Neutral Citation Number: [2014] EWCA Civ 399

Case No: A3/2013/2099

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE HIGH COURT OF JUSTICE
CHANCERY DIVISION
MR JUSTICE MORGAN
[2013] EWHC 1993 (Ch)

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: Monday 31st March 2014

Before :

THE CHANCELLOR OF THE HIGH COURT
LADY JUSTICE MACUR
and
SIR TIMOTHY LLOYD

- - - - - - - - - - - - - - - - - - - -

Between :

(1) PAVEL SUKHORUCHKIN
(2) HURLEY INVESTMENT HOLDINGS LIMITED
(3) PAVEL NOVOSELOV
(4) VICKGRAM HOLDINGS LIMITED

Appellants

- and –

(1) MARC GIEBELS VAN BEKESTEIN
(2) SANJIT TALUKDAR
(3) AMETISTA PATRIMONIAL (MAURITIUS) LIMITED
(4) PNT CAPITAL ADVISORS
(5) BLUE PEARL ADVISORS LIMITED
(6) TELNIC LIMITED
(7) AMETISTA PATRIMONIAL SA

Respondents

(Transcript of the Handed Down Judgment of
WordWave International Limited
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Official Shorthand Writers to the Court)

Mr Robert Miles QC, Ms Louise Hutton and Mr James Sheehan (instructed by **Herbert Smith Freehills LLP**) for the **Appellants**
Mr Daniel Lightman, Mr Paul Adams and Mr Thomas Elias (instructed by **Mishcon de Reya LLP**) for the **1st to 5th and 7th Respondents**

Hearing dates : 12th and 13th March 2014

Judgment
As Approved by the Court

The Chancellor (Sir Terence Etherton) :

1. This is an appeal from the order of Mr Justice Morgan dated 11 July 2013 by which, among other things, he dismissed an application by the appellants, the claimants in the proceedings, to continue until judgment or further order a proprietary injunction and worldwide freezing injunction granted by Christopher Clarke J on 15 May 2013 on the appellants' *ex parte* application.

The appellants' claims

2. The following is a brief summary of the appellants' case.

3. In early 2008 the second respondent, Sanjit Talukdar ("Sanjit"), proposed a business venture to the first appellant, Pavel Sukhoruchkin ("Pavel S"), and the third appellant, Pavel Novoselov ("Pavel N") (together "the Pavels"). The proposal was that the Pavels, Sanjit and the first respondent, Marc Giebels van Bekestein ("Marc"), would create and operate a fund of funds business. It was agreed that the four of them (together "the founders") would share equally in the benefits of the joint venture. Sanjit also proposed the structure to be used in the joint venture. It would involve an offshore investment advisory company, as both voting shareholder in and investment advisor to a fund company. The fund company which they decided to use was a Cayman Islands company, Hadar Fund Limited ("Hadar Fund"). The investment advisory company was another Cayman Islands company, Hadar Investment Advisers Limited ("HIA"). The founders often referred to themselves as "the Partners" in emails and other communications between themselves and with third parties.

4. It was understood and agreed from the outset that the companies in the fund structure would have professional nominee directors. It was also understood that those directors would look to the founders for directions about the running of the business of the fund companies. The founders agreed that Marc and Sanjit would have primary responsibility for communicating with the directors on behalf of all of them, that is as their representative or agent. That is what happened, with Sanjit taking prime responsibility. In many instances Sanjit communicated with the directors without communicating first with the Pavels and without copying them in on the relevant communication. The Pavels were content to allow Sanjit to do this as the relationship between the founders was one of trust and confidence.

5. The corporate framework was established and operated in the following way. HIA received management and performance fees from Hadar Fund. The sole shareholder in HIA was a BVI company, Haysom Limited ("Haysom"). The shares in Haysom were held by Veltro Limited ("Veltro"), another BVI company. Veltro held 25 per cent of the shares in Haysom on trust for each of four companies which were each ultimately beneficially owned by Pavel S, Pavel N, Marc and Sanjit respectively. Those companies were (1) the second appellant, Hurley Investment Holdings, which was ultimately beneficially owned by Pavel S, (2) the fourth appellant, Vickgram Holdings, which was ultimately beneficially owned by Pavel N, (3) the seventh respondent, Ametista Patrimonial SA ("Ametista Andorra"), which was beneficially owned by Marc and his family, and (4) the fourth respondent, PNT Capital Advisors ("PNT"), which was beneficially owned by Sanjit. Ametista Andorra's beneficial holding was subsequently passed to the third respondent, Ametista Patrimonial

(Mauritius) Limited (“Ametista Mauritius"), which itself was beneficially owned by Marc and his family.

6. There was further elongation of the structure in respect of the companies ultimately beneficially owned by the Pavels in that Veltro was interposed again as holder of the shares in the second and fourth appellant companies on trust for each of the Pavels.

7. None of the Pavels, Marc or Sanjit was a director of the offshore companies. The companies in the structure had professional nominee directors.

8. The money received by HIA in respect of its management and performance fees was passed through the corporate structure by way of dividend. The ultimate result was that the individuals (or entities ultimately beneficially owned by them) would each be entitled to 25 per cent of the fees received by HIA.

9. In February 2011 Hadar Fund and HIA entered into an agreement ("the Distribution Agreement"), which provided for two-thirds of the sums which would have been paid by Hadar Fund to HIA referable to a particular US$1 billion investment to be paid instead to the fifth respondent, Blue Pearl Advisors Limited ("Blue Pearl"). That is a company incorporated in Mauritius which is owned by Ametista Mauritius and PNT (in turn beneficially owned by Marc and his family and by Sanjit respectively).

10. The appellants claim that the Distribution Agreement was entered into without their knowledge or consent and was “bogus”. The appellants allege that the Distribution Agreement stated untruthfully that the payments were in compensation for Blue Pearl introducing the investor, when in fact none of the respondents had anything to do with such an introduction. The appellants allege that the relevant US$1 billion investment was made by an investor introduced by the Pavels and with whom the respondents had almost no contact. In the 21 months that the Distribution Agreement was in place Blue Pearl was paid about US$41.3 million. In addition the respondents received between them half of the remaining one third payable to HIA (through the agreed four way split of income).

11. The appellants claim that Blue Pearl also received secret payments of another US$1.9 million under arrangements in relation to a further fund company within the same structure, Rio Capital Fund. They claim that those were also fees that were wrongly diverted to Blue Pearl pursuant to a written distribution agreement ("the Rio Agreement").

12. Finally, the appellants allege that Marc and Sanjit wrongfully procured Hadar Fund to invest US$22 million in Telnic Limited ("Telnic"), a private dotcom company, for the payment to Blue Pearl of a secret US$4.4 million "finder's fee" which was not disclosed to the Pavels (or Hadar Fund) at the time of the investment.

13. The appellants allege that the founders, as partners in the joint venture, owed each other, among other things, fiduciary duties of loyalty and good faith and that, by wrongly diverting profits away from the venture to their own vehicle, Blue Pearl, Marc and Sanjit acted in breach of their fiduciary duties to the appellants. The appellants claim, among other things, (1) a declaration that the respondents and each of them are liable to account to the appellants for all unauthorised benefits they have received from or in respect of the joint venture; (2) a declaration that the respondents

and each of them hold all such unauthorised benefits and their proceeds or assets representing the same as constructive trustees for the appellants; (3) equitable compensation; (4) damages for breach of contract; and (5) damages for conspiracy.

The order of Christopher Clarke J

14. The order of 15 May 2013, on the *ex parte* application of the appellants, took the form of a proprietary injunction and a worldwide freezing injunction. The proprietary injunction restrained dealings with what were referred to as Trust Assets. That phrase was defined so as to refer, essentially, to sums received by Blue Pearl from the Distribution Agreement and the Rio Agreement and any money derived from such sums. The freezing injunction was a worldwide injunction restraining dealings with assets up to a value of £13 million.

The application to Morgan J

15. The application to Morgan J was essentially to continue the order made on 15 May 2013 until judgment or further order in the meantime but with some enlargement. He was asked to extend the definition of Trust Assets, the subject of the proprietary injunction, so that the definition would include any sum received directly or indirectly by Blue Pearl from Telnic. He was also asked to increase the value of the assets frozen from £13 million to £14.5 million.

The Judge's judgment

16. The hearing before the Judge took place over four days. He handed down a careful and comprehensive written judgment three days later.

17. The Judge set out the applicable tests for a freezing injunction and a proprietary injunction. As to a freezing injunction, he said (at paragraph [6]) that the appellants had to show that (1) they have a good arguable case both in relation to the legal propositions on which they rely and as to the facts which they allege will entitle them to judgment at the trial; (2) there are relevant assets to be made the subject of the order; (3) there are substantial grounds for concluding that there is a real risk of the respondents' assets being disposed of, so that a judgment in favour of the appellants would go unsatisfied; and (4) it would be just and convenient for such an order to be made.

18. As to a proprietary injunction, the Judge said (at paragraph [7]) that the principles to be applied are the normal *American Cyanamid* principles, namely that the appellants must show that there is a serious issue to be tried, that damages would not be an adequate remedy for the appellants and that the balance of convenience or balance of justice favours the grant of an injunction. He said, in relation to the *American Cyanamid* principles, that where the scales are evenly balanced in relation to the balance of convenience one can take into account the relative strength of the parties' cases.

19. The Judge rejected the argument of Mr Jeffrey Gruder QC, for the respondents, that there is a different test to the *American Cyanamid* test in a case where the alleged proprietary interest only came into existence by reason of the defendant's alleged wrongdoing, for example where the alleged wrongdoing involved a fiduciary

acquiring an asset from a third party in circumstances which involved a breach of his or her fiduciary duty.

20. The Judge observed (in paragraph [12]) that the parties fundamentally disagree about the relevant facts. He said that this is not a case where the facts reliably appear from the contemporaneous documents. So far as concerns oral evidence, he said that someone is telling lies and the trial judge will inevitably reject some of the evidence of the witnesses on the ground that it is not only incorrect but it is knowingly untrue. He added (in paragraph [13]) that it is entirely possible that the appellants will not be believed at the trial and that, on the material he had seen, some of the appellants' factual assertions are less than probable, but that it would be dangerous for him to go further than that and to conclude for the purposes of the application for injunctions that he should reject parts of the appellants' evidence. He said (in paragraph [14]) that he would, accordingly, not attempt to form any view as to which side has the more plausible case.

21. The Judge held that the appellants have a good arguable case that Marc and Sanjit owed fiduciary obligations to the Pavels arising out of the joint venture agreement and arrangements which I have briefly described above. He said as follows in paragraph [49]:

> "In the present case, the essential case which is pleaded is that Hadar Fund Ltd and HIA would not be operated and managed through their constitutional organs but would be operated and managed informally by Pavel S, Pavel N, Marc and Sanjit and, of these four, Marc and Sanjit would effectively act as agents, or something akin to agents, for Pavel S and Pavel N. A relationship of principal and agent is a classic relationship in which fiduciary obligations are owed. I consider that the Claimants have done enough to show that they have a good arguable case on the facts and on the law that Marc and Sanjit owed Pavel S and Pavel N fiduciary duties in exercising their de facto power of management and control of Hadar Fund Ltd and HIA."

22. Although the Judge found in favour of the appellants that Marc and Sanjit owed such fiduciary duties, he nevertheless held that by virtue of the "no reflective loss" principle the appellants do not have a seriously arguable case for the recovery of the loss that they allege they suffered in consequence of breach of Marc's and Sanjit's fiduciary duties in connection with the making of the Distribution Agreement and the Rio Agreement.

23. The Judge referred to a number of cases on the no reflective loss principle. He took the principle from the following passage in the judgment of Neuberger LJ in *Gardner v Parker* [2004] EWCA Civ 781, [2004] 3 BCLC 554 at [33]:

> "I think that the effect of the speeches in *Johnson's* case can be taken as accurately summarised by Blackburne J at first instance in *Giles v Rhind* [2001] 2 BCLC 582 at [27], subject to the qualifications expressed in the judgment of Chadwick LJ in the Court of Appeal (see [2003] 1 BCLC 1 at [61] and [62],

> [2003] Ch 618 at [61] and [62]). As amended by those two qualifications, it seems to me that Blackburne J's formulation was approved by this court (Keene LJ having agreed with Chadwick LJ) in the following terms, so far as relevant:
>
> "'(1) a loss claimed by a shareholder which is merely reflective of a loss suffered by the company - ie a loss which would be made good if the company had enforced in full its rights against the defendant wrongdoer -is not recoverable by the shareholder [*save in a case where, by reason of the wrong done to it, the company is unable to pursue its claim against the wrongdoer*]; (2) where there is no reasonable doubt that that is the case, the court can properly act, in advance of trial, to strike out the offending heads of claim; (3) the irrecoverable loss (being merely reflective of the company's loss) is not confined to the individual claimant's loss of dividends on his shares or diminution in the value of his shareholding in the company but extends ... to "all other payments which the shareholder might have obtained from the company if it had not been deprived of its funds" and also ... "to other payments which the company would have made if it had had the necessary funds even if the plaintiff would have received them qua employee and not qua shareholder" [*save that this does not apply to the loss of future benefits to which the claimant had an expectation but no contractual entitlement*]; (4) the principle is not rooted simply in the avoidance of double recovery in fact; it extends to heads of loss which the company could have claimed but has chosen not to and therefore includes the case where the company has settled for less than it might ... ; (5) provided the loss claimed by the shareholder is merely reflective of the company's loss and provided the defendant wrongdoer owed duties both to the company and to the shareholder, it is irrelevant that the duties so owed may be different in content.'
>
> (The italicised text is taken from the judgment of Chadwick LJ [2003] 1 BCLC 1 at [61] and [62], [2003] Ch 618 at [61] and [62].)"

24. The onus of proving the necessary facts for the application of the no reflective loss principle being on the defendant who asserts it, the Judge said (at paragraph [62]) that he had to consider how the matter might look at the trial of the action where the respondents set out to establish a defence based on the principle.

25. In reaching his conclusion that the appellants' claims in relation to the Distribution Agreement and the Rio Agreement were barred by the no reflective loss principle, the Judge examined closely the appellants' allegations in the particulars of claim. In addition to breach of fiduciary duty, they include allegations of breach of contract, unlawful means conspiracy, dishonest assistance by Blue Pearl in Marc's and Sanjit's breaches of fiduciary duty and knowing receipt by Blue Pearl of money paid to it in breach of fiduciary duty.

26. In a detailed analysis the Judge said that (l) it would be inappropriate to proceed on the basis that the appellants will not establish dishonesty (which they relied upon as showing that there was a serious risk of the respondents dissipating their assets unless restrained by the court) "but will establish some milder allegation which would allow the [appellants] to say they do, but that HIA does not, have a cause of action arising out of that milder allegation" (paragraph [63]); (2) it is specifically alleged that Marc and Sanjit deceived Mr Graham, the director of HIA, as to the appropriateness of HIA entering into the Distribution Agreement and the Rio Agreement and so giving rise to a cause of action for deceit (paragraph [64]); (3) the facts alleged as to a conspiracy between Marc, Sanjit and Blue Pearl to commit a breach of Marc's and Sanjit's fiduciary duty to the Pavels would also establish a conspiracy to deceive HIA (paragraph [64]); (4) the appellants' case strongly supports the conclusion that Marc and Sanjit were shadow directors of HIA who owed fiduciary duties to HIA and so, on the facts alleged, Marc and Sanjit broke those duties and Blue Pearl conspired with them to do so, and further Blue Pearl knowingly received money paid to it as a result of breach of those fiduciary duties and dishonestly assisted such breach (paragraph [65]); (5) the suggestion of Mr Robert Miles QC, for the appellants, that on the facts HIA might at one time have had a right to rescind the Distribution Agreement but no longer had such a cause of action because it had affirmed the Distribution Agreement with knowledge of the misrepresentation made by Marc and Sanjit to Mr Graham "is completely unrealistic" (paragraph [67]); (6) in any event, the right analysis in such a case would be that (or would be analogous to a situation in which) HIA had a cause of action which it then gave up and, on the authorities, that did not prevent the application of the no reflective loss principle (paragraph [68]).

27. For those reasons, the Judge concluded (in paragraph [72]) that the appellants do not have a good arguable claim in relation to the losses resulting from the Distribution Agreement and the Rio Agreement as such a claim "is clearly barred by the no reflective loss principle" and that the appellants' case that there is a serious issue to be tried "is no more than borderline."

28. The Judge addressed the claim in relation to the US$22 million investment in Telnic and the US$4.4 million fee paid by Telnic to Blue Pearl in paragraphs [75] to [81] of his judgment. Nothing on this appeal turns on his disposal of that matter and so it is not necessary to mention it further in this judgment.

29. The Judge said (at paragraph [96]) that, had he been persuaded that the appellants have a good arguable claim against the respondents in relation to the Distribution Agreement and the Rio Agreement, he would have been prepared to grant a freezing order against the respondents bearing in mind that the allegations are ones of dishonesty and concealment. He rejected the arguments of the respondents that the application for a freezing order should be refused because of the appellants' delay or the absence of any substantial risk of dissipation of assets. He also rejected the respondents' contention that the appellants were in breach of their duty to make full and frank disclosure to the court at the *ex parte* hearing in that, among other things, they failed to raise the no reflective loss principle at that hearing.

30. In stating his conclusion in paragraph [100] of his judgment, the Judge repeated that the appellants do not have a good arguable case in relation to the Distribution Agreement and the Rio Agreement and that he would not grant freezing injunctions in relation to the sums claimed in consequence of them. He said that, as to the claim to

proprietary injunctions, the appellants have at most a borderline case that there is a serious issue to be tried, and bearing that in mind and the very invasive nature of the proprietary injunctions claimed, he did "not consider that it is justified for the court to intervene in the way requested on the basis of such weak claims".

The appeal

31. At the heart of the appeal is the contention that the Judge was wrong in principle to decide at this interlocutory stage that the appellants do not have a good arguable case in relation to the Distribution Agreement and the Rio Agreement because of the no reflective loss principle. Despite the Judge's careful analysis, I agree with this ground of appeal.

32. The general principle is now well established that, on an application for an interim injunction, the court should not attempt to resolve critical disputed questions of fact or difficult points of law on which the claim of either party may ultimately depend, particularly where the point of law turns on fine questions of fact which are in dispute or are presently obscure: *Derby v Weldon* [1990] Ch 48, 58F-G, 63G-H.

33. The Judge in the present case cited relevant passages in *Derby v Weldon* which state and illustrate the operation of that principle but he nevertheless felt able to reach the firm conclusion in paragraph [72] of his judgment that the appellants' claims in relation to the Distribution Agreement and the Rio Agreement are "clearly barred by the no reflective loss principle". Indeed, as I read that paragraph in his judgment, he considered that, had there been an application to strike out those claims, he would have granted that application. It was only because there had not been an application to strike out the claims and so it might be said that there is no reason why they should not be investigated at trial that he went on to say that the appellants' case that the claims give rise to a serious issue to be tried "is no more than borderline".

34. I do not consider that the Judge was entitled to take that view at this interlocutory stage for the following reasons.

35. Mr Daniel Lightman, counsel leading for the respondents on this appeal, said that this is a clear case of reflective loss since what the appellants claim to have lost are the dividends from HIA which, but for the respondents' alleged wrongdoing, would have passed up the corporate structure for the ultimate benefit of all four founders, including the Pavels. Notwithstanding what Mr Lightman asserted is the obviousness of the point, the respondents only raised the issue of reflective loss as a defence to the appellants' claims for the first time in their skeleton argument served on Friday 28 June 2013, some six weeks after the hearing before Christopher Clarke J and two working days before the return hearing before the Judge and after the service of considerable evidence. Even then, the respondents did not identify in that skeleton argument the precise causes of action which HIA might have against Marc and Sanjit if the appellants were successful in their claims for breach of fiduciary duty in connection with the Distribution Agreement and the Rio Agreement. Indeed, such causes of action are not identified in the formal defence which has now been served.

36. It appears that at the hearing two such possible claims were considered by the Judge. One, raised by the respondents, was a claim by HIA against Marc and Sanjit for deceit. The other, initially suggested by the Judge himself, was for breach of

fiduciary duty by Marc and Sanjit as shadow directors of HIA. The Judge decided that, if the appellants succeeded at trial in proving the allegations pleaded in the particulars of claim, HIA would also succeed in both those causes of action. Expressed more accurately in the context of the tests for the grant of a freezing injunction and a proprietary injunction, the Judge did not consider that the appellants have a good arguable case (or even a more than borderline serious issue to be tried) that at trial they would succeed in their claims against Marc and Sanjit for breach of fiduciary duty but the respondents would not succeed in their argument that HIA would have a claim for the same loss.

37. Mr Lightman identified a number of other possible causes of action by HIA to which the allegations in the particulars of claim would give rise and which are consistent with the analysis of the Judge, including rescission of the Distribution Agreement and restitution of sums paid pursuant to it, dishonest assistance by Blue Pearl in breaches of the fiduciary duties of Marc and Sanjit to HIA, receipt of property by Blue Pearl with knowledge of those breaches of fiduciary duty, and unlawful means conspiracy by Marc, Sanjit and Blue Pearl.

38. If the Judge was wrong to conclude that the appellants do not have a good arguable claim for breach of fiduciary duty by Marc and Sanjit because HIA would have a claim against them for breach of fiduciary duty as shadow directors of HIA or because HIA would have a claim against them for deceit (and so the no reflective loss principle would apply), then those other causes of action identified by Mr Lightman would equally not prevent the appellants from having a good arguable claim. I did not understand Mr Lightman to argue the contrary. Such an argument has certainly not been raised in the respondents' notice as an additional ground for upholding the order of the Judge.

39. So far as concerns a possible cause of action by HIA against Marc and Sanjit for breach of fiduciary duty, I do not consider that the Judge was entitled to take the view (in paragraph [65] of the judgment) that there is "a strong case" that Marc and Sanjit were shadow directors of HIA owing fiduciary duties to HIA. It appears that this issue was raised by the Judge himself during the hearing before him and that it only became apparent that it was a significant issue during the course of reply submissions. In his analysis in paragraph [65] of his judgment the Judge did not make any allowance for the possibility that the law of the Cayman Islands on shadow directors and their duties, which is the applicable law so far as concerns HIA, might be different from the law of England and Wales. He referred to the decision of Lewison J in *Ultraframe (UK) Limited v Fielding* [2005] EWHC 1638 (Ch), and in particular to passages in which Lewison J said that the mere fact that a person falls within the statutory definition of "shadow director" is not enough to impose on him the same fiduciary duties to the company as are owed by a *de jure* or *de facto* director but that, on the facts of a particular case, the activities of a shadow director might go beyond indirect influence and give rise to fiduciary obligations. The Judge held that in the present case it is central to the appellants' case that Marc and Sanjit effectively controlled the decisions made by, and the actions of, HIA and so, on the pleadings as well as the evidence, there is a strong case for saying that Marc and Sanjit owed fiduciary duties to HIA.

40. In the period since the Judge's judgment the duties owed by shadow directors have been the subject of close examination by Newey J in *Vivendi SA v Richards* [2013]

EWHC 3006 (Ch), [2013] BCC 771. Having reviewed a number of the cases, including Australian authority, and academic commentary, Newey J concluded in paragraph [142] that there are a number of reasons for thinking that shadow directors commonly owe fiduciary duties to at least some degree. He set out those reasons in sub-paragraphs [142(i) –(vii)]. He then expressed as follows in paragraph [143] the extent of his disagreement with *Ultraframe*:

> "In the end, my own view is that *Ultraframe* understates the extent to which shadow directors owe fiduciary duties. It seems to me that a shadow director will typically owe such duties in relation at least to the directions or instructions that he gives to the *de jure* directors. More particularly, I consider that a shadow director will normally owe the duty of good faith (or loyalty) discussed below [for the avoidance of doubt, I regard the duty of good faith as a fiduciary duty] when giving such directions or instructions. A shadow director can, I think, reasonably be expected to act in the company's interests rather than his own separate interests when giving such directions and instructions."

41. Even if Cayman law were the same as English law (as to which doubt is cast by the latest evidence to which I refer below), I do not consider that the Judge was entitled at this interlocutory stage to come to the conclusion that there is a strong case for saying that, if the appellants succeed at trial on the claims against Marc and Sanjit for breach of their fiduciary duties as co-venturers, HIA would also have a claim against Marc and Sanjit on the ground that they owed fiduciary duties as shadow directors and were in breach of those duties. In the first place, it is apparent from the differing approaches in *Ultraframe* and *Vivendi* that the law is not entirely settled as to the circumstances in which a shadow director owes fiduciary duties. That difference of judicial approach in *Ultraframe* and *Vivendi* is inconsistent with what I understood to be Mr Lightman's submission that this issue is merely one of elementary general equitable principles common to both England and the Cayman Islands. Secondly, what is clear on the existing case law is that whether or not a person is a shadow director who owes such duties is highly fact dependent. In the present case, there is a conflict on this aspect between the claims and evidence of the appellants, on the one hand, and the defence and evidence of the respondents, on the other hand. In particular, it is denied by Marc and Sanjit that they gave any relevant directions or instructions to the directors of HIA. Their case is that they only ever communicated information or expressions of view. It is impossible to resolve that dispute at this interlocutory stage.

42. That is sufficient for a successful appeal on this particular aspect of the Judge's judgment. In addition, however, I do not consider that the Judge was entitled to make the assumption that the law of the Cayman Islands on the issue of shadow directors and their fiduciary duties is the same as the law of England and Wales. As Newey J has explained in paragraph [133] of *Vivendi*, the expression "shadow director" derives from provisions in UK company legislation. The expression itself first featured in section 63 of the Companies Act 1980. The first reported case in which there was a reference to shadow directors owing fiduciary duties was *Yukong Line Ltd of Korea v Rendsburg Investments Corp of Liberia* [1998] 1 WLR 294, [1998] BCC 870

(Toulson J). There was no proper basis for the Judge to assume that the statutory and non-statutory law of the Cayman Islands is the same as that of England and Wales on this topic: c.f. *Shaker v Al-Bedrawi* [2002] EWCA Civ 1452, [2003] Ch 350 at [64]-[67].

43. Furthermore, the appellants have now obtained expert evidence of Cayman law in the form of a joint expert report by Shân Warnock-Smith QC and Andrew James De La Rosa. Patten LJ granted the appellants permission to adduce that evidence on this appeal, but subject to any application by the respondents to set aside that grant. The conclusion of the experts is that existing Cayman authority is against the imposition of fiduciary duties for persons in the position of a shadow director (outside a limited statutory context not relevant to the facts of the present case) or who instruct or direct directors in relation to their duties. Their opinion is that, "[i]f the question were to arise in a future case, the issue would be open (to put it at its lowest) to serious and prolonged debate".

44. Patten LJ gave the respondents permission to adduce their own expert evidence of Cayman law but they have not done so. They applied to set aside the grant of permission to the appellants to adduce the joint expert report on this appeal. That application was directed to be heard with the substantive appeal. Mr Lightman submitted that the appellants have failed to satisfy the requirements in *Ladd v Marshall* [1954] 1 WLR 1489 because such expert evidence could have been obtained with reasonable diligence for use at the hearing before the Judge or, at any event, there is no satisfactory explanation by the appellants as to why they could not have done so, and in any event the expert opinion is inconclusive and is not inconsistent with the Judge's conclusion.

45. Mr Lightman further submitted that the application to adduce the expert report on the appeal is deficient because there is no statement on behalf of the appellants explaining when they (or, more likely, their legal advisers) first became aware that there might be an issue as to the application of the no reflective loss principle in the present case. In the course of his submissions Mr Lightman drew our attention to a lengthy letter before action dated 19 April 2013 from the respondents' solicitors to Pavel S making serious allegations about the conduct of the Pavels and others in relation to the affairs of HIA and Haysom and mentioning the possible application of the no reflective loss principle to those claims. That letter also stated that HIA and Haysom would be joined as nominal defendants only, for the purpose of enabling Ametista Mauritius and PNT to seek relief on their behalf and for their benefit. It described the intended claim on their behalf as "a derivative claim". A similar letter was sent to, among others, Pavel N. The appellants' *ex parte* application to Christopher Clarke J was made on 15 May 2013, that is to say very shortly after that letter was sent. Mr Lightman submitted that the letter should have alerted the appellants to the possible application to their own claims of the no reflective loss principle. He also suggested that the reflective loss point was raised by Christopher Clarke J himself at the hearing before him.

46. I would refuse to set aside Patten LJ's grant of permission to the appellants to adduce the joint expert report on Cayman law. There has been debate and disagreement between each side as to whether or not Christopher Clarke J raised the issue of reflective loss. Notwithstanding what was said by the respondents in their own letter before action dated 19 April 2013, and whatever Christopher Clarke J may have said

or intended, the fact remains that the respondents only raised the issue of reflective loss as a defence to the appellants' claim in the respondents' skeleton argument served a few days in advance of the hearing before the Judge; and the possibility that Marc and Sanjit might be liable for breach of fiduciary duty as shadow directors of HIA only became clearly identified as a significant issue at the stage of reply submissions in the hearing before the Judge. The Judge handed down his written judgment with admirable speed within three days of the end of the hearing. In those circumstances, I do not consider that the appellants can be said to have failed to exercise reasonable diligence to adduce expert evidence of Cayman law during the hearing before the Judge or, at any event, before his judgment. Permitting the joint expert report to be adduced would give effect to the overriding objective in CPR 1.1. The *Ladd v Marshall* requirements are, in my view, satisfied. It follows that the contents of that report are an additional reason why the Judge was wrong to conclude as he did in paragraph [65] of his judgment as to the strength of a case that Marc and Sanjit were in breach of fiduciary duties as shadow directors of HIA.

47. So far as concerns a possible cause of action by HIA against Marc and Sanjit for deceit, reliance is placed by the respondents on the following allegations in the particulars of claim. In paragraph 64 of the particulars of claim it is alleged that Sanjit and/or Marc, without the knowledge or consent of the Pavels, wrongfully procured a significant proportion of the profits of the joint venture to be diverted into Blue Pearl pursuant to the Distribution Agreement. In paragraph 65 of the particulars of claim it is alleged that certain statements in the Distribution Agreement were untrue, and that there was no legitimate basis on which 66.66 per cent of the management fees which would otherwise have been payable by Hadar Fund to HIA could be diverted from HIA and thus ultimately from the principals in the joint venture as a whole. In paragraph 66 of the particulars of claim it is alleged that the Distribution Agreement was procured by Sanjit falsely representing to Mr Graham (who executed the Distribution Agreement on behalf of both Hadar Fund and HIA) that it was approved by all of the principals in the joint venture.

48. Paragraphs 71 to 73 of the particulars of claim contain the appellants' allegations concerning the Rio Agreement and the consequential diversion of management fees to Blue Pearl. It is alleged in paragraph 72 that those matters were procured by a false representation to the effect that Blue Pearl was owned by all four principals in the joint venture.

49. At the time of the hearing before the Judge the respondents had not served a defence. Their evidence was that there was no misrepresentation as alleged in paragraph 66 or paragraph 72 of the particulars of claim and that Mr Graham was at all material times aware who owned Blue Pearl. Those assertions are pleaded in the defence which the respondents have subsequently served.

50. Two arguments were advanced below and have been advanced on appeal by the appellants as to why HIA might not have a claim against Marc and Sanjit in deceit even if Marc and Sanjit are liable to the Pavels for breach of fiduciary duty in consequence of the Distribution Agreement and the Rio Agreement.

51. The first argument of the appellants on this aspect is that it is possible that Mr Graham was initially misled as alleged in paragraph 66 of the particulars of claim but, before the fees were diverted to Blue Pearl, he became aware of the true facts. Mr Miles

emphasised on the appeal that we are still at a very early stage of the proceedings and it is possible that the case of the various parties may develop in a number of ways, of which that suggested outcome is one. I certainly accept that, in the light of the complexity of the factual background and the range of factual issues in dispute, it would be wrong to assume that the particulars of claim might not be amended from time to time: cf. *Derby v Weldon* at 62G-H (Nicholls LJ). Nevertheless, the argument of the appellants on this aspect was rightly rejected by the Judge as fanciful. On the material before the court there is simply no evidential basis for a factual finding at trial lying somewhere between the appellants' case that Mr Graham was misled at the time of the Distribution Agreement and at all subsequent relevant times and the respondents' case that Mr Graham and indeed the Pavels always knew the true position and were never misled in any material way in relation to the Distribution Agreement.

52. The second argument of the appellants is that, although the particulars of claim allege that the Distribution Agreement and the Rio Agreement were procured by Sanjit's misrepresentation to Mr Graham, the appellants might fail in that allegation because Sanjit did not make the representation and yet the appellants might nevertheless still succeed in their claim against Marc and Sanjit for breach of fiduciary duty as co-joint venturers.

53. The Judge appears to have addressed and dismissed that argument on the ground that the possibility of the appellants failing to establish dishonesty on the part of Marc and Sanjit and yet succeeding in "some milder allegation" against them was unrealistic. The relevant part of the judgment is at paragraph [63] as follows:

> "I consider that I should not close my mind to the possibility that the Claimants might only prove some of the facts pleaded but still have a claim against the Defendants. However, I will wish to approach this question in a realistic way remembering that what I have to decide on this application is whether the Claimants have a good arguable claim or whether there is a serious issue to be tried in relation to their claims. I also consider that the Claimants cannot have it both ways. They strongly emphasise the serious nature of their allegations of dishonesty for the purpose of persuading me that there is a serious risk that these allegedly dishonest Defendants will dissipate their assets unless restrained by order of the court; it seems to me it would be inappropriate to accept that submission and at the same time proceed on the basis that the Claimants will not establish the alleged dishonesty but will establish some milder allegation which would allow the Claimants to say they do, but that HIA does not, have a cause of action arising out of that milder allegation."

54. With respect to the Judge, I do not consider that those comments properly address the appellants' argument. In order to understand why that is so it is necessary to disentangle a number of separate points. In the first place, the appellants' claim against Marc and Sanjit for breach of fiduciary duty, including the claim for proprietary relief, does not depend on proving that the breach of duty was dishonest. Secondly, dishonesty is relevant to the interlocutory injunctive relief sought by the

appellants insofar as it bears on the issue whether there is a real risk that the respondents will dissipate their assets so that a judgment in favour of the appellants would go unsatisfied. Thirdly, the appellants do indeed assert, for that purpose, that at trial Marc and Sanjit will be found liable for dishonest breaches of trust and not some "milder" infraction. The alleged breaches of fiduciary duty in relation to the Distribution Agreement and the Rio Agreement are not, however, the only matters on the basis of which the Judge was entitled to find a risk of dissipation of assets. There was the allegation concerning the Telnic investment and the non-disclosure of the US$4.4 million "finder's fee". There were also all the other matters mentioned in paragraphs 77 to 85 of the appellants' skeleton argument for the hearing before the Judge. Fourthly, and critically, it is not a necessary pre-condition of the liability of Marc and Sanjit for breach of fiduciary duty as co-venturers that there was a misrepresentation to Mr Graham. It would be sufficient to establish both a breach of fiduciary duty and dishonesty that they knowingly procured the payment to themselves (via Blue Pearl) of money from the joint venture which they knew should have been divided between all four of the principals. That is what is pleaded in paragraph 65(3) of the particulars of claim (i.e. before, and irrespective of, the allegation of misrepresentation in paragraph 66).

55. As I have said, the Judge never addressed that way in which the appellants put their case. For those reasons, and bearing in mind the current state of the disputed evidence, I consider that the appellants have a good arguable case for an outcome in which they will succeed at trial in establishing dishonest breach of fiduciary duty by Marc and Sanjit but HIA would not have a claim against Marc or Sanjit.

56. Mr Miles also argued that there are aspects of the no reflective loss principle which are not entirely settled and that is a further reason why the Judge ought not to have concluded at this interlocutory stage that that the appellants' claims in relation to the Distribution Agreement and the Rio Agreement are clearly barred by that principle. It has been decided at the level of the Court of Appeal that the principle is applicable even where the claimant's claim against the defendant is for a proprietary remedy for breach of fiduciary duty: *Gardner v Parker*; *Shaker* at [81] and [83]. Mr Miles said that the appellants wish to reserve the right to challenge that decision in the Supreme Court.

57. Mr Miles also submitted that there is uncertainty in the law as to whether, as the Judge held in paragraph [68] of his judgment, the no reflective loss would bar a claim even where the company was precluded from claiming because it had affirmed a contract induced by misrepresentation. In that connection, Mr Miles referred to the decisions in *Perry v Day* [2004] EWHC 1398 (Ch), [2005] BCC 375, *Shaker* and *Barings plc v Coopers & Lybrand (No. 1)* [2002] 2 BCLC 364. Mr Miles' contention was that a distinction has to be made, or arguably has to be made, between what he called procedural bars such as limitation defences or a settlement of the claim by the company, which do not prevent the operation of the no reflective loss principle, and what he called defences to the substantive cause of action, which do preclude the operation of the principle. Authority was cited by Mr Lightman in support of a different analysis. Mr Miles submitted that this is a developing area of the law.

58. I prefer to base my decision on this appeal, not on the ground that the no reflective loss principle is a complex or developing area of the law in a respect relevant to the present case, but rather on the point that its application is highly fact dependent and,

because of the current state of the disputed evidence, the appellants have a good arguable case that their claims for relief against Marc and Sanjit for breach of fiduciary duty will not be barred at trial by the no reflective loss principle.

59. In order to circumvent the no reflective loss argument of the respondents and the decision of the Judge in favour of the respondents on the basis of that principle, the appellants also wish to rely on a very recent assignment by HIA to the Pavels of all claims it may have in connection with or relating to the Distribution Agreement. The assignment is dated 4 March 2014. The appellants claim that the assignment solves any difficulty that would otherwise arise from the no reflective loss principle. It is not necessary to address that new point in view of my decision that the appeal should be allowed on other grounds. I would not, in any event, have determined the assignment point on this appeal. The assignment is very recent and the respondents are entitled to further time to consider its validity and effect.

60. The respondents' notice raises three grounds for upholding the Judge's order in addition to the reasons given by the Judge in his judgment. One of them is that the appellants failed to draw to the attention of Christopher Clarke J on the *ex parte* hearing the potential no reflective loss defence to the appellants' claims and so the respondents were in breach of their duties of full and frank disclosure. The Judge considered this point and said at paragraph [99] of his judgment that, if he had held after examining the arguments as to the no reflective loss principle that it would otherwise be appropriate to continue the injunctions, he would not have declined to do so because that principle was not raised on the *ex parte* hearing.

61. I have referred above to the letters before action to the Pavels dated 19 April 2013 (one of which was shown to Christopher Clarke J on the *ex parte* hearing), the disagreement as to whether or not Christopher Clarke J referred to the reflective loss point, the fact that the respondents themselves did not raise the possibility of a reflective loss defence to the appellants' claims until the respondents' skeleton argument served very shortly before the return hearing before the Judge, and the absence of any identification of the precise potential claims by HIA against the Pavels supporting a no reflective loss defence until the oral submissions at that hearing. Furthermore, this point only arises on the hypothesis that (as I have decided) the no reflective loss point does not prevent the appellants from having a good arguable claim, and the Judge should have so held. The question whether or not, had the Judge otherwise been minded to continue the injunctions, he would or should have declined to do so on the ground of material non-disclosure on the *ex parte* application, was a matter within the discretion of the Judge. He addressed that point. His conclusion that he would not have declined to continue the injunctions cannot be faulted in all the circumstances as one falling outside the bounds of a proper exercise of judicial discretion.

62. Another ground in the respondents' notice is that Blue Pearl has claims against the appellants which are strongly arguable, and at least as strongly arguable as the appellants' claims against the respondents, and are greater in amount than the appellants' claims. They were set out in the respondents' letter before action dated 19 April 2013. They are now the subject of a lengthy counterclaim.

63. I am not surprised that the Judge did not refer to this argument of the respondents. As I have said, there are extensive conflicts of evidence, which the Judge correctly held

he could not resolve or evaluate at this interlocutory stage. Mr Lightman rightly did not spend any time in his oral submissions addressing the strength of those counterclaims. The fact that there is a disputed counterclaim of Blue Pearl, the factual basis for which cannot be determined at this stage, does not seem to me to be of any assistance in resolving whether or not the appellants can show that they have (in relation to the freezing injunction) a good arguable case or that there is (in the case of the proprietary injunction) a serious issue to be tried.

64. The third of the grounds in the respondents' notice is that there is not a serious issue to be tried as to whether the alleged wrongful diversion of funds to Blue Pearl pursuant to the Distribution Agreement and the Rio Agreement gives rise to a proprietary claim against the respondents. Mr Lightman submitted that, in accordance with the analysis of Lord Neuberger MR in *Sinclair Investments (UK) Ltd v Versailles Trade Finance Ltd* [2011] EWCA Civ 347, [2012] Ch 453 at [88] and [89], with which the other members of the court agreed, the wrongful diversion cannot give rise to a proprietary claim by the appellants unless the opportunity to obtain those funds belonged beneficially to the appellants.

65. Mr Lightman submitted firstly, that this is not a case in which there was a diversion to the fiduciary of a new opportunity (but rather the diversion of an existing income stream) and, secondly, that the opportunity to receive the income was plainly beneficially that of HIA or possibly (in the case of the Rio Agreement) of Rio Capital Consultoria e Gestao de Recursos Financeiros Ltda and not of the appellants. That second point has an immediate attraction. I do not consider, however, that it would be right to allow either point to be deployed on this appeal. They were not raised before the Judge. The issue as to which circumstances give rise to a constructive trust when a fiduciary makes a gain from an opportunity which arises only because of the fiduciary's position as such (other than the misappropriation or misapplication of the principal's property) is a complicated and contentious area of the law. The Judge had the benefit of considering the rival submissions of the parties and the voluminous evidence over four days. There was only a much shorter time for hearing the appeal before us. It was insufficient for a proper analysis of the law and the facts on these new points raised for the first time on appeal. Furthermore, the law in this area is likely to be clarified in the near future when the Supreme Court hears the appeal in *FHR European Ventures LLP v Mankarious* [2013] EWCA Civ 17, [2014] Ch 1. Once the appeal in that case has been determined the respondents can decide whether or not at that point to make a fresh application to discharge the proprietary injunctions on the basis of the law as clarified.

Conclusion

66. For all those reasons, I would allow this appeal.

Lady Justice Macur

67. The Respondents have not attempted to challenge the substance of the expert report adduced as new evidence but rather the circumstances of its late production. I agree with the Chancellor that they have failed to establish that it should be rejected on procedural grounds and would dismiss their application to set aside permission to adduce the new evidence in the appeal.

68. I agree with the Chancellor that the appeal should be allowed for the reasons he gives.

Sir Timothy Lloyd

69. I agree with the Chancellor that the application to set aside the grant of permission to adduce new evidence on the appeal should be refused, and that the appeal should be allowed, and I also agree with his reasons for making both of those orders.