
**Michaelmas Term**
[2024] UKPC 32
**Privy Council Appeal No 0045 of 2023**

# JUDGMENT

# Kuwait Ports Authority and another (Respondents) *v* Mark Eric Williams and 2 others (Appellants) (Cayman Islands)

## From the Court of Appeal of the Cayman Islands

before

**Lord Reed**
**Lord Hodge**
**Lord Hamblen**
**Lord Leggatt**
**Lady Simler**

**JUDGMENT GIVEN ON**
**28 October 2024**

**Heard on 20 June 2024**

*Appellants*
Graham Chapman KC
Andrew Pullinger
Harry Shaw
(Instructed by Campbells LLP and Sinclair Gibson LLP)

*Respondents*
David Allison KC
Dan McCourt Fritz KC
Rachael Reynolds KC
(Instructed by Ogier (Cayman) LLP and Baker & McKenzie LLP (London))

**LORD HAMBLEN:**

## Introduction

1. The Cayman Islands Exempted Limited Partnership Act (2021 Revision) (the "Act") provides for the establishment of exempted limited partnerships (an "ELP"). A limited partner in an ELP enjoys limited liability but is precluded from participating in the conduct of the business of the ELP, which is carried out exclusively by a general partner.

2. This appeal concerns the circumstances in which a limited partner can bring a derivative action on behalf of the ELP for injury or damage done to the ELP. This is governed by section 33(3) of the Act which provides that such an action may be brought if the general partner has "without cause, failed or refused to institute proceedings".

3. This is the first case in which this issue has been considered. In its decision the Court of Appeal of the Cayman Islands (Sir Richard Field, Sir Michael Birt and Sir Jack Beatson JJA) provided general guidance as to the approach to be adopted to derivative actions brought pursuant to section 33(3) of the Act and concluded that the general partner in this case did refuse or fail to institute proceedings "without cause" and that as a matter of discretion it was appropriate to allow the respondents' derivative claims to be brought. The appellants contend that the Court of Appeal was wrong so to conclude. The respondents cross-appeal is in respect of one aspect of the general guidance provided, namely at what point in time the section 33(3) test falls to be assessed.

## Factual background

4. The Port Fund LP (the "Fund") is a Cayman Islands ELP which invested in port-related assets around the world. It was established in 2007 by KGL Investment Company KSCC ("KGLI Kuwait") which acted as the Fund's sponsor and placement agent and was also one of the limited partners in the Fund. The Fund has one general partner and eleven limited partners including KGLI Kuwait and the two respondents, Kuwait Ports Authority ("KPA") and The Public Institution for Social Security ("PIFSS"). The limited partners invested a total of US$188,152,000, approximately 65% of which was invested by the respondents.

5. The general partner of the Fund is Port Link GP Ltd, a Cayman Islands exempted limited company (the "General Partner"). It was appointed as the sole general partner from 21 March 2007 onwards pursuant to identical limited partnership agreements between itself and the limited partners.

6. The first appellant ("Mr Williams") is the ultimate beneficial owner of the General Partner and has very close connections with the second appellant, Wellspring Capital Group Inc ("Wellspring"), and the third appellant, KGL Investment Company Asia ("KGLI Asia"). In summary:

(1) Mr Williams was a vice president of KGLI Kuwait from September 2007 until 2008 and its investment director from 2009 until 2011. Mr Williams was also a member of the Investment Committee of the Fund from 2009 until 2013.

(2) Mr Williams is the sole shareholder and director of Port Link Holdings USA Inc ("Port Link Holdings"), which since July 2018 has owned the entirety of the issued share capital of the General Partner.

(3) On 23 January 2020 Mr Williams was appointed as the authorised representative of the General Partner in relation to proceedings against it by KPA seeking information regarding the condition of the Fund pursuant to section 22 of the Act ("the section 22 proceedings"). The resolution conferred full authority on Mr Williams to take all necessary actions in relation to those proceedings.

(4) Mr Williams is also the chief executive, chief financial officer, president, vice president, treasurer and secretary of Wellspring. Wellspring is owned by the Mark E Williams Living Trust, the trustees of which are Mr Williams, his wife and his brother.

(5) Mr Williams has been the chief executive officer of KGLI Asia since 1 January 2012. KGLI Asia is owned by KGLI Kuwait. KGLI Asia is said by the appellants to have provided administrative support to the Fund between December 2017 and August 2020 pursuant to an administrative services agreement dated 1 December 2017. KGLI Asia has been in voluntary liquidation since 20 December 2020.

7. The respondents began raising concerns with the General Partner concerning the management of the Fund from October 2016. On 29 January 2020, KPA commenced the section 22 proceedings against the General Partner seeking disclosure of certain documents to which it claimed to be entitled.

8. Also on 29 January 2020, after Mr Williams was appointed as the authorised representative of the General Partner, certain professional directors from FFP (Directors) Ltd (the "FFP Directors") were appointed as directors of the General Partner by Abdulghfoor Alwadhi ("Mr Alwadhi") and Mr Williams. They initially acted alongside Mr Alwadhi, who was a director of the General Partner from 2010 until he

resigned on 28 March 2021. Mr Alwadhi was the sole appointed director from 24 May 2018 until 29 January 2020, which was when much of the wrongdoing alleged by the respondents took place. The FFP Directors have no connection to such wrongdoing and describe themselves as "independent directors". They remained in office until they resigned on 15 February 2023.

9. KPA's application in the section 22 proceedings was opposed by the General Partner at a time when the FFP Directors were in post, but KPA obtained an order requiring the General Partner to disclose various documents in August 2020. The General Partner sought to appeal that order but that appeal was compromised and the General Partner agreed to provide various documents to the respondents pursuant to a consent order made in November 2020.

**The proceedings**

10. On 14 October 2020, the current proceedings were commenced in the Grand Court of the Cayman Islands (the "Grand Court") by the respondents against the General Partner only.

11. On 12 February 2021, the respondents' statement of claim was amended and re-filed joining the appellants as the second to fourth defendants respectively. The respondents advance both direct and derivative claims on behalf of the Fund against Mr Williams and Wellspring, and derivative claims only against KGLI Asia. The respondents allege that the assets of the Fund, which are held on statutory trust by the General Partner, have been misappropriated as part of an unlawful means conspiracy and/or due to dishonest and/or negligent breaches of trust and fiduciary duty, in which each of the appellants have wrongfully participated, in some cases having knowingly received some or all of the proceeds.

12. So far as relevant, the claims made by the respondents may be summarised as follows (see para 152 of the Court of Appeal judgment):

> (1) The respondents allege that the General Partner has been guilty of wrongdoing which has caused the Fund loss said to be well in excess of US $100m.
>
> (2) The claims against the General Partner allege that, in breach of its fiduciary, contractual and other duties, it acted contrary to the interests of the Fund and the limited partners by making substantial payments, using the Fund's monies, that were not for the benefit of the Fund and/or the limited partners. Amongst these is the alleged sham settlement of proceedings brought against it in

the Dubai International Finance Centre Court (the "DIFCC proceedings") as a result of which US $59,990,461.30 (the "Wellspring Payment") was paid to Wellspring. It is alleged that the General Partner conspired with, amongst others, Mr Williams and Wellspring to cause loss to the Fund and/or the limited partners by unlawful means in relation to the DIFCC proceedings and the Wellspring Payment.

(3) The claims against Mr Williams are that he orchestrated the DIFCC proceedings and the Wellspring Payment and was accordingly party to the above conspiracy. It is further alleged that he dishonestly assisted in the General Partner's breach of trust/fiduciary duty, knowingly procured the General Partner to breach its contractual duties and was in breach of fiduciary duties he owed to the Fund and/or the General Partner.

(4) The claims against Wellspring are for knowing receipt of the Wellspring Payment, conspiracy in relation to the Wellspring Payment and the DIFCC Proceedings and for repayment of the Wellspring Payment.

(5) The claim against KGLI Asia is for knowing receipt in respect of a number of payments said to have been made to it in breach of trust and/or fiduciary duty by the General Partner.

13. The appellants deny the claims against them, counterclaim against the respondents, alleging that the proceedings are an abuse of process commenced for an improper collateral purpose, and crossclaim against the General Partner in respect of alleged underpayments and rights to indemnification. No application has been made to strike out the respondents' claims on their merits or for reverse summary judgment. The claims must therefore be treated as having a real prospect of success.

14. The FFP Directors stated in sworn evidence that, for the purpose of determining whether there was cause for the derivative claims to be pursued by the Fund as required by section 33(3) of the Act, they conducted an intensive, forensic investigation into the actions of the General Partner and the former management team of the Fund. The stated results of the FFP Directors' investigations are set out in various memoranda dated from 28 May 2021 and in the third affidavit of Richard Lewis (one of the FFP Directors) dated 4 June 2021. These set out that, in the General Partner's view (acting by the FFP Directors), there was currently no cause to bring the derivative claims against the General Partner or the appellants, and that even if such claims did have merit, the General Partner would need to undertake a cost/benefit analysis of whether it was in the best interests of the Fund to pursue them and, if so, whether the Fund was in a position to pursue them or could raise funding to do so.

15. On 7 June 2021, the General Partner and the appellants applied to the Grand Court to strike out the derivative claims against them, on the grounds that such claims failed to satisfy the statutory test under section 33(3) of the Act. Those applications were heard by Parker J between 13-19 October 2021. On 25 November 2021, the Grand Court handed down its judgment granting part of the General Partner's summons on discrete points that did not result in any claims against it being struck out and dismissing the appellants' application.

16. The Grand Court's order was appealed by both the General Partner and the appellants. That appeal was heard by the Court of Appeal on 25 and 26 May 2022 and its judgment was handed down on 20 January 2023. It dismissed the strike out appeal save in relation to the derivative claims made against the General Partner.

17. On or around 15 February 2023, the FFP Directors resigned as the General Partner was apparently unable to pay their professional fees. The respondents thereafter applied (i) to be joined as defendants to the appellants' crossclaim against the General Partner and (ii) for receivers to be appointed in respect of the General Partner.

18. On 2 May 2023, the General Partner was placed into voluntary liquidation by resolution of its sole shareholder, Port Link Holdings, that is ultimately beneficially owned by Mr Williams.

19. By an order dated 1 June 2023, Parker J ordered the appointment of receivers in respect of the General Partner for the express purpose of conducting all litigation on behalf of the General Partner and the Fund (the "Receivers").

20. By an order dated 2 June 2023, Parker J ordered that the respondents be joined as defendants to the appellants' crossclaim against the General Partner in the proceedings. An appeal from this order was dismissed by the Court of Appeal on 15 August 2024.

21. The joint voluntary liquidators of the General Partner applied, in accordance with their statutory obligation to do so, to convert the voluntary liquidation of the General Partner into an official liquidation. This application was dismissed by Parker J on 18 September 2023 and the Receivers were permitted to continue managing the litigation commenced by and against the General Partner and the Fund. The Receivers therefore have conduct on behalf of the General Partner and the Fund of all litigation to which the General Partner or Fund are parties (save for the respondents' derivative claims). The Receivers have decided that the General Partner is not to appeal the Court of Appeal’s decision.

**The legal framework**

*The Act*

22. Section 3 provides that the rules of equity and of common law applicable to partnerships as modified by the Partnership Act (2013 Revision) but excluding certain sections shall apply to ELPs, except where they are inconsistent with the express provisions of the Act.

23. Under section 4, ELPs are to consist of general partners and limited partners. General partners are liable for the debts and obligations of the ELP whilst limited partners generally have no such liability.

24. Section 14 provides that all contracts, letters, deeds, instruments or other documents are to be entered into by the general partner on behalf of the ELP and that the limited partners are not to take part in the conduct of the ELP's business.

25. Under section 16, any rights or property of the ELP, including choses in action, are held by the general partner upon trust as an asset of the ELP. The Act thereby creates a statutory trust.

26. Section 19 provides that the general partner is to act at all times in good faith. Subject to any express provisions to the contrary in the partnership agreement, the general partner is to act in the interests of the ELP and limited partners owe no fiduciary duties to the ELP or the other limited partners.

27. Proceedings involving an ELP are governed by section 33 which provides:

> "(1) Subject to subsection (3), legal proceedings by or against an exempted limited partnership may be instituted by or against any one or more of the general partners only, and a limited partner shall not be a party to or named in the proceedings.
>
> (2) If the court considers it just and equitable any person or a general partner shall have the right to join in or otherwise institute proceedings against any one or more of the limited partners who may be liable under section 20(1) or to enforce

> the return of the contribution, if any, required by section 34(1).
>
> (3) A limited partner may bring an action on behalf of an exempted limited partnership if any one or more of the general partners with authority to do so have, without cause, failed or refused to institute proceedings.
>
> (4) If any action taken pursuant to subsection (3) is successful, in whole or in part, as a result of a judgment, compromise or settlement of any action, the court may award any limited partner bringing any action reasonable expenses, including attorney's fees, from any recovery in any action or from an exempted limited partnership."

*Relevant case law*

28. Although there is no prior case law concerning section 33 of the Act, the Court of Appeal recognised that some assistance may be derived from common law and equitable principles developed in relation to the bringing of derivative claims in the context of trusts and limited partnerships, particularly given the statutory trust imposed by section 16 of the Act (paras 101 and 140(ix)).

29. The relevant principles in relation to trusts are summarised in *Lewin on Trusts (20th Edition)* at paras 47-006 and 47-008:

> "47-006. However, as an alternative to proceedings brought in the name of trustees, a beneficiary may, sometimes, bring an action in his name on behalf of the trust against a third party. The fact that the action is brought in the name of a beneficiary rather than the name of the trustees does not alter its character. The action is a derivative action in which the beneficiary stands in the place of the trustees and sues in right of the trust, and does not enforce duties owed to him rather than to the trustees; a beneficiary can be in no better position than trustees carrying out their duties in a proper manner…
>
> 47-008. A beneficiary can bring a derivative action only in special circumstances, for example circumstances which tend to disable the trustees from suing (as where their acts and conduct with reference to the trust fund are impeached), or

> circumstances rendering it difficult or inconvenient for the trustees to sue, as where there is a conflict between their interest and duty. Special circumstances are not confined to circumstances of these kinds. The guiding principle is that there must be exceptional circumstances, which embrace a failure, excusable or inexcusable, by the trustees in the performance of a duty to the beneficiaries to protect the trust estate, or to protect the interest of the beneficiaries in the trust estate. The special circumstances relied on must have something to do with the willingness or ability of the trustee or alleged trustees to bring the action."

30. The fact that the special circumstances must have "something to do with the willingness or ability of the trustee or alleged trustees to bring the action" provides a clear link to the focus in section 33(3) on the justification for the failure or refusal of the general partner to institute proceedings.

31. Recent leading cases on the requirement for special circumstances include *Hayim v Citibank NA* [1987] AC 730 and *Roberts v Gill & Co* [2010] UKSC 22; [2011] 1 AC 240. In the latter case Lord Collins of Mapesbury provided the following summary of the law at para 46:

> "The cases go back to the 18th century, and many of them were reviewed in *Hayim v Citibank NA* [1987] AC 730. The special circumstances which were identified in the earliest authorities as justifying a beneficiary's action were fraud on the part of the trustee, or collusion between the trustee and the third party, or the insolvency of the trustee, but it has always been clear that these are merely examples of special circumstances, and that the underlying question is whether the circumstances are sufficiently special to make it just for the beneficiary to have the remedy…."

Lord Walker of Gestingthorpe (at para 110) stated that "what has to be special about the circumstances – is that the derivative action is needed to avoid injustice…."

32. The determination of whether there are circumstances which are special therefore involves a consideration of what the interests of justice require – see *In re Field, decd* [1971] 1 WLR 555 at 561 per Goff J, cited with approval by Lord Collins in *Roberts v Gill* at 258D-F: see also *Nurcombe v Nurcombe* [1985] 1 WLR 370 at 378D-H per Browne-Wilkinson LJ.

33. In *Certain Limited Partners in Henderson PFI Secondary Fund II LLP (a firm) v Henderson PFI Secondary Fund II LP (a firm)* [2012] EWHC 3259 (Comm); [2013] QB 934 ("Henderson") Cooke J held that that the special circumstances test also applied to the bringing of a derivative claim by a limited partner on behalf of an English limited partnership. As with an ELP, a limited partnership established under the Limited Partnerships Act 1907 is not a separate legal entity and limited partners have no role in the management of the partnership business, which is exclusively carried out by the general partner. There is, however, no provision equivalent to section 33 of the Act.

34. The Board agrees with the Court of Appeal that the special circumstances test and case law are relevant to the interpretation and application of section 33. If there are special circumstances which mean that a derivative action is needed to avoid injustice then the failure or refusal of the general partner to institute proceedings may well be without cause. Conversely, if there are no such circumstances then the failure or refusal to do so may well be justifiable and therefore with cause.

35. Graham Chapman KC for the appellants submitted that the case law relating to the bringing of derivative claims on behalf of a company is also of assistance and in particular the fraud on the minority exception to the rule in *Foss v Harbottle* (1843) 2 Hare 461, 67 ER 189 that the proper plaintiff for a wrong done to a company is the company itself. There are, however, a number of important distinctions between ELPs and companies which mean that little assistance can be derived from such case law. In particular:

(1) An ELP has no separate legal personality.

(2) A company's articles of association constitute a contract between the company and its members, but no contractual relationship exists between an ELP and its constituent partners. The rights and obligations of the partners in an ELP are governed by a contract between the partners and a statutory trust.

(3) The directors of a company owe fiduciary duties to the company alone and not to the company's shareholders, whilst the general partner of an ELP owes fiduciary duties to all the ELP's limited partners.

(4) The directors of a company are treated as trustees in respect of the company's assets which are under their control, holding them for the company rather than for its shareholders. In contrast, the general partner of an ELP holds the ELP's assets on trust for all the limited partners.

(5) When a wrong is done to a company, it is the company, not its shareholders, that suffers loss. When a wrong is done to an ELP, its constituent partners suffer loss directly: the ELP itself does not suffer any loss that is separate or distinct from the partners' loss.

(6) A majority of shareholders in a company generally have a range of rights and powers, including the power to remove or replace directors and to pass a special resolution requiring a company to bring legal proceedings. A majority of limited partners in an ELP do not have an equivalent power; faced with a general partner who refuses to bring proceedings on behalf of an ELP without cause, their only recourse is to bring a derivative claim.

(7) The fraud on the minority exception concerns control over the bringing of proceedings by the majority shareholders. No such issue arises as between limited partners. As this case illustrates, the majority of limited partners may be seeking to bring the derivative claim.

**The Court of Appeal judgment**

36. At para 140 of its judgment the Court of Appeal gave general guidance in respect of derivative proceedings under section 33(3) of the Act. This guidance will be considered further below, but it includes the following summary of the nature of the court's task in deciding whether the requirements of section 33(3) have been complied with:

> "(viii) The essential task for the court at such a hearing is to determine whether the limited partner has brought himself within the terms of section 33(3), namely that the general partner has failed or refused to bring the relevant proceedings without cause.
>
> (ix) In determining this issue, the court is likely to be assisted by consideration of whether special circumstances (as developed in cases concerning trusts, limited partnerships and other entities) exist, but the court's task remains one of applying the statutory test set out in section 33(3).
>
> (x) Whilst reference to a 'good arguable case' may be a helpful indicator of the level of comfort which the court should have when deciding whether the requirements of section 33(3) are met, the court's task is essentially an

> evaluative one having regard to the facts as they appear to the court at that stage of the proceedings from the material before the court and the need to avoid injustice balanced with the need to respect the fact that a derivative action is an exception to the general principle in the [Act] that management (including decisions as to litigation) of an ELP is for the general partner, not the limited partners. … the court should consider, inter alia, the strength of the evidence that the general partner has failed or refused to institute proceedings without cause, the strength of the underlying claim which is sought to be brought and the likelihood and nature of any injustice if the derivative claim is not permitted.
>
> (xi) The court should reach its decision as to standing by reference to the facts as they appear at the date of the hearing of the strike out or preliminary issue.
>
> (xii) Even where the requirements of section 33(3) are met, the court has a discretion as to whether to permit a derivative claim to continue. One of the factors which is likely to be relevant in exercising that discretion is whether the plaintiff has an alternative remedy."

37. In relation to the interpretation of section 33(3), the Court of Appeal held that the expression "without cause" must carry the implication of "good" cause**,** noting that the legislature cannot have intended that a decision for any cause, no matter how inhibited or conflicted the decision maker might be, would be sufficient to prevent the bringing of a derivative action under section 33(3) (para 95). The Court of Appeal further held that the relevant inhibition or conflict of interest is that of the general partner itself, as opposed to that of its directors from time to time (para 168).

38. On the facts, the Court of Appeal held that the section 33(3) test was satisfied as the General Partner was under a relevant inhibition when it determined (acting by the FFP Directors) that there was cause not to bring the derivative claims against the appellants. The Court of Appeal observed that, on the respondents' case, the General Partner was deeply involved in the alleged wrongdoing, as was Mr Williams, and that the General Partner had to decide whether to institute proceedings against the appellants, in circumstances where (para 158):

> (1) The essential wrongdoing giving rise to the claims against the appellants was that of the General Partner itself in making various payments and where the

General Partner was part of the unlawful means conspiracy to injure the Fund involving Mr Williams and Wellspring.

(2) The contemplated proceedings would have to be brought against Mr Williams, the ultimate beneficial owner of the General Partner and against two companies with which he is deeply and closely involved, namely Wellspring and KGLI Asia.

(3) The General Partner would also have to consider whether (as general partner) it should sue itself (in its own right) as a co-conspirator in the alleged unlawful means conspiracy.

39. The Court of Appeal found (para 159) that this amounted to an "obvious and serious conflict of interest" by reason of which the General Partner was under an inhibition which would amount to special circumstances in the context of a trust or limited partnership and which also meant that the failure by the General Partner to bring proceedings was without cause. In so finding the Court of Appeal was upholding the Grand Court's conclusion to the same effect.

40. As to discretion, it was submitted that because the respondents have direct claims against the first and second appellants they have an alternative remedy against them and so there is no need to bring a derivative claim. The Court of Appeal concluded, however, that it was appropriate to allow the claim to continue in circumstances where there was uncertainty around whether the respondents had direct claims against the first and second appellants and whether the court could order restoration of the trust fund on the success of such direct claims in the absence of a derivative claim on behalf of the Fund (para 170). Both the direct and derivative claims against the first and second appellants were therefore permitted to continue.

**The appeal**

41. The appellants contend that the Court of Appeal erred in the interpretation of section 33(3) and/or the exercise of its discretion by:

(1) Finding that the General Partner was subject to a relevant inhibition precluding it from making a valid determination as to whether to bring the derivative claims.

(2) Failing to give due regard to the commercial judgment of the General Partner (acting by the FFP Directors) that the derivative claims should not be pursued.

(3) Allowing the respondents to continue the derivative claims in circumstances where the General Partner had validly determined with "cause" that the derivative claims should not be pursued.

(4) Establishing a test which allows a limited partner to bring or continue a derivative claim simply by impugning the conduct of the general partner so as to give rise (on the basis of the Court of Appeal's findings) to a perceived potential conflict of interest that inevitably renders any decision not to bring such claims as one "without cause".

*(1) Did the Court of Appeal err in finding that the General Partner was subject to a relevant inhibition precluding it from making a valid determination as to whether to bring the derivative claims?*

42. The appellants accept that a failure to bring proceedings may be without cause where the decision making is subject to a relevant inhibition.

43. The appellants also accept that an actual conflict of interest would be a relevant inhibition (see para 90 of their written case).

44. A conflict of interest is a clear example of special circumstances justifying the bringing of a derivative claim. This is one of the examples given in *Lewin* at para 47-008. It was also the basis upon which Cooke J held that special circumstances existed in *Henderson.* In that case a derivative claim was allowed to be brought by the limited partners for alleged wrongdoing by the management company appointed by the general partner, which was a sister company of the general partner. Cooke J held that this sister company relationship gave rise to an "irreconcilable conflict of interest" and that the partnership's prospects of obtaining redress against the management company were "virtually eliminated" (para 57).

45. Mr Chapman submitted that there was no relevant conflict of interest in this case as the Court of Appeal had merely held that there was a potential conflict of interest rather than an actual conflict of interest and there was no finding, as in *Henderson,* as to the impact of that conflict on the prospects of obtaining redress.

46. In the Board's view, it is clear that the Court of Appeal correctly held that there was an actual conflict of interest and indeed an equivalent conflict of interest to that found to be established in *Henderson.* As the Court of Appeal stated (emphasis added):

> "158. We respectfully agree with the decision of Cooke J in *Henderson*. In our judgment there *is* a similar conflict of interest in the present case. On the plaintiffs' case, D1 as the general partner was deeply involved in all the alleged wrongdoing as was Mr Williams. …
>
> 159. On the face of it, *by reason of the obvious and serious conflict of interest*, D1 *is* under an inhibition which would amount to special circumstances in the context of a trust or limited partnership and this inhibition also means that the failure by D1 to bring proceedings against D2 – D4 is without cause for the purposes of section 33(3).
>
> …
>
> 163. … [the General Partner] *is* subject to the conflicts of interest we have summarised above…
>
> …
>
> 167. … There is no doubt in our view that [the General Partner] *was and is* suffering from an inhibition … ."

47. It is correct that the Court of Appeal refers (at para 163) to the fact that the General Partner "cannot be seen to be in a position to take a fair and independent decision about the potential litigation", but that (and other like comments) is a description of the consequence of the conflict of interest rather than of its nature.

48. If the General Partner's decision whether or not to institute proceedings is subject to the conflict of interest which the Court of Appeal identified then the decision is inhibited thereby – it is not necessary or appropriate to go on to consider how it in fact affected the decision.

49. Further, in concluding that there was an actual conflict of interest the Court of Appeal was upholding the like finding made by the Grand Court:

> "104. The [General Partner] is a defendant to litigation where it is accused of serious wrongdoing: wilful default, liability under the Fraudulent Dispositions Act, and conspiracy with the other defendants are alleged.
>
> 105. A large number of the claims against [the appellants] are premised on a breach of duty by the [General Partner]. For example the allegation of knowing receipt is based upon a breach of duty by the [General Partner]. In the circumstances the [General Partner] cannot be expected to be the arbiter of whether to bring a claim against another defendant that is premised on its own breach of duty. It is in my view incapable of exercising an impartial decision-making function."

50. The Board agrees with the reasoning and conclusion of the Court of Appeal and the Grand Court.

*(2) Did the Court of Appeal err in failing to give due regard to the commercial judgment of the General Partner (acting by the FFP Directors) that the derivative claims should not be pursued?*

51. The appellants contend that the General Partner's decision not to bring the claims which are now brought derivatively was the product of a careful and thorough investigation and, ultimately, the considered exercise of commercial judgment by the General Partner acting by its independent FFP Directors. They reasonably concluded that the claims were not of sufficient merit to justify the bringing of proceedings. They appropriately also took into account how such claims might be funded and that the bringing of such proceedings might give rise to claims against the Fund, as it has done. This commercial decision is one with which the court should not interfere.

52. For a number of reasons, the fact that a commercial decision was taken by the FFP Directors does not avoid the conflict of interest which the Court of Appeal found there to be or the resulting inhibition on decision making.

53. First, as both the Grand Court and the Court of Appeal held, it is the position of the General Partner, not its directors, which must be considered. This is made clear by section 33 in general, which focuses on the "general partner", and by section 33(3) in particular, which refers to the "general partner" having failed or refused to bring proceedings without cause.

54. If, as the Court of Appeal held, the General Partner was subject to a disqualifying conflict of interest in making the decision whether or not to bring proceedings then that is not affected by the identity or independence of its directors. The conflict and the inhibition remain regardless of the identity of the directors from time to time.

55. Nor is this conclusion affected by the possibility adverted to by the Court of Appeal (at para 163) that different considerations might arise if liquidators were appointed by the court. It is not necessary to decide whether or not this is correct but, as the Court of Appeal observed, liquidators are not in the same position as directors as they are subject to the supervision of the court.

56. Secondly, even if it is appropriate to have regard to the position of the FFP Directors, they too were subject to a disqualifying conflict of interest and, moreover, one which they seemingly did not recognise. That conflict arises because the FFP Directors owed a duty to act in the best interests of the General Partner. Where there is a conflict between the interests of the General Partner and the Fund then that duty puts the FFP Directors in a conflicted position. The fact that the General Partner has a duty to act in the best interests of the Fund does not avoid that conflict; indeed, it highlights it.

57. As the Grand Court held, the FFP Directors were "seriously inhibited from making impartial decisions" regarding the bringing of proceedings because "they owe their duties primarily to the [General Partner] and it is obviously not in the [General Partner's] interests to be sued" (para 110). The Court of Appeal similarly recognised the conflict "between acting in the best interests of [the Fund] (which might include taking action against [the General Partner] as a co-conspirator) and acting in the best interests of [the General Partner] (which might be said to include the avoidance of being sued)" (para 163).

58. Thirdly, in any event the Grand Court further found that there was a "prima facie case that [the FFP Directors] are unable to assess the claims properly in an independent and objective way, notwithstanding Mr Lewis' extensive evidence" (para 110) and a "prima facie case that [the FFP Directors] have been guided (until recently) in their investigations by information provided by those who were under investigation themselves, and by their legal advisers, who were also conflicted" (para 111). This led the Grand Court to reach the following conclusion on the evidence:

> "121. Based on the available evidence, I have formed the view that there is a relevant inhibition which prevents the FFP Directors' decision making process being fair, because the decisions not to pursue the claims are insufficiently distinct from the wrongdoing upon which the claims are founded. …"

59. Mr Chapman submitted that this conclusion was undermined by the fact that the Grand Court had wrongly evaluated the evidence on the basis that it was only necessary to show a "prima facie" case. However, notwithstanding the different approach which the Court of Appeal held to be appropriate, it endorsed the Grand Court's conclusion, stating as follows:

> "168. Given our decision to uphold the judge's conclusion that it is the position of [the first defendant] as the general partner which must be considered in relation to any inhibition rather than the position of the directors from time to time, it is not necessary for us to address his finding about the position of the FFP Directors. Suffice it to say that, if we had found it necessary to do so, we would have considered that the judge was entitled to reach the conclusions which he did in this respect."

60. That endorsement of the Grand Court's conclusion necessarily includes the findings upon which that conclusion was based, as summarised above. Those findings are not open to challenge on this appeal.

*(3) Did the Court of Appeal err in allowing the respondents to continue the derivative claims in circumstances where the General Partner had validly determined with "cause" that the derivative claims should not be pursued?*

61. The basis upon which the appellants contend that the Court of Appeal so erred is that the FFP Directors had determined that the claims should not be pursued. All the reasons set out above as to why that decision was and remained conflicted and so was not made with "cause" equally apply to the exercise of any discretion to allow a derivative claim. This issue does, however, raise the question of whether there is such a discretion and, if so, its juridical basis. This question was raised by the Board at the hearing and, since the parties had not come to court prepared to deal with the issue, they were invited to address it by making written submissions.

62. Having had the benefit of those submissions, the Board concludes that there is no proper basis for the two stage approach adopted by the Court of Appeal whereby the court considers first if the section 33(3) test of whether there has been a refusal or failure to institute proceedings without cause is satisfied, and secondly whether as a matter of discretion the derivative claim should be permitted. Given that this two stage approach was common ground before the Court of Appeal, its appropriateness was not an issue which it addressed.

63. Section 33 does not refer to the court having any discretion, nor does it lay down any requirement for the court to grant permission or leave for the derivative proceedings to be brought. The sole statutory criterion is whether the requirements of section 33(3) are met. Although the subsection states that the limited partner "may" bring derivative proceedings where the test is satisfied, this relates to what the limited partner may do, not what the court may allow the limited partner to do. It is inconsistent with that statutory scheme to import a separate requirement that the bringing of derivative proceedings is additionally subject to the exercise of the court's discretion.

64. As explained above, however, the special circumstances test is relevant to the interpretation and application of section 33(3) and that involves a consideration of what the interests of justice require. This allows the court to take into account factors which might otherwise be regarded as relevant to the exercise of a discretion ("discretionary considerations") as part of its evaluative determination of whether the requirements of section 33(3) are met. This would include, for example, whether there is an alternative remedy available, or whether the derivative claim is being brought for an ulterior motive, or views expressed by other limited partners.

65. Indeed, this is implicitly recognised in the Court of Appeal's description of how the court should approach the determination of whether the requirements of section 33(3) are met in para 140(x) of its judgment. It there refers to the court's task being an "evaluative one" which involves balancing "the need to avoid injustice" with "the need to respect the fact that a derivative action is an exception to the general principle" that decisions as to litigation are for the general partner. It also refers to the need to consider "the likelihood and nature of any injustice if the derivative claim is not permitted". Such an approach allows the court to have regard to discretionary considerations.

66. The Court of Appeal was therefore correct to have regard to discretionary considerations in reaching its conclusion, albeit that this should have been as part of its determination that the requirements of section 33(3) were met rather than as a separate step in a two stage approach. For the reasons stated in para 61 above, there was no error in its treatment of such factors.

*(4) Did the Court of Appeal err by establishing a test which allows a limited partner to bring or continue a derivative claim simply by impugning the conduct of the general partner so as to give rise (on the basis of the Court of Appeal's findings) to a perceived potential conflict of interest that inevitably renders any decision not to bring such claims as one "without cause"?*

67. As already stated, the Court of Appeal did not hold that there was "a perceived potential conflict of interest" but rather an actual conflict of interest and one which was, moreover, "obvious and serious".

68. Mr Chapman nevertheless submitted that the Court of Appeal's interpretation of section 33(3) set the bar too low and would be likely to lead to an undesirable proliferation of derivative claims in relation to ELPs.

69. As the Court of Appeal observed (para 173), such arguments do not bear on the proper interpretation of section 33(3) and are more matters for the legislature.

70. In any event, the Board would not accept that the bar has been set low. The Court of Appeal's decision is only likely to apply to a conflict of interest on the part of the general partner in the case of a claim against persons closely associated with the general partner, or a claim in which the general partner is implicated, and which is seriously arguable.

71. Mr Chapman further submitted that the effect of the Court of Appeal's decision is that once a general partner is conflicted it is always likely to be conflicted and that the only way to avoid such a conflict is going to be the replacement of the general partner. Further, in the present case, due to the terms of the partnership agreement, that would lead to dissolution of the ELP.

72. Conflicts of interest may, however, take many different forms and be of varying levels of seriousness. In many cases, it may be possible to remove and resolve the conflict without there being any need to replace the general partner. This case may be different because of the "obvious and serious" nature of the conflict of interest, if there is substance in the allegations in the respondents' claims. As to the potential difficulties arising from the terms of the partnership agreement, this is not inherent in the operation of the Act; it is the consequence of the partnership terms agreed.

**The cross-appeal**

73. The respondents' position is that the Court of Appeal was correct as to the meaning, effect and application of section 33(3), save that, by their cross-appeal, the respondents submit that the Court of Appeal erred when it held that the point at which the section 33(3) test is to be assessed is the date of the strike out hearing, rather than, as the Judge held, at the time the derivative claim was commenced (the "Timing Issue").

74. On the Timing Issue the Court of Appeal held that the Judge's approach would require the court to ignore anything that had happened between the institution of proceedings and the hearing, which could lead to highly unsatisfactory results. It gave the example of the appointment of a new general partner which removed any question of inhibition or conflict of interest. It concluded that "the legislature cannot have intended that the court should allow a derivative claim to proceed in circumstances

where, as at the date of the hearing of the strike out or preliminary issue, the requirements of section 33(3) are not met …" (para 125).

75. The respondents criticise that decision and rely in particular on the fact that the words "failed or refused" in section 33(3) are in the past tense, which suggests that the relevant failure or refusal must have taken place before the date of institution of the derivative claim.

76. In the Board's view the Court of Appeal reached the correct conclusion for a number of reasons.

77. First, although section 33(3) uses the past tense when it refers to whether the general partners "have, without cause, failed or refused to institute proceedings", that can refer to a failure or refusal to do so which began before the derivative action was commenced and continues up until the time of the court's determination. Similarly, although section 33(3) states that a limited partner may "bring" an action, which would most obviously refer to the commencement of the action, it can also refer to commencing and maintaining an action.

78. Secondly, this interpretation of section 33(3) is supported by pragmatic considerations and the fact that the nature of the evaluative decision which the court is called upon to make under section 33(3) is one which requires regard to be had to all relevant circumstances at the time of the decision. In particular, any consideration of what the interests of justice require can only properly be made on the basis of what justice currently requires, as opposed to what it may in the past have required.

79. As the Court of Appeal held, it would be highly unsatisfactory if the court could not have regard to how circumstances may have changed since the initiation of the proceedings, including, for example, the removal of the inhibition or conflict that was the basis for contending that the refusal or failure to institute proceedings was without cause.

80. Other examples given by the appellants of potentially important developments post-dating the initiation of proceedings include: (i) the insolvency of the derivative defendants; (ii) the defendants being denied insurance coverage for the claimed loss; (iii) determinative documents arising on discovery; (iv) adverse interlocutory findings during the course of proceedings; and (v) the costs of proceedings exceeding the value of the claim.

81. The respondents recognised the force of this point and acknowledged that it should be possible for the court to take into account later developments. They

contended that the court could do so in the exercise of its discretion. On their approach there are two stages. The first stage is whether the requirements of section 33(3) are met, which is to be determined on the basis of the facts as at the time of the initiation of the proceedings. The second stage is the exercise of the court's discretion to allow the proceedings to be brought, which is to be determined on the basis of all facts as known at the time of the hearing before the court. However, for the reasons set out above, there is no two stage process; there is a single evaluative decision to be made which will include consideration of discretionary considerations. Unless that decision is made on the basis of the facts as they appear to the court at the hearing, it will not be possible to take into account changing circumstances, notwithstanding the respondents' acknowledgment of the need to do so.

82. Thirdly, the authorities on special circumstances show that that is an issue which goes to the cause of action being asserted and is required to be pleaded and proved. So, for example, in *Roberts v Gill* Lord Walker stated that "special circumstances are part of his cause of action" which must be pleaded (para 103, p 272F) and that special circumstances are one of the "building blocks" and "essential facts … which must be pleaded and proved (if not admitted) in order to establish the cause of action" (para 108, p 274B-C).

83. This is borne out by the majority decision in *Roberts v Gill* that the amendment to add a derivative claim involved a new cause of action being brought after the expiry of the relevant limitation period. In that case the claimant commenced proceedings against two firms of solicitors who had advised the former personal representatives of his grandmother's estate. This claim was brought in his personal capacity as a beneficiary of the estate. After the limitation period had expired, he applied to amend to bring a derivative claim on behalf of the estate. The application was dismissed by the deputy judge on the grounds that no special circumstances existed. Although the Court of Appeal held that special circumstances did exist, it dismissed the appeal on the grounds that the amendment required the addition of a new party, the administrator of the estate, and that this was not permissible under CPR r 19.5(3)(b) (now CPR r 19.6(3)(b)) as such addition was not necessary in order to pursue the personal claim originally made. The House of Lords allowed the appeal against the Court of Appeal's decision as to the existence of special circumstances, but the majority (Lord Rodger of Earlsferry, Lord Walker and Lord Collins) also held that the Court of Appeal was correct to hold that the application did not meet the requirements of rule 19.5. Integral to that decision was their conclusion that the bringing of a derivative claim involved a new cause of action, as the capacity in which the party is suing is part of the cause of action. As Lord Collins stated at para 41:

> "The [derivative] claim is a claim involving a new cause of action since the capacity in which [the claimant] makes the claim is an essential part of the claim".

84. This decision implies that, at common law, the special circumstances justifying a derivative claim must, if disputed, be proved in order for the claim to succeed. If that is so, then it follows that, at common law, the special circumstances must continue to exist at the date of determination. Reading "bring" as meaning "commence and maintain" therefore has the consequence that the statutory regime is similar in this respect to the common law relating to derivative claims. That this is likely to have been intended is supported by the general preservation of common law rules except where inconsistent with express provisions (section 3 of the Act), and the link between the special circumstance mentioned in section 33(3) and the common law, to which attention has already been drawn (see paras 30−34 above).

**The guidance**

85. As referred to above, in its judgment the Court of Appeal gave general guidance as to how applications under section 33 should be approached and determined. The parties did not take issue with this guidance, save in relation to the Timing Issue. For the reasons explained above, the Board considers that the Court of Appeal erred in stating that the court has a discretion as to whether to permit a derivative action to continue even where the requirements of section 33(3) are met. There is a single evaluative decision to be made as to whether the statutory requirements are met, but that decision allows for account to be taken of discretionary considerations. For the same reason, it is not strictly correct to refer to the court permitting or allowing derivative proceedings to be brought. There is no permission or leave requirement. Subject to those clarifications, the Board endorses the guidance given by the Court of Appeal, in the amended form set out below:

> (1) There is no requirement for leave to bring derivative proceedings under section 33(3). A limited partner may simply institute such proceedings.
>
> (2) A limited partner must however plead the facts and matters relied upon as showing that it can bring itself within the requirements of the subsection.
>
> (3) If a defendant wishes to raise an issue as to whether the requirements of the subsection are met, it should do so by means of a strike out application or seek the trial of a preliminary issue.
>
> (4) Whichever of these routes is chosen does not affect the test which has to be applied in deciding whether section 33(3) is complied with.
>
> (5) The decision of the court on such an application or preliminary issue is determinative (subject to appeal). If the court holds that the derivative claim may

be continued, the limited partner may pursue the claim. It is not an issue which is deferred until or revisited at trial (save possibly in the context of costs at the end of the trial).

(6) The court should not conduct a mini trial as to whether the requirements of section 33(3) are satisfied. The court has to reach its decision on the basis of the material before it, which will be more limited than it will be following discovery and trial.

(7) At the hearing, the onus is on the limited partner to satisfy the court that the requirements of section 33(3) are met. Reference to 'onus' is not to be mistaken as a reference to a 'burden' in the sense of having to show something on the balance of probabilities.

(8) The essential task for the court at such a hearing is to determine whether the limited partner has brought itself within the terms of section 33(3), namely that the general partner has failed or refused to bring the relevant proceedings without cause.

(9) In determining this issue, the court is likely to be assisted by consideration of whether special circumstances (as developed in cases concerning trusts, limited partnerships and other entities) exist, but the court's task remains one of applying the statutory test set out in section 33(3).

(10) Whilst reference to a good arguable case may be a helpful indicator of the level of comfort which the court should have when deciding whether the requirements of section 33(3) are met, the court's task is essentially an evaluative one having regard to the facts as they appear to the court at that stage of the proceedings from the material before the court. Regard should be had to the need to avoid injustice balanced with the need to respect the fact that a derivative action is an exception to the general principle in the Act that management (including decisions as to litigation) of an ELP is for the general partner, not the limited partners. The court should consider, inter alia, the strength of the evidence that the general partner has failed or refused to institute proceedings without cause, the strength of the underlying claim which is sought to be brought and the likelihood and nature of any injustice if the derivative claim does not proceed. This will allow for account to be taken of discretionary considerations, such as whether the plaintiff has an alternative remedy.

(11) The court should reach its decision by reference to the facts as they appear at the date of the hearing of the strike out or preliminary issue.

## Conclusion

86. For the reasons set out above the Board will humbly advise His Majesty that the appeal and the cross-appeal should be dismissed.