# In The Supreme Court of Bermuda

**CIVIL JURISDICTION**

**2019: No. 50**

**BETWEEN:**

**PANACORP CASA DE VALORES S.A.** **Plaintiff**

**-and-**

**CASTLE HARBOUR SECURITIES LIMITED** **Defendant**

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**Before:** **Hon. Chief Justice Hargun**

**Appearances:** **Mr. Kevin Taylor and Mr. Benjamin McCosker of Walkers (Bermuda) Limited for the Plaintiff**

**Mr. Simon Davenport QC and Mr. Richard Horseman of Wakefield Quin Limited for the Defendant**

**Date of Hearing:** **12 &13 October 2020 and 15 & 16 March 2021**

**Date of Judgment:** **20 May 2021**

## JUDGMENT

*breach of a corporate custodian agreement; whether sale of securities justified on account of AML concerns; recovery of damages in contract in a rising market; application of the principle*

*of transferred loss; construction of exemption clauses; whether actions of the custodian constituted gross negligence and/or willful default*

**HARGUN CJ**

## A. Introduction

1. In this action Panacorp Casa de Valores, S.A. ("**Panacorp**"), a corporation established and existing under the laws of the Republic of Panama, seeks damages from Castle Harbour Securities Limited ("**CHS**"), an exempt company incorporated in Bermuda pursuant to the Companies Act 1981, for breach of the Corporate Custodian Agreement dated 15 January 2018, between Panacorp and CHS (the "**CCA**").

2. Panacorp is engaged in the business of providing brokerage and stock and exchange services in local and international markets, as well as capital market services and transactions. CHS carries on business as a provider of brokerage and administrative financial services. It is an entity regulated by the Bermuda Monetary Authority (the "**BMA**") and its Investment Business Licence permits CHS to deal in investments, arrange deals in investments, manage investments and give or offer investment advice and hold client assets and safeguard and administer investments.

3. During the term of the CCA, CHS held as custodian for Panacorp pursuant to the terms of the CCA 100 million bonds issued by Petróleos de Venezuela, S.A. with ISIN code XS1126891685 and maturity date of 28 October 2022 (the "**PDVSA Bonds**"). The PDVSA Bonds had a nominal value of US $100 million.

4. On 27 December 2018, CHS sold Panacorp's PDVSA Bonds in an over-the-counter, off-exchange transaction. The sale price of the PDVSA Bonds was US $0.10132, yielding total sale proceeds of US $10,132,000 (the "**Disposal Proceeds**").

5. Panacorp contends that the sale by CCH of the PDVSA Bonds was unauthorised and in breach of section 3 of the CCA which provides that CCH is only authorised to transfer any

investment held in custody upon receipt of "*Proper Instructions*" received from Panacorp. Panacorp contends that not only did it not provide any Proper Instructions for the sale of the PDVSA Bonds, but it expressly instructed CHL not to sell the PDVSA Bonds and after the PDVSA Bonds had been sold instructed CHS to remedy the unauthorised sale by going into the market and purchasing replacement PDVSA Bonds.

6. Panacorp contends that the unauthorised disposal of the PDVSA Bonds deprived Panacorp of the opportunity to sell the Bonds at the time and price of its choosing. On 23 January 2019, there were 12 separate trades of PDVSA Bonds, which occurred at prices between US $0.1850 and US $0.21850. Panacorp contends that but for the CHS's unauthorised disposal of Panacorp's PDVSA Bonds, Panacorp would have sold the PDVSA Bonds on 23 January 2019, yielding total disposal proceeds of between US $18,500,000 and US $21,850,000. In the circumstances Panacorp seeks from CHS damages in the sum of US $11,718,012.38.

## B. Background

7. CHS is licensed under the Investment Business Act 2003 and as such is permitted to engage in investment activity as defined by section 3 and the First Schedule to the Act. CHS has an office in Bermuda with two permanent and two transient executive staff. Mr. Omar Ulrich is the Chief Executive Officer ('**CEO**"). The remaining members of the staff sit between premises in London, and travel intermittently, to Bermuda for meetings. The trading and back office activity is carried out by a small number of staff. Mr. Benjamin Chekroun is the Chief Operating Officer and is based in London. Mr. Chekroun works with several external consultants who seek out and introduce clients to CHS. Mrs. Faye Fouladi is the President and beneficial owner of CHS.

8. Panacorp is a recognised broker-dealer in the Latin American securities market. Panacorp acts as a broker (or agent) when it executes orders on behalf of its clients, and acts as a dealer (or principal) when it trades on its own account. According to Javiela Matilde Cedeño ("**Ms. Cedeño**"), an Executive Principal of Panacorp, on 25 September 2017, she

received an unsolicited email from Eric Barbosa of CHS stating that CHS could assist Panacorp in managing its investments in not only "*traditional asset classes (i.e. equity/fixed income/commodity/Forex) but also in non-traditional assets with the more complex instruments whenever the need arises*." Ms. Cedeño agreed to a meeting in Panama City which was attended by Mr. Barbosa and his colleague Mr. Chekroun. At that meeting, Ms. Cedeño explained to Mr. Barbosa the nature of Panacorp's business and its relationship with both its clients and other broker-dealers with whom Panacorp does business. Mr. Barbosa said that CHS could provide custodial services for the securities that Panacorp held both on its own behalf and on behalf of its clients. According to Ms. Cedeño, Mr. Barbosa confirmed that in terms of brokerage services, CHS could transact securities on both delivery versus payment ("**DVP**") and delivery free of payment ("**DFP**") bases. In a DVP settlement, the transfer of the securities and associated payment occur simultaneously, whereas in a DFP settlement, the transfer of the securities occurs free of payment.

9. These discussions resulted in the parties entering into the CCA dated 15 January 2018. The material terms of the CCA, for the purposes of these proceedings, are set out in the table below:

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| *"Proper Instructions" means, written, cabled, telefaxed or telexed instructions, or those instructions submitted electronically via the Custodian's electronic custody system, in respect of any of the matters referred to in this Agreement… In instances indicated in advance by the Company…and agreed by the Custodian… Instructions given by designated persons…"* **(Clause 1.1)** | It is not in dispute that no Proper Instructions were given by Panacorp to sell the PDVSA 2022 Bonds and in fact, a clear instruction was given not to sell the bonds. |
| *"… the Custodian shall on receipt of Proper Instructions from the Company transfer and/or make delivery of investments which have been sold"* **(Clause 3.1.4)** | Panacorp contends that CHS needed to be in receipt of a Proper Instruction before proceeding with the sale of the Bonds. |
| *"… the Custodian shall keep or cause to be kept at its premises in Bermuda such books, records and statements as may be necessary to give a complete record of the Investments held and transactions carried out by it hereunder or otherwise on behalf of the Company and shall permit the Company or its professional advisors to inspect such books, records, documents of title and* | CHS has asserted that it sold the Bonds to Castle Harbour Securities LLP, its affiliate under common control, but says it has no records of the trade, and no records or knowledge of what that related entity did with them or how much it |

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| *statements of all reasonable times and on reasonable notice"* **(Clause 3.1.6)** | sold them for. Panacorp contends that this proposition, is not in conformance with its stated obligations under the CCA. |
| *"…the Custodian may (but shall not be obliged to) decline to accept the deposit or transfer of any Investments with or to the Custodian, if the Custodian considers that the acquisition, deposit or transfer of such Investments would or could in its opinion infringe any applicable law, the constitution of the Company or its published investment policy or any directions of the Board or would or could involve the Custodian assuming a liability."* **(Clause 3.1.11)** | Panacorp contends that CHS was entitled to decline the deposit of the PDVSA 2022 Bonds but did not do so. It was only 9 months later, after it had sold the Bonds to its affiliate under common control, that it suggested that holding the Bonds contravened its policies. CHS contends that it can rely upon this provision even after it has initially accepted the investment. |
| *"…the Custodian's duties to the Company in respect of the Investments will be that of a bailee and the Custodian shall have no further trustee or fiduciary obligations to the Company or investors in the Company."* **(Clause 8.1)** | CHS contends that its liability under the CCA is that of a bailee |
| *"The Custodian shall not be responsible or liable for or in respect of any error of judgment or any liability, loss, damage, expense or failure to make a profit incurred or suffered by the Company or any other person as a result of any action or omission undertaken by the Custodian in the performance, save in the case of gross negligence, wilful default or fraud of the Custodian hereunder*." **(Clause 8.2)** | CHS contends that it can only be made liable if it can be shown that its actions were grossly negligent or in wilful default or fraudulent. Panacorp contends that CHS was indeed grossly negligent and in wilful default. |
| *"The Custodian's responsibility and duty of care in the performance of its duties hereunder shall be owed only to the Company and the Custodian shall not be liable in any circumstances for any liability, loss, damage expenses of failure to make a profit incurred or suffered by the Manager, Investment Adviser, or any investor, potential investor or ex-investor in the Company or any other person."* **(Clause 8.4)** | CHS contends that it has no liability under the CCA because the loss lies with the beneficial owners of the PDVSA 2022 Bonds and CHS is expressly exempt from that loss. |
| *"The Custodian shall not be liable in any circumstances for any indirect or consequential loss or damage, or any failure to make a profit, or any lost opportunity suffered or incurred by the Company or any other person."* **(Clause 8.5)** | CHS contends that Panacorp's or Third parties' loss in relation to consequential loss and "failure to make a profit" is expressly excluded under the CCA |
| *"The Company hereby undertakes to hold harmless and indemnify the Custodian against all actions, proceedings, claims, costs, demands and expenses which may be brought against or suffered or incurred by the Custodian by reason of any action or obligation of the Custodian undertaken in the performance or non-performance of any of its powers hereunder, or otherwise, except such* | Panacorp contends that CHS' conduct amounts to gross negligence and or wilful default of the CCA, thereby disentitling it on this indemnification provision in order to seek to avoid liability |

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| *actions or omissions as constitute gross negligence or willful default on the part of the Custodian,"* **(Clause 8.6)** | |
| *"The Custodian shall be entitled to resign its appointment hereunder…by giving not less than three months' notice"* **(Clause 11.1)**<br>*"As soon as is reasonably practicable after termination hereof…the Custodian shall deliver or cause or procure to be transferred and/or delivered to or to the order of any succeeding Custodian or…to the order of the Company its Investments…"* **(Clause 11.5.1.1)** | Panacorp disputes CHS' assertion that it had no choice but to sell the Bonds. Panacorp contends that the CCA set out this mechanism by which the Bonds could simply be delivered to an alternative custodian. |

10. According to the evidence of Ms. Cedeño, which the Court accepts, the PDVSA Bonds were held by Panacorp on behalf of its clients Commonwealth Bank Ltd ("**Commonwealth Bank**") and Phoenix World Trade Inc. ("**Phoenix**"). Commonwealth Bank is a private bank incorporated in the Commonwealth of Dominica. Phoenix is a Venezuelan fashion and lifestyle retail company operating in Latin America and incorporated in Panama. Mohamed Ibrahim ("**Mr. Ibrahim**"), a 31% shareholder of Panacorp, is the President of the Board of Directors of Phoenix and owns 33% of the shares of Phoenix. Phoenix is a private company owned and controlled by the Ibrahim family.

11. The PDVSA Bonds were delivered to CHS free of payment in three separate tranches:

    (a) on 30 March 2018, 40 million of the PDVSA Bonds were received by CHS;

    (b) on 16 May 2018, 10 million of the PDVSA Bonds were received by CHS; and

    (c) on one June 2018, 50 million of the PDVSA Bonds were received by CHS.

12. It is the evidence of Ms. Cedeño that the Venezuelan Government appointed Dinosaur Merchant Bank Limited ("**Dinosaur**") to act as broker on its behalf in relation to the issuance of the PDVSA Bonds. On 18 May 2017, Commonwealth Bank, purchased 40 million of the PDVSA Bonds from Dinosaur. On 8 March 2019, two instructions were issued in connection with Commonwealth Bank's acquisition of the Bonds: (i) Commonwealth Bank instructed Dinosaur to deliver the Bonds free of payment to CHS;

and (ii) Panacorp instructed CHS to receive the Bonds in its account 60093226, being the client sub-account.

13. On 5 July 2018, Phoenix (on the instructions of Mr. Ibrahim) instructed Panacorp to arrange for the transfer of 35 million of the PDVSA Bonds from CHS to Banque Audi (Suisse) S.A., a Lebanon-based bank and financial services company and the largest bank in Lebanon ("**Bank Audi**").

14. In accordance with Phoenix's instructions, on 6 July 2018 Panacorp issued a Proper Instruction to CHS, authorising CHS to deliver to Bank Audi free of payment 35 million of the PDVSA Bonds. The trade date prescribed by the Proper Instruction was 9 July 2018. The Bonds were to be held by Bank Audi as custodian for the beneficial owner, Mr. Ibrahim (as the shareholder and director of Phoenix).

15. On 10 July 2018, representatives of the Bank Audi wrote to Panacorp indicating that the trade had not completed. Panacorp contacted CHS to ascertain the reason why the trade had not completed and it was explained by Mr. Chekroun of CHS that the its Compliance Department had issues with the trade given that the Bonds were being transferred to a different beneficial owner (from Phoenix to Mr. Ibrahim) without the payment of any monies.

16. Under questioning by Mr. Horseman for CHS, Ms. Cedeño stated that had CHS requested any further information or due diligence on Mr. Ibrahim, as the transferee, she would have provided that information. However, it appears that CHS in fact did not request any further due diligence on Mr. Ibrahim or any other entity.[1] This trade in the end did not proceed and was in fact cancelled. However, this incident led to a meeting of between the representatives of CHS and Panacorp in Panama.

[1] At the hearing Ms. Cedeño also explained that apparently only 35% of the 100 million PDVSA Bonds were beneficially owned by Phoenix and the remaining 65% were beneficially owned by Commonwealth. The 5 million of the first 40 million Bonds transferred to CHS belonged to Commonwealth. She was clear in her evidence that the entire 100 million Bonds belonged in their entirety to Phoenix and Commonwealth.

17. According to the evidence of Ms. Cedeño, which I accept, on 17 August 2018, Mr. Chekroun and Mr. Ullrich of CHS, attended Panacorp's offices for a meeting in relation to the PDVSA Bonds. Ms. Cedeño, Ms. Patricia Tejera and Mr. Erwin Thomas, Vice President and General Counsel, attended on behalf of Panacorp. At that meeting Mr. Ulrich stated that CHS had concerns about Panacorp's pattern of trading activity and did not understand why Panacorp would wish to hold Venezuelan debt. Ms. Cedeño explained to Mr. Ulrich that the two clients on whose behalf Panacorp held PDVSA Bonds saw value in the bonds and wished to continue to invest in Venezuela.

18. At the meeting, Mr. Ulrich stated that CHS did not understand Panacorp's business or how it made its money. The reason for Mr. Ulrich's question became clear later in the meeting, when he explained to Panacorp's representatives that Panacorp, as a client, was "*not profitable*" for CHS due to the way in which Panacorp used CHS' services for delivery free of payment settlements.

19. At lunch, following the meeting, Mr. Chekroun stated that CHS was willing to support Panacorp in selling the PDVSA Bonds. Ms. Cedeño advised that she would need to contact Panacorp's clients, as it was not a decision that Panacorp could make on their behalf, but that she would speak with the ultimate clients and, if instructions were received, will work together with CHS to sell the Bonds.

20. On 15 August 20 18, Ms. Cedeño sent an email to Mr. Chekroun to inquire as to what price might be able to be achieved for the PDVSA Bonds, in the event that Phoenix and/or Commonwealth Bank instructed Panacorp to sell the bonds. Mr. Chekroun replied on 17 August 2018 advising that given the issuance of the Bonds was not approved by the National Assembly most investors were not interested in purchasing the Bonds. Mr. Chekroun continued: "*Nevertheless, we have found one potential buyer who would be ready to buy the whole position at 15%. It seems to be a good opportunity knowing the very small universe of potential buyers in the current situation, and the trend of the price for the security*."

21. By the end of August, Ms. Cedeño had received confirmation from Commonwealth and Phoenix that they were not open to selling PDVSA Bonds at the price of $0.15 as proposed by CHS, because it was their expectation that the Bonds would trade up to a price of at least $0.20. Ms. Cedeño had received instructions that the client would reconsider a sale once the price reached $0.20. Accordingly, Ms. Cedeño advised Mr. Chekroun in an email sent on the 31 August 2018 that "*…the client is close to selling at the price given. Let's wait and see if the position goes high and I can receive an order to sell 20 million of it and so on*."

22. It is the evidence of Ms. Cedeño, which I accept, that by the end of August 2018, CHS was threatening to close Panacorp's accounts if it did not agree to sell the PDVSA Bonds. Ms. Cedeño was being told by Mr. Chekroun that CHS did not want to hold Venezuelan debt because of the risk involved in doing so. Mr. Chekroun also suggested that CHS would unilaterally liquidate the position if Panacorp did not agree to sell. In a WhatsApp message Mr. Chekroun stated:

> "*Hi Javiela, the liquidation is the classic procedure when there is suspicious movements like for your account."*

23. Ms. Cedeño states that this made no sense at all to her. Panacorp's holding of PDVSA Bonds was not *"suspicious*" and its transacting in the bonds did not offend any law, sanction or other regulation that she or her advisers were aware of. Accordingly, she questioned Mr. Chekroun:

> "*Now I will like to check in the contract where it says that you can sell my position if you close my account.*
>
> *Would it be in the custodian agreement?*
>
> *Or in the terms of business?"*

24. Mr. Chekroun replied:

> *"I would need to check, but this is very specific situation.*
>
> *We will only get the feedback on Monday but am afraid the decision has been taken to close this account because of very high risk it incurs."*

25. Later the same day, Ms. Cedeño confirmed with Mr. Chekroun the instructions she had received from the beneficial owners of the PDVSA Bonds:

> *"But the client said he would be monitoring the price if it goes up to see if he sell 20 million…he is waiting to see if it goes to 20."*

26. Ms. Cedeño also confirmed to Mr. Chekroun that if CHS was considering terminating Panacorp's accounts, that Panacorp would likely move the PDVSA Bonds to Dinosaur. In a WhatsApp message sent on 5 September 2018 Ms. Cedeño advised Mr. Chekroun that:

> "*So we are talking to Dino saying the transaction needs to be taken back.*
>
> *We have being asked by Dino for 24 hours to give us hopefully positive answer, it is being elevated."*

27. In response to the suggestion by Ms. Cedeño that a solution to CHS' concerns was that Dinosaur would simply take back the Bonds, Mr. Chekroun raised the issue whether that would be acceptable to the Compliance Department of CHS. In a WhatsApp message on 1 October2018 he advised that unfortunately he had not heard anything yet from Compliance. Following that message Ms. Cedeño inquired from Mr. Chekroun: "*Should I send you the instructions to move it back*" to which Mr. Chekroun responded; "*I think its better to wait a little until we get a feedback on the situation*", referring back to potential compliance issues raised earlier by him.

28. On 30 October 2018, Ms. Cedeño advised Mr. Chekroun that she was in a position to order the transfer of the PDSVA Bonds back to Dinosaur. Mr. Chekroun advised Ms. Cedeño in strong terms that this was inadvisable as reflected in the following WhatsApp messages on that date:

> *"Ms. Cedeño: I can order the transfer back to the original custodian.*
>
> *Mr. Chekroun: not at the moment*
>
> *Ms. Cedeño: What would attach [sic] me not to? Or why? If it is a client order*
>
> *Mr. Chekroun: if you need this situation and have proper explanation we can organise a meeting with our Compliance Officer, they will come to Panama with the head of our regulator, and we will do the meeting at the SMV, is it ok for you?*

*In this meeting they will explain clearly the situation. Let me know what date is ok for you and we will organise the meeting.*

*Ms. Cedeño: This is not the idea. We have been waiting. We have been patient. You suggested taking back we talked to the custodian they say ok."*

29. The reference by Mr. Chekroun in the WhatsApp messages to the *"head of our regulator"* is a reference to the Chief Executive Officer of the Bermuda Monetary Authority and the reference to SMV is a reference to the Panamanian equivalent.

30. It is clear to me from the WhatsApp messages that Ms. Cedeño is offering to arrange the transfer of the PDVSA Bonds back to Dinosaur, the previous custodian. It is also clear to me that Mr. Chekroun is threatening Ms. Cedeño that if she pursued this course Mr. Chekroun will ensure the regulatory authorities of both Bermuda and Panama become involved in relation to this transaction.

31. There appears to be no rational basis upon which Mr. Chekroun could make a statement that CHS "*can organize a meeting… with the head of our regulator, and… do the meeting at SMV*." Leaving aside the issue that the BMA has no jurisdiction over Panamanian financial institutions, it is fanciful to suggest that the Chief Executive of the BMA would take a flight to Panama City, at the request of CHS, to deal with the apparent issues relating to this transaction.

32. The evidence examined so far shows that the main person dealing with this transaction on behalf of CHS is Mr. Chekroun. He also attended a meeting with Mr. Ulrich, the CEO of CHS, in Panama City in August 2018. In preparation for this trial CHS understandably filed affidavits/witness statements of Mr. Chekroun and Mr. Ulrich and it was expected that they would be available for cross-examination by counsel for Panacorp. In the event, CHS elected not to tender Mr. Chekroun and Mr. Ulrich as witnesses and their affidavits/witness statements were withdrawn. It is regrettable that the Court did not have the benefit of evidence from Mr. Chekroun, who is clearly the prime actor on behalf of

CHS in this transaction. In the circumstances, the Court has no hesitation in accepting the evidence of Ms. Cedeño in relation to her dealings with Mr. Chekroun.[2]

33. Having regard to the evidence of Ms. Cedeño and the WhatsApp messages, I find as facts that (i) Panacorp, through Ms. Cedeño, offered to CHS that the custody of PDVSA Bonds would be transferred back to Dinosaur, the previous custodian; (ii) Dinosaur was willing to take back the custody of the of the PDVSA Bonds; (iii) during the period 1 October to 30 October 2018, Ms. Cedeño, on behalf of Panacorp, was prepared to provide Proper Instructions to CHS to transfer the PDVSA Bonds to Dinosaur; (iv) the reason why such Proper Instructions were not given by the Panacorp was because Mr. Chekroun dissuaded Ms. Cedeño from doing so; (v) on 30 October 2018, Mr. Chekroun threatened Ms. Cedeño that if she was to provide such Proper Instructions he would take steps to involve the regulatory authorities of Bermuda (BMA) and of Panama (SMV); and (vi) Mr. Chekroun must have realised that his threat to involve the Chief Executive of the BMA in this matter was completely baseless and fanciful.

34. I accept the evidence of Ms. Cedeño that at the beginning of December 2018, Panacorp's treasury department was instructed by the owners of the PDVSA Bonds to find out what price might be able to be achieved for the sale of 20 million of the Bonds. Phoenix and Commonwealth Bank wished to see at what price the market might absorb the Bonds so that they could decide whether it might be an opportune time to sell some, or all, of their positions in the PDVSA Bonds. I accept her evidence that CHS was instructed at the start of December 2018 to go out to the market on a speculative basis to see what price might be able to be achieved. I also accept her evidence that Phoenix and Commonwealth were, in principle, open to selling the Bonds at the right price and that they had been made aware of CHS's complaints in relation to the holding the Bonds, and were prepared to instruct

[2] During cross-examination of Ms. Cedeño, on one occasion Mr. Thomas, General Counsel of Panacorp, was heard to answer one of the questions posed by Mr. Horseman. CHS accused Mr. Thomas of coaching Ms. Cedeño. Panacorp in response said this was merely a case of Mr. Thomas commenting to himself without ensuring that his microphone had been turned off. CHS invites the Court to sanction Panacorp by discounting the evidence of Ms. Cedeño. I consider that such an outcome would be wholly disproportionate. In this regard I note that Mr. Thomas made no further comments after the Court asked him to remain silent. Further, in relation to the substantive points in issue, I found Ms. Cedeño to be entirely credible.

CHS to deliver the Bonds to an alternative custodian in the event that a sufficient sale price could not be achieved.

35. On 17 December 2018, Ms. Cedeño advised Mr. Chekroun in a WhatsApp message that "*The client had finally decided to sell the bonds a part of it*" and confirmed that the clients had agreed to sell 20 million of the Bonds.

36. It is the evidence of Ms. Cedeño that what should have happened at this time was that Mr. Chekroun would continue to seek out a buyer for 20 million of the Bonds, work out the best price that could be achieved for the sale and then present the price to her so that she would in turn ask her clients whether they wished to proceed. If she was given approval to proceed, she would then issue Proper Instructions to CHS to sell the Bonds. Then, and only then, contends Ms. Cedeño, would CHS have been permitted to sell the Bonds.

37. What in fact happened is that at 4.28 on 20 December 2018, Ms. Cedeño had a telephone conversation with Mr. Chekroun during which he informed that CHS's compliance team had decided to sell the PDVSA Bonds. Ms. Cedeño advised Mr. Chekroun that Panacorp did not agree to the sale and CHS was not entitled to dispose of the securities unilaterally in the absence of a Proper Instruction.

38. On 27 December 2018 CHS sent a letter "*for the amiable attention of*" Panacorp, signed by Mr. Ulrich, as the CEO of CHS, and Mrs. Fouladi, as the Chairman of the Board of Directors of CHS, advising that:

> *"With regards to:*
>
> *-The nature of the various operations processed concerning the account held by Panacorp Casa de Valores, S.A. pre Castle Harbour Securities Ltd including but not limited to: Free of Payment Receive, Free of Payment Delivery, Cash Payment Wire In, Wire Out Cash Payment, Transaction Buy, Transaction Sell;*
>
> *-the security with description PETROLES DE VENEZUELA S.A. with theoretical maturity date 28 October 2022 and theoretical coupon 6%,*

*currently in payment default (failure to pay), with ISIN CODE: XS1126891685, with CUSIP: JV9618804, with SEDOL: BZ12TZ7;*

*-The nature of the various operations of the said security including but limited to: Free of Payment Receive, attempt of Free of Payment Delivery;*

*-The qualified very high level of risk linked to the above-mentioned operations; and the nature of the security itself linked to the unprecedented ongoing and unspeakable dramatic economic and political situation and the very high level of risk associated;*

*Holding of such security no longer meet standards requirements;*

*Therefore disposal of same holding processed;*

*Resulting of cash proceeds of USD 10,131,987.62 including of all applicable settlement charges.*

*Panacorp Casa de Valores S.A. is hereby requested to provide USD banking instructions so the same cash amount can be wired at any point of time*."

39. In response Panacorp advised CHS that; "*Panacorp thereby rejects and denies such transaction since Castle Harbour was not duly authorized directly or indirectly by Panacorp, according to the Custodial Agreement. In conclusion, you are not authorized to settle DVP transaction on the settlement date, December 31/12/2018*."

40. By letter dated 10 January 2019 from Walkers (Bermuda) Limited, attorneys acting on behalf of Panacorp, CHS was advised that Panacorp was prepared to resolve this matter on the basis that Panacorp replaced the PDVSA Bonds sold in the unauthorised sale by purchasing the same in the open market.

41. An aspect of this matter which has contributed to suspicion and distrust on the part of Panacorp is the identity of the purchaser and the consideration paid for the PDVSA Bonds. At one stage in the discovery skirmishes it was contended on behalf of CHS that these issues were not relevant to any of the issues on the pleaded case.

42. As counsel for Panacorp correctly submitted it was only at the trial of these proceedings, upon the cross examination of Mrs. Fouladi (the President and ultimate beneficiary of CHS), that the identity of the purchaser of the PDVSA Bonds was disclosed. Mrs. Fouladi stated that CHS had sold the PDVSA Bonds to Castle Harbour Securities LLP ("**Castle Harbour LLP**"), an affiliate of CHS which Panacorp contends is under common control. Mrs. Fouladi stated; "*Well, we sold the bonds to LLP, who would have gone and sold them. That's the way it works*." When asked what Castle Harbour LLP did with the bonds, Mrs. Fouladi responded "*It went into the market to sell them*." When asked what price did Castle Harbour Securities sell the PDVSA Bonds, Mrs. Fouladi responded *"I don't know, and I don't have copies internally of what LLP gave, and which brokers they went out to in the market, or clients. I don't know who they went to…*"

43. In her witness statement Mrs. Fouladi stated that Mr. Chekroun gave instructions to sell the PDVSA Bonds "*via*" Castle Harbour LLP and advised that Castle Harbour LLP was a separately owned brokerage based in London via which CHS transacts in the markets from time to time. At the trial of this matter Mrs. Fouladi advised the Court that CHS had in fact sold the securities **to** Castle Harbour LLP.

44. The audited accounts of Castle Harbour LLP show that Mrs. Fouladi was a member of that entity until 16 February 2019, long after the sale of PDVSA Bonds. On or before November 2020, shortly after the conclusion of the first half of the hearing on 13 October 2020, Castle Harbour LLP made a number of filings with the Companies House which purports to show that Mrs. Fouladi had actually resigned her membership of that company as of 16 November 2018. Mrs. Fouladi explained in cross-examination that prior to that date Castle Harbour LLP was owned jointly by her and her former husband. On separation in 2017 and as part of the overall settlement Mrs. Fouladi agreed to transfer her interest in Castle Harbour LLP to her husband. It would appear that at the time when the PDVSA Bonds were sold to Castle Harbour LLP, the entity was owned by her former husband.

45. Mrs. Fouladi gave evidence that the entire purchase price received by CHS from Castle Harbour LLP was paid over to Panacorp with the result that CHS itself did not make any

profit on the sale. However, she did not know if and what profits or commissions were made by Castle Harbour LLP. She gave evidence that she did not know on what date, or at what price Castle Harbour LLP had sold the PDVSA Bonds in the market, or the identity of the purchaser. This remains the state of the evidence at the conclusion of the trial on 16 March 2021.

## C. Whether there was a breach of the CCA?

46. Panacorp contends that it is a fundamental term of the CCA that CHS, as the Custodian of the PDVSA Bonds, only deal with the PDVSA Bonds in accordance with the Proper Instructions, as defined, in accordance with clause 3.1.4 of the CCA. In this case CHS did not receive any Proper Instruction to effect a sale of the PDVSA Bonds in December 2018. In the circumstances, subject to any positive defences raised by CHS, CHS was in clear breach of clause 3.1.1 and 3.1.4 of the CCA.

47. CHS argues that as a matter of Bermuda law it had no option but to sell the PDVSA Bonds and it was entitled to do so on a number of grounds under the CCA or under general law. CHS argues that it was obliged by Bermudian anti-money laundering ("**AML**") laws to monitor its business relationship with Panacorp for money laundering risks. If CHS considered that there was an unmanageable risk of money laundering inherent in the relationship with Panacorp (or those for whom Panacorp acted), then CHS was obliged to immediately cease all transactions for, and immediately terminate the relationship with, Panacorp and/or any person(s) for whom Panacorp acted. This was a judgment call for CHS to make on the basis of its subjective view as to money laundering risks.

48. CHS contends that to enable Panacorp to trade a wide range of securities via CHS, the parties agreed on a limited form of custodianship, in the form of the CCA, whereby CHS's duties would be strictly limited to those of a bailee. The parties agreed on terms that would enable CHS to fully comply with its regulatory obligations and to avoid assuming liabilities as a result of dealing with or holding the PDVSA Bonds.

49. First, CHS's duties under the CCA were expressly subject to its AML obligations, as detailed in the relevant legislation and the quasi-legislative guidance interpreting those laws that were published by the BMA. In practical terms, CHS asserts, this meant that:

    (a) CHS was not obliged to follow Proper Instructions while it remained unsatisfied as to the level of money laundering risk in the relationship(s); and

    (b) If CHS considered that the risk of money laundering could not be managed, it was entitled to return any of the PDVSA Bonds as part of terminating the relationship with Panacorp and/or the relevant owner(s). If that was not possible, CHS was entitled to liquidate the PDVSA Bonds to enable it to terminate the relevant relationship(s).

50. CHS further contends that it could decline the custody or transfer of any investments both prior to, ***and after***, accepting the same if it considered that doing otherwise would or could in its opinion infringe any applicable law or involve CHS assuming a liability. Where CHS refused to continue holding certain investments, such as the PDVSA Bonds, Panacorp was obliged to remove those assets within a reasonable period of time. If Panacorp failed to do so, CHS, like any other bailee, was entitled to liquidate the assets and remit the proceeds to Panacorp.

51. CHS maintains that Panacorp misused its relationship with CHS, and contends that the evidence shows that:

    (a) Panacorp barely used the account to trade, contrary to representations made to CHS as part of the initial customer due diligence process and the parties' common intention.

    (b) Panacorp engaged in a series of transfers that were typical of money laundering "*layering*" transactions.

    (c) Having accepted in good faith the custody of US $100 million 6% PDVSA 2022 Bonds with a maturity date 28 October 2022, CHS discovered that the securities

were the infamous "*Hunger Bonds*" that were tied to allegations of corruption and other crimes against the Venezuelan people.

(d) Panacorp attempted to transfer 35 million of the Bonds to the personal account of an unknown party for no consideration.

52. Each of these issues was an AML red flag that would have set alarm bells ringing at any competent regulated financial institution ("**RFI**"), which is exactly what, CHS contends, occurred in CHS' compliance department.

53. As a result, CHS argues, it was obliged under Bermudian law to reassess the level of risk of money laundering inherent in the relationships, including with the Bonds' true owner(s), and determine whether it could continue with those relationships. It argues that it had no choice but to terminate the business relationship with the true owner(s) of the Bonds as it had no customer due diligence information in respect of these persons, and it could not rely on Panacorp to obtain the same in light of its conduct above.

54. CHS maintains that it did everything it could to have the Bonds removed from its books so that it could terminate the relationship with the Bonds' owner(s). CHS repeatedly asked Panacorp to arrange for the Bonds to be sent elsewhere. However, CHS asserts, Panacorp failed to provide either Proper Instructions or an alternative custodian within a reasonable period of time, or at all, in breach of its obligations under the CCA. In the end, CHS argues, it was left with no choice of continuing to hold the Bonds and breaching its AML obligations or liquidating the Bonds to terminate the relationship with the Bonds' owner(s). It chose the latter course. CHS submits that this was not a breach of contract as:

(a) The liquidation was mandated by Bermudian law, and CHS' duties did not extend to keeping the Bonds when this was contrary to the same.

(b) CHS considered that to hold the Bonds would *or could*, in its opinion, infringe applicable laws and involved CHS assuming a liability (most probably, for breach of AML laws and international sanctions). Panacorp's breach in failing to remove

the Bonds within a reasonable period of time meant that CHS was entitled to liquidate the same.

(c) Panacorp's refusal to remove the Bonds even when apprised of CHS' regulatory concerns and the looming threat of international sanctions meant that CHS, like a bailee of perishable goods, was entitled to liquidate them under the doctrine of agency of necessity.

***The statutory and regulatory framework***

55. I accept CHS' submission that in considering the express and implied terms of the CCA, the Court should have regard to the background that would have been reasonably known to the parties when they entered that agreement. I accept that the considerations of the Bermudian AML regime and the international sanctions regime are in principle relevant.

***The Bermudian AML regime***

56. The Bermudian AML regime comprises the Proceeds of Crime Act 1997 ("**POCA**"), the Proceeds of Crime (Anti-Money Laundering and Anti-Terrorist) Regulations 2008 (the "2008 Regulations"), the BMA AML Guidance Notes published pursuant to section 5 (2) of the Proceeds of Crime (Anti-Money Laundering and Anti-Terrorist Financing Supervision and Enforcement) Act 2008 (the "**AML Guidance Notes**"), which include Guidance Notes for Anti-Money Laundering & Anti-Terrorist Financing (AML/ATF) Regulated Financial Institutions on AML/ATF (the "**Main Guidance**"), and "Sector-Specific Guidance Notes for Investment Business Providers, Investment Funds and Fund the Administrators" (the "**Sectoral Guidance**").

***Relevant provisions of POCA***

57. Section 7 of POCA defines money laundering as an act which constitutes an offence under section 43, 44 or 45 of POCA and includes aiding, abetting, counseling or procuring the commission of an offence under sections 43, 44 and 45.

58. Section 43 of POCA provides that:

> "***Concealing or transferring criminal property***
>
> *43 (1) A person commits an offence if he—*
>
> *(a) conceals criminal property;*
>
> *(b) disguises criminal property;*
>
> *(c) converts criminal property;*
>
> *(d) transfers criminal property; or*
>
> *(e) removes criminal property from Bermuda.*
>
> *(2) But a person does not commit such an offence if—*
>
> *(a) he makes a disclosure under section 46 and (if the disclosure is made before he does the act mentioned in subsection (1)) he has the consent of the FIA;*
>
> *(b) he intended to make such a disclosure but had a reasonable excuse for not doing so; or*
>
> *(c) in the act he does is done in carrying out a function he has relating to the enforcement of any provision of this Act or of any other enactment relating to criminal conduct or benefit from criminal conduct."*

59. Section 42A (2) defines "***criminal property***" as property which constitute a person's benefit from criminal conduct or represents such a benefit and the alleged offender knows

or suspect constitutes or represents such benefit. "***Criminal conduct***" is defined in section 3 as drug trafficking or any relevant offence. A "***relevant offence***" is defined as any indictable offense in Bermuda which would include an offense under sections 43 to 46 of POCA.

60. Section 44 of POCA provides that:

> *"**Assisting another to retain criminal property***
>
> *44 (1)A person commits an offence if he enters into or becomes concerned in an arrangement which he knows or suspects facilitates (by whatever means) the—*
>
> *(a) acquisition;*
>
> *(b) retention;*
>
> *(c) use; or*
>
> *(d) control,*
>
> *of criminal property by or on behalf of another person.*
>
> *(2) But a person does not commit such an offence if—*
>
> *(a) he makes a disclosure under section 46 and (if the disclosure is made before he does the act mentioned in subsection (1)) he has the consent of the FIA;*
>
> *(b)he intended to make such a disclosure but had a reasonable excuse for not doing so; or*
>
> *(c) the act he does is done in carrying out a function he has relating to the enforcement of any provision of this Act or of any other enactment relating to criminal conduct or benefit from criminal conduct."*

61. Section 45 of POCA provides that:

> ***"Acquisition, possession or use of criminal property***
>
> *45 (1) A person commits an offence if he—*

*(a) acquires criminal property;*

*(b) uses criminal property;*

*(c) or has possession of criminal property."*

*62.* Section 46 of POCA provides that*:*

*"**Disclosure of knowledge or suspicion of money laundering***

*46 (A1) A person shall make a disclosure to the FIA when they know, suspect or have reasonable grounds to suspect that—*

(a) *any currency, funds or other assets are derived from or used in connection with any criminal conduct; or*

(b) *a money laundering offence has been committed, is in the course of being committed or has been attempted,*

*and this information has come to him in the course of his trade, profession, business or employment. (1) Where a person in good faith discloses to the FIA—*

(a) *his suspicion or belief that another person is engaged in money laundering, or any information or*

(b) *other matter on which that suspicion or belief is based he disclosure shall not be treated as a breach of any restriction upon the disclosure of information however imposed.*

*(2) A person is guilty of an offence if—*

*(a) he knows, suspects or has reasonable grounds to suspect that another person is engaged in money laundering which relates to any proceeds of criminal conduct;*

*(b)the information, or other matter, on which that knowledge or suspicion is based came to his attention in the course of his trade, profession, business or employment; and*

*(c)he does not promptly disclose this information or other matter to the FIA after it comes to his attention."*

***The 2008 Regulations***

63. Regulation 6 provides that a person such as CHS must apply customer due diligence measures ("**CDD**") when he:

    (a) establishes a business relationship;

    (b) carries out an occasional transaction;

    (c) suspects money laundering or terrorist financing; or

    (d) doubts the veracity or adequacy of documents, data or information previously obtained for the purpose of identification or verification.

64. Regulation 6 (2) provides that a relevant person must apply CDD at appropriate times to the existing customers on a risk sensitive basis. The relevant person must:

    (a) determine the extent of CDD on a risk sensitive basis depending on the type of customer, business relationship, geographic areas, services, delivery channels, product or transaction; and

    (b) be able to demonstrate to its supervisory authority that the extent of CDD is appropriate in view of the risks of money laundering and terrorist financing.

65. Regulation 9 provides that where in relation to any customer, a relevant person is unable to apply CDD he:

(a) shall not open an account or carry out a transaction for the customer;

(b) shall not establish a business relationship or carry out an occasional transaction with the customer;

(c) shall terminate any existing business relationship with the customer; and

(d) shall consider whether he is required to make a disclosure under section 46(2) of POCA.

66. The BMA Main Guidance deals, *inter-alia*, with the requirement to cease transactions and cease existing business relationship:

(a) Paragraph 3.33 provides that where the immediate termination of a business relationship is impracticable due to contractual or legal reasons outside the control of the RFI (regulated financial institution such as CHS), the RFI must ensure that the risk is managed and mitigated effectively until such time as termination of the relationship is practicable.

(b) Paragraph 3.34 provides that where funds have already been received and the RFI concludes that the circumstances support the making of a report to the Financial Intelligence Agency ("**FIA**"), the RFI must retain the funds until the competent authority has given consent for the return of the funds to the original source from which they came.

(c) Paragraph 3.35 provides that where funds have already been received and the RFI concludes that there are no grounds for making a report to the Financial Intelligence Agency, it will need to determine whether to retain the funds while seeking other ways of being reasonably satisfied as to the customer's identity, or whether to return the funds to the original source from which they came. Returning the funds in such circumstances is part of the process of terminating the business relationship; it is

closing the account, rather than carrying out a transaction with or on behalf of the customer.

67. The BMA Main Guidance also deals with the obligation to report suspicious activity. Paragraph 9.3 provides that RFIs must put in place appropriate policies and procedures to ensure that knowledge or suspicion that funds or assets or the proceeds of crime or that the person is involved in money laundering are identified, inquired into, documented and reported. Paragraph 9.9 provides the following guidance in relation to the issue of "suspicion":

> *"Suspicion is subjective. Suspicion must be more than a vague feeling of unease; it may not be self-induced. At the same time, suspicion does not need to be clear or firmly grounded. Suspicion is sufficiently established when a relevant employee thinks "I have a suspicion but I cannot prove it by the fact or hard evidence."*

***Discussion in relation to the impact of the AML regime***

68. As regulation 9(1) seems to make clear where a relevant person is unable to apply CDD in accordance with the 2018 Regulations the relevant person is required to terminate any existing business relationship with the customer. However, it is not clear that the relevant person can entirely disregard its contractual obligations in relation to the issue of termination under the relevant contractual agreement. Indeed, paragraph 3.33 of the BMA Main Guidance clearly recognises that in the case of an existing contractual relationship termination of that relationship may be "*impracticable due to contractual or legal reasons outside of the control of the RFI*." Paragraph 3.33 of the Main Guidance clearly assumes that the pre-existing contractual obligations in relation to the issue of termination continue to have full force and effect.

69. The CCA itself allowed CHS as the Custodian to terminate the Agreement at its sole discretion if it chose to do so. Clause 11.1.1 provides that the Custodian shall be entitled to resign its appointment under the agreement by giving not less than three months' notice.

In the event that the CCA is terminated pursuant to clause 11.1.1 CHS is obliged to deliver to Panacorp the PDVSA Bonds held by CHS as the Custodian.

70. It may not matter much whether the CCA is terminated in accordance with clause 11.1.1 since CHS advances the positive case that it was entitled to sell the bonds because CHS was unable to return the bonds to Panacorp or the previous custodian. In the written submissions filed on behalf of CHS it is said (paragraph 107) that whilst Ms. Cedeño suggested that she could order the transfer back to the original custodian, two of the four essential prerequisite for delivery of securities that Ms. Cedeño herself sets out were unsatisfied; (a) no recipient bank or broker-dealer was properly identified, and no recipient account details were provided; and (b) no Proper Instruction was issued.

71. I have already held as a fact that the reason why Ms. Cedeño did not issue the relevant Proper Instruction was because Mr. Chekroun would not allow her to do so and indeed threatened Ms. Cedeño with the involvement of the regulatory authorities if she proceeded to do so. I accept Ms. Cedeño's evidence under cross-examination in relation to this issue:

> *Q: "Why did you not, sometime between August and December, just issue one of these proper instructions… And transfers somewhere to get them out…?"*
>
> *A: "They didn't let me"*
>
> *Q: "Yes, I mean my point is, you never sent to the proper instructions to transfer the out…?"*
>
> *A: "No. They didn't let me…Dino was agreed to take him back. They were waiting for us to send them the instructions if Castle would let me to but Castle would never let me to."*

72. CHS also relies upon clause 3.1.15 of the CCA in support of its case that it was entitled to sell the PDVSA Bonds if it took the view that continued custody of the Bonds could involve CHS in assuming a liability. Clause 3.1.15 provides:

> *"[During the continuance of its appointment and subject to and in accordance with the Laws, the Custodian:] may (but shall not be obliged to) <u>decline to accept the</u>*

*deposit or transfer of any Investments with the Custodian, if the Custodian considers that the acquisition, deposit or transfer of such Investments with or to the Custodian considers that the acquisition, deposit or transfer of such Investments would or could in its opinion infringe any applicable law, the Constitution of the Company or its published investment policy or any directions of the Board or would or could involve the Custodian assuming a liability."* (Emphasis added)

73. In my judgment, on a proper construction of clause 3.1.15 of the CCA, CHS' discretion to "*decline to accept the deposit or transfer of any investments*" is limited to the occasion when the investments are first sought to be transferred or deposited with CHS. It seems to me that this is the plain meaning of the words underlined in clause 3.1.15. I do not consider that this leads to any uncommercial results as it is always open to the Custodian to resign by giving the requisite notice to do so.

74. In any event the construction of clause 3.1.15 may not matter much in this case as CHS accepts that its entitlement to sell the PDVSA Bonds only arises if Panacorp fails to remove the PDVSA Bonds within a reasonable period of time, when requested to do so by CHS. As I have already held Panacorp did not refuse to remove the PDVSA Bonds from CHS. It was prevented from doing so by Mr. Chekroun on behalf of CHS.

75. The primary case advanced by CHS in relation to the AML regulatory regime is that there was no realistic prospect of CHS being able to apply sufficient CDD measures to justify its continued relationship with the ultimate beneficial owners of the Bonds. In particular CHS had no means of securing CDD information directly from the ultimate beneficial owners of the Bonds. In the circumstances it would have been wholly irresponsible and impermissible, CHS contends, for it to have relied on Panacorp for CDD purposes going forward. Whilst at the commencement of the parties' relationship Panacorp had represented in the "*New Client Questionnaire*" that it was an institution with comprehensive AML procedures and controls, the picture which emerged thereafter, CHS says, is that Panacorp's approach to AML was woefully inadequate. Ultimately CHS concluded that it was appropriate to terminate the business relationship with Panacorp's clients. It was a

judgment call for CHS to make under the 2008 Regulations based on its assessment of the risk of money laundering and whether it considered that it could be reasonably satisfied as to the identity of the beneficial owners and any other intermediaries. Having decided to terminate the relationship, CHS says it was entitled to sell the PDVSA Bonds in the open market and return the proceeds to Panacorp.

76. In his oral submissions, Mr. Davenport QC, appearing on behalf of CHS, submitted that this was not a case where CHS had any suspicions that there was any criminal activity or that money laundering offences might have been committed and therefore there was no room for the application of section 43 of POCA to the facts and circumstances of this case. He submitted that this was simply a case where CHS did not have sufficient information in relation to the identity of the beneficial owners and other intermediaries and given the lack of information CHS was entitled to terminate the relationship. The decision to terminate the relationship entitled CHS to sell the PDVSA Bonds in the market and return the proceeds to Panacorp.

77. I am unable to accept the submission that CHS' concerns, as represented to the Court in affidavits and witness statement of Mrs. Fouladi, were limited to not having sufficient information in relation to the identity of the unofficial owners and intermediaries. It seems to me that the evidence tendered by CHS was designed to show that CHS had serious concerns about money laundering offences. CHS accepted that the circumstances were such that they warranted filing a Suspicious Activity Report ("**SAR**") with the FIA. In this regard I refer to the following facts and circumstances:

    (a) As noted above section 46 of POCA requires that a person in the position of CHS shall make a disclosure to the FIA when it knows, suspects or has reasonable grounds to suspect that a money laundering offence has been committed, is in the course of being committed or has been attempted. The failure to make the necessary disclosure to the FIA is an offence under section 46(2). It is the sworn evidence of Mrs. Fouladi that the facts and circumstances of which she complained were such that they warranted the filing of the SAR with the FIA under section 46 of POCA.

In paragraph 22(b) of her Second Affidavit, sworn on 19 September 2019, Mrs. Fouladi deposes:

> *"As to notes required to be maintained regarding suspicious activity under the AML Policy, we incorrectly chose not to make a suspicious activity report and not to create supporting documents which would evidence such examples of activity generating sufficient concern. The fashion in which Panacorp conducted its account and the apparent AML breaches was so voluminous that we accept that we potentially breached our own AML policies by not closing their accounts sooner. We allowed the relationship manager excessive liberty to try to increase the overall volume of business such that the incidence of free of payment transactions with dubious purpose, and from one account to another and without apparent economic motivation seems less concentrated in their occurrence… While we accept that which would have filed a SAR at this point we viewed the impact to business to be extremely disruptive, not least because the account would then have been immediately frozen pending investigation by the regulator putting at risk are relationship with our service providers who could have immediately withdrawn services which would have impacted severely our other clients and possibly led to the immediate economic loss to them"* (emphasis added).

(b) In paragraph 24 of her Witness Statement dated 15 August 2019 Mrs. Fouladi expressed her concern as to the legality of the creation of the PDVSA Bonds and stated:

> *"Added to this, we had suspected the transfer request was to a Venezuela resident, based in Panama, in relation to Hunger Bonds which were alleged to be an instrument which the function was intended as a way of the illegal diverting Government cash to individuals in Venezuela."*

(c) In paragraphs 10 and 11 of the First Affidavit Mrs. Fouladi reiterates that CHS had genuine concerns that it was being involved in a transaction which was extremely suspicious and in essence a "*layering transaction.*" The concern expressed in paragraph 10 and 11 of Mrs. Fouladi's First Affidavit is not that CHS needs further information in relation to the identity of the beneficial owners of the Bonds but that she is concerned that the transactions which have taken place so far constitute offences of money laundering:

> *"10. As I highlighted in my first witness statement, the Defendant had genuine concerns that it was being involved in a transaction which was extremely suspicious. The Plaintiff organized a transfer of the PDVSA 2022 Bonds from the Dinosaur Bank to our account free of payment. The Defendant held them from March 20 18th and July 2018 at which time it received instructions to simply transfer the bonds to a personal account of Kamal/O Mohamad Ibrahim again free of payment.*
>
> *11. The specific account was held at Lebanese Bank, Banque Audi, located in Switzerland. It appears that the Defendant was being used by the Ibrahims as an intermediary to simply transfer the bonds onward to their personal account in what could be a layering transaction.*

(d) The same point is made in a letter from Wakefield Quin Limited, CHS' Bermuda attorneys, in their letter dated 19 April 2022 to the attorneys for Panacorp:

> *"To be blunt, the transaction centering around the PDVSA bonds ("the bonds") appear to involve money laundering… The free payment trade from Dino to our client and then to subsequent instruction to transfer the bonds free of payments to the personal account of KAMAL/O MOHAMAD IBRAHIM"s account in a Lebanese Bank situated in Switzerland appear to be a classic layering transaction to give the appearance of a legitimate transaction"*

(e)The terms of the letter from CHS dated 27 December 2018 are set out at paragraph 38 above. The letter complains of the nature of the various operations processed concerning the account; the nature of the security PDVSA Bonds; the very high level of risk linked to the operations and the security itself linked to the unprecedented ongoing and unspeakable dramatic economic and political situation and the very high level of risk associated with it. The allegations set out in the letter point to possible money laundering offences. There is no express allegation in the letter advising of the sale of the PDVSA Bonds, that the Bonds were sold because CHS lacked the information in relation to the beneficial owners of the Bonds.

(f) Concern about "*layering*" is also expressed in the closing submissions of CHS (paragraph 84) where it is submitted that:

> *"Further concerns were raised by the few transactions that the Plaintiffs did make using its account with the Defendant. The evidence shows that on 31 May 2018 the Plaintiff received $20 million of US Treasuries free of payment from Dinosaur into its account at the Defendant [as set out in paragraph 10 of Mrs. Fouladi's Witness Statement]. By a series of transactions on 11 June 2018, 12 June 2018 and 10 July 2018, these securities were sold and the proceeds remitted to Puerto Rico in a structure typical of "layering" transactions, i.e. "separating the proceeds of criminal activity from their true origins by putting them through several layers of financial transactions" (See the Main Guidance at paragraph 10)"*

78. The evidence outlined above demonstrates that it was CHS' own case that it harboured serious concerns that, having regard to the nature of the security and the transactions concerned, money laundering offences might have been committed. It believed that some of the transactions were in the nature of *"layering*" transactions. CHS, through its President Mrs. Fouladi, also believed that the facts and circumstances warranted filing a SAR with the FIA. An issue for the Court to consider is whether, having regard to CHS' knowledge

and suspicion of these facts, CHS could reasonably and lawfully sell the PDVSA Bonds in the market and remit the proceeds to Panacorp.

79. In all the circumstances I do not consider that CHS can legally justify the sale of the PDVSA Bonds on the ground that the statutory and regulatory requirements of the Bermudian AML regime compelled CHS to take that action. My reasons for this conclusion are as follows.

80. First, the entire justification based upon the Bermudian statutory and regulatory AML regime is premised upon the assertion by CHS that it asked Panacorp to remove the Bonds from its custody and Panacorp failed to do so. As set out above at paragraphs 26 to 33 I do not accept that this assertion is factually correct. I have held that Panacorp advised CHS that Dinosaur, the previous custodian, was willing to accept the Bonds and that Panacorp was prepared to issue a Proper Instruction to give effect to that transfer. However, Mr. Chekroun advised Ms. Cedeño that no such instruction should be given. Indeed, Mr. Chekroun threatened Ms. Cedeño that if Panacorp was minded to give such an instruction, CHS would report the matter to the BMA and SMV.

81. Second, in light of the fact that CHS contends that it believed (i) that circumstances existed in relation to the operation of the custody account such that a SAR should be filed with the FIA; and (ii) the issuance of PDVSA Bonds was an instrument for "*illegal diverting Government cash to individuals in Venezuela*", CHS was prohibited by the terms of sections 43-45 of POCA to sell the Bonds and transmit the proceeds to Panacorp. Indeed, such actions would have constituted the offence of money laundering. If CHS' factual assertions are well-founded, the sale of the Bonds by CHS in these circumstances likely would have contravened section 43(1)(c) (converts criminal property); section 43(1)(d) (transfers criminal property); section 43(1)(e) (removes criminal property from Bermuda); and section 44(1)(b) (concerned in an arrangement which he suspects facilitates the retention of criminal property on behalf of another person).

82. Third, whilst the Bermudian statutory and regulatory regime allows a relevant person to return the funds as "*part of the process of terminating the relationship*", the Main Guidance

Notes do not allow or contemplate a relevant person to sell the investment owned by a third party investor and remit the proceeds of that sale to the investor. To allow a relevant person to effect a sale of an investment and remit the resulting cash to a third party investor would be contrary to the scheme of POCA (in particular sections 43 and 44) and the Main Guidance. It is to be noted that paragraph 3.35 of the Main Guidance, dealing with the return of funds to the investor, is restrictive in its operation. A relevant person can only return the funds if (i) a relevant person concludes that there are no grounds for filing a SAR with the FIA; (ii) funds were received by a relevant person as part of the initial engagement; and (iii) the same funds must be returned to the original source of the funds. Paragraph 3.35 provides no support for the contention that a relevant person may convert the investment by sale and remit the resulting funds to the third party investor.

83. Fourth, the Bermudian statutory and regulatory AML regime does not provide that, in the event a relevant person decides to terminate the business relationship due to lack of sufficient information relating to the identity of beneficial owners, the relevant person can simply ignore the existing contractual rights and obligations existing between the relevant person and the client. Paragraph 3.33 of the Main Guidance recognises that immediate termination of the business relationship may not be possible due to pre-existing contractual obligations. As noted, paragraph 3.33 provides that where the immediate termination of the business relationship is impracticable due to contractual or legal reasons outside of the control of a relevant person, he must ensure that risk is managed and mitigated effectively until such time as termination of the relationship is practicable.

84. Fifth, I reject CHS' submission that CHS in this case was entitled to sell the Bonds as agent of necessity. CHS argues that in this case, its custody of the Bonds was akin to the bailee's custody of perishable goods. CHS further argues that not only it would have been in breach of its obligations under the 2008 Regulations were it unable to rid itself of the Bonds, but there was a virtual certainty that further international sanctions were eventually going to be imposed. As the Court has already held, at paragraphs 26 to 33 above, Panacorp was willing to have the Bonds transferred from CHS to Dinosaur, the previous custodian and the only reason it did not do so was because it was dissuaded from doing so by Mr.

Chekroun. Furthermore, as noted above, at paragraphs 81 to 82, the sale of the bonds by CHS, on its own case, was likely to be in breach of sections 43 (1)(c)(d) and (e) and section 44(1)(b) of POCA.

85. In relation to the issue of sanctions, I accept the submission made on behalf of Panacorp that any sanctions regime imposed by the United States Office of Foreign Assets Control ("**OFAC**") on Venezuelan sovereign and quasi-sovereign debt, cannot justify the sale of the PDVSA Bonds by CHS. In that regard I accept the unopposed expert evidence of Mr. Andres Fernandez, of the law firm Holland &Knight who states that:

> *"…[N]one of the sanctions administered and enforced by OFAC with respect to the PDVSA 2022 Bonds… Prohibited Castle Harbour to hold or otherwise deal in the PDVSA 2022 Bonds. More specifically, none of such sanctions required Castle Harbour to sell the PDVSA 2022 Bonds on December 27, 2018."*

86. In all the circumstances I conclude that CHS was not entitled to sell the PDVSA Bonds without receiving Proper Instructions from Panacorp and his decision to sell the Bonds, without Proper Instructions, on 20 December 2018 was in breach of clause 3.1.4 of the CCA.

## D. <u>Issue of damages</u>

87. In its written submissions Panacorp invites the Court to approach the issue of assessment of damages by looking at the approach which has been applied in cases where errant stockbrokers have converted a client's shares by disposing of them to a third party. Panacorp relies upon the Privy Council's decision in *BBMM Finance (Hong Kong) Ltd v Eda Holdings Ltd* [1990] 1 WLR 409 at 412B:

> *"The general rule…that a plaintiff whose property is irretrievably converted has vested in him a right to damages for conversion measured by the value of the property at the date of conversion."*

88. Panacorp submits that there are, however, established exceptions to this general rule in the context of damages suffered by reason of the unauthorised sale of assets into a rising market. Counsel for Panacorp refers to the Court of Appeal decision in *Sachs v Miklos* [1948] 2 KB 23 at 39:

> *"The value of goods converted, at the time of the conversion, is one thing… but it does not follow that the sum is the measure of the plaintiff's loss. The question is what is the plaintiff's loss, what damages he has suffered, by the wrongful act of the defendants."*

89. Counsel for Panacorp submits that the case law draws an important distinction between the situation where an asset holder had an opportunity to prevent the assets from being sold into a rising market, on the one hand, and the situation where an asset holder did not know or was not able to prevent the asset being sold into a rising market, on the other hand. In the former situation, "*this great rise in value which has taken place since is not damage which he can recover as flowing from the wrongful act*", but in the latter, "*it is impossible to say that he is not entitled to recover the value of the goods at that time*" (*Sachs v Miklos* at 39).[3]

90. It is said on behalf of Panacorp that this case is of the latter variety. When CHS first began to suggest it may liquidate the PDVSA Bonds, Panacorp immediately suggested moving them back to the custody of the issuing bank, which proposal was rejected by Mr. Chekroun suggesting that it will result in the involvement of the BMA and SMV. On 27 December 2018, when CHS announced its intention to sell the Bonds, Panacorp immediately wrote to CHS stating that CHS was not authorised to settle the transaction on the settlement date. Panacorp argues that it did not have an opportunity to avoid the loss and damage which it suffered when CHS breached the CCA.

91. Counsel for Panacorp submits that in the present circumstances, where there is evidence that Panacorp would have sold the PDVSA Bonds had the price exceeded US$0.20, the

[3] Counsel for Panacorp also relies upon *Industria Azucarera Nacional SA v Empresa Expotado de Azucar* [1983] 2 Lloyd's Rep 171 (the "*Playa Larga*").

proper assessment of damages is the price consistent with the prior stated intention, which would have been achieved upon the occurrence of the "liquidity event" on 23 January 2019.

92. Counsel for CHS submits that Panacorp's starting point in relation to the assessment of damages is erroneous. CHS argues that in a claim for breach of contract the correct starting point is that where a party sustains loss by reason of breach of contract, they are, so far as money can do it, to be placed in the same position, with respect to damages, as if the contract had been performed. CHS submits that Panacorp's pleaded claims for damages is for damages arising out of a breach of contract and not for the tort of conversion.

93. The measure of damages in contract, CHS submits, is to be contrasted with the approach to assessing damages in claims in conversion and detinue, of which *BBMM Finance v Eda, Sachs v Miklos* and the *Playa Larga* are all examples. The approaches for damages for conversion and detinue were explained by Mustill J (as he then was) in the *Playa Larga* [1980] Lexis Citation 51:

    (a) As to conversion, Mustill J explained that "*the plaintiff does not complain of a continuing wrongful refusal to deliver up the goods, but of a past wrongful denial of title. The cause of action arises once and for all when that act occurs, and the plaintiff's loss is prima facie to be assessed by reference to the value of the goods on that date*".

    (b) As to detinue, Mustill J explained that "*the action in detinue is essentially an action in rem, in which the plaintiff continues to assert his right to possession up to the moment of judgment… The plaintiff does, however, have the option to recover, not the chattel itself, but the value of the chattel as assessed… Since the value of the chattel thus awarded is in essence a substitute for chattel itself, the assessment of the value is made as the day when judgment was given*."

94. Counsel for CHS submits that once the nature of damages for torts of conversion and detinue is understood, as explained by Mustill J in *Playa Larga*, it becomes clear that Panacorp's reliance on *Sachs v Miklos* is misplaced. The reason why Lord Goddard CJ

considered that the plaintiff there *might* be able to claim for the rise in the market subsequent to the sale of the furniture, subject to mitigation, was, submits counsel, because damages for detinue would have been a substitute for receiving the chattel itself on the date of the judgment, after the rise in the market. *Sachs v Miklos* is therefore, argues counsel, irrelevant to the question of how damages are to be assessed for breach of contract.

95. It is submitted on behalf of CHS that if Panacorp wishes to claim the highest intermediate value of the PDVSA Bonds between CHS' liquidating them and judgment, Panacorp must show, on the balance of probabilities, that those Bonds would have been sold at the height of the market on or around 23 January 2019. I accept that this is the correct test for damages in contract and is supported by the decisions of the Court of Appeal in *Playa Larga* and *Ata v American Express Bank Ltd* [1998] 14 LDAB 221.

96. In *Playa Larga* it was argued that the damages recoverable by the innocent party in contract should be related to the *highest price* of sugar, not delivered in breach of contract, prevailing at any time between the date of the breach and the date of the arbitration award. There was no evidence that the innocent party could have sold at the highest price. On the contrary, the reasonable inference was that the sugar would have been resold for domestic or other consumption in the country. Theoretically the innocent party was capable of selling the sugar at the highest price, but there was no evidence that it did so. This argument was rejected by the Court of Appeal. Ackner LJ held at 181:

> "*Accordingly, to the Plaintiffs' contention that Cubazugar should not profit from its own wrong comes the simple reply: they have not shown that Cubazugar had done so. We cannot, therefore, see any basis upon which Iansa can seek to achieve a windfall in the form of an extra $1,200 per tonne over and above the price which was prevailing when they should have bought in the market*."

97. The holding in *Playa Larga* was followed in *ATA v American Express Bank Ltd*, where Hirst LJ approved the analysis of Rix J in the court below holding:

*"If, of course, a claimant in the position of the plaintiff in Michael v Hart could prove on the balance of probabilities that he would have sold at the height of the market if his shares had not been sold earlier, then he would indeed be able to recover damages calculated on that hypothesis."*

98. The claim pursued by Panacorp in these proceedings is a claim for breach of the CCA. This is made clear by paragraph 12 of the Statement of Claim. There is no claim for the tort of conversion in the Statement of Claim.

99. The written submissions filed on behalf of Panacorp make it clear that the claim is confined to breach of contract. In this regard the written submissions assert:

(a) "*It was this wilful and incomprehensible breach of the CCA which led to the issuance of these proceedings in January 2019*" (Paragraph 6).

*(b)* "*There is no legally recognised defence to the Defendant's breach of the CCA" (paragraph 7).*

(c) *"Based on its pleaded case, and for the reasons as stated in the preceding paragraphs, the Defendant has no credible argument which would allow it to avoid liability for its breach of the CCA*" (paragraph 50).

(d) "*In the event, the Plaintiff was denied the opportunity to sell the bonds at a price and time of its choosing due to the Defendant's inexplicable decision to unilaterally dispose of the entire position without having a Proper Instruction in hand*" (paragraph 60).

(e) "*The Plaintiff's case is that but for the Defendant's breach of the CCA on 31 December 2018, it would have been instructed to maintain its position in the PDVSA 2022 Bonds until the price increase to at least US$0.20. At that stage, it would have been instructed to place a sell order, and given the liquidity event that*

*occurred on 23 January 2019, that sale would have yielded total proceeds of between US $18,5000,000 and US $21,850,000*" (paragraph 65).

100. In the circumstances, I am satisfied that as the claim being pursued by Panacorp is a claim for breach of contract; in order to recover the loss on the basis of the price prevailing on 23 January 2019, Panacorp must show, on a balance of probabilities, that the Bonds would have been sold by Panacorp at the height of the market on 23 January 2019.

***The evidence in relation to sale of the Bonds on 23 January 2019***

101. There is no direct evidence from either Phoenix or commonwealth Bank in relation to their intention to sell the PDVSA Bonds either in relation to price or the time period. The Court did receive evidence from Ms. Cedeño in relation to her instructions from Phoenix and Commonwealth Bank in relation to the sale of the PDVSA Bonds. Ms. Cedeño's evidence is as follows:

(a) On 14 August 2018, Ms. Cedeño exchanged messages on WhatsApp with Mr. Chekroun and advised Mr. Chekroun "*I talked to my director related the forms, and represent to them the recommendation to sell. And restructure the client portfolio. They are going to contact the client. And see if the client will be open to it*."

(b) On 15 August 2018, Ms. Cedeño sent an email to Mr. Chekroun to inquire as to what price might be able to be achieved for the PDVSA Bonds, in the event that Phoenix and or commonwealth Bank instructed Panacorp to sell the Bonds.

(c) On 17 August 2018, Mr. Chekroun advised Ms. Cedeño that CHS has found one potential buyer who would be ready to buy the whole position at 15%.

(d) At the end of August 2018, Ms. Cedeño received confirmation from Phoenix and Commonwealth Bank that they were not open to selling the PDVSA Bonds at the price of US$0.15 as proposed by CHS because it was their expectation that the Bonds would trade up in price to at least US$0.20. Ms. Cedeño advised Mr.

Chekroun "*Let's wait and see if the position goes high and I can receive an order to sell 20 million of it and so on*".

(e) On 31 August 2018 Ms. Cedeño advised Mr. Chekroun "*the Client said he would be monitoring the price if it goes up to see if he sell 20 million… He is waiting to see if it goes to 20*".

(f) At the beginning of December 2018, Panacorp's Treasury Department was instructed by the owners of PDVSA Bonds to find out what price might be able to be achieved for the sale of 20 million of the Bonds (i.e. 20% of the total position). Phoenix and Commonwealth Bank wished to see at what price the market might absorb the Bonds so that they could decide whether it might be an opportune time to sell some, or all, of their position in the PDVSA Bonds.

(g) CHS was instructed at the start of December 2018 to go out to the market on a speculative basis to see what price might be able to be achieved. "*Phoenix and Commonwealth were, in principle, <u>open to selling the bonds at the right price</u>*" (paragraph 50 of Ms. Cedeño's witness statement).

(h) For the first 2 weeks of December, limited progress was made. On 17 December 2018, Ms. Cedeño wrote to Mr. Chekroun "*The clients have finally decided to sell the bonds a part of it*.'

(i) "*What should have happened at this time was Mr. Chekroun would continue to seek out a buyer for 20,000,000 of the PDVSA 2022 Bonds, workout the best price that could be achieved for the sale and then present the price to mean so that I could in turn asked my clients whether they wish to proceed if I was given approval to proceed, I would then issue a Proper Instruction to Castle Harbor to sell the bonds*" (paragraph 52 of Ms. Cedeño's witness statement).

(j) In relation to the sale of the Bonds by CHS on the 20 December 2018 Ms. Cedeño states at paragraph 60 of her witness statement that "*The situation*

*is particularly distressing for Panacorp's clients, Commonwealth Bank and Phoenix, who had expressly instructed me not to agree to the sale of the PDVSA 2022 Bonds at any price under US$0.20, and even then to only dispose of 20,000,000 of the bonds, rather than the entire position*" (emphasis added)

(k) Ms. Cedeño contends that if CHS had not disposed of the Bonds, Panacorp's clients would have been able to sell the Bonds for more than twice the price that CHS achieved for them just three weeks later. At paragraph 61 of her witness statement she states "*In my view, Panacorp would have been able to act in accordance with its clients' instructions to sell the bonds, or some of them, for US$ 0.20* "(emphasis added).

(l) In cross-examination Ms. Cedeño agreed that her authority to sell the Bonds was limited to only 20 million of the Bonds:

"Mr. Horseman: *Even if the price had gone to .20, your client was telling you that they only want to sell dollars 20 million. Right?*
Ms. Cedeño: *Only, 20 million.*"

102. On the basis of Ms. Cedeño's evidence, both in terms of her witness statement and in cross examination, I am satisfied that the most she can say is that she had authority to sell 20% of the Bonds if the price reached US$ 0.20. There is no evidence before the Court upon which the Court can properly conclude, on the balance of probabilities, that both Phoenix and Commonwealth Bank would have sold the entirety of their positions in relation to PDVSA Bonds on 23 January 2019.

103. The trading in the US markets for the PDVSA Bonds was suspended on 28 January 2019, owing to the imposition of sanctions by the US Government against Venezuela. According to Mr. Lynch, the expert called on behalf of CHS, the Bonds did not trade again according to FINRA until 30 August 2019, where a dealer bought and sold $2 million of Bonds with non-FINRA counterparts, at an average price of 9.875 cents on the dollar of face value.

Mr. Lynch's evidence was that as of 3 October 2019 the Bonds were trading between 5 and 10 cents on the dollar in a normal market size of $2 to 3 million face value.

104. According to Mr. Jorge Piedrahita, expert for Panacorp, the price of the Bonds, since the resumption of trading, has gradually declined from 10 cents, 9.78 cents, 5 cents, 3 cents to 2.5 cents. Mr. Piedrahita agreed that the price for the Bonds has not been as high as 3 cents since 12 May 2019 and the Bonds were trading at 2.5 cents in March 2021. Mr. Piedrahita agreed with Counsel for CHS that trading in the Bonds was stopped on 28 January due to the sanctions imposed by the US Government and since the resumption of trading in August 2019 "*the market has always been lower than the sale price of achieved by Castle Harbour and thereafter.*"

105. It follows that if 20% of the PDVSA Bonds had been sold on 23 January 2019 at a price of US $0.20 the sale would have realized US $4 million for Panacorp's clients, Phoenix and Commonwealth Bank. However, there is no reliable evidence of the price which would have been realised for the remaining 80% of the Bonds. In the circumstances it is not possible for the Court to conclude whether the total price realised by the sales directed by Panacorp would have exceeded the amount realised by CHS as a result of its sale concluded on 17 December 2018. Accordingly, on the basis of the above evidence, I am bound to conclude, on the balance of probabilities, that Panacorp has not established that it has suffered any quantifiable damage for its claim based upon breach of the CCA. Accordingly, subject to the other issues dealt below, the Court can only award Panacorp nominal damages for the established breach of the CCA.

## E. <u>Other points argued by counsel</u>

106. In light of the Court's finding above in relation to the recoverable damage, it is unnecessary to deal in detail with a number of other points argued by counsel in relation to the issue of damages. However, given that this matter may proceed further I set out briefly my views in relation to those other points concerning the issue of damages.

***AML and liquidity issues in relation to the sale of the Bonds***

107. On the assumption that CHS was provided with Proper Instructions to sell the entirety of the PDVSA Bonds on 23 January 2019 at a price of US $0.20, CHS contends that such an instruction was incapable of being carried out. CHS contends that (i) it would have been obliged (or entitled as a matter of AML laws) to carry out the instructions; and (ii) even if CHS had attempted to sell all 100 million of the Bonds in that afternoon, there was no proven liquidity to enable the Bonds to be disposed of in the manner, and for the price, suggested.

108. In relation to the AML issues, I would not have held that, in the present circumstances, any lack of due diligence documentation in relation to the beneficial owners would have provided CHS with a reasonable basis for not carrying out the Proper Instructions. As noted at paragraph 16 above it was Ms. Cedeño's evidence that had CHS requested any further information or due diligence on Mr. Ibrahim, she would have provided that information. She confirmed that the position remained that CHS never requested any further due diligence on Mr. Ibrahim or any other entity.

109. In relation to the issue of liquidity on 23 January 2019, I would accept the opinion evidence of Mr. Piedrahita that on 23 January 2019, Panacorp could have sold 100 million PDVSA 2022 Bonds in one or more of the following transactions: (i) the Bonds would have been an opportunity for someone with a short position to reduce the risk in one single trade; and (ii) market makers would have been eager to buy the Bonds to satisfy the investor demand in other Bonds as the PDVSA 2022 Bonds would have served to hedge a portfolio of short positions given the security's elevated correlation to almost all of the PDVSA Bonds. I would have accepted Mr. Piedrahita's evidence, based on his experience as a trader and his knowledge of the sovereign debt markets during January 2019, that Panacorp could have sold $100 million PDVSA 2022 Bonds at a price of $0.202 $0.214. for total proceeds of $20 million to $21 million on or after 23 January 2019.

***Panacorp would not have been entitled to the proceeds of any sale***

110. CHS argues that the default rule is that if Panacorp is to succeed, it must show that it (and not third parties) has suffered a recoverable loss. It argues that it is plain that the Bonds were not the property of Panacorp but were the property of its clients, Phoenix and Commonwealth Bank. It follows that the proceeds from a sale of the Bonds on 23 January 2019 would have ultimately been owed, and therefore paid over, to the true beneficial owners of the Bonds. CHS argues that there is no evidence before the Court to suggest that Panacorp would have retained the Bond proceeds for its own benefit.

111. In response Panacorp relies upon the principle of transferred loss and relies upon the judgment of Lord Sumption in *Swynson Ltd v Lowick Rose LLP* [2017] UKSC 32. I accept that this exception to the general principle can only be relied upon where the following conditions are satisfied:

(a) First, it must have been the common intention of the parties to benefit a third party or a class of persons to which a third party belongs, and the anticipated effect of the breach of duty will be to cause loss to that third party. In this regard Lord Neuburger explained at [104], there must be "*nothing in the contract or the surrounding circumstances which negatives the conclusion that the principle should apply*".

(b) Second, there must be a legal black hole. As Lord Sumption said at [16]; *"It is therefore an essential feature of the principle that the recognition of a right in the contracting party to recover the third party's loss should be necessary to give effect to the object of the transaction and to avoid a "legal black hole", in which in the anticipated course of events the only party entitled to recover would be different from the only party which could be treated as suffering loss.*"

112. I would have held that the present case satisfies the requirements of the principle of transferred loss as set out by Lord Sumption in *Swynson*. I accept Ms. Cedeño's evidence that CHS knew from the very outset (and in any event prior to the PDVSA Bonds being deposited) that Panacorp was a broker-dealer which traded on behalf of its clients who were

the beneficial owners of the relevant assets. As Ms. Cedeño confirms in her witness statement, on 29 January 2018 she exchanged emails with Mr. Chekroun in relation to the initial funding of Panacorp's account with CHS, and also in relation to the establishment of a sub-account to segregate Panacorp's trading activities from those of its clients. In the circumstances it would have been apparent to CHS that the assets in the sub-account belonged to the clients of Panacorp and the potential beneficiaries of the services being rendered by CHS in relation to the assets in the sub-accounts were the clients of Panacorp. In the circumstances CHS must have known that the object of the transaction whereby assets were deposited in its sub-accounts established by CHS was to benefit third parties, namely, clients of Panacorp.

113. I do not accept CHS's argument that clause 8.6 of the CCA is wholly incompatible with an inference that the parties intended for the contract to be for the benefit of the Plaintiff's clients. Clause 8.6 provides that Panacorp undertakes to hold harmless and shall indemnify CHS against all claims and actions, relating to the CCA, by third parties against CHS. However, clause 8.6 only provides limited indemnity to CHS in relation to claims by third parties. It does not apply where the claim by a third party is based upon gross negligence or wilful default on part of CHS.

114. I am satisfied that if Panacorp is unable to pursue claims in relation to the assets belonging to its clients and deposited in the sub-accounts of CHS, they would indeed be a legal black hole. A theoretical claim by Panacorp's clients against Panacorp itself does not prevent such a legal black hole from arising. The facts in Court of Appeal's decision in *BV Nederlands Industrie Van Eiprodukten v Rembrandt Enterprises Inc CA* [2019] EWCA Civ 596, a case relied upon by CHS, were exceptional. In that case the Court of Appeal held that it was not satisfied that there was a legal black hole because on the evidence it was established that there was *an agreement* whereby the third party could pursue its claims against the plaintiff in those proceedings.

***Panacorp could have repurchased the Bonds in order to mitigate its loss***

115. CHS argues that if Panacorp did suffer loss by reason of the liquidation of the Bonds on 27 December 2019, the evidence shows that Panacorp had every opportunity to go back into the market to repurchase the Bonds. CHS contends that Panacorp was aware of CHS' intention to liquidate the Bonds on 20 December 2018. Even if Panacorp was unable to purchase new Bonds at that stage, by 29 December 2018 it was, contends CHS, unquestionably in a position to do so using the proceeds from the liquidation. Instead, argues CHS, Panacorp took a legally erroneous approach to mitigation, whereby instead of going into the market it asked CHS to repurchase the Bonds, which CHS contends would have been a breach of CHS's AML obligations.

116. In this regard I would have accepted Mr. Piedrahita's evidence that it was very difficult, if not impossible, for Panacorp to repurchase the Bonds in the market to mitigate its loss caused by CHS because:

(a) the money only landed in Panacorp's account in San Juan, Puerto Rico, on Thursday, 17 January 2019;

(b) it would have taken a minimum of one to two clear business days to wire the funds out of Puerto Rico, meaning that they could not arrive with a new brokerage until Tuesday, 22 January 2019;

(c) the new broker would need to conduct KYC/CDD, likely to take at least a few days further, and only then, and once in funds, would they be willing to begin the process of trying to purchase fresh securities in the market; and

(d) the effect of all this is that it was unlikely that Panacorp could have gone back into the market for the securities before the market seized on 24 January 2019.

***Panacorp's claims are excluded under clauses 8.2 and 8.6 of the CCA***

117. CHS argues that Panacorp's claim for damages is precluded by clause 8.2 and 8.6 of the CCA. Clause 8.2 of the CCA provides:

> "*The Custodian shall not be responsible or liable for or in respect of any error of judgment or any liability, loss, damage, expense, or failure to make a profit incurred or suffered by the Company or any other person as a result of any action or omission undertaken by the Custodian in the performance of its duties hereunder save in the case of gross negligence, willful default or fraud of the Custodian hereunder*"

118. Clause 8.6 of the CCA provides:

> "*The Company hereby undertakes to hold harmless and indemnify the Custodian against all actions, proceedings, claims, costs, demands and expenses which may be brought against or suffered or incurred by the Custodian by reason of any action or omission of the Custodian undertaken in the performance or non-performance of the Custodian's obligations, functions or duties or the exercise of any of its powers hereunder, or otherwise, except such actions or omissions as constitute gross negligence or willful default on the part of the Custodian*."

119. In *Red Sea Tankers Ltd v Papachristidis (The Ardent)* [1997] 2 Ll Rep 547 Mance LJ held at 586 that the concept of "gross negligence" includes serious disregard of or indifference to an obvious risk:

> "*If the matter is viewed according to purely English principles of construction, I would reach the same conclusion. "Gross" negligence is clearly intended to represent something more fundamental than failure to exercise proper skill and/or care constituting negligence. But, as a matter of ordinary language and general impression, the concept of gross negligence seems to me capable of embracing not*

*only conduct undertaken with actual appreciation of the risks involved, but also serious disregard of or indifference to an obvious risk*."

120. In *Kingate Global Fund v PWC* [2014] SC (Bda) 83 Com (4 November 2014), Hellman J held at [14] that a person will be liable for wilful misconduct if he deliberately acts or omits to act; (i) knowing and appreciating that such act or omission is wrong in the sense of being in breach of duty; or (ii) recklessly, i.e. knowing and appreciating the risk that the act or omission may result in loss, but regardless of the consequences or when in all the circumstances the act or omission is otherwise unreasonable.

121. I have summarised at paragraphs 26 to 39 the acts and omissions taken on behalf of CHS which led to the sale of the PDVSA Bonds on 27 December 2018. CHS' actions and omissions have to be evaluated in light of the facts which I have found and which include the following:

(a) Panacorp, through Ms. Cedeño, offered to CHS that the custody of the PDVSA Bonds would be transferred back to Dinosaur, the previous custodian;

(b) Dinosaur was willing to take back the custody of the PDVSA Bonds;

(c) during the period 1 October to 30 October 2018, Ms. Cedeño, on behalf of Panacorp, was prepared to provide Proper Instructions to CHS to transfer the Bonds to Dinosaur;

(d) the reason why such proper instruction was not given by Panacorp was because Mr. Chekroun dissuaded Ms. Cedeño from doing so;

(e) on 30 October 2018, Mr. Chekroun threatened Ms. Cedeño that if she was to provide such Proper Instructions Mr. Chekroun would take steps to involve the regulatory authorities of Bermuda (the BMA) and of Panama (the SMV).

(f) Mr. Chekroun must have realised that his threat to involve the Chief Executive of the BMA in this matter was completely baseless and fanciful;

(g) the justification of the subsequent sale of the Bonds on the ground that Panacorp failed to take steps to transfer the Bonds was baseless and Mr. Chekroun must have appreciated as such;

(h) CHS proceeded with the sale of the Bonds, to an associated company of CHS, in the face of express instructions from Panacorp not to do so;

(i) in light of the fact that CHS contended under oath that it believed that (i) circumstances existed in relation to the operation of the custody accounts such that a SAR should be filed with the FIA; and (ii) the issuance of the Bonds was an instrument for "*illegal diverting Government cash to individuals in Venezuela*", CHS was prohibited by the terms of sections 43-45 of POCA from selling the Bonds and transmit the proceeds to Panacorp: and

(j) if CHS' assertions as to its belief in (i) above are correct, the sale of the Bonds by CHS likely would have contravened section 43(1)(c) (converts criminal property); section 43(1)(d) (transfers criminal property); section 43(1)(e) (removes criminal property from Bermuda); and section 44(1)(b) (concerned in an arrangement which he suspects facilitate the retention of criminal property on behalf of another person).

122. The actions set out in subparagraphs (a) to (j) above, in my judgment, constitute gross negligence and wilful default, as those terms are used within clauses 8.2 and 8.6 of the CCA. In the circumstances, it follows that I would not have held that the claim for damages by Panacorp in this case is precluded by the terms of clauses 8.2 and 8.6 of the CCA.

***Applicability of clauses 8.4 and 8.5 of the CCA***

123. CHS also relies upon clauses 8.4 and 8.5 of the CCA. Clause 8.4 provides that:

*"The Custodian's responsibility and the duty of care in performance of its duties hereunder shall be owed only to the Company and the Custodian shall not be liable in any circumstances for any liability, loss, damage, expense or failure to make a*

*profit incurred or suffered by the Manager, Investment Adviser, any investor, potential investor or ex-investor in the Company or any other person."*

124. CHS argues that it is accepted by Panacorp that the Bonds were ultimately owned by Phoenix and Commonwealth Bank and in the circumstances it must follow that the claim falls within the language of this clause which excludes liability suffered by "*any investor*" or "*any other person*".

125. Clause 8.5 of the CCA provides that:

*"The Custodian shall not be liable in any circumstances for any indirect or consequential loss or damage, or any failure to make a profit, or any lost opportunity suffered or incurred by the Company or any other person."*

126. CHS argues that the claim for failure to make a profit is excluded under this clause. It is to be noted, as submitted by Panacorp, that there is potential tension between clause 8.2 and 8.5 of the CCA. The wording of clause 8.2 suggests that CHS shall not be responsible for any liability relating to "*failure to make a profit*" unless the act or omission complained of constituted gross negligence or wilful default or fraud on the part of CHS. In contrast the wording of clause 8.5 suggests that CHS shall not be responsible for any liability relating to "*failure to make a profit*" irrespective of whether the act or omission complained of constituted gross negligence or wilful default or fraud on the part of CHS.

127. The issue for the Court is whether these provisions, as a matter of construction, apply to the facts as found by this Court. The Court did not have the benefit of extensive argument or citation of authority in relation to the construction of the exemption clauses intended to limit the liability of contracting parties. I consider the general principles, for the purposes of the present case, which apply to such an exercise to be as follows:

(a) In principle parties are free to exclude or modify their obligations under the contract. The issue for the court is to construe the exemption clause to ascertain the

intention of the parties. The issue whether a particular exemption clause applies to the facts allegedly giving rise to liability on the part of the defendant is a matter of construction of the agreement and in particular the exemption clause.

(b) Liability arising out of deliberate misconduct on the part of the defendant is in principle capable of being excluded by a suitably worded exemption clause. There is no rule of law which prohibit such liability from being excluded. Whether a particular clause achieves that result is a matter of construction of the clause at issue. Ordinarily the Court would require "*strong language*" to achieve that result.

(c) In construing the exemption clause the Court is likely to assume that the parties intended to retain the legal characteristics of a contract. The Court is also likely to assume, as part of the construction exercise and as a starting point, that the parties do not intend to defeat the main object of the contract. It would be a rare case where the parties so intend and the Court is likely to require express language to achieve that result.

128. Here, the parties entered into the CCA, the main object of which is (i) the safe custody of the assets deposited with the Custodian; and (ii) to transfer the assets upon the receipt and in accordance with Proper Instructions. The obligation to comply with Proper Instructions is a fundamental obligation of any commercial custodian agreement and if that that obligation can be ignored with impunity by the Custodian, the custody agreement in question is likely to defeat its main object.

129. In this case, on the basis of the facts found by the Court, Panacorp was willing to issue Proper Instructions to transfer the Bonds to Dinosaur in order to avoid freezing the custody account. CHS dissuaded Panacorp from issuing Proper Instructions requiring such a transfer to be carried out. Instead CHS elected to sell the Bonds to an associated company, Castle Harbour LLP, in the face of a direction from Panacorp not to do so. The Court has no knowledge of the price at which Castle Harbour LLP sold the Bonds or the identity of

the purchaser. These were clearly deliberate actions on the part of CHS, which I have also held to be wrongful.

130. I accept that clauses 8.4 and 8.5 use strong language ("*shall not be liable in any circumstances*") which is capable of applying the deliberate breaches of the contract. However, in this case the main object of the CCA was circumvented. The issue for the Court is whether in agreeing to clauses 8.4 and 8.5 of the CCA the parties contemplated that these provisions would cover a situation where (i) CHS sells the Bonds in circumstances where that action is contrary to the express instructions of Panacorp; (ii) at the time when Panacorp is prepared to issue Proper Instructions to transfer the Bonds to the previous custodian; (iii) without informing Panacorp, CHS decides to sell the Bonds to an associated Company, Castle Harbour LLP; and (iv) Panacorp is not advised of the sale price achieved by Castle Harbour LLP or the identity of the ultimate purchaser.

131. Despite the strong language used in clauses 8.4 and 8.5 of the CCA, I have come to the conclusion that, as a matter of construction of these clauses, the parties did not contemplate that they would cover the factual situation identified in in paragraph 130 above. Accordingly, I would have held that clauses 8.4 and 8.5 do not have the effect of excluding all liability in the exceptional circumstances found to exist by the Court and as set out in paragraph 130 above. I should add that I would not have denied the enforceability of clauses 8.4 and 8.5 on the basis that by its actions in selling the Bonds CHS had repudiated the CCA. It seems to me that such a result is foreclosed by the decision of the House of Lords in *Photo Production Ltd v Securicor Transport Ltd* [1980] AC 827.

## F. <u>Conclusion</u>

132. I have found that in all the circumstances CHS was not entitled to sell the PDVSA Bonds without receiving Proper Instructions from Panacorp and its decision to sell the Bonds on 27 December 2018 was a breach of clause 3.1.4 of the CCA. I have also found that on the basis of the evidence presented to the Court that Panacorp was only likely to be authorised

to sell 20% of the Bonds. For the reasons set out at paragraph 101 to 105 above, I am bound to conclude, on the balance of probabilities, that Panacorp has not established recoverable loss suffered by it in relation to its claim based upon breach of the CCA. Accordingly, the Court awards Panacorp nominal damages in the amount of US $5.

Dated this 20th day of May 2021

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NARINDER K HARGUN
CHIEF JUSTICE