IN THE GRAND COURT OF THE CAYMAN ISLANDS
FINANCIAL SERVICES DIVISION

CAUSE NO: FSD 29 OF 2011 (AJJ)

THE HON MR JUSTICE ANDREW J. JONES QC
IN CHAMBERS, 23RD NOVEMBER 2011

IN THE MATTER OF THE COMPANIES LAW (2010 REVISION)

AND IN THE MATTER OF EMERGENT CAPITAL LIMITED (IN LIQUIDATON)

Appearances:

Mr. Jason Wood of Appleby for KTC and Kazal Brothers Pty Ltd ("Kazal Ltd")

Mr. Michael Robertrs instructed by Timothy Haynes of Walkers for RAAL Limited ("RAAL")

Mr. Jayson Wood of Appleby for Australian World Trading Pty Ltd, AWT LLC, Mr. Andrew Kelly, Mr. James Frawley and Mr. Ashley Palm ("the Claimants")

Mr. Nigel Meeson QC of Conyers Dill & Pearman for the Joint Official Liquidators of Emergent Capital Limited (In Liquidation) ("the Liquidators" and "ECL")

PRELIMINARY RULING

1. There were two applications before the Court made pursuant to CWR Order 16, rr.20 and 21, namely (1) a Summons dated 9th September 2011 by which KTC seeks an order that RAAL's admitted proof of debt be partially expunged and (2) a Summons dated 12th September 2011 by which RAAL seeks an order that Kazal Ltd's admitted proof of debt be totally expunged. This summons has now been withdrawn. I was also due to hear summonses issued by the Claimants pursuant to CWR Order 16, rr.17-19 by which they appealed against the rejection of their respective proofs. Theses summonses have also been withdrawn, but I anticipate that, at least to some extent, these claims may be re-formulated and submitted by KTC. In order to adjudicate

upon these various applications and assist the Liquidators with the adjudication of any new proofs of debt, it is necessary for me to make a preliminary ruling upon the terms of the underlying joint venture agreement between KTC and RAAL. This agreement governs the basis upon which KTC and RAAL are entitled to have expenditure incurred by them credited to their respective shareholder loan accounts with ECL. Although Kazal Ltd, AWT and Davids Group were not themselves parties to the joint venture agreement, its terms indirectly affected their contractual relationships.

2. The relevant factual background is set out in my judgment delivered earlier today, following a five day trial, in which I determined an issue relating to the validity of a debt/equity transaction made pursuant to a decision of ECL's board of directors on 28th January 2010. It is not necessary that I repeat any of this background although some of my findings are relevant to the issues which I have to decide on the Summons. I shall use in this Ruling the same definitions and abbreviations as are used in my Judgment.

3. I find that an oral joint venture agreement was concluded between Mr. Charif Kazal ("Charif Kazal") and Mr. Roderick David ("Mr. David") at two meetings which took place in Sydney on 22nd February and 3rd March 2008. It was agreed, as a fundamental term of the joint venture agreement, that there would be "equal funding, equal representation and equal equity". It was also agreed that the joint venture would be implemented and carried on through an investment holding company and a series of subsidiaries. ECL was incorporated as the investment holding company. Although the oral joint venture agreement was concluded between Charif Kazal and Mr. David, it was always intended that their interests in the joint venture would be held through special purpose vehicles which would be incorporated at the same time as the holding company. These are KTC and RAAL. It was originally anticipated, at least by Charif Kazal and Mr. David, that the three Kazal brothers would participate as shareholders of KTC, but in the event only Tony and Charif Kazal did so. RAAL is wholly owned by Mr. David.

4. The terms of the joint venture agreement, as it related to the funding of the businesses, is central to the determination of the Summonses before the Court. Although not directly relevant to the determination of the validity of the debt/equity transaction, this subject was in fact

addressed at length in the written and oral evidence put before the Court and I was persuaded to make findings about what was agreed between Charif Kazal and Mr. David which are now relevant to the issues arising on the Summonses. It is perhaps not surprising that the details of the procedure to be adopted in respect of funding the business was left unsaid at the original meetings. In these circumstances the proper approach for the Court towards ascertaining the intention of the parties is that described by the Privy Council in *Attorney-General of Belize –v-Belize Telecom Ltd* [2009] 2 All E.R. 1127, per Lord Hoffman at paragraphs 16-21. In that case the Privy Council was concerned with the construction of a written contract, but the same principles apply to the construction of an oral agreement. I have no power to improve upon the oral joint venture agreement. I cannot introduce terms to make it fairer or more reasonable. I am concerned only to discover what the parties intended their agreement to mean. To the extent that terms are not expressed, the parties will be taken to have agreed that which is necessary to give business efficacy to their joint venture agreement. This question is answered objectively. I must ask myself what a reasonable person, having all the background knowledge available to Mr. David and the Kazal brothers, would have intended to happen in the context of financing businesses to be carried on in Abu Dhabi and elsewhere through a special purpose holding company which would not, initially at least, have any bank account or accounting records of its own.

5. Having identified the applicable legal principles, I must now identify the evidence upon which I am relying. First, I take account of the evidence put before the Court in the recent trial comprising thirteen witness statements made by eight witnesses, all of whom were cross-examined over a period of five days. In addition, I rely upon the documentary evidence upon which the witnesses were cross-examined. I also make the observation that I allowed counsel a good deal of latitude in the scope of their cross examination. At times, I felt that it was addressed, not towards the issues actually before the Court, but towards issues which they knew would come before the Court on the Summonses then waiting in the wings. Second, I have affidavits sworn specifically for the purposes of the Summonses, to which are exhibited a large volume of documentation, some of which I have already examined for the purposes of the trial and some of which comprises accounting records now produced in support or opposition to the proofs of debt. Third, I will rely upon the evidence contained in the reports produced by Ernst &

Young, both in their capacity as independent experts who conducted a forensic accounting exercise pursuant to directions which I made in FSD Cause No.139 of 2010 and in their capacity as official liquidators. For the purposes of adjudicating the proofs of debt, the Liquidators have of course relied upon their own work product and conclusions reached in their previous capacity as independent expert witnesses. I will rely upon this evidence in connection with the merits of the Summons but it is not relevant to the preliminary issue addressed in this Ruling.

6. The joint venture businesses owned through ECL were financed exclusively by loans and advances made by or on behalf of the joint venture partners. I am not concerned with what might or should have occurred if ECL had been capitalized by issuing shares or borrowing money from a bank. This did not happen. As I have already said, the companies were not incorporated until 4th September 2008 but the joint venture business had commenced several months earlier and it was a term of the joint venture agreement that pre-corporation assets and liabilities would be assumed by the companies on incorporation. The actual business of the joint venture in Abu Dhabi commenced on or about 10th July 2008 when Davids Group entered into a memorandum of understanding with 4N. The benefit of this contract was assigned (or is treated for accounting purposes as having been assigned) to IPS Cayman when it was incorporated on 4th September as a wholly owned subsidiary of ECL. Conversely, the pre-incorporation expenses incurred in negotiating that contract were also assumed by ECL. I have not yet been addressed and have made no finding about the precise date upon which the joint venture business commenced, but it cannot have been earlier than 3rd March 2008. It follows that expenditure incurred prior to this date cannot be credited to KTC/RAAL's shareholder loan accounts or otherwise admitted to proof in ECL's liquidation.

7. The evidence establishes that it was a term of the joint venture agreement that all capital contributions made by the joint venture partners would be accounted for through the shareholder loan accounts established on the books of ECL. I use the expression "the books of ECL" in a notional sense. It never had any bank account or accounting records of its own, nor did KTC and RAAL. Therefore, sums posted to the shareholder loan accounts as payables due from ECL to KTC or RAAL, as the case may be, were extracted from the accounting records of the related party by whom or through whom the money was advanced or expenditure incurred. Sums

credited to RAAL's shareholder loan account were or should be extracted from Davids Group's accounting records or Mr. David's own personal financial records. Similarly, sums which were or should now be posted to KTC's shareholder loan account were or should be extracted from the accounting records of the entities in question, principally AWT and Kazal Ltd. This was the agreed arrangement. Plainly, this arrangement did not meet minimally acceptable business standards or comply with the basic requirements of Section 59 of the Companies Law, but it is what the parties agreed and it is the basis upon which I have to approach the issues raised on the Summonses.

8. The crucial question is to identify the express and/or implied terms of the joint venture agreement governing the circumstances in which it agreed that sums advanced or expenditure incurred by or on behalf of KTC and RAAL to or for the benefit of ECL and/or its subsidiaries should be treated as having been credited to their respective shareholder loan accounts, thus becoming a liability owing by ECL for which they are entitled to prove as creditors in its liquidation. The evidence leads to the conclusion that I must answer this question in the following way.

(1) First, any sum paid to or any expense incurred or accrued on behalf of ECL or a subsidiary, with the express agreement of Charif Kazal and Mr. David, should be treated as having been credited to the shareholder loan account of KTC or RAAL as the case may be. Clearly, the parties' express agreement might be reached prospectively or retrospectively.

(2) Second, sums advanced or expenses incurred without the express agreement of Charif Kazal and Mr. David should be treated as having been credited to the shareholder loan account of KTC or RAAL , as the case may be, if, and only if, the following criteria are met –

(a) any cash advance must have been paid to one or other of the subsidiaries; and

(b) any expense incurred must be for the benefit of ECL and/or its subsidiaries and it must be an expense which was reasonably and properly incurred in the ordinary course of the business in question.

9. Whether or not an expense has been reasonably and properly incurred in the ordinary course of business imports both subjective and an objective tests. The person incurring the expense must have done so *bona fide* in the belief that it was in the business interests of the subsidiary in question. An expense cannot be said to have been properly incurred unless the person who incurred it believed, and had reasonable grounds for believing, that there was a reasonable prospect that the subsidiary in question would be able to repay it. It must also be shown that it was objectively reasonable to incur the expense in question. There must be a proper business purpose for the expense and its amount must be reasonable and proportionate having regard to the financial condition of the business. It follows that expenses incurred by Mr. David without the express agreement of Charif Kazal will not normally be credited to RAAL's shareholder loan account unless it can be demonstrated that the expense was incurred pursuant to a cogent business plan which had been disclosed to the joint venture parties.

10. As regards the accrual of fees and service charges allegedly payable to related parties, such as Mr. David, Charif Kazal, Davids Group of AWT, it must be demonstrated that it was expressly agreed between Charif Kazak and Mr. David that the party providing the service would be entitled to make a charge and that the charge would be credited to the shareholder loan account of KTC or RAAL as the case may be. If the related party's right to charge for a service has been agreed in principle, the service provided and the amount charged for it must have been reasonably and properly done/charged in the ordinary course of business, in accordance with the criteria set out above. It follows that expenses cannot be accrued retrospectively.

11. It must be a term of the joint venture agreement that self serving written agreements, such as loan agreements and consultancy services agreements, cannot be relied upon in support of the contention that an expense or charge should be credited to a shareholder loan account and treated as a liability of ECL, unless the agreement has been executed by or with the express agreement of both joint venture parties. Any other construction would be contrary to the fundamental terms of the contract. The Court cannot imply terms inconsistent with the express terms. The concept of "equal funding and equal representation" prevents the Court from implying a term into the contract which would permit either party, acting unilaterally, to impose liabilities upon ECL which must then be shared.

12. Kazal Ltd has withdrawn its proof of debt, notwithstanding that the Liquidators admitted it in full. Consequently, RAAL's summons to expunge the admitted claim has necessarily been withdrawn. However, this cannot be the end of the matter and I have no doubt that KTC will submit a proof of debt for the same amount based upon the same facts and so it will be appropriate for me to direct the Liquidators how to deal with the matter. At the request of Mr. Singh, it was agreed between Charif Kazal and Mr. David that AUD$600,000 would be advanced to GRA principally for the purpose of meeting expenses of the litigation against the Corporation. The money was advanced in installments by Kazal Ltd, but I find as a fact that it was done on behalf of KTC pursuant to the joint venture agreement, which called for "equal funding" through ECL.[1] It follows that the principal amount of AUD$600,000 should be treated as having been credited to KTC's loan account and is now repayable by ECL. I shall direct the Liquidators to admit KTC to proof for this amount plus interest at the agreed rate of 12% per annum compounded quarterly. Whatever funding arrangements were made between KTC and Kazal Ltd is of no concern to ECL and its Liquidators.

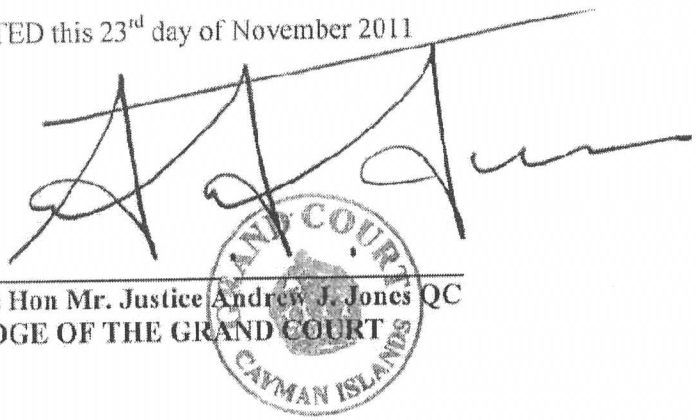
13. Having made this preliminary ruling, I proceeded to hear Mr Wood's opening submissions on the merits of the Summons but it became apparent that he needed more time in which to formulate his case in a clear and concise way in the light of my Ruling. Having regard to the fact that the Liquidators have not yet adjudicated the whole of RAAL's proof and that Mr Wood intends to reformulate the claims previously made by the Claimants as a claim by KTC, I came to the conclusion, on case management grounds, that I ought to adjourn the Summons and give directions designed to ensure that *all* the contested issues relating to creditor claims are dealt with at a single hearing to take place before the end of the year.

14. I direct the Liquidators to adjudicate the outstanding proofs of debt in accordance with the directions and guidance contained in this Ruling. Mr Meeson pointed out that the terms of reference given to Ernst & Young for the purposes of the forensic accounting exercise provided

[1] On the "books" of ECL, this transaction resulted in a liability/payable due to KTC and a corresponding asset/receivable due from GRA. This receivable must have been taken into account and eliminated under the terms of the purchase and sale agreement whereby GRL (the parent company of GRA) was sold to an independent third party for AUD$25 million.

that they should only examine individual transactions, amounts or ledger entries in excess of AUD$10,000. RAAL's admitted proof of debt includes approximately AUD$500,000 representing the total of numerous small items falling below this threshold. In response to the Liquidators' enquiry, I directed that they should not do any further investigatory work in this regard.

DATED this 23rd day of November 2011



The Hon Mr. Justice Andrew J. Jones QC
JUDGE OF THE GRAND COURT