THE HIGH COURT

COMMERCIAL

2008 10983 P

BETWEEN

THEMA INTERNATIONAL FUND PLC

PLAINTIFF

AND

HSBC INSTITUTIONAL TRUST SERVICES (IRELAND)

DEFENDANT

AND

THEMA ASSET MANAGEMENT LIMITED AND 2020 MEDICI AG

THIRD PARTIES

AND

THE HIGH COURT

COMMERCIAL

2008 10981 P

BETWEEN

A.A. (ALTERNATIVE ADVANTAGE) PLC

PLAINTIFF

AND

HSBC INSTITUTIONAL TRUST SERVICES (IRELAND) LIMITED

DEFENDANTS

AND

M & B CAPITAL ADVISERS JESTION SGHCSA

AND

M & B CAPITAL ADVISERS SOCIEDAD DE VALORES SA

THIRD PARTIES

JUDGMENT of Mr. Justice Clarke delivered the 26th January, 2010

1. Introduction

1.1 The above two proceedings are some of the cases currently being collectively managed as part of the so called "Madoff" litigation. For a general history of the circumstances in which the series of linked cases come to be managed together see my judgment in Kalix Fund v. HSBC International Services (Ireland) Ltd [2009] IEHC 457. In the two cases with which I am currently concerned the plaintiffs (respectively "Thema" and "AA") claim damages under a number of headings against the defendants ("HTIE"). The respective third parties in both proceedings are not directly relevant to the issue which I now have to decide.

1.2 In the course of dealing with case management, the question of the adequacy of certain replies given by HTIE to requests for particulars concerning its defence, have been raised by both Thema and AA. While a number of specific and technical questions are raised by Thema, there is one common and significant issue which arises in both the Thema and AA proceedings. The principal purpose of this judgment is to deal with that issue. It concerns the extent to which HTIE has adequately set out its defence in relation to an important aspect of these proceedings. In order to understand the issue which has arisen and which is common to both of these proceedings, it is necessary to turn briefly to a broad description of what appears to be (on the basis of the evidence and arguments currently put forward), part of the factual background to the issues which arise in both of these proceedings. I turn to that background.

2. Factual Background

2.1 Both Thema and AA operate funds in this jurisdiction into which investors placed monies. The funds were kept in a

liquid form so that an investor would have ready access to the current value of the fund on short notice. HTIE was the so called custodian of each fund. There are issues between the parties (and, indeed, between HTIE and certain investors who have maintained independent proceedings) as to the precise scope of the duties of HTIE in those circumstances. However, it is clear that, in general terms, HTIE had an obligation to preserve the funds entrusted to it. It would also appear that most of the monies comprised in both the fund operated by Thema ("Thema Fund") and AA ("AA Fund") are now lost as a result of fraudulent activity on the part of Bernard Madoff and companies associated with him. The responsibility for those losses is at the heart of all of the linked proceedings.

2.2 However, in the context of the issue that I now have to decide, the question which arises concerns monies which were held by HTIE as custodian of the respective Thema and AA funds but which were handed over to companies controlled by Bernard Madoff. It is the capacity in which those monies were handed over to and received by Madoff related entities that is in issue. In that context, it is necessary to refer first to the pleadings including the particulars raised in respect of those pleadings.

3. The Pleadings
3.1 In its amended defence in the Thema proceedings, HTIE denies, at para. 11 the claims made by Thema to the effect that HTIE entered into an agreement with entities related to Bernard Madoff as sub-custodian of the assets of Thema. Paragraph 11 states as follows:-

> *"Paragraph 16 [of Thema's statement of claim] is denied. It is denied that the defendant, by itself or its global sub-custodian enetered into an agreement with Bernard L Madoff Investment Securities LLC ("Madoff LLC") and/or other companies controlled by and/or affiliated to Bernard Madoff and/or Bernard Madoff in his personal capacity (and together with Madoff LLC, "BMIS") as sub-custodian of the assets of the plaintiff, as pleaded at para. 16 of the statement of claim. The defendant pleads that any agreement as it did enter with Madoff LLC was done at the direction and/or request of the plaintiff and/or with the approval of the plaintiff."*

A similar denial is to be found at para. 12 of HTIE's defence in the AA proceedings.

3.2 The solicitors for HTIE further stated in correspondence to the solicitors for AA on 13th November, 2009, and 1st December, 2009, that they are not prepared at this stage to state that the relevant funds were handed over to Bernard L Madoff Investment Securities LLC ("Madoff LLC") in the capacity of sub-custodian. In its letter of 13th November, 2009, the solicitors for HTIE stated that it "accepts that it entered into a document entitled "Sub-Custody Agreement" with Madoff LLC…but is not prepared at this stage to admit that the legal characterisation of the capacity in which Madoff LLC received assets of the plaintiff was, or that the execution of that agreement is such as to appoint Madoff LLC as a sub-custodian" in relation to the relevant assets. In a subsequent letter of 1st December, 2009, to the solicitors for AA, the solicitors for HTIE repeat that their client was not "prepared to admit the legal characterisation of the capacity in which Madoff LLC received the said assets or that the extent of the agreement entitled "Sub-Custody Agreement" was such to appoint Madoff LLC as sub-custodian" in relation to the relevant assets. There was an almost identical exchange of correspondence in relation to the Thema proceedings.

3.3 As appears from the documentation which has passed between the parties, HTIE does not, at this stage, admit that funds which were, it would appear, undoubtedly passed on to Madoff entities were so passed on in circumstances where it is proper to characterise Madoff LLC as a sub-custodian. It is said that proper characterisation is a matter for submission. However, both Thema and AA are anxious to obtain greater clarity about precisely what it is that HTIE is saying in this regard. A principal reason for seeking such additional clarity is said to be that it will be highly material as a means of defining the parameters within which discovery of documents should operate. In general terms it seems to me that as much clarity as can be obtained should be secured at this stage. HTIE should be required to specify what its case is to the extent that it is now reasonably possible so to do.

3.4 Before turning to the specifics of that question, it is appropriate to say something about the sequencing of pleadings with other pre-trial procedures such as discovery.

4. Pre-Trial Sequencing
4.1 It has been suggested in some quarters that the fact that, in the Commercial Court, parties are required, well prior to trial, to exchange statements setting out a précis of the evidence which any witness, whether of fact or expert, is due to give, coupled with the requirement to exchange written submissions on the legal issues which are likely to arise at the hearing, significantly reduces the need for a very high level of particularity at the pleading stage. There is, undoubtedly, some truth in that proposition. One point of pleadings (and a very important aspect of same in cases where there is not likely to be a pre-trial exchange of witness statements and submissions) is to define with some precision the questions which are likely to arise at the trial so that the parties can not be prejudiced by being taken by surprise. Clearly in circumstances where witness statements and written submissions have to be exchanged, the extent to which a party could reasonably be taken by surprise at trial is significantly reduced. However, there is another important function which pleadings play, particularly in cases where significant discovery is likely to follow.

4.2 The starting point in any consideration of whether it is reasonable to direct discovery of a category of documents is the relevance of the category sought. Relevance is determined by reference to the issues which are likely to arise at the trial. Discovery is sought after pleadings have closed but before trial preparation steps (such as the exchange of witness statements and the like) has been engaged in. At the time when discovery is sought or directed (in the case of dispute) relevance is, necessarily, determined by the pleadings. It follows that there can well be circumstances where a lack of reasonable precision in the pleadings can give rise to a risk of discovery being directed which is much broader than might otherwise be necessary. Given that, in cases where documents are likely to play a significant role, the volume of documents which may need to be discovered (and thus the resources both of time and money which needs to be put into preparing discovery) can be very substantial indeed. The whole reason for recent developments in the rules concerning discovery and the approach of the courts in the light of those new rules has been a recognition that over broad discovery can bring its own injustice.

4.3 On the one hand there is, of course, a fear that by failing to order relevant discovery, material and significant evidence which could assist one party will not be disclosed so that an injustice might follow. On the other hand, overly broad discovery carries with it the risk that in virtually every case, the costs of the proceedings will be increased for no gain in terms of the likely justice in the vast majority of cases, so that whatever party has to bear the burden of paying

for that discovery (normally the loosing party), will bear a larger burden than might otherwise have been the case. The injustice, to at least one party in virtually every case, that would arise in those circumstances is obvious.

4.4 The need to strike a balance is also obvious. As Fennelly J. put it in Ryanair Plc v. Aer Rianta C.P.T. [2003] IESC 62:-

"In the great majority of cases, discovery disputes have revolved around the issue of relevancy. There are fewer cases concerning necessity. There are good reasons for this. If there are relevant documents in the possession of one party, it will normally be unfair if they are not available to the opposing party. Finlay C. J., in his judgment in Smurfit Paribas Bank Limited v. A.I.B. Export Finance Limited [1990] 1 I.R. 469 emphasised "the full disclosure both prior to and during the course of legal proceedings which in the interests of the common good is desirable for the purpose of ascertaining the truth and rendering justice." The overriding interest in the proper conduct of the administration of justice will be the guiding consideration, when evaluating the necessity for discovery.

The issue of "necessity" for discovery has, consequently, usually been debated in cases where some other interest is involved, particularly the confidentiality of documents, especially where they involve the interests of third parties. To that extent, the arguments advanced on behalf of Aer Rianta on this appeal, effectively that Ryanair does not need the documents, because they have alternative means of establishing the relevant facts, has rarely arisen.

In order to establish that discovery of particular categories of documents is "necessary for disposing fairly of the cause or matter," the applicant does not have to prove that they are, in any sense absolutely necessary. Kelly J. considered the matter in his judgment in Cooper Flynn v. Radio Telefís Eireann [2000] 3 I.R. 344. He derived the useful notion of "litigious advantage" from certain English cases. He adopted the following statement of Bingham M.R. in Taylor v. Anderton [1995] 1 W.L.R. 447 at 462:-

'The crucial consideration is, in my judgment, the meaning of the expression 'disposing fairly of the cause or matter'. Those words direct attention to the question whether inspection is necessary for the fair determination of the matter, whether by trial or otherwise. The purpose of the rule is to ensure that one party does not enjoy an unfair advantage or suffer an unfair disadvantage in the litigation as a result of a document not being produced for inspection. It is, I think, of no importance that a party is curious about the contents of a document or would like to know the contents of it if he suffers no litigious disadvantage by not seeing it and would gain no litigious advantage by seeing it. That, in my judgment, is the test.'

It may not be wise to substitute a new term of art, "litigious advantage," for the words of the rule. Nonetheless, the discussion gives guidance as to the context in which the matter has to be considered. Within that context, the court has to reach a conclusion as to the likely effect of the grant or refusal of the discovery on the fair disposal of the litigation.

The change made in 1999 exemplifies, however, growing concern about the dangers of unnecessarily costly and protracted litigation and, in particular, the burdens on parties and the courts arising from excessive resort to automatic blanket discovery. The public interest in the proper administration of justice is not confined to the relentless search for perfect truth. The just and proper conduct of litigation also encompasses the objectives of expedition and economy.

The court, in exercising the broad discretion conferred upon it by Order 31, rule 12, sub-rules 2 and 3, must have regard to the issues in the action as they appear from the pleadings and the reasons furnished by the applicant to show that the specified categories of documents are required. It should also consider the necessity for discovery having regard to all the relevant circumstances, including the burden, scale and cost of the discovery sought. The court should be willing to confine categories of documents sought to what is genuinely necessary for the fairness of the litigation."

4.5 In those circumstances it has already come to be recognised that there must be some proportionality between the breadth of discovery sought and the likelihood of the discovered category of documents having some meaningful bearing on the proceedings. Likewise, similar considerations have led to the view that where documents which have a significant confidentiality attaching to them are sought, same should only be discovered (again on the basis of proportionality) where it is necessary that they be discovered, both from the point of view of there being no other means for the party concerned obtaining the same evidence (see for example, Ryanair plc v. Aer Rianta) or, so as to avoid immediate discovery in circumstances where it is only possible that the relevant documentation might become important at trial (see Independent Newspapers v. Murphy Junior [2006] IEHC 276, Yap v. Children's University Hospital Temple Street [2006] IEHC 308 and Hartside Ltd v. Heineken Ireland Ltd (Unreported, High Court, Clarke J., 15th January, 2010).

4.6 It seems to me that like overriding considerations apply to the question which arises in some cases as to the extent to which it may be reasonable to postpone giving detailed particulars until after discovery or until other steps have been taken by parties from whom the relevant particulars are sought. A similar set of competing requirements applies. To enable a party to move to discovery without having adequately pleaded its case is to run the risk of a significant injustice by virtue of that party being allowed to trawl through the other side's often confidential information without real justification. On the other hand, to require a party to plead at a level of detail (in advance of discovery or the like) which it could not reasonably obtain other than by discovery or other procedural steps can lead to an obvious injustice. A balance again needs to be struck (see, for example, National Welfare Education Board v. Ryan [2007] IEHC 428 and Ryanair v. Bravofly [2009] IEHC 41). While National Education Welfare Board referred to fraud and Ryanair v. Bravofly referred to allegations of breach of competition law (both of which areas involve clandestine activity, the details of which will not necessarily be known to a party who suffers from it) nonetheless it seems to me that a broader general principle is at play. There may be circumstances (which have, indeed, been long recognised) where it is not reasonable to require a party to give detailed particulars of certain aspects of its claim until it has had the benefit of discovery (or, indeed, other pre-trial procedures) in circumstances where it is only after availing of those procedures that a party can reasonably be required to specify their claim at the necessary level of precision, which is required before the case commences.

4.7 It seems to me that it is against the background of those general principles that the issues which have arisen between the parties on this application needs to be judged. It is important that HTIE give as much particulars of its true position as it can now give. To do otherwise would, as counsel for both Thema and AA point out, run a serious risk that whole areas of discovery, which may not ultimately be necessary, may be sought and obtained, thus significantly increasing the costs of these proceedings in an unnecessary way. On the other hand, regard must be had, in relation to any particulars sought, to any circumstances which might make it reasonable for HTIE to await obtaining further information, through the pre-trial process or otherwise, in order that it can finally specify the parameters of its claim. In complex cases it may be necessary to attempt to fashion orders particularly geared towards the specific questions and

problems which arise in the case under consideration so as to best, insofar as it is possible, meet both of those competing requirements.

4.8 Against that background, it is necessary to turn to the specific questions which have arisen.

5. The Relevant Defence

5.1 While it might not be blindingly obvious from the exchange of correspondence referred to above (it certainly was not blindingly obvious to me), in the course of debating the issue with counsel (and in particular, with counsel for HTIE) the true nature of the case under this heading which HTIE wishes to make seems to me to have become quite clear.

5.2 HTIE asserts that Madoff entities were appointed to three separate roles in respect of both Thema Fund and AA Fund. As pointed out earlier it is accepted that a document exists appointing Madoff LLC as sub-custodian. I did not understand counsel for HTIE to suggest that the document concerned does anything other than, as it were, do what it says on the tin. It is not suggested that a proper construction of the relevant agreement, for example, would lead to it being viewed as not being a sub-custodian agreement even though it purports to be such. Rather it is said that Madoff entities were also appointed as a so called dealer/broker and in addition that, Madoff entities were appointed as investment managers in relation to the respective funds. Two aspects of the argument which thereby arises need to be noted. Firstly, at a general level, it is said on behalf of HTIE that it was the appointment of Madoff entities to each of the three roles to which I have referred (i.e. sub-custodian, dealer/broker and investment manager) that facilitated the fraud. At a simplistic level, it is suggested that it was the fact that relevant Madoff entities acted as investment manager which allowed them to create a subterfuge which retrospectively suggested that profitable investments had been engaged in. In those circumstances, as of the relevant settlement date for payment for the investments concerned, monies would be paid to a Madoff entity in its capacity as dealer/broker to enable it, apparently, to pay for the investment concerned. In addition, it may also be that any relevant securities were and should have been held by Madoff entities in their capacity as sub-custodian. It is said that those combined circumstances permitted relevant Madoff entities to create a false impression that profits were being made by retrospectively backing horses which had already won. Whether that or something similar to it, is, in fact, what happened is a matter which will, of course, need to be determined at the trial. If it, or something like it, is what in fact happened, then the extent to which it may be said that the ability of the relevant Madoff entity or entities to perpetrate the fraud concerned was facilitated by it or their appointment to those three roles is again a matter that will need to be determined at trial. To the extent that any or all of the foregoing may turn out to be so, then there will, doubtless, be a legal debate as to the consequences of any such findings of fact for the legal liabilities of any parties to these proceedings.

5.3 However, at this stage it seems clear that that there is, at least, likely to be an issue of fact as to the capacity in which any relevant Madoff entity actually received funds from HTIE. That Madoff entities were appointed as sub-custodian is not in dispute. However, it is asserted that Madoff entities also had other roles. While it is not, as I understand it, asserted that any monies would have been paid to a Madoff entity in its capacity as an investment manager (the relevance of that role to these proceedings seems to be confined, on the case as I understand it, to one which is said to have facilitated the fraud occurring rather than being one which is said to have facilitated the receipt of monies as such), nonetheless it is said on behalf of HTIE that the payment over of monies by it to Madoff entities could, therefore, have been in the capacity either as a sub-custodian or as a broker/dealer. It is for that reason, rather than any question concerning the proper construction of the relevant aspect of the underlying relationship between HTIE on the one part and relevant Madoff entities on the other part, that the alleged doubt as to the capacity in which Madoff related entities actually had the money paid to them now arises. As indicated earlier, that that was the precise problem was not, it seems to me, particularly obvious from the correspondence to which I have referred even though there was, of course, mention of the position of relevant Madoff entities as broker/dealer and investment manager. Nonetheless the position of HTIE now seems to be clear (and this is perhaps an occasion to note that a relatively short oral procedure has brought, in my view, a much greater degree of clarity to what is truly in issue than a lengthy exchange of correspondence). It is next necessary to turn to the consequences.

6. The Consequences

6.1 Firstly it seems to me that, for the avoidance of any further doubt, it is important that the case as orally made by counsel on behalf of HTIE in the course of the hearing is incorporated, in an appropriate fashion, in the pleadings. I will leave it to counsel for HTIE to suggest precisely how that should be done. However, before any of the parties become involved in complex questions concerning the scope of discovery, it is important that there be the maximum clarity possible.

6.2 In addition there is, however, the remaining question which derives from the stated inability of HTIE, at this stage, to specify, with any particularity, what its case is as to the extent to which particular funds may have been handed over to Madoff related entities in the capacity as sub-custodian on the one hand or dealer/broker on the other hand. As I understand what I was told by counsel on behalf of HTIE, it has been possible to ascertain that at least some funds will be said by HTIE to have been handed over to Madoff related entities in the capacity of dealer/broker. In respect of other funds it has not, it is said, been possible to formulate a view as to the case which HTIE wishes to make. Against that background it is necessary to turn, briefly, to what appears to be said as to the circumstances which might determine the capacity in which any particular set of funds may have been handed over by HTIE to a Madoff entity.

6.3 It would seem obvious that any instructions given by Thema Fund or AA Fund to HTIE concerning the basis for a transfer of relevant funds to Madoff entities would bear significant weight in determining the capacity in which it is proper to characterise relevant funds as having been handed over. However, it would appear from the oral argument addressed by counsel for HTIE that other factors will be said to be relevant. For example, the account within relevant Madoff entities into which monies were actually paid is said to have a bearing. Whether that will actually turn out to be case may be a matter of some debate. I can well see that issues might arise where, at the time of payment, HTIE had reason (by virtue of the knowledge of HTIE concerning the nature of the account into which relevant monies were being paid) to believe that the monies concerned were being paid to a relevant Madoff entity in one capacity or the other. It is not so obvious how the account where monies actually ended up could be very relevant to the proper characterisation of the basis on which HTIE paid monies to the relevant Madoff entity, unless HTIE were aware of the identity of separate accounts that would have been referable to respectively broker/dealer status or a sub-custodian status.

6.4 Be that as it may, it seems to me that some realistic way of bringing these proceedings forward needs to be identified. The real concern expressed on the part of both Thema and AA was that significant discovery might be embarked on which would turn out to be unnecessary. If, therefore, it should transpire that the case made on behalf of

HTIE was that all or virtually all of the funds were handed over to Madoff entities in the capacity as dealer/broker (and if Thema and AA were to accept that fact), then it may well be that issues concerning Madoff entities as sub-custodian would decrease significantly in importance in these proceedings with a consequent knock-on affect on the scope of discovery that might properly be sought, relevant to such issues.

6.5 On the other hand, provided that a significant amount of monies are accepted as having been handed over to Madoff entities in the capacity as sub-custodian (even though further significant monies may be said to have been handed over in the capacity as dealer/broker), it is clear that both sub-custodian and dealer/broker issues will arise at the hearing. For those purposes it would not be particularly relevant, at this stage, (although it would necessarily be something that would need to be clarified prior to trial) to specify exactly what proportion of the relevant funds are said to have been handed over to Madoff entities in the two respective capacities. What is, in my view, vital to identify at the earliest possible stage is whether, on HTIE's case, significant funds (in the context of the sort of monies with which we are dealing in these proceedings) were handed over in both capacities.

6.6 It does not seem to me that HTIE should require a very lengthy period of time to be able to identify that fact, although I would accept that HTIE may require further time to specify with exact precision how much is said to have been handed over in respectively a sub-custodian or a dealer/broker capacity. I will hear counsel for HTIE further when this judgment has been delivered as to the time limit within which an answer to that question can be delivered.

6.7 However, for the present, it seems to me that I should, in general terms, stipulate that it will be necessary for HTIE to incorporate an appropriate amendment either to the pleadings or, more likely, the particulars so as to do two things. First, the explanation for HTIE's case which I have sought to summarise earlier in this judgment needs to be clearly incorporated in relevant pleadings. Second, it will be necessary to specify, at least in general terms, the extent to which it is contended that monies were paid to relevant Madoff entities in either the capacity of sub-custodian or dealer/broker. For the avoidance of doubt, what will be required is a general specification in order of magnitude terms rather than a specific allocation between the two categories.

6.8 I also propose dealing in an oral judgment with the other points raised in the Thema proceedings.