets sufficient to qualify as a Defaulting Partner").

[411] JX-1434 ¶ 1. *Compare* Compl. ¶ 183–92, *with* PTO ¶ 74(a)(iv).

Injunction.[412] In post-trial briefing, ATP seeks a far more limited declaration, asking for "an order declaring that the Global Default provision[,]" Paragraph 5(c) of the LPA, "governs defaults" and "ha[s] not been altered or amended."[413]

As currently framed, ATP's request is so narrow as to be undisputed, as Rigmora does not deny that the Global Default Provisions have never been amended.[414] Because there is not dispute between the parties on this point, there is no actual controversy. ATP's request for declaratory relief is not ripe. For that reason, it is dismissed.

D. Attorney's Fees

ATP requested attorney's fees under the "loser pays" principles of Cayman Island laws and the Common Law in the Complaint and in the Pre-Trial Order.[415] The Pre-Trial Order referred the court to ATP's pre-trial brief for a discussion of disputed issues, but ATP's pre-trial brief did not address the issue.[416] Rigmora addressed this issue directly in pre-trial briefing, arguing that the American rule under Delaware law governs the issue of attorney's fees.[417] ATP's post-trial opening brief made no mention of attorneys' fees. ATP did not address this issue until its post-trial reply brief and then did so in a cursory fashion.

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[412] ATP Pre-Trial Br. at 56 n.22.

[413] ATP Post-Trial Opening Br. at 82; Dkt. 266, [Proposed] Order and Final Judgment ¶¶ 2(b), 2(d).

[414] *See* Rigmora Post-Trial Br. at 60.

[415] PTO ¶ 74(g).

[416] *See generally* ATP Post-Trial Opening Br.

[417] Rigmora Post-Trial Br. at 62.

Whether a party has waived an argument by failing to raise it in briefing is a procedural matter, so Delaware law governs whether ATP's request for attorneys' fees has been waived.[418] "It is settled Delaware law that a party waives an argument by not including it in its brief."[419] "[A]n issue not raised in post-trial briefing has been waived, even if it was properly raised pre-trial."[420]

ATP's failure to meaningfully brief the issue of its entitlement to fees under Cayman law until its post-trial reply brief constituted waiver. Thus, to the extent that Cayman law supports awarding ATP its attorney's fees and expenses, which this decision does not address, the claim is denied.

III. CONCLUSION

Excluding the Capital Call for Replicate, Rigmora is ordered to specifically perform its obligation to fund the Capital Calls. ATP is not entitled to specific performance relating to the budgeting approvals. ATP's request for a declaratory judgment concerning the Exculpatory Provision or the Discretionary-Action Provision are held in abeyance. ATP's request for a declaratory judgment concerning the Global

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[418] *See Wheeler v. Wheeler*, 636 A.2d 888, 891 (Del. 1993); *Americas Mining Corp. v. Theriault*, 51 A.3d 1213, 1264 (Del. 2012) (Berger, J., concurring) (unanimously holding that "the motion for reargument is procedurally barred under Delaware law, because the issue raised on reargument was not fully and fairly presented in the Defendants' opening briefs"); *Chaplake Hldgs., LTD. v. Chrysler Corp.*, 766 A.2d 1, 6 (Del. 2001).

[419] *Emerald P'rs v. Berlin*, 2003 WL 21003437, at *43 (Del. Ch. Apr. 28, 2003), *aff'd*, 840 A.2d 641 (Del. 2003).

[420] *Oxbow Carbon & Mins. Hldgs., Inc. v. Crestview-Oxbow Acq., LLC*, 202 A.3d 482, 502 n.77 (Del. 2019); *see also In re IBP, Inc. S'holders Litig.*, 789 A.2d 14, 62 (Del. Ch. 2001).

Default Provision is dismissed. ATP is noted entitled to its attorney's fees under the Cayman law's loser-pays rule. The parties are ordered to submit a form of order or competing forms of order implementing this decision within three business days.