[2022] EWHC 3270 (Comm)

Claim No: LM-2020-000230

IN THE HIGH COURT OF JUSTICE
BUSINESS AND PROPERTY COURTS OF ENGLAND AND WALES
LONDON CIRCUIT COMMERCIAL COURT (KBD)

Royal Courts of Justice
Rolls Building, London, EC4A 1NL
Date 21 December 2022

Before
Philip Marshall KC (sitting as a Deputy Judge of the High Court)

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Between:

RIVERROCK EUROPEAN CAPITAL PARTNERS LLP

Claimant

-and-

(1) NICOLAUS HARNACK

(2) FRANZ LUCIEN MÖRSDORF

Defendants

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APPROVED JUDGMENT

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Cleon Catsambis (instructed by Mishcon de Reya LLP) for the Claimants
The First Defendant appeared in person (via videolink)
Adam Cloherty (instructed by Fladgate LLP) on behalf of the Second Defendant
Hearing dates: 20, 21, 22 and 26 September 2022

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I direct that pursuant to CPR rule 39.9 no official shorthand note shall be taken of this Judgment and that copies of this version as handed down may be treated as authentic

PHILIP MARSHALL KC

PHILIP MARSHALL KC:

A. Introduction

1. This judgment follows the trial of claims made by RiverRock European Capital Partners Limited LLP **("RiverRock")** seeking a payment of €1,617,270 from the Defendants, Mr. Harnack and Mr. Moersdorf.

2. The claims are based on an alleged entitlement of RiverRock to certain payments on termination of a consultancy agreement it made with Deutsche Real Estate Asset Management Limited **("DREAM")** dated 9 September 2016 (but later revised on 8 June 2017) (the "**Consultancy Agreement**"). Under this and allied agreements (referred to collectively as **"the DREAM Agreements"[1])** DREAM acted as the "Appointed Representative" of RiverRock, within the meaning of s.39(2) of the Financial Services and Markets Act 2000 **("FSMA")** in respect of a fund, namely the RiverRock European Real Estate Fund (the "**Fund**"). This Fund had a target size of €200 to €250 million and was focused on investments in mezzanine debt instruments backed primarily by commercial real estate in Germany.

3. The right to terminate is said to have arisen following the striking off of DREAM from the Register of Companies and its dissolution and to have given rise to a right to receive payment from Mr. Harnack and Mr. Moersdorf in the claimed amount pursuant to two deeds of covenant executed by each of them on 9 September 2016 **("the Deeds")**. It is said that under these Deeds Mr. Harnack and Mr. Moersdorf each undertook, directly and by way of guarantee, to meet financial obligations of DREAM following termination.

4. The issues raised principally concern the true construction of the various contractual provisions applicable to the creation and operation of the Fund and the obligations of DREAM in respect of it. Three questions have been formulated in an agreed list of issues:

[1] I shall treat this term as encompassing all of the agreements with RiverRock to which DREAM was a party but excluding the deeds executed by the Defendants dated 9 September 2016.

(1) Did the dissolution and striking off of DREAM [from the Register of Companies] constitute a breach of one or more of the provisions of the DREAM Agreements and/or the Deeds, which entitled RiverRock to terminate the Consultancy Agreement?

(2) If so, do certain provisions requiring payment set out in clauses 6.5 and 6.7 of the Consultancy Agreement constitute an unenforceable penalty as the Defendants allege?

(3) If not, are the sums set out in a "Revised Schedule of Fees and Expenses" recoverable?

Issues (2) and (3) therefore only arise for consideration if RiverRock is successful on issue (1).

5. Although the dispute mainly concerns points of construction the court heard a limited amount of oral evidence provided by Mr. Diamandis Karamagias, the Chief Financial Officer and Chief Operating Officer of RiverRock, and by Mr. Harnack and Mr. Moersdorf. In the case of Mr. Harnack this was done by way of video link by agreement between the parties. Mr. Harnack also participated in the trial more generally by this method. Permission for this was sought and given on the ground first, that he is now resident in Canada and his resources did not permit him to travel to England to attend in person, and secondly, on the basis that his participation in this manner was not objected to by the other parties.

6. My impression of all of the witnesses when giving oral evidence was that they were generally seeking to assist the court and giving testimony to the best of their recollection. In the case of Mr. Moersdorf, whose native language was German, it would have been better if he had given his evidence through an interpreter. Whilst he was tolerably fluent in English it was evident that he had some difficulty in understanding technical language and I was not always confident that he fully understood what was being asked. It is also the case, that in some respects the oral evidence did not match what had been said previously in witness statements. In these instances I have generally accepted what has been stated in oral evidence. The particular areas in which this inconsistency occurred are addressed in the course of this judgment.

B. The Parties and Relevant Agreements

7. RiverRock is a limited liability partnership with its registered office in London. It operates as a European alternative investment firm. As explained in the witness statement of Mr. Karamagias, it specialises in a variety of forms of debt investment strategy and is regulated by the Financial Conduct Authority **("FCA")**.

8. Mr. Harnack and Mr. Moersdorf described their background and the origination of the idea of the Fund in their witness statements in the following manner:

   (1) Mr. Harnack is a real estate investment banker and adviser. Mr. Moersdorf is an independent real estate adviser based in Frankfurt, Germany. They have known each other since 1997, when they were both employed by the international property firm, Richard Ellis.

   (2) Mr. Harnack went on to work at Credit Suisse. After resigning from that bank in 2011 he developed a business plan for a mezzanine debt fund focussed specifically on German commercial real estate.

   (3) In July 2012 he approached the then-Chief Executive Officer and co-founder of RiverRock, Mr. Florian Lahnstein, with a proposal to establish such a fund. This seems to have resulted in the production of a term sheet dated 15 November 2012. This provided for Mr Harnack to manage the fund and for RiverRock to obtain regulatory approvals and supply various forms of assistance, including marketing and administrative support.

   (4) Mr. Harnack then approached Mr. Moersdorf with a proposal that he should become an adviser to the fund, an idea that was also promoted by Mr. Michel Peretie, a partner in and co-Chief Executive Officer of RiverRock. Mr. Moersdorf agreed to take on this role. At this time Mr. Moersdorf was working for his own independent real estate investment and asset management company in Germany, Deutsche Real Estate Asset Management GmbH.

(5) During the period between 2013 and 2015 Mr. Harnack and Mr. Moersdorf undertook various trips in Europe to meet potential investors and reported back to RiverRock. The correspondence available also shows that they were seeking to recruit staff to assist in the promotion of the proposed fund and to agree the contractual arrangements that would be put in place with RiverRock.

(6) Ultimately, in March 2016, the final arrangements for the creation and operation of the Fund were agreed in principle. RiverRock would advise the Fund and act as "Alternative Investment Fund Manager". It would delegate certain advisory functions to a company to be formed by Mr. Harnack and Mr. Moersdorf, and they would act as portfolio managers. In practice, Mr. Harnack and Mr. Moersdorf would be responsible for the day-to-day operation and management of the Fund. Since the services to be provided by Mr. Harnack, Mr. Moersdorf and their company would include activities regulated by the FCA, RiverRock was to appoint that company as its "Appointed Representative" under FSMA and assume responsibility for its regulated activities. RiverRock was also to obtain approval for Mr. Harnack and Mr. Moersdorf to perform FCA-regulated activities.

(7) On 22 June 2016 DREAM was incorporated in England and Wales as the company to fulfil the "Appointed Representative" role. It had its registered office at Mr. Harnack's then residential address in Fetcham, Surrey. However, the sole director and shareholder was Mr. Moersdorf, who was based in Frankfurt. It seems to have been intended that Mr. Harnack should become a 50% shareholder (something that was noted in an email of Mr. Harnack sent on the same date as the incorporation) but this never in fact happened.

9. A number of agreements were then concluded to implement what had been agreed in principle. These contracts were drafted by solicitors representing RiverRock. Mr. Harnack and Mr. Moersdorf did not have legal representation with regard to the drafting of the documents. They contained a number of overlapping provisions.

10. First in time was an agreement whereby RiverRock appointed DREAM as an "Appointed Representative" for the purpose of providing FCA-regulated activities in connection with the establishment and operation of the Fund **("the AR Agreement")**. This is dated 1 June 2016 but was actually signed on 29 June 2016. It contained the following clauses on which RiverRock relies:

    (1) By clause 1.1 RiverRock engaged DREAM to provide defined services, including the sourcing of investments for the Fund and the management of those investments.

    (2) Under clause 2.1(c), DREAM undertook that it would fully cooperate with RiverRock to enable it to meet its obligations under FSMA, the FCA Rules and other legal provisions applicable to the business of operating the Fund.

    (3) Under clauses 2.3(c) and (d), DREAM was to notify RiverRock as soon as it became aware that there was a material adverse change in its financial position or grounds to believe that certain representations or warranties, regarding its ability to perform and the expertise of its staff, were not accurate. There was also an obligation to notify if there was any material change in the information provided to RiverRock or the FCA about DREAM (clause 2.3(g)).

    (4) Lastly, under clause 2.5(e) there was an obligation on DREAM to procure that Mr. Harnack and Mr. Moersdorf would use all due care, skill and diligence in the provision of the defined services referred to in clause 1.1.

11. Thereafter there was the Consultancy Agreement between RiverRock and DREAM, whereby DREAM was given various advisory functions in respect of the Fund. The Consultancy Agreement contained the following provisions on which RiverRock relies for the present proceedings (some of which duplicate to an extent those in the AR Agreement set out above):

    (1) By clause 3.1 DREAM was to provide defined services to RiverRock, which included the services necessary to establish the feasibility of the Fund,

marketing the Fund to investors, sourcing investments and managing the investments.

(2) By clause 3.3.1 DREAM was to procure that these defined services were provided by "Key Men", namely, Mr. Harnack and Mr. Moersdorf, with all due care and skill and to the best of these individuals' ability.

(3) By clause 3.3.3, DREAM was to procure that such individuals, when providing the defined services, used their best endeavours to protect, promote, develop and extend the interests and reputation of the Fund and the RiverRock group and its funds.

(4) Under clause 3.4.3, DREAM was fully to cooperate with RiverRock to enable it to meet its obligations under the FCA Rules or any other legal or regulatory requirements or standards that might apply to it.

(5) Under clause 3.4.4, DREAM was promptly to notify RiverRock in the event that it was no longer able to make available the "Key Men" to RiverRock in accordance with the agreement.

(6) Clause 6.3, provided in material part that:

"Notwithstanding Clause 2.1, [RiverRock] may terminate this Agreement with immediate effect and without notice and without liability to pay any unpaid fees, expenses or damages if at any time:

6.3.1 [DREAM] or the Key Men commit a material or (having been given notice in writing) persistent breach of the terms of this Agreement, the Appointed Representative Agreement, the Secondment Agreement, the Fund Documents or the individual Deeds of Covenant or any other obligations that it or he owes to the Fund or RiverRock;

6.3.2 [DREAM] makes a resolution for its winding up, makes an arrangement or composition with its creditors or makes an application to a court of

competent jurisdiction for protection from its creditors or an administration or winding-up order is made or an administrative receiver is appointed to [DREAM];…

6.3.4[DREAM] causes [RiverRock] to be in breach of any of its obligations pursuant to…the FCA Rules;…

6.3.6 [DREAM] or the Key Men commit a breach of the FCA Rules or the Compliance Manual or any other applicable legal or regulatory provision or policy to which [DREAM], the Key Men, the Fund or [the RiverRock group and its funds] is subject…"

6.3.7 either Key Man or [DREAM] ceases or fails to hold the regulatory approvals that RiverRock considers necessary or advisable for the provision of the Services…; or

6.3.8 [DREAM] or either Key Man…acts in a manner which brings or may bring [DREAM], the Key Men, the Fund and/or RiverRock into disrepute or which is materially adverse to the interests of the Fund or [the RiverRock group and its funds]".

(7) In the event of termination under clause 6.3, clause 6.5 went on to provide for the payment of certain defined expenses incurred by RiverRock and not reimbursed by the Fund or its investors (referred to as "the Final Cost Accounting").

(8) The above provision was supplemented by clause 6.7 which provided that if the Consultancy Agreement was terminated for any reason DREAM was to repay to RiverRock any advances, salary or fixed fees paid to DREAM or Mr. Harnack or Mr. Moersdorf where they had not been taken into account in determining a variable fee that this agreement provided for.

12. In addition to the above, there was another agreement dated 9 September 2016 **("the Secondment Agreement")** whereby DREAM agreed to second Mr. Harnack and Mr. Moersdorf to RiverRock to provide investment management services to the Fund. RiverRock also places reliance on certain provisions of this agreement, which again largely replicate provisions in the AR Agreement and Consultancy Agreement, namely an obligation on DREAM to procure that these individuals were its employees or consultants (clause 2.1) and almost identical obligations to those in clauses 2.1(c) and 2.5(e) of the AR Agreement and clauses 3.3.1, 3.3.3 and 3.4.3 of the Consultancy Agreement. Further under clause 3.2(5) of the Secondment Agreement DREAM was to ensure Mr. Harnack and Mr. Moersdorf complied with RiverRock's compliance manual, the FCA rules and with any other legal or regulatory requirements or standards that might apply to them.

13. Finally, there were the two Deeds, identical in all material respects, one of which was executed by Mr. Harnack and one by Mr. Moersdorf. RiverRock relies on clause 2 of these instruments whereby each individual undertook to comply with and confirmed his agreement with the obligations of DREAM set out in the Consultancy Agreement, AR Agreement and Secondment Agreement "*as if he were party to such agreements"*. It also relies on clauses 3(i), (iii) and (iv) of each Deed which contained obligations for the individual mirroring those in clause 2.5(e) of the AR Agreement and clause 3.3.3 of the Consultancy Agreement and a further obligation to promptly give RiverRock such information, explanations and reports it as might reasonably require in connection with the services to be provided by DREAM and RiverRock under the Consultancy Agreement. Reference is also made to clause 4 of each Deed whereby each of Mr. Harnack and Mr. Moersdorf guaranteed any financial liabilities of DREAM arising in a variety of circumstances.

C. <u>The Operation of the Fund</u>

14. The Fund launched in November 2016 but there were problems in raising investments. Once under operation the Fund only ever had three investors, the two largest by far being subsidiaries of Banque Regionale d'Escompte et de Depots" **("Bred")**, from whom funds of some €30 million in aggregate were raised.

15. There were also difficulties in sourcing investments. In his witness statement Mr Harnack referred to the fact that there was only one successful investment in 2017. In his evidence Mr. Karamagias referred to only some €9 million having been invested out of a fund under management of some €35 million by 2018.

16. In early 2018 RiverRock was actively looking for other potential portfolio managers for the Fund. As Mr. Karamagias put it in his evidence: *"…now we need a new team that can do better"*.

17. Thus a Mr. Oliver Chappell wrote on behalf of RiverRock on 15 January 2018 to another asset management firm in Holland saying "*RR is looking for a portfolio manager for this business. If you know someone who is based in Germany – mid-range I'd like to hear suggestions"*. He thereafter passed on details of a Mr. Thomas Ertl and "someone more junior" to Inder Bir Singh, the Head of Asset Management at RiverRock.

18. On 5 February 2018 Mr Peretie of RiverRock sent an email to Mr. Harnack and Mr. Moersdorf recording that the latter had said the Fund was underperforming in terms of deals done, time spent and "hit ratio" when a potential deal was identified. He then said *"We all agree that we are dealing with frustrated investors who we have to get back to with a strategic plan…We should…beef up the team (affordability)"*.

19. On 7 February 2018 in an internal email of RiverRock in response, a Mr. Antoine Chausson informed Mr Bir Singh and other senior employees at the firm that he wanted information as to priorities on managing the situation. He continued: *"Last week I was asked to inform the lead Bred contact that RR was planning to appoint quickly new management to lead [the Fund] origination. I was also asked to book a meeting with him asap to explain how RR will make it happen (new managers/new origination/delaying final closing to allow new investor coming in on new pipeline strength..)…it would be helpful if you could indicate whether RR has formally agreed with Nick and Franz that new managers will come in to replace them?, to run the fund? To advise? Accordingly, please confirm whether you want me to book a pipeline call with client and Nick, or alternatively book a meeting with RR management to discuss management replacement…"*

20. Later the same day Mr. Bir Singh replied that *"the priority is to execute Plan B. However, we cannot inform Nick/Franz of the changes before the initial discussion with your investors"*. As Mr. Karamagias accepted in cross-examination, "Plan B" involved the replacement of Mr. Harnack and Mr. Moersdorf at least in respect of the origination of potential investments.

21. A few days later, on 12 February 2018, a draft presentation regarding the Fund was circulating between RiverRock representatives and Mr. Ertl. This contained details of personnel at the Fund. Under the heading "Senior Investment Team" it had Mr. Chappell and Mr. Ertl as "Head Portfolio Manager" and Mr. Harnack as "Senior Portfolio Manager", which, as Mr. Karamagias accepted, was a demotion. Mr. Moersdorf did not feature as part of this team at all but later in the document as a "portfolio manager".

22. These draft proposals had not been discussed with Mr. Harnack or Mr. Moersdorf but were nevertheless provided to BRED by the end of that month for the purposes of obtaining the approval of this controlling investor group.

23. A few days later, on 1 March 2018, Mr. Karamagias was seeking various documents which were to facilitate a "performance review" by Mr. Peretie of Mr. Harnack and Mr. Moersdorf as portfolio managers. As Mr. Karamagias explained in cross-examination the performance review would be used as a basis for a negotiation with Mr. Harnack and Mr. Moersdorf about how the investment team for the Fund was to be restructured.

24. It is evident that RiverRock did not anticipate that their restructuring of management of the Fund was going to be accepted and was likely to lead to a dispute. In my judgment, this explains why correspondence of Mr. Chausson at this point (6 March 2018) is headed "confidential and privileged" (despite not referring to or containing any legal advice). In that correspondence Mr. Chausson refers, at paragraph "a", to a proposed meeting with "existing management" in which the termination of the Fund and crystallisation of financial obligations to RiverRock were to be raised along with allegations of breach of duty to investors. In the cross-examination of Mr. Karamagias the following exchange took place regarding this situation:

"Q.Option A is termination of the fund isn't it?
A. Yes.

Q.What he is saying there is that in that event we need to hunt around for reasons to find that Mr. Moersdorf and Mr. Harnack are in breach of the agreements?
A. Yes."

25. In the same email at paragraph "b" Mr. Chausson referred to an alternative proposal for a probationary period during which "legacy fund managers" might choose to work under new fund managers "subject to new fund management approval and under terms to be agreed with RR". As Mr. Karamagias accepted, this was RiverRock's preferred option and meant termination of the DREAM agreements.

26. Neither of these options was a recipe for a peaceful conclusion to relations with Mr. Harnack and Mr. Moersdorf. As Mr. Karamagias himself put it, RiverRock were *"preparing a plan that is not going to be smooth in explaining and getting their agreement"*.

D. <u>The Dissolution of DREAM</u>

27. Such was the context in which the dissolution of DREAM came to light.

28. DREAM had been obliged to file a Confirmation Statement with Companies House on 5 July 2017 but this had not been done.

29. On 12 September 2017 the Registrar of Companies had given notice that within 2 months DREAM would be struck off the register and the company would be dissolved. The notice was sent to Mr. Harnack's home.

30. No action having been taken in response to this notice, DREAM was duly struck off and dissolved on 26 November 2017. The precise reason no action was taken was explored in cross-examination with Mr. Harnack and Mr. Moersdorf. It seems that an arrangement had been made for Mr. Harnack to bring mail for DREAM to Mr. Moersdorf in Germany since they were meeting regularly in Frankfurt. However, Mr. Harnack had moved from his home in England in August 2017. He then arranged for the forwarding of mail. In an email to RiverRock of 7 March 2018 Mr. Harnack had said that the Confirmation Statement had been sent to Companies House in June 2017, something that he confirmed in cross-examination. But I accept the oral evidence of Mr. Moersdorf, that this did not fact occur. The 7 March 2018 email and evidence of Mr. Harnack and earlier statement in

the Defence of Mr. Moersdorf to the contrary effect are incorrect and the result of Mr. Moersdorf misremembering what had actually been done. He had intended to deal with the Confirmation Statement by post, had told Mr. Harnack of this but had then forgotten to do it.

31. The dissolution of DREAM was only discovered by the parties at the point at which Mr. Karamagias was gathering together documentation for a compliance and performance review on 1 March 2018. He raised the matter, in passing, in the following way in an email to Mr. Moersdorf the next day:

> *"In addition, and to my surprise, I note that DREAM UK was dissolved on 28 November 2017. As a result, we will need to execute a new AR Agreement as DREAM UK no longer exists. Please can you urgently let us know which entity you propose to use as the counterparty to our AR arrangements. We will need to file this with the FCA. As of today, the consultancy arrangements are non-operational and you are currently in breach of your obligations towards the FCA".*

32. Mr. Karamagias accepted in cross-examination that he regarded the issue as soluble. I reject the evidence in his witness statement to the effect that he was "completely horrified" by the discovery of the dissolution, which is neither consistent with his own email message nor his oral evidence in cross-examination.

33. In my judgment, others within RiverRock, however, saw this as an opportunity to bring about the termination of the DREAM agreements and to remove Mr. Harnack and Mr. Moersdorf from further involvement in the Fund. Thus later the same day, 2 March 2018, Mr. Peretie described the situation as *"very troublesome"* and then stated in an email to Mr. Harnack "*Registered companies have to fill(sic) account statements and financial information at least once a year. If not companies are automatically dissolved. As a director of the company it is your duty (as well as Franz) to make sure that you comply with the regulation especially regarding the fact that DREAM UK is our appointed representative. We have a very serious issue here".*

34. Mr. Peretie evidently appreciated that the dissolution was not the result of deliberate inaction but the result of ignorance of the legal requirements or oversight, which is why he explained the legal requirements to Mr. Harnack, who had already said by this time that the dissolution was news to him. Mr. Moersdorf had also explained in an email to

Mr. Karamagias of 6 March 2018 that *"PS Regarding D.R.E.A.M Ltd. the company address is Nic's home address – obviously post was not received since he is in Berlin since August. He promised to reestablish the firm! Again here – I apologize (sic)! I should have known before"*.

35. Notwithstanding RiverRock therefore appreciating that the dissolution was an oversight (as Mr. Karamagias accepted in cross-examination), communications began with the FCA without mentioning this:

    (1) Thus on 6 March 2018 RiverRock contacted the FCA by email. After explaining that DREAM was an appointed representative for the Fund and that it had been dissolved, the message continued: *"It is our understanding that the dissolution of DREAM makes the Appointed Representative arrangement null and void and we shall therefore be submitting the notification to withdraw DREAM as an appointed representative of RiverRock. We are also in the process of filing a Form C in respect of each of the Portfolio Managers whilst we carry out an investigation into why DREAM was dissolved and why the Portfolio Managers (each of whom personally undertook to RiverRock to comply with the obligations of DREAM) did not notify us of its threatened and actual dissolution…RiverRock will use its best endeavours to conclude its investigation and, with the required approval of the investors, to appoint portfolio managers to the Fund with appropriate FCA approvals as soon as practicable"*. There was no mention of the explanation that the dissolution was an oversight and that the situation was regarded as soluble.

    (2) On 9 March 2018 the FCA responded. It was evident from its response that it was proceeding on the misapprehension that the dissolution of DREAM had followed its insolvency and that there would be claims for compensation by investors. Even so, beyond explaining what had to be done to rectify the position, the FCA did not take any further action.

    (3) RiverRock did not immediately disabuse the FCA of its misapprehension. But rather, through its Associate General Counsel and Compliance Officer, Mr. Oliver Allan, RiverRock continued the FCA's misunderstanding by stating in

an email of the same day that *"Separately, the Firm is dealing with the financial consequences of the dissolution with the two individuals in question"* without explaining that such *"financial consequences"* were a claim by RiverRock rather than any insolvency or possible compensation claim by investors.

(4) The position was partly clarified in response to a request from the FCA for further explanations on various matters, including as to the financial consequences of the dissolution of DREAM. But this was only after the DREAM agreements had been terminated. On 16 March 2018 Mr. Allan explained to the FCA that the only financial consequences were RiverRock's right to repayment from DREAM under various agreements, there had been no financial consequence to any Fund investor. The explanation of Mr. Harnack and Mr. Moersdorf, that the dissolution occurred only through a failure to file a Compliance Statement on time (as opposed to insolvency), was now also mentioned.

(5) Ultimately, after some further questions in correspondence in April 2018 the matter was resolved to the FCA's satisfaction without any further action.

36. On 7 March 2018 Mr. Moersdorf applied for the restoration of DREAM to the register and filed a Confirmation Statement. He informed Mr. Peretie of this by email the same day explaining that *"The restoration is a standard process at Companies House, as the dissolvement (sic) of registered companies happen (sic) quite often, as they told us on the telephone…We will get a confirmation from Companies House shortly that states that the LTD is not dissolved…"*

37. Despite this, Mr. Harnack and Mr. Moersdorf were required to attend a meeting with RiverRock representatives on 9 March 2018. At that meeting they were handed a letter from the General Counsel of RiverRock informing them that the dissolution had rendered the DREAM Agreements "operationally ineffective" and that *"For the avoidance of any doubt RiverRock, in accordance with its rights to terminate with immediate effect "for cause", hereby gives notice that it is terminating the Consultancy Agreement, Secondment Agreement and Appointed Representative Agreement to take effect*

immediately on any restoration of DREAM UK to the register". There was then a demand for repayment based on the same provisions as the current claim.

38. This was followed by the delivery of an invoice to Mr Harnack and Mr. Moersdorf on 12 March 2018 seeking payment of €80,000 described as "*Repayment of consulting services for the months of November 2017 – February 2018"* (covering the period in which DREAM was dissolved).

39. After correcting the period to which any repayment should relate Mr. Moersdorf arranged a transfer of €19,975 to RiverRock in March 2018 and a further €10,000 in May 2018. In his witness statement he explained that he paid what he believed he owed in respect of overpaid consultancy payments during the period DREAM was struck off.

40. RiverRock has asserted that the invoice supplied was not intended to limit its claim. The Defendants have not contended that it did. By the same token it has not been suggested that Mr. Moersdorf's payment inhibits him in any way in contesting the current claim.

41. Relations with Mr. Moersdorf did not in fact end after the termination letter of 9 March 2018. Less than two weeks later (21 March) Mr. Moersdorf was offered and accepted a position as an adviser to the Fund, sourcing further investment opportunities for Mr. Ertl and Mr. Chappell who were now the sole fund managers. His continued role was reported to investors on 19 April 2018. But the position was not long lived. Although he seems to have worked briefly with Mr. Ertl, all communication between Mr. Moersdorf and RiverRock personnel had finished by September 2018.

42. Mr. Harnack was not appointed to any new position and received a letter demanding payment of €1,397,269 dated 4 April 2018. Two years then passed with no payment being made. RiverRock eventually instructed solicitors to bring the present claim in April 2020.

43. The Fund came to an end in August 2021 with capital being returned to the investors.

E. <u>Analysis</u>

44. I now turn to the agreed list of issues.

(i) Did the dissolution and striking off of DREAM [from the Register of Companies] constitute a breach of one or more of the provisions of the DREAM Agreements and/or the Deeds, which entitled RiverRock to terminate the Consultancy Agreement?

45. In the written opening submissions filed on behalf of the Claimants four broad categories of alleged breach were relied upon as giving rise to a right to terminate the Consultancy Agreement, namely:

(1) a material breach by DREAM or the Defendants of the terms of the DREAM Agreements or the Deeds (clause 6.3.1 of the Consultancy Agreement);

(2) breaches of the FCA Rules / failure to hold the necessary regulatory approvals (clauses 6.3.4, 6.3.6 and 6.3.7 of the Consultancy Agreement);

(3) DREAM or the Defendants acting in a manner which brought or might have brought DREAM, the Defendants, the Fund and/or RiverRock into disrepute or which was materially adverse to the interests of the Fund or RiverRock (clause 6.3.8 of the Consultancy Agreement); and

(4) a breach of the implied terms pleaded at paragraphs 19.1(a) and (b) of the Amended Particulars of Claim (the "Implied Terms").

46. Taking each of these matters in turn.

(a) Clause 6.3.1 and “material breach”

47. Clause 6.3.1 of the Consultancy Agreement required the existence of a “material” breach or (after written notice had been given) a persistent breach by DREAM or Mr. Harnack or Mr. Moersdorf of one of the DREAM agreements or the Deeds.

48. It is not alleged that there was any persistent breach, within the meaning of clause 6.3.1, in this case. The issue is whether any of the breaches said to result from the striking off and dissolution of DREAM were material.

49. The concept of a "material" breach has not been easy to define. As observed in Green Deal Marketing Southern Ltd. v Economy Energy Trading Ltd. [2019] 2 All ER (Comm) 191 at [98], it is not very precise. Its meaning is dependent on the context and is likely to be dictated by reference to the consequences which would flow from a finding that it had occurred. Where the consequences would be significant, such as the termination of a contract that has required significant investment of time or resources by the parties, something substantial, meaning a serious matter rather than one of little consequence, may be required. Thus in Mid Essex Hospital Services NHS Trust v Compass Group UK and Ireland Ltd. [2013] EWCA Civ 200, Jackson LJ, giving the principal judgment of the Court of Appeal, addressed the question in this way at [125]-[126]:

> *"124. Counsel have cited a number of authorities in relation to the meaning of "material breach". For present purposes I only need refer to two of those authorities. In Dalkia Utilities Services plc v Celltech International Ltd [2006] EWHC 63 (Comm), [2006] 1 Lloyd's Rep 599 the claimant agreed to provide electricity and steam to a large paper mill which the defendant was constructing. Clause 14 of the agreement provided that the claimant could terminate if the defendant was in material breach of its obligation to pay. The claimant successfully terminated pursuant to that provision. In commenting on the operation of that clause Christopher Clarke J observed at paragraph 102:*
>
> > *"The sums involved were neither trivial nor minimal. Celtech's continued failure to pay them was serious. In assessing the materiality of any breach it is relevant to consider not only of what the breach consists but also the circumstances in which the breach arises, including any explanation given or apparent as to why it has occurred."*
>
> *125. In Fitzroy House Epsworth Street (No. 1) Ltd v Financial Times Ltd [2006] EWCA Civ 329, [2006] 1 WLR 2207 a lease contained a break clause which the tenant could exercise if it had "materially complied" with its obligations. The tenant was in breach of its repairing obligations in certain respects, but the Court of Appeal upheld a decision that the tenant was still entitled to exercise its right under the break clause. Sir Andrew Morritt C, with whom Jacob and Moore-Bick LJJ agreed, stated at paragraph 24 that the test for "material compliance" was objective, not subjective. At paragraphs 35-36 the Chancellor elaborated on the meaning of "material" as follows:*

"35. ... But I see no justification for attributing to the parties an intention that the insertion of the word 'material' was intended to permit only breaches which were trivial or trifling. Those words are of uncertain meaning also and are not the words used by the parties. Nor is it, in my view, of any assistance to consider whether the word 'material' permits more or different breaches than the commonly used alternatives 'substantial' or 'reasonable'. The words 'substantial' and 'material', depending on the context, are interchangeable. The word 'reasonable' connotes a different test."

126. Reverting to the present case, I must consider what "material breach" means in the context of clause 28.4.1 of the conditions. In my view this phrase connotes a breach of contract which is more than trivial, but need not be repudiatory. Clause 28.4 has the drastic effect of allowing Medirest to cancel a long term contract on one month's notice. Having regard to the context of this provision, I think that "material breach" means a breach which is substantial. The breach must be a serious matter, rather than a matter of little consequence".

50. A number of first instance decisions have provided illustrations of possible factors to consider. An example is the checklist put forward in the unreported case of Phoenix Media v Cobweb Information, 16 May 2000 (which was adopted as useful in Gallagher International Ltd v Tlais Enterprises Ltd [2008] EWHC 804 (Comm) at [764] and in Crosstown Music Company 1, LLC v Rive Droite Music Limited [2009] EWHC 600 (Ch) at [96] to [99] (unchallenged on this point on appeal)). In Phoenix Neuberger J said:

"Materiality involves considering the following: the actual breaches, the consequence of the breaches to [the innocent party]; [the guilty party's] explanation for the breaches; the breaches in the context of TEL Agreement; the consequences of holding TEL Agreement determined and the consequences of holding TEL Agreement continues".

51. In my judgment, the context of the present case is a Consulting Agreement which was expected to continue for some time and which, if terminated, might result in the waste of years of work by Mr. Harnack and Mr. Moersdorf. This warrants an approach similar to that adopted in the Mid Essex Hospital Services case. A repudiatory breach was not required (otherwise the term would add little since the Consulting Agreement could be terminated in the context of a repudiatory breach in any event at common law (as pointed out in Dalkia Utilities Services Plc v Celtech International Ltd. [2006] 1 Lloyd's Rep.599,

at [92])). Instead what was needed was a substantial breach. It had to involve serious consequences for the innocent party, for which purpose I adopt the description of Neuberger J. in Glolite Ltd. v Jasper Conran Ltd.,The Times, 28 January 1998 of serious *"…in the wide sense of having a serious effect on the benefit which the innocent party would otherwise derive from performance of the contract in accordance with its terms"*.

52. I am by no means convinced that the large number of breaches of contract alleged in this case to have resulted from the striking off and dissolution of DREAM in fact occurred. In particular it seems to me conceptually very strained to allege a breach of obligations regarding the provision of information by DREAM after its dissolution (such as in clauses 2.3(c), (d) and (g) of the AP Agreement and clause 3.3.4 of the Consultancy Agreement). But even if breaches were committed of all the terms alleged, adopting the above interpretation, I have no doubt in concluding that they were not material. In arriving at this conclusion I have considered all of the evidence but have had particular regard to the following features:

    (1) The breaches were the result of a mistake on the part of Mr. Moersdorf in failing to comply with the requirements of the Registrar of Companies.

    (2) The breaches were readily capable of remedy. DREAM could have been restored to the register within a very short period without difficulty and Mr. Moersdorf had set in train the necessary steps to achieve this. The arrangements between the parties could have continued had RiverRock been willing to proceed in this way.

    (3) RiverRock was not in fact concerned by the dissolution of DREAM. It used the dissolution as a means of justifying the termination of its existing contractual arrangements with DREAM and Mr. Harnack and Mr. Moersdorf, something it had already decided on before the dissolution came to its knowledge.

    (4) The consequences of the dissolution caused no loss to the Fund or its investors and caused no complaint or claim against RiverRock. Indeed RiverRock

ensured investors remained in ignorance of the dissolution. There was also no reason to think that it would cause any such loss or complaint.

(5) The dissolution did not lead to any action against RiverRock on the part of the FCA. No regulatory action was taken and no penalty of any kind was imposed. I reject the suggestion of Mr. Catsambis, counsel for RiverRock, that this was because of the prompt action of his client. If anything the action of RiverRock resulted in the FCA having an initial misapprehension as to the cause of the dissolution and likely impact on investors, which tended to encourage rather than discourage it from intervening.

(6) There was no reason to think that the FCA would take any action beyond that which it actually did take, especially if the position was fully explained to it.

(7) No other practical consequences to RiverRock arising from the dissolution have been identified beyond the replacement of Mr. Harnack and Mr. Moersdorf as the lead managers of the Fund, something which RiverRock had aimed to bring about imminently in any event.

53. For these reasons I reject the claim based on clause 6.3.1 of the Consultancy Agreement.

(b) Alleged breaches of the FCA Rules / alleged failure to hold the necessary regulatory approvals

54. The case of RiverRock under this heading was more fully explained in supplementary written submissions. It was contended that clauses 6.3.4, 6.3.6 and 6.3.7 of the Consultancy Agreement provided grounds for its termination irrespective of the existence of any material breach. These clauses have been quoted earlier but in essence concerned DREAM causing RiverRock to be in breach of its obligations under the FCA rules; a breach of the FCA rules and other applicable provisions by DREAM or Mr. Harnack or Mr. Moersdorf; or the failure of DREAM and these two Defendants to hold regulatory approvals.

55. Mr. Catsambis for RiverRock submitted, in summary, as follows:

(1) The dissolution of DREAM was the result of its failure to institute, implement and review adequate compliance systems, including in relation to Companies House and its filing requirements. This in turn was said to be a breach of Principles 2 and 3 of the FCA "Principles for Business" (which in essence require a firm to conduct its business with due skill, care and diligence and to control its affairs responsibly and effectively with adequate risk management systems). This in turn was a breach of clause 2.1 and of Appendix 1, paragraph 8 of the AR Agreement and justified termination under clause 6.3.6 of the Consultancy Agreement.

(2) By allowing DREAM to be dissolved the Defendants breached Principle 2 of the FCA `"Statement of Principle and Code of Practice for Approved Persons" which provides that *"An approved person must act with due skill, care and diligence in carrying out his accountable functions"*. This was also said to be a breach of clause 6.3.6 of the Consultancy Agreement.

(3) When DREAM was dissolved the Defendants lost such authorisations as they held through DREAM. This is said to have constituted a breach of Condition C of the Consultancy Agreement giving rise to a right to terminate under clause 6.3.7.

(4) Since RiverRock was responsible for anything done by DREAM as its "Appointed Representative", pursuant to s.39 of FSMA, its breaches and dissolution caused RiverRock to be in breach also. This was said to have been a breach of Appendix 1, paragraph 2 of the AR Agreement entitling RiverRock to terminate under clause 6.3.4.

56. Mr. Cloherty, counsel for Mr. Moersdorf, addressed first the alleged breach of clause 6.3.4 of the Consultancy Agreement. He submitted that the dissolution of DREAM did not cause RiverRock immediately to be in breach of any FCA rule and RiverRock had not identified anything to suggest the contrary. If the case based on clause 6.3.4 was to stand up it had to be on the ground that there were breaches by DREAM which caused RiverRock also to be in breach by virtue of the effect of s.39 of FSMA. I accept this submission. The mere fact that DREAM was dissolved could not without more cause

RiverRock to be in breach of any FCA rule. Whether DREAM itself otherwise acted in breach so as to cause a breach by RiverRock also, through the effect of s.39(4), is addressed below when considering the allegations of breach of clause 6.3.6 of the Consultancy Agreement.

57. Mr. Cloherty submitted that there were no breaches of clause 6.3.6 either. Firstly, he pointed out that Principles 2 and 3 of the FCA "Principles for Business" were contained in the "High Level Standards" section of the FCA Handbook and were "a general statement of the fundamental obligations of firms under the regulatory system" (see PRIN 1.1.2G). It is necessary to have regard to more particular rules and guidance in the Code of Practice for Approved Persons or "APER" to give the principles content. Under APER 3.1.3G, in determining whether conduct complies with a Statement of Principle, the FCA will take account of all of the circumstances of the particular case. Further, under APER 3.1.4(1)G *"an approved person will only be in breach of a Statement of Principle where he is personally culpable. Personal culpability arises where an approved person's conduct was deliberate or where the approved person's standard of conduct was below that which was reasonable in all the circumstances".*

58. Secondly, it was submitted that the specific guidance on Principle 2 in APER 4.2 did not support the conclusion that an oversight causing the temporary dissolution of DREAM was a breach of Principle 2. The examples provided all support the conclusion that only misconduct of a serious as opposed to that of an inconsequential nature is required for there to be a breach of Principle 2. A similar point was made by reference to Principle 3 on the basis of the quidance in APER 4.3.

59. Mr. Cloherty made further points based on the absence of any plea of a specific breach on the part of DREAM or the Defendants, falling within the illustrations given in the FCA publications, and the FCA's approach to the withdrawal of approved person status in its Enforcement Guide.

60. In my judgment, the point that Principles 2 and 3 of the Principles of Business must be considered in light of the specific guidance in the FCA Code of Practice is well made. The illustrations provided by the FCA of conduct constituting a breach of these Principles show that only matters of a serious nature fall into this category, with most of the

examples being of conduct causing a significant impact on customers (such as failing to explain the risks of an investment to a customer (APER 4.2.4G(1)) or mismarking trading positions (APER 4.2.4G(2)). See also the description of cases in which a breach has actually been considered to have occurred and in which disciplinary action has been taken in Morris, *Financial Services Regulation in Practice,* pp.229-230. The striking off and dissolution of DREAM in the circumstances of this case (which I have already described in the context of the analysis of the claim based on clause 6.3.1 of the Consultancy Agreement) was not such as to fall within this level of misconduct. I therefore reject the claim founded on a breach of clause 6.3.6 and for the same reasons I do not consider DREAM to have caused RiverRock to be in breach of any FCA rules by virtue of its position as "Appointed Representative" and the effect of s.39 of FSMA.

61. With regard to clause 6.3.7 Mr. Catsambis accepted that, in respect of the requirement for Mr. Harnack and Mr. Moersdorf to have *"the regulatory approvals that RiverRock considers necessary or advisable"* to provide the services defined in the Consultancy Agreement, it was implicit that this could only be such regulatory approvals as were reasonably considered necessary or advisable. In my judgment it follows that RiverRock could not act in a capricious manner in respect of such approvals and nor could it require approvals for a purpose other than ensuring that the provision of the services met regulatory requirements.

62. Mr. Cloherty pointed to the fact that Mr. Harnack and Mr. Moersdorf at all times had direct regulatory approval for the services to be supplied. It was provided through RiverRock separately from DREAM. Such approval through RiverRock was needed because these individuals were to provide services in a personal capacity under the Deeds and were seconded to RiverRock under the Secondment Agreement, so creating an arrangement for the carrying out of a regulated activity within the meaning of s.59 of FSMA. In answer Mr. Catsambis contended that this was not the relevant arrangement because it was envisaged that the structure would involve DREAM and therefore further regulatory approval for them to act through DREAM was required. I am not persuaded that this answers the point; whether there was a different arrangement with DREAM that also mandated regulatory approval was neither here nor there, the fact is that Mr. Harnack and Mr. Moersdorf retained the regulatory approval needed to provide the services required of them. In any event, even if that were wrong, I reject the submission as a basis

for contending that the required regulatory approvals fell away simply through what ought to have been only a temporary dissolution of DREAM. The key matter for the arrangements between the parties was the involvement of Mr. Harnack and Mr. Moersdorf, who were described as "the Key Men". DREAM was merely a functionary which had no other business than such as resulted from their activity. In my judgment, in the circumstances pertaining in this case, there was no reasonable basis for contending that further regulatory approvals were required beyond those which were already in place at the point at which RiverRock served notice of termination on 9 March 2018. Further, in so far as RiverRock based termination ostensibly upon the absence of a regulatory approval relating to DREAM, this was for an ulterior purpose. It was to secure the replacement of Mr. Harnack and Mr. Moersdorf for perceived performance failures of the Fund, and not because of the absence of a regulatory approval on the part of these individuals which was considered either necessary or advisable.

63. I therefore also reject the claim based on termination under clause 6.3.7 of the Consultancy Agreement.

(c) Allegedly acting in a manner which brings or may bring DREAM, the Defendants, the Fund and/or RiverRock into disrepute or which is materially adverse to the interests of the Fund or RiverRock (clause 6.3.8 of the Consultancy Agreement);

64. RiverRock contends that, by permitting DREAM to be dissolved, placing RiverRock in a perilous position as regards both the FCA and investors and undermining the viability of the Fund. Mr. Harnack and Mr. Moersdorf acted in a manner that brought or might have brought DREAM, the Fund, themselves or RiverRock into disrepute or in a manner materially adverse to the interests of the Fund or RiverRock. It is claimed that on this basis termination was justified under clause 6.3.8 of the Consultancy Agreement.

65. I reject this contention for largely the same reasons as my rejection of the claim based on clause 6.3.1. The dissolution of DREAM was an oversight which did not have and should not have had any serious consequence. RiverRock was not placed in a perilous position with investors, who were never informed of the matter in any event. Nor was it in any danger with the FCA, especially not if the FCA had been properly informed of the true

circumstances. Nor did the dissolution undermine the viability of the Fund. The Fund continued irrespective of DREAM and in any event its dissolution could be quickly reversed. In my judgment there is no basis for the suggestion that Mr. Harnack or Mr. Moersdorf brought any relevant party into disrepute or could have done so from this event and nor did it materially adversely affect the interests of the Fund or RiverRock.

(d) Implied Terms

66. Next RiverRock contends that terms are to be implied into each of the DREAM Agreements on the basis that they are necessary to give business efficacy to those agreements or that they are so obvious as to go without saying, namely:

(1) DREAM was under a duty to ensure it remained in legal existence and maintained itself on the Companies House register;

(2) DREAM was under a duty to provide the necessary information requested by Companies House in a timely manner;

(3) DREAM was under a duty to ensure it remained able to comply with its legal obligations (including its contractual obligations); and

(4) In the alternative DREAM was under a duty to use its best endeavours to comply with the obligations set out in (1) to (3) above.

67. An implied term was also said to exist in the DREAM Agreements and the Deeds requiring the Defendants to ensure that DREAM remained in existence and remained able to comply with its legal obligations and creating obligations on the Defendants personally in an equivalent form to those set out in sub-paragraph (2) and (4) above.

68. It also seemed to be contended that a breach of these implied terms amounted almost automatically to a material breach under clause 6.3.1 of the Consultancy Agreement. The

argument seems to proceed on the footing that, since the dissolution of DREAM involved a more comprehensive breach of such implied terms, it could not be denied that a material breach within the meaning of clause 6.3.1 had occurred.

69. I reject the suggestion that the terms contended for fall to be implied. Such terms were not necessary to make the relevant contracts work in this case (that is to say to give them commercial or practical coherence) nor were they obvious in the relevant sense, given the other provisions of the agreements (to adopt the language used in the leading decisions in Marks & Spencer Plc v BNP Paribas Securities Services Trust Co. (Jersey) Ltd. [2015] UKSC 72, at [18] to [21] and Ali v Petroleum Co. of Trinidad and Tobago [2017] UKPC 2, at [7]). The dissolution of DREAM would have meant that it could no longer provide the services it had contracted to provide and thereby involve a breach of at least clauses 1.1 of the AR Agreement and 3.1 of the Consultancy Agreement and thereby also a breach of the Deeds. There was no practical need to have additional provisions of the type suggested. Further, I bear in mind that these were detailed commercial agreements drafted by professional lawyers appointed by RiverRock. As observed in *Chitty on Contracts* (34th Edn.), Vol.1, para.16-012, it is no easy task to persuade a court to imply terms into contracts of that type and I decline to do so here in connection with those suggested.

70. Further, even if such terms could be implied, I reject the suggestion that a material breach within the meaning of clause 6.3.1 necessarily followed. Dissolution of DREAM could come about through a variety of circumstances and types of conduct. In the circumstances of this case, for the reasons already explained, I would not have regarded a breach of such implied terms as being material and as giving rise to an immediate right of termination.

(ii) The remaining issues

71. In light of my conclusions on issue (i) the remaining issues do not arise.

F. CONCLUSION

72. For the reasons set out above I shall dismiss the claims. I shall hear further argument on the issue of costs and any other consequential matters in so far as necessary.