CICA 27/2013

IN THE COURT OF APPEAL OF THE CAYMAN ISLANDS
ON APPEAL FROM THE GRAND COURT
FINANCIAL SERVICES DIVISION
(Justice Quin)
FSD 87 of 2011 (CQJ)

BEFORE

The Rt Hon Sir John Chadwick, President
The Hon Elliott Mottley, Justice of Appeal
The Hon John Martin, Justice of Appeal

IN THE MATTER OF THE COMPANIES LAW (2007 Revision)

AND IN THE MATTER OF LANCELOT INVESTORS FUND, LTD (in Official Liquidation) ("the Company")

BETWEEN

KBC INVESTMENTS LIMITED

Appellant

-and-

GEOFFREY VARGA AS OFFICIAL LIQUIDATOR OF THE COMPANY

Respondent

Thomas Lowe QC instructed by Sam Dawson of Solomon Harris appeared for the Appellant

Ross McDonough of Campbells appeared for the Respondent

Hearing and Judgment: 10 April 2014
Reasons released: 27 April 2015

REASONS FOR DECISION

MARTIN J.A.

1. These are my reasons for concurring in this Court's dismissal on 10 April 2014 of an appeal by KBC Investments Limited ("KBC") against a decision of Quin J. By his decision, dated 12 August 2013, the judge upheld the rejection by the Official Liquidator of Lancelot Investors Fund, Ltd ("the Company" or, in quoted documents, "the Fund") of a

proof of debt filed on 30 July 2009 by Fortis Bank (Cayman) Ltd ("Fortis"). The proof of debt related to the proceeds of the redemption of shares in the Company registered in the name of Fortis but held by Fortis as custodian for KBC. The amount of the debt that Fortis sought to prove was US$17,897,266.72.

2. The circumstances in which the debt is said to have arisen are as follows.

3. By a Confidential Information Memorandum issued in March 2006 ("the CIM"), the Company set out the terms on which it would issue redeemable shares to investors. Those terms included provisions relating to voluntary redemptions. So far as relevant, they were as follows:

Shares may be redeemed as of the last business day of each fiscal quarter.... Notwithstanding the foregoing, for Shares purchased by Shareholders on or before January 31, 2006, Shareholders may not redeem Shares prior to the first fiscal quarter-end following the one-year anniversary of their purchase of the Shares being redeemed. Moreover, for Shares purchased by Shareholders on or after February 1, 2006, Shareholders may not redeem Shares prior to the two-year anniversary of their purchase of the Shares being redeemed. ... Written notice of redemption must be given to the Administrator at least sixty (60) calendar days prior to the proposed redemption date, indicating the number of Shares proposed to be redeemed; provided, however, that the Fund typically will allow partial redemptions only if the aggregate Share NAV of the Shares held by the redeeming Shareholder after such redemption equals or exceeds $1,000,000. Unless the Fund otherwise agrees, such partial redemptions shall be made on a first-in first-out ("FIFO") basis with respect to the redeeming Shareholder's Shares. ... Redemptions may be permitted at such other times or with such shorter notice as the Fund, in its absolute discretion, may determine.

4. Shares that were acquired on or before 31 January 2006 were termed PS Shares: under the terms set out above, investors acquiring such shares were locked in for a minimum of one year from the date of acquisition. Shares acquired on or after 1 February 2006 were termed PS-1 Shares: investors acquiring such shares were locked in for a minimum of two years from acquisition.

5. The CIM recorded that Lancelot Investment Management, LLC ("LIM") had been appointed Investment Manager of the Company "to be responsible for conducting all investment management operations of the Fund". At page 12, it stated that

> *The Investment Manager will be responsible for, and control, all the day-to-day operations of the Fund, including its investment activities and decisions, subject only to any restrictions which may from time to time be adopted by the Fund's Board of Directors and to the review and approval by the Loan Acquisition Officer in the case of investment activities and decisions, as discussed herein. The Investment Manager's sole principal is Gregory Bell.*

6. On 6 June 2007 KBC (but not Fortis) entered into a side agreement ("the side agreement") purporting to be an agreement with the Company relating to "Subscription by [Fortis] as custodian for [KBC]". It was designed to replace the lock-up period stipulated by the CIM for the PS-1 shares with a right to redeem at any time but subject to a reducing percentage penalty. It stated that, "as consideration for current and future investments by [KBC] in the Fund", every provision of the CIM that limited redemption in respect of the PS-1 Shares was revised with respect to KBC's investments in the Company -

> *to provide a redemption right by [KBC] of all or any part of [KBC'S] Shares in the Fund as of the last business day of any fiscal month,*

upon 60 calendar days' prior written notice; provided, however, that redemptions of Shares that occur (i) on or before the last business day of the first six fiscal months following the effective date of the subscription for such Shares shall be subject to a 3% redemption fee on the amount redeemed; (ii) after the six fiscal months but on or before the last business day of the ninth fiscal month following the effective date of the subscription for such Shares shall be subject to a 2% redemption fee on the amount redeemed; and (iii) after the ninth fiscal month but on or before the last business day of the twelfth fiscal month following the effective date of the subscription for such Shares shall be subject to a 1% redemption fee on the amount redeemed.

The side agreement also stated that

[KBC] and the Fund each hereby represent and warrant that this letter agreement has been duly authorised, executed and delivered and constitute its legal, valid and binding obligation.

The side agreement was executed on behalf of the Company "by [LIM], its investment manager", LIM itself acting by Mr Bell.

7. As at 30 October 2007, Fortis held as custodian for KBC the following shares of the Company that had been issued pursuant to the terms of the CIM:

   (a) 5,687.8031 PS Shares. These shares had been issued to Fortis on or before 31 January 2006, and had consequently been held for more than one year. They were therefore redeemable under the terms of the CIM at the end of the fiscal quarter occurring after sixty days' notice had been given.

   (b) 14,404.9078 PS-1 Shares. Of these, 7,500.8926 had been issued to Fortis as at 31 March 2006, and 2,476.6773 had been issued as at 30 April 2006. Under the terms of the CIM, they were locked up until 30 June 2008 (being the next fiscal quarter end after the second anniversary of their

acquisition). If the terms of the side letter were binding on the Company and available to Fortis, they were redeemable on 60 days' notice at the end of any month without penalty. The remaining 4,427.3379 PS-1 Shares were issued on or before 4 May 2007, and under the terms of the CIM were locked up until 30 June 2009. Under the terms of the side letter, they were redeemable on 60 days' notice at the end of any month on payment of a 2% redemption fee.

8. On 31 October 2007 Fortis wrote to Swiss Financial Services (Bahamas) Ltd ("SFS"), the Company's administrator, in the following terms (so far as material):

Re: Fortis Bank (Cayman) Ltd as Custodian of KBC Investments Ltd

Please accept this letter as our advice that the above referenced entity wishes to execute the following trade:

transaction: partial redemption
fund: Lancelot Investors Fund, Ltd
amount/quantity: USD 29,000,000.00
for value: 31 December 2007

...

Please also note that whilst [Fortis] is the registered owner of the shares, the beneficial owner is KBC Investments Ltd....

The letter was sent by fax as well as by courier, and so gave sixty days' notice.

9. On 8 November 2007, SFS sent two letters to Fortis "as Custodian of KBC Investments Ltd". The first letter, headed "Full Redemption Acknowledgement", stated:

We confirm that we have received your request to redeem

5,687.8031 shares

of Lancelot Investors Fund, Ltd. Voting Participating Shares. Your request will be processed based on the Asset Value as of December 31, 2007.

The second letter was headed "Partial Redemption Acknowledgement", and stated:

We confirm that we have received your request to redeem

USD 18,200,000.00

worth of Lancelot Investors Fund, Ltd. PS-1 Voting Participating Shares. Your request will be processed based on the Asset Value as of December 31, 2007.

10. On 22 January, 2008, however, SFS sent an email to Fortis in the following terms:

In reference to your redemption request letter dated October 31, 2007 for partial redemption in the amount of $29M, please be advised that we cannot honor your redemption in Class PS-1. As per the Fund's Offering Memorandum, any redemptions relating to subscriptions occurring on or after February 1, 2006 (PS-1) will be subject to a two-year lock-up period. Operating on a First-In-First-Out (FIFO) method, we have accepted the full redemption of your Class PS shares with a full redemption value of $11,102,733.28 as at the net asset value of December 31, 2007. Unfortunately due to the lock-up period, we are unable to honor the redemption of the class PS-1 remainder. We have accordingly revised your transaction acknowledgement and attached a copy for your reference.

If you require any further information regarding the amendment of the redemption, please contact the Investment Manager at Lancelot Investment Management, LLC.

11. The redemption proceeds of Fortis's PS Shares were subsequently paid in the sum of US$11,102,733.28 referred to in SFS's email of 22 January 2008. The redemption proceeds of the PS-1 Shares (amounting to US$17,897,266.72, the balance of the US$29m requested redemption) had not been paid by 27 September 2008, when the Company suspended share redemptions following an FBI raid the previous day on the offices of Petters Group Worldwide. It

appears that almost all of the capital raised by the Company was used to purchase promissory notes which related to supposed inventory financing deals entered into for the benefit of Petters Company Inc ("PCI"); but in fact PCI turned out to be part of a fraudulent scheme, and there were no inventory financing schemes, nor any inventory to support the notes.

12. On 13 October 2008 a petition for the winding-up of the Company was presented in the Grand Court, and on 10 December 2008 the Respondent, Geoffrey Varga, was appointed Official Liquidator of the Company. In the meantime, the Company had filed for relief under Chapter 7 of the US Bankruptcy Code, and a case trustee had been appointed. On 30 July 2009 Fortis filed a proof of debt in the Chapter 7 proceedings. By agreement between the case trustee and the Respondent, the Respondent and the Cayman courts undertook responsibility for adjudication on creditors' claims.

13. On 12 September 2012 the Respondent gave notice to Fortis of rejection of its proof. There were four grounds of rejection: (1) the redemption request relating to the PS-1 Shares was correctly refused. This was in reliance on the two year lock-up period stipulated by the CIM; (2) Fortis's claim was barred by acquiescence or related doctrines. This was in reliance on Fortis's failure to object to the rejection by SFS of its claim until after the fraud was discovered; (3) in the alternative to (1) and (2), the NAV as at 31 December 2007 was clearly incorrect and the Company was not bound by it. This was on the basis that the fraud meant that the assets held by the Company were valueless; (4) again in the alternative to (1) and (2), the Company was entitled to reduce Fortis's claim to nil by setting off cross-claims. The cross-claims relate to previous redemptions at values that were inaccurate because of the effect of the fraud. In relation to grounds (3) and (4), KBC accepted that there was an issue

as to the net asset values that would have remained even if the appeal had otherwise succeeded.

14. The appeal to the Grand Court against the rejection of the proof was made by KBC, not by Fortis. That fact was central to the judge's rejection of the appeal. He held that KBC had no locus to appeal, since it was not the registered holder of the shares to which the redemption request related and there had been no assignment by Fortis to KBC of the right to receive the amount claimed in the proof of debt. As he put it at paragraph 125 of his judgment,

> "I find that the shareholding in the Company is still vested in Fortis and unless and until those shares are transferred to the Appellant, the status quo remains the same. Consequently, the Appellant has no *locus standi* to appeal the rejection by the Official Liquidator of Fortis' Proof of Debt".

He went on to hold that in any event the side agreement was not binding on the Company: it was not executed with the Company's authority; even if made by KBC as agent for Fortis it had not been ratified by Fortis so as to entitle Fortis to enforce it; and if otherwise binding on the Company it would have amounted to an invalid variation of class rights. He summarized his conclusions on the point thus at paragraph 136:

> "[If] the Appellant chose to hold its investment through Fortis, it cannot suddenly recant from what Fortis has or has not done. Fortis did not enter into any separate agreement with the Company. Fortis did not execute any Side Letter with the Company and, accordingly, the Side Letter has no effect on the contract between the Company and the registered shareholder, Fortis. I therefore find on the balance of probability that the Side Letter does not affect Fortis' rights in any way whatsoever".

Finally, he held that the redemption request could not be treated as a valid request to redeem on the first date permitted by the CIM, and rejected KBC's argument that SFS's "partial redemption

acknowledgement" amounted to an acceptance of the request that bound the Company.

15. KBC's appeal to this court was on the following grounds. First, the judge was wrong to hold that KBC had no locus to appeal against rejection of the proof; instead, he should have held that the right to enforce Fortis's claim had become vested in KBC as a result of the custodianship arrangements between Fortis and KBC, or as a result of the termination of those arrangements (grounds 1 and 2) ("**the standing point**"). Secondly, the judge was wrong to hold that the side agreement was not binding on the Company; instead, he should have held that LIM had authority to execute the side agreement on behalf of the Company and KBC had authority (initial or by ratification) to execute the side agreement on behalf of Fortis (grounds 3 – 5) ("**the side agreement point**"). Finally, the judge was wrong to hold that the redemption request relating to the PS-1 shares was of no effect; instead, he should have held either (i) that SFS had accepted an offer to redeem, had waived the two-year notice requirement or ratified the side agreement, or (ii) that the redemption request took effect on the first date for which valid notice could have been given (grounds 6 – 8) ("**the redemption request point**").

The standing point

16. KBC's basic contention is that the effect of the redemption request made by Fortis was to change Fortis's status from shareholder to creditor; and that thereafter there was nothing to prevent Fortis from assigning the right to receive the redemption proceeds, such an assignment occurring as a result of the terms of the custodian agreement between Fortis and KBC. The Official Liquidator supported the line taken by the judge, which was that the right to the redemption proceeds was an incident of the package of rights held by the shareholder and as such could only be enforced by the registered

shareholder. To the extent that it was possible to assign the right to receive the proceeds separately from the shares themselves, that had not in fact been done.

17. There is no doubt that in ordinary circumstances the rights attaching to shares may only be pursued by the registered shareholder. This general principle finds expression in article 133 of the Company's Articles of Association, which is in the following terms:

> *"No person shall be recognised by the Company as holding any share upon any trust and the Company shall not, unless required by law, be bound by or be compelled in any way to recognise (even when having notice thereof) any equitable, contingent or future interest in any of its shares or any other rights in respect thereof except an absolute right to the entirety thereof in each Member registered in the Register of Members".*

The principle is also the foundation of the rule that only a registered shareholder may bring proceedings to vindicate shareholder rights: see, for example, *Schultz v Reynolds* [1992-3 CILR 59] and *Svanstrom v Jonasson* [1997 CILR 192], both decisions of this court holding that a mere beneficial owner of shares could not maintain a derivative action on behalf of a company; and *Hannoun v R Ltd* [2009 CILR 124], in which the Grand Court held that a beneficiary under a bare trust of shares could not petition for a winding-up on the just and equitable ground. In the present case, the principle would have prevented anyone but Fortis from making a valid redemption request; but in fact it was Fortis that made the redemption request.

18. Article 42 of the Company's Articles of Association provides that the effect of making such a request is as follows:

> *Any share in respect of which notice of redemption has been given shall not be entitled to participate in the profits of the Company in respect of the period after the date specified as the date of redemption in the notice of redemption.*

KBC contended that the effect of that article was that Fortis's rights as shareholder were translated into rights as creditor as soon as notice of redemption was given. Since the article is clearly intended to operate only if a *valid* redemption notice has been given, and the validity of Fortis's notice is one of the points at issue on the appeal, it is necessary to consider KBC's contention on the assumption that the notice was valid. But even on that basis I do not agree with the contention: it seems to me that the article means no more than it says, and has only the effect of crystallising the shareholder's financial interest in the Company at the date specified in the redemption notice. It does not have the effect of removing the shareholder's right to participate (as by voting at meetings) in the Company's affairs - as opposed to its profits - at any time until actual redemption occurs. It follows that Fortis remained a shareholder despite giving notice of redemption, and had no right capable of assignment separately from the shares themselves.

19. It seems to me, however, that that position changed when the Company went into liquidation. At that point, all claims against the Company – including Fortis's claim to the redemption proceeds of the PS-1 shares – became provable in the winding-up. The various claims would rank for dividend; and, by virtue of Order 18, rule 9(1) of the Companies Winding Up Rules 2008, the right to receive a dividend is assignable. In consequence, such rights as Fortis had to receive a dividend in respect of its claim to the proceeds of redemption were freely assignable by it to anyone it chose. There is no requirement that an assignee should be a shareholder, or indeed have any status in relation to the Company save as assignee of the benefit of the proof. If, therefore, Fortis validly assigned the benefit of its proof to KBC, KBC will be entitled to be treated as the creditor in relation to the proof, and entitled as a creditor to appeal to the court under Order 16, rule 17 of the 2008 Rules against the rejection of the proof.

20. KBC does not contend that it has the benefit of an assignment expressly relating to the right to receive any dividend due to Fortis; but it relies on the terms of the agreement under which Fortis held the shares in the Company as custodian for KBC as constituting an assignment. By that agreement ("the custodian agreement"), dated 26 August 2005, Fortis was appointed by KBC to *act as custodian and deliver payment for, receive and hold in safe custody on behalf of* KBC (among other things) *documents of title or certificates or other documents evidencing title to any shares, bonds, Hedge Fund Investments or other securities ("Securities")*. By clause 3.1, *any Cash, Securities or Other Assets held by [Fortis] for and on behalf of [KBC] shall be held by [Fortis] in segregated accounts such that it is plain that the legal owner of such Cash, Securities and Other Assets is [KBC] and not [Fortis] nor any third party*; and by clause 3.2(a) Fortis was required *upon receipt of and in accordance with instructions from [KBC] [to] deal with and/or give instructions in respect of any Securities or Other Assets beneficially owned by [KBC] and held by [Fortis] or by any third party to the order of [Fortis]*. By clause 3.2(f) Fortis was required *on the instructions of [KBC], and in the name of [Fortis] as custodian for [KBC],* [to] *subscribe for and redeem shares, units or interests in the Hedge Fund Investments*; by clause 3.2(g) Fortis was to receive payment in respect of redemptions of Hedge Fund Investments made on behalf of KBC; and by clause 3.2(l) Fortis was required to *take all other lawful action in relation to the Securities or Other Assets as [Fortis] is directed to pursuant to instructions received from [KBC]*. Clause 7 required Fortis to keep any certificates or other documents evidencing ownership relating to KBC's Securities *in such a manner generally that it is readily apparent that the Securities and Other Assets to which they relate beneficially belong to [KBC] and not to [Fortis]*. Finally, clause 13.6 provided that on termination -

> *[Fortis] shall deliver to [KBC] or to the succeeding custodian, as directed by [KBC], all documents of title to or evidencing ownership*

of Securities and Other Assets then held by [Fortis] on behalf of [KBC] pursuant to this Agreement duly endorsed or otherwise in requisite form of transfer together with all books of account, records, registers, documents, statements and assets relating to the affairs of [KBC].

21. KBC contended that the effect of the custodian agreement was that, throughout its currency, Fortis held assets subject to it as bare trustee for KBC; and that KBC was accordingly in the position of an equitable assignee, and able to maintain a claim to the redemption proceeds in that capacity. If that contention were wrong, KBC nevertheless asserted that – once the custodian agreement was terminated, as it was by Fortis on 26 April 2011 - clause 13 took effect as an equitable assignment of all assets formerly held by Fortis, including the benefit of the proof of debt filed by Fortis in July 2009.

22. I accept that the relationship between Fortis and KBC during the currency of the custodian agreement was that of bare trustee and beneficiary. The terms of the agreement make clear that Fortis was a mere nominee, with no interest of its own in the assets it held and no decision-making powers. However, so long as Fortis's rights in respect of the Company were in its capacity as shareholder, the Company was not obliged to recognise the trust relationship between Fortis and KBC, and KBC could not have maintained an action as equitable assignee. Once Fortis's relevant capacity changed to that of proving creditor, however, there was no obstacle to KBC maintaining a claim as equitable assignee, even while the custodian agreement continued. Once it came to an end, the provisions of clause 13.6 took effect as a separate equitable assignment – arising not from the bare trust that had previously prevailed, but from the obligation to transfer everything to KBC. That obligation was to transfer in due form, contemplating a registered transfer of any shares and a formal assignment of the benefit of the proof; and if that had been done,

there would have been a legal assignment of the benefit of the proof once notice had been given to the Official Liquidator. Before it was done, however, the obligation to do so took effect in equity, giving rise to an equitable assignment to KBC. An equitable assignee may sue in his own name, although it is necessary that the assignor be joined in the proceedings prior to judgment so as to be bound by the result: see *Roberts v Gill & Co* [2011] 1 AC 240 at [67]. Moreover, although this is less clear, it seems to me that an equitable assignee has the benefit of the debt and so is, subject to giving notice, entitled to be regarded as a creditor for the purpose of Order 16, rule 17 of the 2008 Rules and as such entitled to maintain an appeal (subject again to joinder of the assignor).

23. In my judgment, therefore, KBC was in principle entitled to maintain a claim as equitable assignee of the benefit of Fortis's proof of debt, and in consequence had standing to appeal against the rejection of the proof. The claim could only have succeeded (if justified on other grounds) if Fortis had been joined as a party prior to judgment; but evidence adduced (without objection) on this appeal suggests that it would have been willing to be joined, and there would have been no good reason to refuse permission for its joinder.

24. It is therefore necessary to consider the substance of KBC's claim to be entitled to the redemption proceeds.

The side agreement point

25. KBC's case in relation to the side agreement is as follows. The terms of the CIM expressly contemplated that "Redemptions may be permitted at such other times or with such shorter notice as the Fund, in its absolute discretion, may determine". The Company could make such a determination by a properly authorised agent. KBC accepted that LIM was not expressly authorised to make such a determination; but the status of LIM as investment manager, and the

description in the CIM of the authority given to LIM, gave LIM ostensible authority to make such a determination, and LIM did so by the side agreement. Alternatively, if the authority given to LIM was insufficient, the Company held out LIM as having authority to make representations about its own authority; and the statement in the side letter that LIM was duly authorised to execute it was itself binding on the Company, with the result that the Company cannot now deny that LIM was authorised to execute the side agreement on its behalf (whether or not in fact that was the position). Although Fortis was not itself a party to the side agreement, the agreement made sense only if made on Fortis's behalf; and Fortis ratified it by making a redemption request that could only have been effective if Fortis had the benefit of the side agreement.

26. As I have said, KBC acknowledges that LIM did not have actual authority to bind the Company to variations of the redemption terms; but it asserts that LIM had ostensible authority to do so. Such authority was described in *Freeman & Lockyear v Buckhurst Park Properties (Mangal) Ltd* [1964] 2 QB 480 by Diplock LJ as follows (at 503):

> *An 'apparent' or 'ostensible' authority on the other hand is a legal relationship between the principal and the contractor created by a representation made by the principal to the contractor, intended to be and in fact acted upon by the contractor, that the agent has authority to enter on behalf of the principal into a contract of a kind within the scope of the 'apparent' authority so as to render the principle liable to perform any obligations imposed upon him by such contract. ... The representation, when acted upon by the contractor by entering into a contract with the agent, operates as an estoppel, preventing the principal from asserting that he is not bound by the contract. It is irrelevant whether the agent had actual authority to enter into the contract.*

27. The question therefore is whether the Company, by words or conduct, held LIM out as having authority to agree variations to the redemption terms, and if so whether KBC relied on that holding out. Any such words or conduct must, however, be set against the statutory background and the Company's constitution. The relevant statutory provision is section 37(3(c) of the Companies Law (as in force at the date of the side agreement), which states that *Redemption or purchase of shares may be effected in such manner and upon such terms as may be authorised by or pursuant to the company's articles of association*. The Company's Articles of Association deal with redemption in article 41, which so far as relevant is in the following terms:

> *REDEMPTION AND PURCHASE OF OWN SHARES*
> *Subject to the provisions of the Companies Law, the Company may:*
> *(a) issue shares on terms that they are to be redeemed or are liable to be redeemed at the option of the Company or the Member on such terms and in such manner as the Directors may, before the issue of such shares, determine.*

That article makes it clear that decisions as to the terms of redemption of shares are the province of the directors. Although it is the case that the CIM, by which the directors set out the redemption terms before the issue of the shares, contained provision for variation of those terms, the terms of the article suggest very strongly that any such variation could be effected - if at all, given the reference to determination "before the issue of such shares" – only by the directors.

28. The only statement made by the Company as to LIM's authority was contained in the CIM. It is quoted in paragraph 5 above. Read in the light of article 41 of the Company's Articles of Association (and indeed read in isolation), it cannot be construed as holding out LIM as

having authority to effect a variation. The description, which stated that LIM would be *responsible for, and control, all the day-to-day operations of the Fund, including its investment activities and decisions*, is limited by the reference to "day-to-day operations". That expression confines LIM's responsibility and control to the mundane, and is not in my judgment apt to cover something as fundamental as changes to the basis on which the Company's capital could be withdrawn by the redemption of shares. The reference to investment activities and decisions is clearly directed to investment of funds held by the Company, not to the terms on which those funds were themselves to be obtained by the Company – something that is put beyond doubt by the express subjection of LIM's authority to *the review and approval by the Loan Acquisition Officer in the case of investment activities and decisions*.

29. The description of LIM's authority was necessarily known to KBC, since the CIM in which the description was contained formed the basis on which KBC (through Fortis) subscribed for its shares. KBC suggested that the scope of LIM's ostensible authority had been extended by the Company's conduct: LIM was authorized to solicit investments, the individual with whom investors (including KBC) dealt was Mr Bell (who was according to the CIM the "sole principal" of LIM but was not a director of the Company), and it was difficult if not impossible for an investor to contact any of the Company's directors. None of these points has any substance. Although it is the case that LIM was authorised to solicit inward investment, as the Respondent conceded, its authority was only to do so on the terms set out in the CIM; the fact that Mr Bell and LIM dealt with investors is wholly consistent with the statement in the CIM that LIM had day to day responsibility for and control of the Company's operations; and the address of the directors was expressly stated in the CIM to be the Company's registered office, whose address was listed on the fifth page of the CIM along with all other relevant addresses. In these

circumstances it does not follow from the fact that Mr Bell was let loose on the investors, as Mr Lowe QC described the position, that he or LIM had ostensible authority to bind the Company to a variation of the redemption terms.

30. Two further points made by KBC have more substance. First, it is said that the Company did in fact honour similar side agreements made by LIM or Mr Bell, ostensibly on the Company's behalf, including several to which KBC was a party. Two such agreements, dated 16 February 2005 and 27 April 2007 respectively, were in evidence. It is not, however, the dates of the agreements that is important, but the dates on which they were honoured – since unless they were honoured before the side agreement in the present case was made the act of honouring them cannot amount to a holding out by the Company that LIM or Mr Bell had authority to enter into such agreements. The evidence disclosed that the Company had honoured the 2005 agreement pursuant to a redemption request acknowledgement given by SFS on 30 October 2007. That is of course after the side agreement was made on 6 June 2007. The evidence said nothing about the date on which the agreement of 27 April 2007 was honoured, but it is unlikely that it would have been before 6 June of the same year, just under six weeks later. Moreover, it is possible to discern from other evidence what attitude the Company's directors took to such side letters. It appears that they did on occasion pass resolutions authorising the entry into side agreements (although, so far as the Company's records go, no resolution was passed authorising LIM or Mr Bell to make such an agreement on the Company's behalf); but in each case they authorised one of their number to execute the side agreement, and they were clearly alive to the possibility that the effect of a side agreement might be to create a new class of shares (in one instance, dated 8 June 2007 – which is to say two days after the side agreement in issue in this case - resolving to offer revised terms to all investors,

not just new investors, expressly on the basis that doing so would avoid the need to create a new class of shares for new investors). In these circumstances it seems to me unlikely that authorization would have been given to LIM to conclude a side agreement in the terms relied on by KBC; but in any event there is nothing capable of amounting to a holding out to KBC that LIM had any such authority.

31. The second point advanced by KBC is that, even if LIM did not have ostensible authority to enter into the side agreement, it did have ostensible authority to convey the Company's decision to enter into that agreement and did so by warranting that it had authority to make the agreement. This argument was based upon the decision of the English Court of Appeal in *First Energy (UK) Ltd v Hungarian International Bank Ltd* [1993] BCC 533. That decision may be regarded as an exception to the general rule, derived from *Armagas Ltd v Mundogas SA* [1986] AC 717, that an agent who has no authority to enter into a transaction on behalf of his principal cannot create the appearance of such authority by making a representation to that effect. The *First Energy* case establishes that an agent who has no authority to enter into a transaction may nevertheless have ostensible authority to communicate that he is authorised to enter into the transaction.

32. First Energy had evolved a scheme by which it would install building heating systems on terms that the building owner would pay for the system over a period of years. It approached Hungarian International Bank ("HIB") for credit facilities. Negotiations began about the terms of a facility, but were never concluded. While they continued, however, an ad hoc loan was made by HIB in respect of a heating system installation. Subsequently, First Energy approached HIB for a similar ad hoc loan for three further installations; and an employee of HIB, who was in charge of HIB's Manchester office (its only office in the UK outside London) and held the title of senior

manager, wrote a letter that was held to contain an offer of finance capable of acceptance. It was common ground that the employee had no authority to make the offer; but the letter was held to be calculated to convey to First Energy that the employee had obtained approval of the transactions at the appropriate level at HIB's head office. The question was whether or not the employee had ostensible authority to transmit the offer; and it was held that the employee's job title and seniority amounted to a holding out by HIB that he had such authority.

33. The tenor of the reasoning is adequately conveyed by the following quotation from the judgment of Steyn LJ (with whom Nourse and Evans LJJ agreed):

> *"It seems to me that the law recognises that in modern commerce an agent who has no apparent authority to conclude a particular transaction may sometimes be clothed with apparent authority to make representations of fact. The level at which such apparent authority could be found to exist may vary and generalisation will be unhelpful. But let me take the concrete example of a company secretary. In Panorama Developments (Guildford) Ltd v Fidelis Furnishing Fabrics Ltd [1971] 2 QB 711 it was recognised that the managerial functions of a company secretary are today far greater than they once were. Mr Ponting was HIB's company secretary. He attended negotiations in July. If he had been asked for a resolution of the board of directors of HIB approving the transaction, and if he had in error sent a document purporting to be such a resolution, it is surely possible, depending on the evidence, that he might have acted within his apparent authority by virtue of his position as company secretary. That would be so despite the fact that he plainly had no apparent authority to sanction the transaction. My reason for this tentative view is that a company secretary is known to be the employee specifically charged with keeping the minutes of board meetings.*

Miss Arden accepted that if the managing director of HIB had confirmed that the transaction had been approved by HIB a case of ostensible authority could be made out. While HIB did not in fact have a general manager, Miss Arden was prepared to accept that the same would generally be true of a general manager. Confining myself strictly to a situation of a merchant bank or a trading bank, such as HIB, I take the view that it would be unrealistic to assert the contrary. And the reason is that in accordance with the general understanding in commerce the managing director and general manager of such a bank is clothed with a general actual or apparent authority to convey such information. It would be absurd to suggest that the third party should seek information from the board of directors as a whole" (at 543H-544D).

34. The type of ostensible authority in issue in that case was general, "arising where the principal has placed the agent in a position which in the outside world is generally regarded as carrying authority to enter into transactions of the kind in question" (per Lord Keith in *Armagas* at [1986] AC 777). In the present case, LIM was the Investment Manager; and the outside world would not generally regard an investment manager as having authority to transmit decisions of the board of directors. Moreover, anyone reading the CIM would be aware that LIM was merely one of a number of persons dealing with the Company's affairs. The CIM listed directors; an administrator, registrar and transfer agent; auditors; legal advisers; and a loan acquisition officer, as well as the investment manager. The administrator, registrar and transfer agent was SFS (generally described as "the Administrator"); and under the broad heading of "Management and Administrator of the Fund" the Administrator's functions are described as follows:

"Pursuant to the Administrative Services Agreement, the Administrator will perform or supervise the performance of services necessary for the operation and administration of the Fund (other

than making investment decisions), including administrative, accounting and Shareholder services. ... Pursuant to the Administrative Services Agreement, the Administrator also acts as registrar and transfer agent for the Shares".

In the light of that description, a person reading the CIM would in my view conclude that, if anyone had authority to convey decisions of the directors about the share terms, it was SFS, not LIM. Matters relating to shares were for SFS, matters relating to investment were for LIM. Again, the fact that Mr Bell had been let loose on the investors did not in the circumstances give him ostensible authority to make representations as to the Company's decisions about share redemption.

35. In *Armagas*, Robert Goff LJ said (in a passage subsequently approved when the case went to the House of Lords):

"The effect of the judge's conclusion was that, although Mr. Magelssen did not have ostensible authority to enter into the contract, he did have ostensible authority to tell Mr. Jensen and Mr. Dannesbøe that he had obtained actual authority to do so. This is, on its face, a most surprising conclusion. It results in an extraordinary distinction between (1) a case where an agent, having no ostensible authority to enter into the relevant contract, wrongly asserts that he is invested with actual authority to do so, in which event the principal is not bound; and (2) a case where an agent, having no ostensible authority, wrongly asserts after negotiations that he has gone back to his principal and obtained actual authority, in which event the principal is bound. As a matter of common sense, this is most unlikely to be the law" (at [1986] AC 717, 730H-731C).

36. In my view, the position in the present case is that LIM did not have ostensible authority either to vary the terms of the shares or to communicate to KBC decisions of the directors about variation of the terms of shares. The highest KBC can put it is that the warranty of

authority in the side agreement is equivalent to situation (2) in the quote immediately above; but it is plain that that is not enough to render the Company liable on the side agreement. It is therefore unnecessary to decide if Fortis had the benefit of the side agreement; but if that question had been relevant I would have held that Fortis had ratified the agreement. The side agreement could in the circumstances only be construed as made on Fortis's behalf, and Fortis's redemption request and proof of debt were explicable only on the basis that it had the benefit of the side agreement.

37. For these reasons, I consider that KBC cannot succeed on the side agreement point.

The redemption request point

38. KBC contends (a) that the redemption request contained in Fortis's letter of 31 October 2007 (paragraph 8 above) constituted an offer to redeem that was accepted by SFS's Partial Redemption Acknowledgement of 8 November 2007 (paragraph 9 above); or (b) that the acknowledgement amounted to a waiver of the two-year notice period or ratification of the side agreement; or (c) that the request, if invalid in so far as it sought redemption of the PS-1 shares on 31 December 2007, was valid notice for 30 June 2008 (being the first available date for which notice could have been given consistently with the terms of the CIM).

39. All of these contentions of course proceed on the footing that the side agreement did not bind the Company, so that the terms of the CIM relating to redemptions applied. The first two of them turn partly on the construction and effect of the request and the acknowledgement, and partly on SFS's ability to bind the Company. The third turns on the terms of the request alone.

40. As to contention (a), it seems to me impossible to construe the request and acknowledgement as an offer and acceptance giving rise to a contract. The request was not couched as an offer, but as an "advice" of Fortis's "wishes". It was not intended to be the opening shot in a contractual negotiation, or to require acceptance, but to be a notice which if valid would trigger the redemption provisions of the CIM and article 42 of the Company's articles. SFS's response was called an "acknowledgement", not an acceptance; and all it did was to confirm receipt of the request and say that it would be "processed based on the Asset Value as of December 31, 2007". A statement that a request will be processed is not a statement that it will be acceded to. It means no more than that the necessary steps will be taken to deal with the request; and if, as happened in this case, the request turns out to be invalid the process comes to a halt. It was said on behalf of KBC that SFS had the responsibility for processing all stages of a request, including making payment, and no doubt that is so; but it does not change a statement that a request would be processed into a statement that it would be met.

41. Similar considerations apply to contention (b). The terms of the acknowledgement cannot be treated as a commitment to meet the request at all, let alone to meet it regardless of its validity – which is what would be required if the acknowledgement were to be treated as a waiver of the notice requirements of the CIM.

42. An alternative way of putting contention (b) advanced by KBC in argument (although not in its grounds of appeal) was that the acknowledgement amounted to ratification by SFS of the side agreement. There was no evidence that SFS knew of the side agreement at the date of the acknowledgement, and without such knowledge there could be no ratification. But in any event the acknowledgement amounts only to a statement that the redemption request would be processed; and it cannot therefore be treated as

containing an implicit acknowledgement that early redemption was permissible and thus as implied ratification of the side agreement.

43. These two contentions accordingly seem to me to fail because the request and acknowledgement do not bear the construction KBC seeks to put on them. Even if they did bear that construction, KBC could succeed only if it could establish that SFS had the ability to bind the Company to a variation, waiver or ratification; and I do not consider that it had. Whilst I accept that a contract would be capable of effecting a variation (although a unilateral waiver unsupported by consideration or change of position would not), and that ratification would in principle be effective, the variation or ratification would bind the Company only if SFS had authority to act on the Company's behalf. It is not suggested that it had actual authority to do so; but again KBC contends that SFS had ostensible authority to vary the redemption terms or ratify the side agreement on the Company's behalf. I do not accept that contention. I have set out in paragraph 34 above the statement made in the CIM about SFS's position and functions; and I have pointed out (in paragraph 27) that article 41 makes clear that decisions about redemption of shares are for the directors. SFS is described as the administrator, and also as registrar and transfer agent for the shares. In my view, the outside world would not generally regard a person fulfilling those functions as having authority to vary the terms relating to subscription of shares, either itself or by ratifying what someone else had done. Nor, in my view, would anybody reading the description of SFS's role, with or without article 41, understand that SFS had such authority: as administrator its function was the provision of services, not the making of decisions about the terms of inward investment; and as registrar and transfer agent its function was to record or facilitate dealings in shares conducted on terms defined by others, not by itself.

44. Contention (c) – that Fortis's request was valid for redemption in June 2008 - depends (as Mr Lowe QC accepted) upon the request being read as if it said "for value: 31 December 2007 or the first date thereafter on which redemption may validly be effected". If it had said that, I accept that it would have constituted a valid request in respect of the PS-1 shares (although some of them were not redeemable until June 2009, and so would not on any basis have been redeemed before the Company was wound up) and would have given rise to a contractual obligation on the Company to redeem; but it did not say that, or anything to similar effect, and it cannot be construed as doing so. It was intended to be what it said it was, namely a request to redeem on a specific date. That date was important, because in the case of a valid request article 42 has the effect of terminating the shareholder's right to participate in the Company's profits from the date specified in the request. Certainty about the date is therefore necessary, and a notice that specifies neither a valid redemption date nor a formula for determining such a date does not provide it. If Fortis's request failed as a valid request for the date specified, as it did, it cannot be rescued by treating it as a request to redeem on some later date.

45. Accordingly I consider that KBC fails on the redemption request point.

Postscript

46. As I have mentioned in paragraph 14 above, one of the judge's reasons for holding that the side agreement was not binding on the Company was that it would otherwise have amounted to an invalid variation of class rights. At the conclusion of the oral argument, Mr Lowe QC for KBC said in response to an enquiry from the Court that he had no answer to this point. However, he and Mr McDonough were given an opportunity to put in some brief written submissions on the point, and they did so in a joint note provided shortly after the

hearing. The effect of the note was that the parties were in agreement that, although the rights of investors whose shares could be redeemed only on two years' notice would be affected by the premature removal of capital by other shareholders, the nature of their individual rights would not be altered; and that accordingly the side agreement would not have amounted to an invalid variation of their rights. Since it makes no difference to the outcome of the appeal I am content to accept, without deciding, that they are right about that.

Conclusion

47. For the reasons I have given, I concluded that the judge was wrong to hold that KBC had no standing to appeal against rejection of Fortis's proof; but that, since the side agreement was not binding on the Company and the redemption request could not otherwise be treated as valid, the result reached by the judge was correct. Accordingly, I was satisfied at the conclusion of the hearing that the appeal to this Court should be dismissed.

MARTIN J.A.

MOTTLEY J.A.

48. I agree.

CHADWICK P.

49. At the conclusion of the oral hearing of this appeal I, too, was satisfied that – for the reasons which Martin J.A. has set out - the appeal from the order made by Quin J. should be dismissed.

50. In those circumstances it was unnecessary to decide whether or not the judge was correct to hold that the side agreement was not binding on the Company for the additional reason mentioned by Martin J.A., by way of postscript, in paragraph 46 of his judgment. Notwithstanding the consensus between counsel in their post-hearing note, I should not be taken to have accepted that the judge was wrong on that point.