UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

IN RE HERALD, PRIMEO AND THEMA FUNDS SECURITIES LITIGATION This document relates to: All actions.	File No: 09 Civ. 289 (RMB) (HBP)

AFFIDAVIT OF THOMAS LOWE IN SUPPORT OF PLAINTIFFS' MEMORANDUM OF LAW IN OPPOSITION TO DEFENDANTS' JOINT MOTION TO DISMISS

I, THOMAS LOWE QC, 103 South Church Street, George Town, Grand Cayman, Cayman Islands, attorney at law of the Grand Court of the Cayman Islands **MAKE OATH AND SAY** as follows:

1. I am an attorney-at-law in the Cayman Islands practicing as a barrister and also practice as a barrister in the Courts of England and Wales. I was appointed Queen's Counsel by Her Majesty the Queen in 2008.

2. I am making this my affidavit in relation to the Primeo Plaintiffs' and Herald Plaintiffs' proposed amended complaints (the "Complaints") in the above-captioned proceedings ("the Proceedings"). In this affidavit I explain my opinion as to the law of the Cayman Islands, applicable to certain matters in the Complaints on the hypothesis that this might be the applicable law.

3. I was called to the Bar of England and Wales in 1985. I first appeared before the Grand Court of the Cayman Islands in 1995. I have also appeared in Courts in Bermuda, the Bahamas, the British Virgin Islands and Jersey and been retained in substantial litigation in Hong Kong and Singapore.

4. For the last 15 years my practice has been increasingly concentrated in the Cayman Islands. I would estimate that in the past 10 years three quarters of my matters have been Cayman Islands-related cases. I have been in independent practice as a barrister for 26 years. I am unaffiliated to any law firm and currently one of only three Queen's Counsel practicing independently in the Cayman Islands.

5. For the last 10 years or more I have been retained to advise and appear in Court in numerous disputes concerning investment funds of different kinds as well as structured finance vehicles. In the course of my practice I have acted for liquidators, investors, directors, and service providers such as custodians and administrators. I append a copy of my current *curriculum vitae* as Exhibit A, which includes a list of my publications in the last 10 years and a list of all of the cases in which I have served as an expert in the last four years. I am being compensated for my work on this matter, including any testimony that may be required, at the hourly rate of US$650 plus out of pocket expenses.

6. The purpose of this affidavit is to set out my opinion on whether Plaintiffs have standing under the law of the Cayman Islands to bring claims for fraud, negligence, gross negligence, breach of fiduciary duty, and breach of contract; whether the law of the Cayman Islands is substantially different than the law of New York for these claims; and whether the Cayman Islands is an adequate forum for this litigation.

I. Sources

7. I have reviewed the following documents in this matter:

7.1. the Complaints;

7.2 Memorandum of Law dated 29 June 2011 in support of Defendants' Joint Motion to Dismiss and in opposition to Plaintiff's Motion for Leave to Amend (the "Defendants' Memo");

7.3. Declaration of William James Tyre Bagnall dated 29 June 2011 in support of the Defendants Memo (the "Bagnall Affidavit");

7.4. Affidavit of Graham Ritchie QC sworn 29 June 2011 in support of the Defendants' Memo (the "Ritchie Affidavit");

7.5. Affidavit of Mark Phillips QC sworn 29 June 2011 in support of the Defendants' Memo (the "Phillips Affidavit").

7.6. Declaration of Joseph Serino Jr dated 29 June 2011 in support of the Defendants' Memo (the "Serino Affidavit").

8. I have been asked by Cohen Milstein Sellers & Toll PLLC, Counsel for Lead Plaintiff Dr. Shmuel Cabilly and Plaintiff Korea Exchange Bank and Lead Counsel for the class in the captioned matter to give my opinion on the matters of Cayman Island and English law raised by the affidavits and declarations identified in paragraph 7 above.

9 Capitalized terms not otherwise defined herein shall have the same meaning ascribed to them in the Complaints.

10. Save where otherwise indicated the facts and matters to which I depose herein I derive from my own knowledge of this matter To the extent that matters to which I depose are

derived from information supplied to me, they are true to the best of my knowledge, information and belief

11. There is now produced and shown to me marked **"TL1"** a paginated bundle of true copy documents, not otherwise readily available, to which I shall refer herein except for the documents referred to in paragraph 8 above.

III. The Legal System of the Cayman Islands

12. The Cayman Islands is a British Overseas Territory. A Governor, a Cabinet of ministers and a Legislative Assembly have executive and legislative power, subject to a power of disallowance by the British Secretary of State for Foreign and Commonwealth affairs. The Cayman Islands enacts statutes and regulations and English statutes after 1727 have no general application to the Cayman Islands unless expressly extended to the Cayman Islands. I agree with what is stated in the Bagnall Declaration at paragraphs 6 to 8 concerning the laws of the Cayman Islands.

13. The Cayman Islands is a common law system. Decisions of the Privy Council are binding on the Grand Court of the Cayman Islands and decisions of other English Courts are of persuasive authority for the Grand Court of the Cayman Islands. Although I agree with paragraph 9 of the Bagnall Declaration that decisions of other commonwealth authorities are persuasive it is not the case that they are "similarly persuasive" when they differ (as is the case here). The Courts of the Cayman Islands will consider the reasoning in each for their cogency and determine the appropriate principle given conditions in the Cayman Islands.

14. Decisions from the Grand Court are subject to appeal to the Court of Appeal of the Cayman Islands. The Court of Appeal is comprised of senior judges from other Caribbean jurisdictions and frequently with one of their number being retired members of

the English judiciary. The current president of the Court of Appeal is Sir John Chadwick, a retired member of the Court of Appeal of England and Wales.

15. The ultimate appellate Court in the Cayman Islands is the judicial committee of the Privy Council, which sits in London. The judicial committee of the Privy Council is largely comprised of members of the English Supreme Court (the highest English Court, formerly known as the judicial committee of the House of Lords). Decisions of the Privy Council sitting on such appeals represent binding precedent in the Cayman Islands.

IV. The Complaints

16 In order to make my declaration I have read the Complaints as setting out in ordinary language a number of allegations of fact and as indicating causes of action sought to be put forward, by reference to those allegations of fact. I assume the allegations of fact to be true. In relation to the causes of action, I have tried to understand the substance of these by reference to the alleged facts, rather than nomenclature, which does not always translate easily to the legal terminology used in the Cayman Islands. I recognise of course that it is the Court considering the Complaints that will determine their meaning and effect.

17. In paragraphs 1 to 14 of the Primeo Complaint the Plaintiffs' claim against the Defendants is summarised as being that the Plaintiffs were induced to invest indirectly with Bernard Madoff as investors in feeder funds, the investment with Madoff having been made into a Ponzi scheme. I will describe these feeder funds as "the Funds." Plaintiffs' investment is now worthless. The allegations are that the Defendants acted in breach of duty and wrongfully.

18. The Bagnall Declaration (with which Mr. Phillips and Mr. Ritchie expressly agree) gives an explanation of derivative actions and the "reflective loss principle." It is important when considering the Bagnall, Phillips and Ritchie Declarations to recognise that the causes of action advanced in the Complaints are all expressed to be causes of action for

some legal wrong to the Plaintiffs or giving a right of recovery by the Plaintiffs themselves. Moreover, except for the Third Party Beneficiary Claims, the causes of action in the Complaints do not appear to make any allegation as to wrongs done to the Fund entities. Every other cause of action is alleged to be that of the Plaintiffs alone.

19. Mr. Bagnall asserts in paragraph 5 of his Declaration that "*From my review of the [Complaints] it appears that these actions are brought by investors ..., the majority of which are properly claims of Herald (USA) and the Primeo Funds themselves.*" If the conclusion that the claims are those of the Funds is simply based on Mr. Bagnall's reading of the Complaints, I disagree. I do not see however where else Mr. Bagnall explains how he reached this conclusion. I disagree because on my reading of the Complaints the Plaintiffs assert causes of action which they claim belong to them personally.

20. Mr. Bagnall makes reference to the decision of the English House of Lords in the case of *Johnson v Gore Wood & Co* [2002] 2 AC 1 and *dicta* from an earlier decision of the English Court of Appeal in *Prudential Assurance v. Newman Industries No 2* [1982] Ch. 204. The Bagnall Declaration refers to this as establishing a "doctrine." I will describe this as the "reflective loss principle." Mr. Bagnall does not explain how this affects the claims in this case, however. I assume that he would regard this principle as precluding any claim but he does not in fact say so. I note in Section II C 1 of the Defendants' Memo these cases are relied upon in support of the argument that the common law claims would be dismissed for lack of standing.

21. Standing and the reflective loss principle are different legal concepts. The reflective loss principle recognised in *Johnson v Gore Wood & Co* is a modern development, which has evolved from a different principle established by the rule in *Foss v. Harbottle* referred to in paragraphs 13 to 16 of the Bagnall Declaration. I do not consider the reflective loss principle to be applicable as I explain below. I also disagree that the Plaintiffs would not have standing under the laws of the Cayman Islands.

V. A Shareholder's Standing to Bring Corporate Claims

22. It is a consequence of the principle that a corporation has a legal personality separate and distinct from its shareholders that a shareholder cannot sue for wrongs done to the company. The claims for those wrongs represent choses in action belonging to the company and not the shareholder. Hence, the proper plaintiff in an action with respect to a wrong allegedly done to a company (whether by management or otherwise) is, with some exceptions, the company itself and not an individual shareholder: *Foss v. Harbottle* (1843) 2 Hare 461; *Edwards v Halliwell* [1950] 2 All ER 1064 at 1066 and *Prudential Assurance Co Ltd v Newman Indus Ltd* (No 2) [1982] Ch 204.

23. This principle was specifically approved by the Cayman Islands Court of Appeal in *Schultz v Reynolds and Newport Ltd* [1992-93] CILR 59 and *Svanstrom & ors v Jonasson* 1997 CILR 192 (at 195-196) and is therefore clearly incorporated into the law of the Cayman Islands. In *Gee v Attridge* [1986-7] CILR 342 the rule was applied to prevent recovery against the Defendant, notwithstanding the fact that the Defendant was the sole shareholder.

24. "Derivative" actions exist by way of exception to the rule that the company is the only legal person with the right of action in respect of damage it has suffered. What has been described as the classic statement of the rule (*see Prudential Assurance Co Ltd v. Newman Indus. (No 2)* [1982] Ch. 204 (at 210)) together with its exceptions, is set out in the judgment of Jenkins LJ in *Edwards v. Halliwell* [1950] 2 AER 1064.

> *"The cases falling within the general ambit of the rule are subject to certain exceptions* [...(i)] *where the act complained of is wholly ultra vires*[1] *the company or association the rule has no application because there is no question of the transaction being confirmed by any majority* [... (ii)] *where what has been done amounts to what is generally called in these cases a fraud on the minority and the wrongdoers are themselves in control of the company, the rule is relaxed in favour of the aggrieved minority who are allowed to bring what is known as a minority shareholders' action on behalf of themselves and all others. The reason for this is that, if they were denied that right, their grievance could never reach the court because the wrongdoers themselves, being in control, would not allow*

[1] An act is *ultra vires* if the company had no power to undertake that act under its Articles of Association or under applicable statutory law. There are very few examples where the common law renders an act *ultra vires*.

the company to sue."

The second of these exceptions is known as the "fraud on the minority" exception to the rule in *Foss v. Harbottle* and was first recognized in *Burland v. Earle* [1902] AC 83 at 94.

25. The shareholder who can bring himself within this exception is described as bringing a "derivative claim." The claim is "derivative" because the action is brought by the shareholder on behalf of the company. Damages recovered belong to the whole of the company. A shareholder cannot therefore bring the action for his sole benefit in circumstances when there are other shareholders or creditors. The exceptional case where a derivative claim can be brought is a procedural device to permit corporate claims to be brought by others in circumstances where those in charge of the company would otherwise prevent the claim. The fact that such claims are nevertheless always made on behalf of the company shows that this is a procedural rule.

26. The Bagnall Declaration contains an entirely conventional and correct description of these principles in paragraphs 13 to 23. In the absence of the exceptional case, a cause of action belonging to one person cannot be the subject of a claim by another person.

27. However, these principles, which relate to standing, are not relevant to Plaintiffs' claims in the Complaints. The Plaintiffs do not advance any causes of action which are vested in anyone but themselves. No claims are asserted that the Funds had any causes of action let alone that the Plaintiffs had any claims as a result of such causes of action. The Plaintiffs cannot be deprived of the claims that belong to them by the rule in *Foss v Harbottle*. The Plaintiffs clearly have standing in the Cayman Islands to assert claims for wrongs done to themselves.

V. Reflective Loss

(a) The General Principle

28. The reflective loss principle is of modern origin. It was first recognized in *Prudential Assurance Co Ltd. v. Newman Indus Ltd (No 2)* [1982] Ch 204. Mr. Bagnall describes the reflective loss principle in paragraphs 24 and 25 of his Declaration. However, Mr. Bagnall presents an incomplete and over-simplified summary of the House of Lords' findings in relation to the nature and recoverability of reflective losses by shareholders in that case and the principles that govern such claims.

29. Lord Bingham in *Johnson v Gore Wood & Co.*, expressing the majority view (Lord Cooke and Lord Hutton expressly agreed with his reasoning), concluded, after reviewing the earlier authorities (at 35-36):

> *"These authorities support the following propositions. (1) Where a company suffers loss caused by a breach of duty owed to it, only the company may sue in respect of that loss. No action lies at the suit of a shareholder suing in that capacity and no other to make good a diminution in the value of the shareholder's shareholding where that merely reflects the loss suffered by the company... (2) Where a company suffers loss but has no cause of action to sue to recover that loss, the shareholder in the company may sue in respect of it (if the shareholder has a cause of action to do so), even though the loss is a diminution in the value of the shareholding... (3) Where a company suffers loss caused by a breach of duty to it, and a shareholder suffers a loss separate and distinct from that suffered by the company caused by breach of a duty independently owed to the shareholder, each may sue to recover the loss caused to it by breach of the duty owed to it but neither may recover loss caused to the other by breach of the duty owed to that other."* [underlining added]

As can be seen Lord Bingham outlined three different situations. In the first case the claim or chose in action as a matter of property belongs only to the company. This category of case is simply covered by the rule in *Foss v. Harbottle*. In the second it belongs only to the shareholder. The third situation deals with the case where the company and the shareholder each have a right of action as a matter of property. In that situation the concern is to avoid double recovery.

30. Lord Millett in *Gore Wood*, (whose reasoning was the minority view, in agreement with Lord Goff), also addressed Lord Bingham's first two categories of cases. He held (at 61-62) that:

> *"where a company suffers loss as a result of an actionable wrong done to it, the cause of action is vested in the company and the company alone can sue No action lies at the suit of a shareholder suing as such, though exceptionally he may be permitted to bring a derivative action in right of the company and recover damages on its behalf. Correspondingly, of course, a company's shares are the property of the shareholder and not of the company, and if he suffers loss as a result of an actionable wrong done to him, then prima facie he alone can sue and the company cannot. On the other hand, although a share is an identifiable piece of property which belongs to the shareholder and has an ascertainable value, it also represents a proportionate part of the company's net assets, and if these are depleted the diminution in its assets will be reflected in the diminution in the value of the shares. The correspondence may not be exact, especially in the case of a company whose shares are publicly traded, since their value depends on market sentiment But in the case of a small private company like this company, the correspondence is exact. This causes no difficulty where the company has a cause of action and the shareholder has none, or where the shareholder has a cause of action and the company has none ... Where the company suffers loss as a result of a wrong to the shareholder but has no cause of action in respect of its loss, the shareholder can sue and recover damages for his own loss, whether of a capital or income nature, measured by the diminution in the value of his shareholding. He must, of course, show that he has an independent cause of action of his own and that he has suffered personal loss caused by the defendant's actionable wrong. Since the company itself has no cause of action in respect of its loss, its assets are not depleted by the recovery of damages by the shareholder.* [underlining added]

This passage deals with the uncontroversial distinction between claims which belong either to the company or to the shareholder but not both.

(b) Avoiding Double Recovery where Duties Overlap

31. Lord Bingham's second category of case appears on my reading of the Complaints to cover the claims brought by the Plaintiffs. Nobody has ever suggested that a plaintiff who is fraudulently induced to subscribe for shares or debentures in a company is by reason of the reflective loss principle or by virtue of the rule in *Foss v. Harbottle* precluded from bringing a complaint against persons who made that representation. *Prima facie* the loss suffered and recoverable by an investor in such case, where the investment was worthless, is the subscription price, that being the difference between what was paid and what was received. This is established by numerous cases such as

Edgington v. Fitzmaurice [1884] 29 Ch. 459, *McConnel v. Wright* [1902] 1 Ch. 546 and *Smith New Court v. Citibank* [1997] AC 254

32. The situation where a duty is owed to both is, as observed above, the subject of Lord Bingham's third category, the case of affirmative duties owed to both company and shareholder. This does not arise in the present case. In that situation any rule excluding recovery is not solely based on a determination of substantive property rights in a claim. The practical procedural need to guard against double recovery comes into play. Lord Millett said:

> *"The position is, however, different where the company suffers loss caused by the breach of a duty owed both to the company and to the shareholder. In such a case the shareholder's loss, in so far as this is measured by the diminution in value of his shareholding or the loss of dividends, merely reflects the loss suffered by the company in respect of which the company has its own cause of action. If the shareholder is allowed to recover in respect of such loss, then either there will be double recovery at the expense of the defendant or the shareholder will recover at the expense of the company and its creditors and other shareholders. Neither course can be permitted."* [underlining added]

It will be observed that Lord Millett and Lord Bingham both expressed concern as to the possibility of double recovery but did not rule that such loss would not be recoverable by a shareholder absent a risk of double recovery. Lord Millett's approach is more restrictive than Lord Bingham's as was noted in a subsequent case. It is Lord Bingham's view that prevailed

33. Where losses are separate and distinct, however, there is no risk of double recovery. The Supreme Court of Canada (the highest court) accepted that a shareholder could bring a claim when he could show loss separate and distinct from that of the company. In *Hercules Managements Ltd. v. Ernst & Young* [1997] 2 S.C.R. 165, 146 D.L.R. (4th) 577, it was alleged that the defendant auditors had negligently prepared financial statements for a company in which some of the plaintiffs owned shares. However, the statements had been prepared under the direction of the company's management and had not been relied on directly by the plaintiffs for investment purposes. La Forest J. reasoned:

> *"One final point should be made here. Referring to the case of Goldex Mines Ltd. v. Revill (1974), 7 O.R. (2d) 216 (C.A.), the appellants submit that where a*

shareholder has been directly and individually harmed, that shareholder may have a personal cause of action even though the corporation may also have a separate and distinct cause of action. Nothing in the foregoing paragraphs should be understood to detract from this principle. In finding that claims in respect of losses stemming from an alleged inability to oversee or supervise management are really derivative and not personal in nature, I have found only that shareholders cannot raise individual claims in respect of a wrong done to the corporation. Indeed, this is the limit of the rule in Foss v. Harbottle. Where, however, a separate and distinct claim (say, in tort) can be raised with respect to a wrong done to a shareholder qua individual, a personal action may well lie, assuming that all the requisite elements of a cause of action can be made out."

The facts of Haig, supra, provide the basis for an example of where such a claim might arise. Had the investors in that case been shareholders of the corporation, and had a similarly negligent report knowingly been provided to them by the auditors for a specified purpose, a duty of care separate and distinct from any duty owed to the audited corporation would have arisen in their favour, just as one arose in favour of Mr. Haig. While the corporation would have been entitled to claim damages in respect of any losses it might have suffered through reliance on the report (assuming, of course, that the report was also provided for the corporation's use), the shareholders in question would also have been able to seek personal compensation for the losses they suffered qua individuals through their personal reliance and investment. On the facts of this case, however, no claims of this sort can be established [at paras. 62-3; emphasis added]

34. Therefore, four out of the five Law Lords (Lord Hutton did not address the point specifically) agreed in *Gore Wood* and the Supreme Court of Canada held that a shareholder can recover in at least two circumstances, namely:

34.1 Where the claim belongs solely to the shareholder and, even though a company suffers loss, it has no cause of action to sue to recover that loss. The shareholder can sue and recover damages for his own loss, even when measured by the diminution in the value of his shareholding, as long as the shareholder has an independent cause of action. This is Lord Bingham's second category and covers the claims brought by Plaintiffs here.

34.2 In addition, where the company and the shareholder are both owed duties, the shareholder is not precluded from recovering loss suffered as a result of a breach

of a duty to that shareholder where the loss is "separate and distinct" from the loss suffered by the company.

35. In any event Lord Bingham, with whom Lords Cooke and Hutton agreed in *Gore Wood*, both considered the only real objection to depriving a shareholder of his own proprietary right to his own claim to be when there is a risk of double recovery. When that risk disappears so does the objection to the shareholder pursuing his claim. That reasoning has been developed in subsequent case law. Soon after *Gore Wood* it was recognized that even in the case of overlapping duties owed both to a company and shareholder there was no hard and fast rule excluding recovery by shareholders.

36. For example, in the case of *Day v. Cook* [2001] EWCA Civ 592, Arden LJ (at paragraph 41 onwards), having explained the reflective loss principle on the footing that it appeared to be more than simply avoiding double recovery (essentially the narrower line pursued by Lord Millett in the minority view on *Gore Wood*), noted:

> *"However, it is apparent that there are limits to the application of the no reflective loss principle. The principal limit is that the no reflective loss principle does not apply where the company has no claim and hence the only duty is the duty owed to the shareholder (Lord Bingham's proposition (2)). Likewise it does not apply where the loss which the shareholder suffers is additional to and different from that which the company suffers and a duty is also owed to the shareholder. see Lord Bingham's proposition (3) and see Heron International v Lord Grade, Associated Communications Corp plc and others [1983] BCLC 244, as explained by Lord Millett in Johnson v. Gore Wood There may well be other limits"* [underlining added]

37. This was taken further by Peter Gibson LJ in delivering the decision of the English Court of Appeal in *Shaker v. Al-Bedrawi & ors* and *Shaker v. Masr* [2003] Ch 350 ("*Shaker*"). He made the point (at paragraph 85):

> *In circumstances where the Prudential principle applies to bar a viable claim on the footing of the company's cause of action which it does not assert, the application of the principle can work hardship. Moreover in this case the application of the principle might serve to leave the trustee holding a profit without being accountable for it to his beneficiary, and that may run counter to a basic equitable principle"*

38. Soon afterwards the English Court of Appeal returned to the subject. This time it was made clear that if the company had been disabled by the defendant from proceeding (such that the risk of double recovery had been eliminated), a shareholder's claim against that defendant would not fail. Waller LJ in *Giles v. Rhind* [2003] Ch 618 ("*Giles*"), which was an appeal from an assessment of damages, liability having been established at trial, distinguished the facts in *Giles* from *Gore Wood* in five important respects:

> *"First,* Johnson v Gore Wood & Co *was a case, as emphasised by Lord Bingham of Cornhill and Lord Millett, where Mr Johnson carried on his business through a small private company. His position was practically indistinguishable from that of his company. It was a case where the depletion in the value of the assets reflected in the diminution in the value of the shares was likely to correspond exactly (in the words of Lord Millett, at p 62B)."*
>
> *"Second, W Ltd had brought an action and compromised the same; indeed Johnson was the directing mind of the company when it agreed to the compromise. There is no reason to think that the company would not have recovered if it had chosen to do so precisely that value which would have reflected the diminution in value of the shares, which Johnson was claiming. There was no question of W Ltd having been disabled from bringing the claim by the very wrongdoing which by contract the defendant had promised the plaintiff he would not carry out."*
>
> *"Third, the action was tried on the assumption that the solicitors owed an independent duty to Johnson, but the nature of the case was such that it was not easy to assume such a totally independent duty."*
>
> *"Fourth, it could not be argued ultimately that the loss of value was other than reflective of the company's loss despite the way the claim was pleaded. But, so far as the damage in relation to investment in shares in this case is concerned, Mr Giles's losses are not as it seems to me "merely reflective" The shares became valueless on his case because the company's business as a whole was destroyed. Obviously the value of his shares reflect to some extent the value of the assets of the company but in his case they also reflect what Lord Millett described as market sentiment or what would have been considered their value because of the potential which the business had"*
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> *"Fifth, it certainly is not in my view in reality a case where Mr Giles is seeking to recover as damages damages which the company could have recovered. The company's claim for damages for breach of contract would have been of a quite different nature based on an assessment of profits lost by virtue of the confidential information being used to take the Netto contract. Mr Giles's loss relates to the fact that the business as a whole was totally destroyed. Indeed even if the company had recovered damages the Netto contract would never*

have been restored, the business would never have been the same and Mr Giles's share would inevitably have been devalued by Mr Rhind's activities The value of the shares when Mr Rhind obtained £300,000 for them in 1993 reflected not only the assets of the company but the good prospects of the company into the future and that loss of value could not be recovered by SHF in any action that it might have brought "

39. Waller LJ (at paragraph 35) then turned to Lord Bingham's third category in *Gore Wood* and addressed the double recovery risk as follows:

> *"In my view there are two aspects of the case which Mr Giles seeks to bring which point to Mr Giles being entitled to pursue his claim for the loss of his investment. First, as it seems to me, part of that loss is not reflective at all. It is a personal loss which would have been suffered at least in some measure even if the company had pursued its claim for damages. Second, even in relation to that part of the claim for diminution which could be said to be reflective of the company's loss, since, if the company had no cause of action to recover that loss the shareholder could bring a claim, the same should be true of a situation in which the wrongdoer has disabled the company from pursuing that cause of action. I accept that on the language of Lord Millett's speech there are difficulties with this second proposition, but I am doubtful whether he intended to go so far as his literal words would take him. Furthermore it seems to me that on Lord Bingham of Cornhill's speech supported by the others, it would not be right to conclude that the second proposition is unarguable "* (emphasis added)

40. Chadwick LJ (who is now a judge of the Court of Appeal of the Cayman Islands) also endorsed the criticism of Lord Millett's stricter exclusionary rule in *Gore Wood* and added (at paragraphs 73 to 74):

> *"As Waller LJ has said, it is difficult to do justice to Lord Millett's speech in Johnson v Gore Wood & Co by citing passages selectively. Waller LJ has set out substantial passages from that speech, and it is unnecessary for me to repeat that exercise. In the first of those passages, at p 62, Lord Millett explained the general rule in terms which present no difficulty in the context of the present appeal.*
>
> *"In such a case [where the company suffers loss caused by the breach of a duty owed both to the company and to the shareholder] the shareholder's loss, in so far as this is measured by the diminution in value of his shareholding or the loss of dividends, merely reflects the loss suffered by the company in respect of which the company has its own cause of action. If the shareholder is allowed to recover in respect of such loss, then either there will be double recovery at the expense of the defendant or the shareholder will recover at the expense of the company and its creditors and other shareholders. Neither course can be*

permitted. This is a matter of principle; there is no discretion involved. Justice to the defendant requires the exclusion of one claim or the other, protection of the interests of the company's creditors requires that it is the company which is allowed to recover to the exclusion of the shareholder."

The premise which underlies that passage is that the company has, and can pursue, its own cause of action. Absent that premise there would be no danger of double recovery at the expense of the defendant; and no occasion to protect the interests of the creditors and other creditors of the company. It is, I think, clear that Lord Millett was not addressing his observations, in that passage, to a case where the company has abandoned its cause of action against the wrongdoer; a fortiori, he was not addressing those observations to a case where the company has had to abandon its cause of action because of the wrong done to it by the wrongdoer." (emphasis added)

41. Referring to Lord Millett's observations in *Gore Wood* (at 66) that "*the disallowance of the shareholder's claim in respect of reflective loss is driven by policy considerations,*" Chadwick LJ (at paragraph 79) noted that:

> "*... [t]he policy consideration to which, as it seems to me, Lord Millett is referring in that passage is the need to avoid a situation in which the wrongdoer cannot safely compromise the company's claim without fear that he may be met with a further claim by the shareholder in respect of the company's loss. ... If that is a correct analysis of that passage, then the passage presents no difficulty in the case where the company has not settled its claim, but has been forced to abandon it by reason of impecuniosity attributable to the wrong which has been done to it. In such a case the policy considerations to which Lord Millett referred are not engaged. And it is difficult to see any other consideration of policy which should lead to the conclusion that a shareholder or creditor who has suffered loss by reason of a wrong which, itself, has prevented the company from pursuing its remedy should be denied any remedy at all.*" (underlining added)

42. This approach was reaffirmed by Neuberger LJ (now Lord Neuberger MR and a former judge of the Supreme Court, the new label for the Court that was formerly the House of Lords) in *Gardner v Parker* [2004] EWCA Civ 781 (paragraph 49) where he concluded:

> *"a loss claimed by a shareholder which is merely reflective of a loss suffered by a company –a loss which would be made good if the company 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."*

43. It is now settled in England that the principles of the rule against reflective loss set out in *Gore Wood,* as qualified by the Court of Appeal in *Giles*, are binding on the English courts (*Webster v. Sanderson* [2009] EWCA Civ 830, per Lord Clarke of Stone-cum-Ebony MR at paragraph 36, where he refused to follow Lord Millett in the Hong Kong case of *Waddington Ltd. v Chan Chun Hoo Thomas* [2009] 2 BCLC 82, who had used the occasion to reiterate his view in *Gore Wood* and expressed doubt about the Court of Appeal's decision in *Giles*).

44. Although the English Court of Appeal was bound to follow *Giles*, Lord Clarke also explained why he favoured the earlier English Court of Appeal cases and disagreed with Lord Millett. The Supreme Court would not have been bound by *Giles* but nobody appealed successfully against these decisions. The opinion of the majority in *Gore Wood*, the decisions in *Giles,* and the cases which follow it are highly persuasive authorities in the courts of the Cayman Islands and are likely to be followed by those courts, particularly since the principle was strongly advocated by one of its own judges and Lord Millett has in effect merely repeated and expanded on his views in *Gore Wood*.

45. Accordingly, the policy behind the rule against reflective loss is to prevent a situation giving rise to double recovery by the person bringing claims, either against the company or a party against whom the company has claims. The policy behind the rule determines the "limits" on the rule such that loss can be recovered either where both the company and the claimant have a claim but the claimant's loss is separate and distinct from that of the company or where there will be no recovery by the company for the loss for which the claimant claims.

46 Additionally, a company may not have a cause of action because it is caught by the principle *ex turpi causa*, which is the name given to what I understand to be called the "*in pari delicto*" defence. I note that the pleaded case is that the Funds made untruthful statements in subscription documents as a result of which they collected funds. The Fund entities would be guilty of deceit if they knew those statements to have been untrue or were reckless as to their truth. In those circumstances it is doubtful that the Funds would

have any claims (*see Stone & Rolls Ltd (in Liq) v Moore Stephens (a firm)* [2009] 1 AC 1391).

(c) Burden of Proof and Need for Clear Case to Deprive Shareholder of Right to Sue

47. The burden of establishing that a plaintiff is precluded by the reflective loss principle is on the defendant. If the defendant to an action relies on the reflective loss principle it will require some proof that the company is owed a duty or overlapping duty. Peter Gibson LJ in delivering the decision of the English Court of Appeal in *Shaker* observed (at paragraph 83):

> *"As the Prudential principle is an exclusionary rule denying a claimant what otherwise would be his right to sue, the onus must be on the defendants to establish its applicability. Further, it would not be right to bar the claimant's action unless the defendants can establish not merely that the company has a claim to recover a loss reflected by the profit, but that such claim is available on the facts…."*

The concerns expressed by Peter Gibson LJ in *Shaker* were echoed by Waller LJ (at paragraph 17) in *Giles v. Rhind* [2003] Ch 618, which was an appeal from an assessment of damages, liability having been established at trial:

> *"It must be remembered that the court is concerned simply with a preliminary issue. One does not know what evidence would be available to establish what. To a large extent the court is seeking to analyse recoverability of damage in the context of assertions by one side as against the other. Only if it is clear that Mr Giles cannot succeed in recovering any of the heads of loss flowing from what is now an established breach of contract should the court prevent the assessment of damages going ahead."* (underlining added)

48. Plaintiffs' claims here are for fraud, negligence, gross negligence, breach of fiduciary duty, conversion and breach of contract. None of them are based on causes of action which belong to the Fund entities. The Bagnall Declaration does not explain what overlapping causes of action the Fund entities might have against the Defendants which would enable them to recover losses occasioned to them, which would in turn make the shareholder whole. In each case it is possible to determine that the facts pleaded are capable of giving rise to a cause of action belonging to the Plaintiffs as opposed to the Funds and loss and damage separate and distinct from that of the Funds.

49. In addition, if Mr. Bagnall *were* able to explain what causes of action these Fund entities had, Plaintiffs would then have the opportunity to show that the Fund entities had decided not to pursue such claims because they lacked the means and resources to do so as a result of the Madoff fraud. If that were demonstrated, Plaintiffs could then also establish that there will in fact be no double recovery on such claims and so no need to apply the rule against reflective loss in order to avoid double recovery.

VII. Cayman Law Governing Plaintiffs' Common Law Claims

(a) Deceit

50 The conventional formulation of the ingredients of the tort of deceit are that a false statement has been made fraudulently if it has been made (i) knowingly or (ii) without belief in its truth or (iii) recklessly not caring whether it was true or false (*see Derry v Peek* (1889) L.R. 14 App. Cas. 337). The common law of the Cayman Islands requires proof that a person has been induced to act to his detriment by a false statement made by another in circumstances where that other made the statement intending it to be relied upon and without honest belief in its truth. The intention that the statement was to be relied upon is established if the maker appreciates that the Plaintiff would be likely to act on the representation (*Shinan Bank v. Sea Containers Ltd* [2003] 2 Ll R 408). It is sometimes said to be presumed that one intends the natural consequences of one's own acts (*see Smith New Court Securities v Citibank* [1997] AC 254).

b) Gross Negligence

51. Gross negligence is not a separate tort from negligence known to the common law of the Cayman Islands. I agree with the Bagnall Declaration in this respect. However, the allegations of gross negligence could be construed as claims for simple negligence. I will therefore address the allegations made by way of gross negligence in the context of my evidence on simple negligence below.

(c) Breach of Fiduciary Duty

52. The Bagnall Declaration and the Phillips Declaration each say that the Complaints do not give rise to a fiduciary duty under Cayman law.

53. I agree with the proposition that a fiduciary duty only exists when there is a fiduciary relationship. This was authoritatively explained by Millett LJ in *Bristol & West Building Society v. Motthew* [1998] Ch. 1 at 18. It is also true that certain categories of relationships are presumed to be fiduciary (such as that of principal and agent, partnerships and director and company), as Mr. Bagnall suggests. Such relationships may also be found to exist on particular facts. It is similarly possible for new categories of fiduciary relationships to arise.

54. Whilst it is true that directors owe their duties to the company of which they are directors, English law recognises that directors can owe fiduciary duties to shareholders in special circumstances. In *Peskin v Anderson* [2001] 1 BCLC 372 the English Court of Appeal remarked that a duality of duties may exist, one to the company and one to a shareholder. This was also recognised in *Stein v Blake No 2* [1998] 1 BCLC 573 at 576 and 579. If such a relationship arises it is not from the mere legal relationship between the director and the company but because of a special factual relationship between directors and the shareholders in a particular case.

55. In *Peskin*, Mummery LJ (at 145-46) gave the following examples explaining the types of special facts which might give rise to fiduciary relationships between directors and shareholders:

> *"33. The fiduciary duties owed to the company arise from the legal relationship between the directors and the company directed and controlled by them. The fiduciary duties owed to the shareholders do not arise from that legal relationship. They are dependent on establishing a special factual relationship between the directors and the shareholders in the particular case. Events may take place which bring the directors of the company into direct and close contact with the shareholders in a manner capable of generating fiduciary obligations, such as a duty of disclosure of material facts to the shareholders, or an obligation to use confidential information and valuable commercial and financial opportunities, which have been acquired by the directors in that office, for the benefit of the shareholders, and not to prefer and promote their own interests at the expense of the shareholders*

34 These duties may arise in special circumstances which replicate the salient features of well established categories of fiduciary relationships. Fiduciary relationships, such as agency, involve duties of trust, confidence and loyalty. Those duties are, in general, attracted by and attached to a person who undertakes, or who, depending on all the circumstances, is treated as having assumed, responsibility to act on behalf of, or for the benefit of, another person. That other person may have entrusted or, depending on all the circumstances, may be treated as having entrusted, the care of his property, affairs, transactions or interests to him. There are, for example, instances of the directors of a company making direct approaches to, and dealing with, the shareholders in relation to a specific transaction and holding themselves out as agents for them in connection with the acquisition or disposal of shares; or making material representations to them; or failing to make material disclosure to them of insider information in the context of negotiations for a take-over of the company's business, or supplying to them specific information and advice on which they have relied. These events are capable of constituting special circumstances and of generating fiduciary obligations, especially in those cases in which the directors, for their own benefit, seek to use their position and special inside knowledge acquired by them to take improper or unfair advantage of the shareholders."

56. An example of a special relationship between a director and shareholder which is characterised as fiduciary is where directors supply information directly to shareholders in relation to an offer to purchase their shares where they express a view as to whether or not a take over or tender offer should be accepted (*see Dawson International v Coats Paton Plc* (1998) 4 BCC 305 and *Coleman v Myers* [1977] 2 NZLR 297). Examples outside the context of small companies were discussed in paragraph 36 of Mummery LJ's judgment in *Peskin*. This demonstrates that the fact that a director owes a fiduciary duty to the company of which he is a director is not a bar to him having a similar duty to shareholders in appropriate circumstances. The existence of such duties is a question of fact. In my view this reasoning would be applied in the Cayman Islands

57. There is as Mr. Bagnall acknowledges little examination in any English authority as to the circumstances in which investment managers, administrators or custodians could owe fiduciary duties. Whether they owe duties is a question of fact (*see Ratiu v. Conway* [2005] EWCA 1305, *JD Wetherspoon v. Van Den Berg & Co* [2009] EWHC 639, where such a duty was found to exist between the directors of the defendant and the claimant, and the Bermudan Court of Appeal decision in *Horizon Bank International v. Walsh* [2008] CA (Bda) 8 Civ, in which Horizon Bank owed fiduciary duties to investors who

had transferred their assets to a company which was part of an offshore investment structure).

58. In the case of *Diamantides v. JPMorgan Chase Bank* [2005] EWCA 1812 (where ultimately it was held that no fiduciary duty was owed) it was said by the Court of Appeal:

> *"35. The importance of this passage lies in the recognition that, in a case where a fiduciary relationship arises out of a contractual relationship, it does not matter whether the person to whom the duty is owed entered into the contract directly or through an agent or through a nominee company. What matters is whether a relationship of trust and confidence has come into being: see paragraph 80. As I understand it, Auld L.J. was seeking to emphasise in these passages that because a fiduciary relationship does not depend on the existence of contractual relations, there may be circumstances in which a duty of that kind may arise not only between the fiduciary and the client but also between the fiduciary and a third person who is closely connected with the client."*

The significance of these observations is that they demonstrate that it is plausible for a fiduciary relationship to spring up derivatively from a contract between Party A (such as an investment manager) and Party B (the fund entity), where Party B is acting on behalf of the person or persons in making the contract, Party C (*i.e.* investors), to whom he owes a duty. Party C may be able to establish a fiduciary relationship with Party A. In effect a court may be more willing to pierce the corporate veil to get to this result than it would normally (*see JD Wetherspoon*, at paragraph 22).

59. A fiduciary duty is essentially a duty of loyalty and honesty as Mr. Bagnall suggests. The counts in the Complaints concerned with these breaches appear to my reading to incorporate facts from which allegations of a special relationship can be gleaned. It is alleged that the Plaintiffs reposed trust and confidence in the Defendants subject to these counts because of their superior position over the Plaintiffs. What is alleged is sufficient to render it arguable that the fiduciary duty owed by the Defendants to the Funds was one which was concluded for the benefit of the ultimate Fund investors.

(c) Negligence

60. Plaintiffs' allegations of omissions and failures to act on the part of Defendants are characterised as giving rise to claims both for negligence and gross negligence. In the Cayman Islands negligence denotes the breach of a duty of care. A duty of care may in certain circumstances be owed to guard against economic loss. The Bagnall Declaration and the Ritchie Declaration both argue that for a variety of reasons these claims would fail in the courts of the Cayman Islands. I disagree that it can be said at this stage that such claims would fail.

Principles of Negligence

61. Negligence can only be established if the defendant owed a duty of care to the plaintiff, which duty was broken and the breach of which has caused injury to the plaintiff which falls within the scope of the duty. The existence of a duty of care of sufficient scope is fundamental to the Counts alleging negligence. Somewhat different considerations apply in the case of misrepresentation.

62. The Ritchie Declaration, the Bagnall Declaration and the Phillips Declaration all suggest that a Court would now conclude that no duty of care was owed to the Plaintiffs by the Defendants to the Complaints. For the reasons set out below I do not consider that on no possible view of the Complaints or such facts as may be found the Plaintiffs could not succeed in establishing a duty of care sounding in damages falling within the scope of such duty.

63. A number of different terms have been used in the past in the English case law in order to describe the determinative factors in identifying a duty of care. The terminology has changed over the years from "proximity" to "assumption of responsibility" to "foreseeability of harm." In *Customs and Excise Commissioners v Barclays Bank Plc* [2007] 1 AC 181 the House of Lords considered the test for a duty of care. Two competing tests were identified: (i) "assumption of responsibility" or (ii) the three-pronged test in *Caparo v. Dickman* [1990] 2 AC 805 (*i.e.*, foreseeability, proximity and a "fair, just and reasonable test" which is discussed in the Ritchie Declaration at paragraph 14). Lord Hoffmann said these labels or slogans did not assist (see paragraph 35 and 72):

> *"The closer the facts of the case in issue to those of a case in which a duty of care has been held to exist, the readier a court will be, on the approach of Brennan J in Sutherland Sire Council v Heyman (1985) 60 ALR 1 at p48 adopted in Caparo v Dickman, to find that there has been an assumption of responsibility or that the proximity and policy conditions of the threefold test are satisfied The converse is also true."*

64. The Ritchie Declaration relies heavily on the three-pronged test derived from the decision of the House of Lords in *Caparo*. Mr Ritchie deduces from it that there must be what he calls "a special factor" or an "extra ingredient." I disagree and the more recent House of Lords case, *Barclays Bank*, demonstrates that the test is much less rigid than this. Lord Bingham rejected use of the test in *Caparo*:

> *"the threefold test itself provided no straightforward answer to "the vexed question" whether or not in a novel situation, a party owes a duty of care Fourthly, the incremental test was of little value as a test in itself, and was only helpful when used in combination with a test or principle which identified the legally significant features of a situation"*

Lord Hoffmann made a similar observation when he said:

> *"[36] It is equally true to say that a sufficient relationship will be held to exist when it is fair, just and reasonable to do so. Because the question of whether a defendant has assumed responsibility is a legal inference to be drawn from his conduct against the background of all the circumstances of the case, it is by no means a simple question of fact. Questions of fairness and policy will enter into the decision and it may be more useful to try to identify these questions than simply to bandy terms like 'assumption of responsibility' and 'fair, just and reasonable.' In Morgan Crucible Co Plc v Hill Samuel & Co Ltd [1991] Ch 295 at 303 I tried to identify some of these considerations in order to encourage the evolution of lower-level principles which could be more useful than the high abstractions commonly used in such debates"*

65. The *Barclays Bank* case shows that the assumption of responsibility may be especially useful in cases where the defendant was under a fiduciary duty to someone and has volunteered an answer to a question or tendered skilled advice or services in providing the answer or performing service when he knows (or ought to know) that somebody else, the plaintiff, will rely on what he said or the service that was rendered (*see* per Lord Mance in *Barclays Bank*). An assumption of responsibility is not based on the subjective intention of the defendant but is judged objectively (*see* Lord Bingham paragraph 6). An assumption of responsibility is a sufficient but not a necessary condition of liability, per

Lord Bingham at paragraph 4 and Lord Rodger at paragraph 52). In the absence of an assumption of responsibility there will be further inquiry. The House of Lords emphasised the need to examine the detailed circumstances of the particular case and the particular relationship of the parties in the context of their legal and factual situation as a whole (*see* Lord Bingham paragraph 8).

66 In almost all cases where there is no clearly established rule it is necessary to await the trial of proceedings to determine whether a duty of care exists. *Barclays Bank* was an exception because it proceeded on agreed facts. The undesirability of striking out a claim against professional advisers such as auditors was emphasised in numerous English cases, a notable example being the Court of Appeal decision in *Coultard v Neville Russell (a firm)* [1998] BCC 359 in which an attempt to strike out the claim was refused. Chadwick LJ said this at 369:

> *"In my view the liability of professional advisers, including auditors, for failure to provide accurate information or correct advice can, truly, be said to be in a state of transition or development. As the House of Lords has pointed out, repeatedly, this is an area in which the law is developing pragmatically and incrementally. It is pre-eminently an area in which the legal result is sensitive to the facts. I am very far from persuaded that the claim in the present case is bound to fail whatever, within the reasonable confines of the pleaded case, the facts turn out to be. That is not to be taken as an expression of view that the claim will succeed; only as an expression of my conviction that this is not one of those plain and obvious cases in which it could be right to deny the plaintiffs the opportunity to attempt to establish their claim at a trial."*

67. A Cayman Court reached much the same decision in *Re Omni Securities (No 3)* [1998] CILR 275, a case mentioned in the Ritchie Declaration at paragraph 11, which might have gone on to explain why the Chief Justice would not strike out the claim against the auditors in that case. The Chief Justice said that, at page 282, that the question whether the auditors in that case were liable would depend on the trial judge's findings of the defendant's knowledge as to the use to which the accounts were put.

Auditors

68. It is perfectly true in relation to auditors that *Caparo* held that in England a duty of care is not in general owed to shareholders who receive the annual accounts from the company

to which the audit reports are attached. It was a critical factor in *Caparo* that the audit was required for a statutory purpose. In particular Lord Oliver who delivered the main judgment said this:

> *"Thus, if and so far as the purpose for which the audit was carried out is a relevant consideration in determining the extent of any general duty in tort owed by the appellants to persons other than the company which is their immediate employer, that purpose was simply that of fulfilling the statutory requirements of the Companies Act 1985. That, in turn, raises the question - and it is one which lies at the threshold of the inquiry upon which your Lordships are invited to embark - of what is the purpose behind the legislative requirement for the carrying out of an annual audit and the circulation of the accounts. For whose protection were these provisions enacted and what object were they intended to achieve? ... I do not, for my part, discern in the legislation any departure from what appears to me to be the original, central and primary purpose of these provisions, that is to say, the informed exercise by those interested in the property of the company, whether as proprietors of shares in the company or as the holders of rights secured by a debenture trust deed, of such powers as are vested in them by virtue of their respective proprietary interests."* (630-631)

It was the fact that the denial of any duty of care for the auditors in *Caparo* was so strongly rooted on the English statutory context that caused the Chief Justice in *Omni Securities No 3* to distinguish the Cayman position. He refused to follow *Caparo* on the specific finding with regard to auditors precisely because there is no statutory audit in the Cayman Islands.

69. The fact that audit reports were required by the Articles of Association does not mean that that the auditors could not be responsible to the shareholders, as suggested by the Ritchie Declaration at paragraphs 19 to 28. Otherwise the auditors in *Omni Securities No 3*, who also prepared audit reports in accordance with the Articles of Association, would have escaped liability. They failed to have the claim dismissed. In my opinion, Mr. Ritchie's reasoning proceeds on the flawed assumption that the English statutory requirement can be equated with the voluntary requirement in Articles of Association. The audit can indeed be prepared for different or additional purposes on given facts other than those envisaged by the Articles of Association.

70. I consider there to be a material difference between the defendant auditors in these

proceedings and the auditors in *Caparo*. There was no statutory requirement. According to the Complaints the periodic audited accounts underpinned the valuations of the Funds in the Information Memoranda. This is borne out by references to valuations in the Information Memoranda along with statements that the auditors had consented to the inclusion of their name and report in the Information Memoranda. In any event I believe a Court in the Cayman Islands would wait to see what facts emerged and follow the decision in *Omni Securities No 3*.

Custodians/Administrators/Investment Managers

71. The Bagnall Declaration appears to acknowledge there is no relevant English let alone Cayman Islands case law on the duties which investment managers and other service providers might owe to the investors of a fund. The duties of the administrator are alleged to arise from their role in performing NAV calculations which were sent to investors. The custodian's duty is alleged to arise from their role in overseeing and monitoring BLMIS' custody of assets. The other Defendants are said to owe duties of care by virtue of their role in selecting and overseeing investment managers. In such a situation, which is novel from a legal point of view, the Court would as I have indicated above, wish to see all the relevant facts at trial

Misrepresentation

72. The Complaints allege that various representations were made to the Plaintiffs by the Defendants. The Defendants' experts deny the allegations on the basis that no such representations were made.

73. In determining whether a defendant owed a duty of care to a plaintiff it is important to remember that the essence of a misrepresentation involves the defendant's deliberate act in making a statement. The duty of care is therefore much more easily established by proving that the statement was made by the defendant and showing that the plaintiff was a person who was likely to rely on the statements and other facts which make it fair to impose a duty of care in the making of such statements. The duty is then to be characterized as one of taking care in the making of statements not in protecting against

some specific loss.

74. The statements attributed to each of the Defendants in the Complaint contain no suggestion that such a Defendant was not the author of those statements. I assume that the Investment Memoranda do not identify any particular person as the author of the document or of particular statements in them. It is therefore a matter of fact to identify the maker of the particular statements.

75. The Funds were the publishers and distributors of the documents containing misstatements. Directors act as agents for the company in making those statements. There is no absolute rule that the director will not be liable for statements made by him on behalf of the company of which he is director. It will of course be a question of fact whether he contributed to the process of publishing the statement. Legal responsibility is another matter. Insofar as the director has been guilty of deceit it is no defence for the director to claim that he made the representation on behalf of his principal (*see Standard Chartered Bank v Pakistan Shipping Corp* [2003] 1 AC 959). Whether an agent such as a director is liable for a negligent misrepresentation depends on whether on objective analysis of the facts the defendant agent assumed personal responsibility for the representation. This is a question of fact (*see Williams v Natural Life Health Foods* [1998] 1 WLR 830). In *Williams* the claim was dismissed because there was no objective evidence to support an assumption of responsibility.

Causation – Intervening Acts

76. I agree with the Bagnall Declaration that the law of the Cayman Islands recognizes that a duty of care is not sufficient to establish negligence. In addition it must be shown in negligence that the loss complained of is within the scope of the duty of care. I also agree that in negligence cases intervening acts of third parties may break the chain of causation. The mere fact that one owes a duty to another does not mean that that person is the insurer of all the plaintiff's loss (see *Banque Bruxelles Lambert SA v Eagle Star Insurance Ltd* [1997] AC 191.

77. That said, the scope of the duty will be looked at broadly with regard to all relevant

facts. Lord Hoffmann made it clear in *Environment Agency v. Empress Car Co. Ltd* [1999] 2 ACC 22 at 30-32 where he said:

> "*I turn next to the question of third parties and natural forces. In answering questions of causation for the purposes of holding someone responsible, both the law and common sense normally attach great significance to deliberate human acts and extraordinary natural events. A factory owner carelessly leaves a drum containing highly inflammable vapour in a place where it could easily be accidentally ignited. If a workman, thinking it is only an empty drum, throws in a cigarette butt and causes an explosion, one would have no difficulty in saying that the negligence of the owner caused the explosion. On the other hand, if the workman, knowing exactly what the drum contains, lights a match and ignites it, one would have equally little difficulty in saying that he had caused the explosion and that the carelessness of the owner had merely provided him with an occasion for what he did. One would probably say the same if the drum was struck by lightning. In both cases one would say that although the vapour-filled drum was a necessary condition for the explosion to happen, it was not caused by the owner's negligence. One might add by way of further explanation that the presence of an arsonist workman or lightning happening to strike at that time and place was a coincidence.*
>
> *On the other hand, there are cases in which the duty imposed by the rule is to take precautions to prevent loss being caused by third parties or natural events. One example has already been given, the common sense rule (not legally enforceable, but neglect of which may expose one to blame from one's wife) which requires one to remove the car radio at night. A legal example is the well known case of Stansbie v. Troman [1948] 2 K.B. 48. A decorator working alone in a house went out to buy wallpaper and left the front door unlocked. He was held liable for the loss caused by a thief who entered while he was away. For the purpose of attributing liability to the thief (e.g. in a prosecution for theft) the loss was caused by his deliberate act and no one would have said that it was caused by the door being left open. But for the purpose of attributing liability to the decorator, the loss was caused by his negligence because his duty was to take reasonable care to guard against thieves entering.*
>
> *These examples show that one cannot give a common sense answer to a question of causation for the purpose of attributing responsibility under some rule without knowing the purpose and scope of the rule. Does the rule impose a duty which requires one to guard against, or makes one responsible for, the deliberate acts of third persons? If so, it will be correct to say, when loss is caused by the act of such a third person, that it was caused by the breach of duty. In Stansbie v. Troman [1948] 2 K.B. 48, 51-52, Tucker L.J. referred to a statement of Lord Sumner in Weld-Blundell v. Stephens [1920] A.C. 956, 986, in which he had said:*
>
> > "*In general . . . even though A is in fault, he is not responsible for injury*

> *to C which B, a stranger to him, deliberately chooses to do. Though A may have given the occasion for B's mischievous activity, B then becomes a new and independent cause."*
>
> *Tucker L.J. went on to comment.*
>
> > *"I do not think that Lord Sumner would have intended that very general statement to apply to the facts of a case such as the present where, as the judge points out, the act of negligence itself consisted in the failure to take reasonable care to guard against the very thing that in fact happened."*
> >
> > *Before answering questions about causation, it is therefore first necessary to identify the scope of the relevant rule. This is not a question of common sense fact; it is a question of law. In Stansbie v. Troman the law imposed a duty which included having to take precautions against burglars. Therefore breach of that duty caused the loss of the property stolen. In the example of the vapour-filled drum, the duty does not extend to taking precautions against arsonists. In other contexts there might be such a duty (compare The Fiona [1994] 2 Lloyd's Rep. 506, 522) but the law of negligence would not impose one.*

78. It is not possible to say whether an intervening act breaks the chain of causation without resolving whether a duty of care exists. Whether a duty of care exists depends on a factual inquiry, which as I have said earlier, is not suitable for determination at the motion to dismiss stage in most cases.

VIII. Cayman Islands – Forum Considerations

79. I have been asked to make some observations about procedural considerations which might be relevant to an appraisal of the Cayman Islands as a forum. The Cayman Islands would not try a matter of this kind with a jury. Discovery would have to be sought in relation to non-party witnesses who are located overseas by means of letters of request. A letter of request is issued by the Court upon application under Grand Court Rules Order 39 Rule 1. The application is directed to a witness who would be asked to bring documents at his deposition. It has the same function as a subpoena and it is matter of discretion whether the Grand Court would grant the application to issue such a letter of request. Because it is discretionary the Grand Court might limit the scope of the discovery or evidence sought. Additionally, the class action device and the option of representing a plaintiff on a contingent basis, as those concepts are understood in the

United States, are unavailable in the Cayman Islands.

I declare under penalty of perjury under the laws of the United States and the state of New Yorkthat the foregoing is true and correct Executed this 30th day of September, 2011, In George Town, Grand Cayman, Cayman Islands

THOMAS WILLIAM GORDON LOWE QC

SIGNED BEFORE ME ON THIS
30TH DAY OF SEPTEMBER, 2011

MELANIE WHITTAKER
NOTARY PUBLIC in and for
the Cayman Islands
My Commission Expires 31st Jan 2012