

BRITISH VIRGIN ISLANDS
EASTERN CARIBBEAN SUPREME COURT
IN THE HIGH COURT OF JUSTICE
COMMERCIAL DIVISION

CLAIM NO: BVIHC (COM) 127/2011

BETWEEN:

EAST PINE MANAGEMENT LIMITED

Claimant

and

(1) TAWNEY ASSETS LIMITED
(2) OLDRIL HOLDINGS LIMITED
(3) GUILDRON TRADING LIMITED

Defendants

Appearances: Mr Christopher R Parker QC for the Claimant
Mr James Ayliffe QC and Ms Keisha Durham for the Defendant

JUDGMENT

[2012: 3-6, 9, 10 July; 18 September]

(Fraudulent misrepresentation inducing joint venture – forecast of future profit – representations about ability of joint venture to carry on business without resorting to making off balance sheet payments including bribes – due diligence – reliance of co-venturer upon alleged representations)

- [1] **Bannister J [ag]:** This claim arises out of what might loosely be described as a joint venture. The Claimant, ('East Pine') is a BVI registered vehicle acquired for the purposes of the transaction with which this claim is concerned by a group of investors who invest on the recommendation of a boutique financial adviser called SI Capital Partners Limited ('SI'), which has its offices in Moscow. The investors were referred to in the course of the trial as partners and in this judgment I shall call them the SI partners. SI is managed by Mr Rudy Amirkhanian ('Mr Amirkhanian') with the assistance of his partner, Ms Elena Lokteva ('Ms Lokteva'). In the summer of 2010, when these events began to evolve, the SI partners, using a company called Mercury Technology Limited ('Mercury'), had recently acquired the assets of a failed Russian agricultural machinery dealership called LLC Matrix Agritech ('Matrix'). Matrix had a John Deere dealership but no current staff. SI

had no experience in the business and was looking for a partner which would provide staff and the commercial expertise necessary to turn the acquired assets to account.

- [2] The first Defendant ('Tawney') is another BVI registered acquired for the purposes of the joint venture by Mr Dmitry Korontsvit ('Mr Korontsvit') and Mr Alexander Altynov ('Mr Altynov'). Before they transferred their shares to Tawney, Mr Korontsvit and Mr Altynov owned the shares in an agricultural machinery business called CJSC Agrosnab Russian ('Agrosnab'), which had a valuable John Deere dealership covering eight Russian regions and considerable experience in the field.
- [3] Omitting intermediate steps, the first stage of the joint venture arrangements, as set out in a term sheet signed by the parties on 22 October 2010, very broadly involved (a) East Pine becoming the indirect holding company of Mercury and transferring Mercury to another BVI registered company, acquired for the purpose, called Guildron Trading Limited ('Guildron') in exchange for the issue of 50% of Guildron's shares to East Pine; and (b) Mr Korontsvit and Mr Altynov agreeing to transfer their ownership of Agrosnab¹ first to Tawney and then to Guildron in exchange for (i) the issue to Tawney of the other 50% of Guildron's shares together with (ii) a balancing payment of US\$4 million, of which US\$2 million was to be paid on completion and the remainder of which was to be settled by the assignment of certain receivables owed to East Pine² as and when they became payable.
- [4] This stage of the arrangements set out in the term sheet ('Stage 1') was completed by the execution, on 25 November 2010, of a Share Subscription Agreement which made provision for the arrangements which I have briefly summarized in the preceding paragraph. The result of those arrangements was that East Pine and Tawney as a matter of law acquired joint control of Guildron which, in turn, became the indirect owner of Mercury and Agrosnab. The second stage of the arrangements envisaged by the term sheet ('Stage 2') was to be the merger of the respective companies through which Guildron indirectly owned Mercury and Agrosnab, thus forming a new holding company in place of Guildron, and the merger of Mercury and Agrosnab into a single subsidiary of the new holding company. For reasons which will become clear, Stage 2 never happened.
- [5] Even during Stage 1, which took legal effect on 25 November 2010, but which operated *de facto* from about late September/early October 2010 until mid March 2011, no control of the ultimate business entities, Mercury and Agrosnab, was exercised through Guildron. The parties cooperated on the ground, with Agrosnab supplying technical assistance and staff at its own expense to Mercury, and took steps towards a unified ordering system, in order to take advantage of Agrosnab's preferential John Deere discount rate. On 15 December 2010 Mercury staff moved into Agrosnab office accommodation. Steps were also taken to institute a unified system of financial control, with a single CFO being appointed to manage the financial affairs of both the operating companies. The two entities promoted themselves under a common logo, MAST,³ which early in 2011 published a consolidated profit and loss account and balance sheet, but during the period with which we are concerned their accounting systems remained separate (although steps towards integration began to be taken on around 18 November 2010) and they were controlled by

¹ there was a smaller associate company of Agrosnab which was also part of the deal

² actually, to an East Pine subsidiary

³ Mercury AgroSnab Technology

separate boards, with Guildron ignored as irrelevant. At the risk of being too simplistic, therefore, by the end of 2010 the parties were moving towards full integration, but were some way off from achieving it.

- [6] Serious strains emerged at the beginning of 2011. On 16 March 2011 Mercury staff walked out without explanation and for good. From that date on the parties did no business together. It was the end of the joint venture project.
- [7] On 1 September 2011 Tawney issued proceedings against Guildron and the SI parties alleging, among other things, breach of the 25 November 2010 Shareholders Agreement, which was supposed to govern the relationship between the parties as members of Guildron, and conspiracy; and claiming injunctions restraining breach of the Shareholders Agreement and tortious acts allegedly aimed at subverting it, damages and other relief under section 184I of the Business Companies Act, 2004 (the unfair prejudice provision). On 13 October 2011 East Pine responded with these proceedings, in which East Pine alleges that the affairs of Guildron have been conducted in a manner which is unfairly prejudicial to East Pine and claiming orders (a) that Tawney transfer its 50% of Guildron to East Pine *gratis*; (b) an order setting aside the machinery by which Mercury became an indirect subsidiary of Guildron; (c) repayment of the US\$2 million paid to AS on completion; (d) damages; and (e) certain consequential relief. It had been agreed between Counsel before the trial began that, despite the fact that it was issued later in time, it would be convenient for East Pine's case to be heard first.
- [8] Thus, shorn of refinements, East Pine's claim is for the unwinding of the transactions carried out pursuant to the Share Subscription Agreement and consequential damages for fraudulent misrepresentations said to have induced East Pine to enter into it. For reasons which I have been unable to fathom, and about which I have neither the intellectual agility nor the will to speculate, it has been dressed up in the clothing of an unfair prejudice claim. When I raised my difficulty at the start of the proceedings and suggested that it proceed as a misrepresentation claim, with such relief as might be granted if the claim were to succeed being tailored to restoring the *status quo ante*, Mr Christopher Parker QC, who has appeared for East Pine throughout these proceedings, accepted that that would be a satisfactory way in which to proceed. Mr Ayliffe QC, who appeared together with Ms Keisha Durham for Tawney, did not suggest that his client would be prejudiced if I were to deal with things in this way in the present proceedings and so that is what I propose to do. It goes without saying that my decision, concurred in by both Counsel, as to the manner in which this case is to be treated does not fetter Mr Ayliffe QC in any way in Tawney's proceedings if they subsequently go to trial.

The evidence

- [9] Mr Amirkhanian, Ms Lokteva and Mr Evgeny Borodkin, a financial analyst employed by SI, gave evidence for East Pine. Mr Korontsvit and Mr Altynov gave evidence for Agrosnab.
- [10] The SI partners had invested US\$17 million in the acquisition, through Mercury, of the Matrix assets - US\$10 million as equity and US\$7 million by way of loan capital.
- [11] Nothing was paid for goodwill, even though it appears that Matrix had a network of regional customers. Its former staff had left, however, and Mr Amirkhanian told me that he was looking to

merge with a professional dealership. He had some informal discussions with Mr Korontsvit during the summer of 2010. Mr Korontsvit/Agrosnab was an attractive proposition for Mr Amirkhanian because they had expertise in the business and had better discount terms with John Deere than Matrix. Mr Amirkhanian described Mr Korontsvit as having come to his rescue, even though it meant that he had had to abandon discussions with a Canadian John Deere dealer who was considering making a \$5 million convertible loan to Agrosnab.

- [12] It appears to have been recognized at a very early stage that the Matrix business was less valuable than that of Agrosnab and that a merger of the two businesses would require a balancing payment⁴ moving from Mercury/East Pine to Tawney/Agrosnab. Mr Amirkhanian's evidence was that it was agreed at the outset that this payment should be subject to adjustment or 'correction' after the merger. Mr Korontsvit said that there was never any such agreement, at the outset or at all.
- [13] On 21 August 2010 Mr Amirkhanian and Mr Korontsvit had dinner together in a restaurant. Mr Korontsvit told me, and I accept, that this was before negotiations, by which I took him to mean detailed negotiations designed to result in a legally binding agreement, had started. Mr Amirkhanian says that at this dinner Mr Korontsvit told him that Agrosnab's operating profit (there was no mention of the expression 'EBITDA'⁵) for 2010 could be US\$1 to US\$1.5 million. He made clear that Mr Korontsvit told him at the time that he was not a financial expert and that the final figure could be above or below this forecast. Although Mr Korontsvit originally denied ever having said any such thing, it is now clear and he accepts that he gave it as his view that Agrosnab could produce an operating profit of US\$1 million in its year ending 31 December 2010. Mr Amirkhanian made a note setting out in parallel rough balance sheets for Mercury on the one hand and Agrosnab on the other. The document is in evidence. Mr Amirkhanian says that Mr Korontsvit wrote the figures \$1 to \$1.5 million on a post-it note and stuck it to the document. He says that it has since disappeared. I find this evidence difficult to accept but as things have turned out it does not much matter whether I do or not, since the trial proceeded on the basis that Mr Korontsvit had indeed forecast a possible operating profit for Agrosnab of US\$1 million for 2010 in the restaurant on 21 August 2010.
- [14] Mr Korontsvit said that he gave his forecast of US\$1 million because he thought that the sales prospects for September to November 2010 were good and because he expected prices to rise. Instead, he said, the turn around did not arrive until December of 2010 and early in 2011. He said initially that this forecast was made at a social dinner, before negotiations started and that neither side was supposed to be relying upon statements made in that context. In cross examination, however, he accepted that both statements (his and Mr Amirkhanian's to the effect that Mercury would make an operating loss for 2010) were significant and were intended to be relied upon.
- [15] Mr Korontsvit also said that the US\$1 million figure was never mentioned again. In that he is mistaken, because Ms Lokteva, having been shown, on 13 October 2010, Agrosnab's management accounts to 31 August 2010 and having noticed that they showed a net loss of some US\$414 million, told Mr Korontsvit on the following day that she had a clear vision that Agrosnab would earn US\$1 million. Mr Korontsvit replied on the same day that he had been referring not to

⁴ the expression is mine – the witnesses preferred to speak of 'price' or 'consideration'

⁵ earnings before interest, tax, depreciation and amortisation

net profit, but to operating profit – pointing out that Mr Amirkhanian had been using the same measure when he had told him on the same occasion that Mercury would make a loss in 2010. I shall have to decide later whether that amounted to a repetition of the representation or was merely a correction of Ms Lokteva's use of the bottom line figure as a comparator.

- [16] This is probably the moment to record that it appeared from the evidence that, although things were not as corrupt as the witnesses said they had been in Russia in the 1990's, it was still impossible to conduct a successful business in that country without the payment of commissions in order to ensure that business was obtained on advantageous terms. It was also common ground that it was Russian business practice to maintain two sets of books. One set, the official financial reports (I shall refer to them as 'official statements' or 'official reports'), was kept to be produced to officials, such as the revenue authorities, or to banks when seeking funding. These official statements might include fictitious profits and commonly failed to bring into account certain types of expenditure, such as bribes. The probability, therefore, was that an enterprise's official statements would give an enhanced impression of a company's profitability when compared with the reality.
- [17] The use of so called black cash was also commonplace. Black cash appears to be a term used to describe payments kept off the books. Frequently (perhaps always – the position never became entirely clear) the term also includes reference to the fact that the cash with which to make the payments was generated by means of transactions which themselves would never appear in a company's official profit and loss account or balance sheet. For example, in Agrosnab's case, the company appears to have had a network of so-called 'partners' who, for a fee, would produce cash against false documents. Although the details of the system were never satisfactorily explained, the arrangement seems to have been in the nature of a shadow banking system. Black cash, however generated, might be used to pay so-called commissions, but it is clear from the evidence that it was regularly used to make routine payments to employees and managers, so that they would not have to declare the amounts received to the fiscal authorities. Indeed, there was evidence that attempts to make such payments through the books and above board would be met with strong resistance from the staff concerned.
- [18] Another device which was apparently in common use was the incurring of imaginary debts to suppliers in respect of imaginary supplies of inventory. The existence of these debts, which had, of course, to be supported by imaginary inventory to correspond with them, created false VAT inputs which could be set against a company's VAT liability on its outputs – at any rate temporarily – thus enabling a company to 'manage' its VAT cashflow.
- [19] The other 'black' or 'grey' device mentioned in the amended statement of claim (transfer pricing) did not feature in the evidence to any extent or at all.
- [20] Mr Korontsvit said, and I accept, that at the 21 August 2010 dinner he made clear to Mr Amirkhanian that his US\$1 million figure took account of the need to make black cash payments but was exclusive of any fictitious profits that might be reflected in the official statements.
- [21] From an early stage Mr Amirkhanian knew, partly because Mr Korontsvit told him so and partly because it was what he expected, that Agrosnab paid bribes. Mr Amirkhanian accepted that he had admitted to Mr Korontsvit that it was also the practice in Mercury to pay bribes and that dividends had been booked as 'marketing' or 'consultancy.' Mr Amirkhanian said that it was

agreed at the outset that if the merger took place it would be necessary to continue the practice, but that such payments should appear in the official statements and be auditable. Mr Amirkhanian was not asked and did not explain how a bribe could be auditable.

- [22] At this time Mr Amirkhanian had it confirmed to him that Agrosnab made use of 'grey' suppliers, although it was not until September 2010 that he became aware that the system was used for managing VAT payments. He also knew that Agrosnab was making other black cash payments, although he was not at this time told of their extent.
- [23] On around 23 August 2010 SI produced a diagram designed to evaluate the respective merits of the proposed merger. One alleged merit was that it would give Agrosnab access to capital. Mr Amirkhanian rejected the notion that this might mean that it was the intention that SI/East Pine should provide Agrosnab with funding. He said it referred to the strength of Mercury's balance sheet and the fact that merger would enable Agrosnab to rely upon it. He stressed, however, that once the merger was effective, funding was to be on the basis of joint venture funding – not funding provided by one of the original joint venturers to the other. I have no hesitation in accepting this evidence.
- [24] Some time later in the summer, but before 10 September 2010, Mr Amirkhanian and Ms Lokteva on the one hand⁶ and Mr Korontsvit on the other attempted to agree what balancing payment would be required to equalize the respective parties' contributions to the merger, based upon the fact that East Pine had already paid US\$17 million for Matrix. One of the curious, but important, features of the negotiations between the parties was that it was agreed from the outset that neither side should do any due diligence on the other. The reason given for this was that it was uncertain whether or not John Deere would object to the proposed merger. It was accordingly decided, so it is said, to push the thing through rapidly and present John Deere with a *fait accompli* about one or two years down the line. As things turned out, John Deere was told what was afoot on around 15 November 2010 and there is no record of it raising any objection to the merger (although Mr Korontsvit was to complain later that Mr Amirkhanian had upset John Deere in some way unexplained). I do not find the reason given for the lack of due diligence convincing – if the intention was not to break the news to John Deere for a further one or two years, then there must have been ample time to carry out due diligence. No reason was given why *due diligence* carried out by either party on the other would antagonize John Deere. I find that the principal reason why no due diligence was carried out was that SI was in a hurry, since without Agrosnab's input and expertise it did not have a viable business. The fact is, however, that while Mercury did investigate Agrosnab's financial position to some extent in the months before conclusion of the Share Subscription Agreement (indeed, Agrosnab even protested that it was surreptitiously carrying out due diligence in contravention of the parties' agreement not to do so) no proper due diligence was ever conducted by either side before completion. Although the nature of the present proceedings naturally meant that the evidence concentrated on the resulting opacity, from Mercury's perspective, surrounding the financial state of Agrosnab, the arrangement, of course, worked (or at any rate was originally envisaged as working) to the potential disadvantage of both sides.
- [25] Because of the absence, when negotiations opened, of actual knowledge of each party about the financial situation of the other (apart from the fact that SI had paid US\$17 million for the Matrix

⁶ another individual called 'Tom' was apparently involved, but he does not feature largely in the narrative

assets) and because of the agreement not to carry out due diligence, the parties resorted to making estimates of the worth of each company in order to agree the amount of the balancing payment. I do not mean to belittle what took place, but what resulted from the process, certainly on the SI side, was what might be called a 'back of an envelope' estimate. Mr Amirkhanian's working paper, on which he set out the various parameters used and attributed a value to each, has survived, although that of Mr Korontsvit has not. Mr Amirkhanian's table consisted of a series of lines, each with a particular quality which might affect the worth of a business of this type, such as 'Territory Potential' or 'Customer Relations' or 'Risk Factor', for example. Each line was scored for each company - so that for 'Territory Potential', for example, Mr Amirkhanian gave Mercury 10 and Agrosnab 8. Each line had a multiplier set against it. 'Territory Potential' had a multiplier of 8, so that in the relevant columns Mercury scored 80 and Agrosnab scored 64. The line for 'Profitability' had a multiplier of 10 - the highest of those contained in the table. Mr Amirkhanian awarded Mercury a 3 for profitability and Mr Korontsvit suggested giving Agrosnab 7, so that Mercury scored 30 and Agrosnab 70 on this line. The columns were then totalled and Mercury was found to have scored 261 against Agrosnab's 393 - in other words, and on that basis, making Agrosnab half as valuable again as Mercury.

- [26] Mr Amirkhanian says, and I accept, that Mr Korontsvit told him that as a result of carrying out a similar exercise, he had reached the conclusion that Agrosnab was worth twice as much as Mercury. He says that they agreed to split the difference and to work on the basis that Agrosnab was worth 1.75 times the amount of Mercury. On the assumption that Mercury was worth the US\$17 odd million which Mercury had paid to acquire and fund Matrix, they calculated that the appropriate balancing payment should be US\$3.75 million. Since it had been decided to bring another Agrosnab business into the merger, which the parties valued at US\$500K, Mr Amirkhanian and Mr Korontsvit settled for a total balancing payment passing from Mercury to Agrosnab of US\$4 million (US\$3.75 million plus half of US\$500K).
- [27] Mr Korontsvit said that he had told Mr Amirkhanian that he predicted that Agrosnab's turnover for 2010 would be US\$25 million inclusive of VAT. It was put to him that Agrosnab's actual turnover for 2010 was exactly that, upon which Agrosnab had on any footing shown a significant loss. Mr Korontsvit accepted that he had been wrong to rely upon any upswing if, as proved to be the case, Agrosnab's turnover turned out as he had predicted.
- [28] Mr Amirkhanian said in cross examination that he relied upon the US\$1 million operating profit representation which Mr Korontsvit had made on 21 August 2010 'to value the business'.
- [29] On 10 September 2010 Mr Amirkhanian wrote to the SI partners about the proposed merger. The letter is important because it is a contemporaneous document setting out what Mr Amirkhanian knew about Agrosnab at that time as well as the reasons why Mr Amirkhanian was recommending the deal.
- [30] The letter opened by informing the SI partners that, subject to their approval, the individuals conducting the negotiations had agreed to ascribe a value of US\$10 million to Mercury and US\$17.5 million⁷ to Agrosnab on the basis of the points which Mr Amirkhanian then proceeded to make. The first point was that Agrosnab would have a 2010 turnover of US\$25 million (including

⁷ this figure does not take into account the agreed value of the associate company

VAT) and a profit⁸ of US\$1.5 million. Mr Amirkhanian said in evidence that he chose the higher figure⁹ because he had been told by Mr Korontsvit that part sales had a higher margin. This explanation makes no sense. Mr Amirkhanian went on in his letter to predict that Mercury would turn over US\$17 to US\$23 million and show a probable loss and said that given the general economic situation, combined with the drought, he considered that the short term profit potential of Agrosnab was a multiple of 2010's profitability, thus, as he put it, making the US\$17.5 million price tag reasonable. This part of the letter shows that Mr Amirkhanian was using the figure of US\$1.5 million not as the reason for going into the deal, but as helping to justify the amount of the balancing payment.

- [31] Mr Amirkhanian went on in the remainder of the letter to list Agrosnab's assets as disclosed to him and to give his view that Agrosnab could handle a five fold increase in sales without the need for additional overheads at the corporate level. Having sketched in some figures about Agrosnab's gross margin, he predicted that eliminating Mercury's headquarters should generate costs synergies of US\$2 million per year without the need to employ additional personnel. As he put it, Agrosnab's structure was easily capable of integrating the Mercury business without the need to add more personnel at corporate level.
- [32] He then mentioned that Mr Korontsvit was seeking to raise the up front payment from US\$1 million to US\$2 million (which is what was eventually agreed) and went on to say that it was his view that the SI partners should agree to the merger now but not tell John Deere about it for a year or two, on the grounds that given Mercury's then operational weakness John Deere might be reluctant to accept a merger that would create the largest or second largest dealer group in Russia. In the meantime John Deere would be told that Mercury was using Mr Korontsvit and his team to manage Mercury on their behalf.
- [33] On this basis Mr Amirkhanian proposed that he and Ms Lokteva should have the leeway to proceed with negotiations on the basis which he had outlined, subject to a formal shareholders' decision prior to conclusion of the deal. He then listed the five benefits which he believed would accrue: the combined entity would be the largest John Deere dealer in Russia in three years time; there would be massive operational synergies, including cost savings and improved efficiencies; SI's administrative resources would maximize potential for both sides, while Mr Korontsvit's excellent relationship with John Deere should help improve Mercury's image with its supplier; Mr Korontsvit would run the combined entity, thus solving Mercury's current management issues; development processes at Agrosnab could be copied at Mercury; and the scale effect of merger would maximize exit valuation – targeted for 2013. Agrosnab's operating profit was not mentioned as a point in favour of merger.
- [34] Also on 10 September 2010 Mr Korontsvit sent Ms Lokteva Agrosnab's official statements to 30 June 2010. They showed an operating profit of US\$22K for the period. Mr Korontsvit told her when forwarding the statements that some items required clarification and comments and he suggested a meeting with Mr Amirkhanian. Ms Lokteva's observation was that the figures were lower than she had been expecting. Mr Korontsvit accepted that these statements took no account of black cash payments (i.e., as I understood him, of actual black cash outgoings). For her

⁸ by which it was agreed that he had meant operating profit

⁹ Mr Korontsvit never admitted to having forecast anything over US\$1 million of operating profit for 2010

part, Ms Lokteva was aware that certain lines could not be relied upon because they could contain fake inventory. She also knew by this time that 'commission' payments were being made to customers and that there were other 'commissions' amounting to around US\$300K.

- [35] Mr Korontsvit said that at this point the basic structure of the deal had been agreed and that there were no further discussions as to terms. I accept this evidence.
- [36] On 24 September 2010 Mr Altynov sent Agrosnab's official statements to 31 August 2010 to Mr Korontsvit and Ms Lokteva, adding that he was ready to comment upon them. The figures showed an operating profit of some US\$354K (a figure which Ms Lokteva was subsequently to revise downwards, using a methodology of her own which she had developed). Mr Korontsvit conceded that these statements could include fictitious profit of some US\$300 – US\$350K, but was unable to say for certain what the precise figure was.
- [37] Mr Altynov also provided Ms Lokteva with information which showed that the spare parts inventory was overstated by some RR80 million (roughly US\$2.65 million at an exchange rate of 30.17). The true figure was in the region of RR39 million, or roughly US\$1.3 million using the same exchange rate. Ms Lokteva was also made aware at this time that the fake inventory was matched in Agrosnab's list of creditors by imaginary debts due to the supposed suppliers – who were in fact part of Agrosnab's shadow banking network, although there is no evidence to suggest that Ms Lokteva knew that at the time.
- [38] Ms Lokteva says that she was suspicious that Agrosnab's 31 August official statements might have understated its profits in order to reduce its tax liability. That is the reason which she gives for sending her email of 28 September 2010 asking Mr Altynov what was the real profitability for the first eight months of 2010 and what was its actual inventory. She also asked if all the debtors were real and asked Mr Altynov to send her a list of real debtors (she made a specific enquiry to the same effect about a particular named debtor). I do not accept that Ms Lokteva thought that Agrosnab might have been understating its profit. Although profitability has nothing to do with inventory or debtors, the whole tone of the letter betrays a suspicion that Agrosnab was less financially sound than the official statements to 31 August 2010 suggested.
- [39] Mr Amirkhanian's evidence was that at around this time he had become aware that fake inventory was being booked in order to manage Agrosnab's VAT liability; that payments were being made to customers and to two suppliers (i.e. to employees of customers and of the two suppliers); and that he had become aware that Mr Korontsvit was making cash withdrawals for his own benefit. He was not, however, aware of the full extent of these black cash payments. I accept that evidence. He said that had he been made aware of their true extent, Mercury/East Pine would not have proceeded with the deal. Mr Amirkhanian said he was 'led to believe' that black cash payments were few. Later, he said, he discovered that there were more.
- [40] On 5 October 2010 Mr Korontsvit suggested that it would help Agrosnab with an imminent VAT liability if Mercury were to sell Agrosnab nine tractors which it had in stock in its St Petersburg depot. The point of the deal from Agrosnab's perspective was that the resulting liability for the purchase price could be set off against its outputs, whereas Mercury had a VAT credit resulting from its acquisition of the Matrix assets which the sale price would absorb. The net result would be to transfer the benefit of Mercury's VAT credit to Agrosnab. A contract was drawn up providing for

the sale by Mercury to Agrosnab of the eight tractors for a total price of RR65.5 million, payable on or before 1 March 2011. In the event, four of the tractors were sold by Agrosnab, which retained the sale proceeds (about US\$1.1 million), while the remainder were sold by Mercury. Apart from a single payment of RR10 million, Agrosnab has not accounted to Mercury for the value of the tractors which it sold and Mercury has obtained judgment in the Russian Arbitrazh Courts for the outstanding balance. There was considerable argument about whether this sale (which was backdated to 29 September 2010 in order to capture the VAT credit) was real or imaginary, the point being whether Agrosnab had become truly indebted to Mercury for the price. The point is academic by reason of the decision of the Russian Arbitrazh Court, but the importance for present purposes of this deal is that it shows that by October 2010 the parties were working closely together, to the extent of sharing assets in the shape of the VAT credit. Indeed, it was the evidence of Mr Korontsvit, which I accept and which in my view is corroborated by the tractor deal, that by October 2010 there had been a *de facto* merger of the two enterprises.

- [41] Ms Lokteva's inquiry of 28 September 2010 about 'real profits' went unanswered until 13 October 2010, when Mr Altynov sent her Agrosnab's management accounts to 31 August 2010. The reason given for the delay was that Agrosnab had been heavily involved in an agricultural machinery exhibition in Moscow for a week and, on their return, in catching up. It was suggested that this delay was in some way suspicious, but I see no reason for rejecting Mr Korontsvit's explanation for it. Mr Altynov explained to Ms Lokteva that the management accounts were calculated more strictly than were the official statements, in that costs were higher to bring into account off balance sheet operations. These management accounts showed an operating profit down to 31 August 2010 of some US\$230K (a figure which Ms Lokteva recalculated to produce her own EBITDA of US\$203K).
- [42] The bottom line in the management accounts showed a net loss of US\$414K. On 14 October 2010 Ms Lokteva told Mr Altynov that she had a clear vision that Agrosnab would earn \$1 million – not make a loss of US\$400K. She asked him whether she was misunderstanding something or whether an upswing was expected from September through December. It must be remembered that Ms Lokteva had not been at the dinner on 21 August 2010, so that she would have been relying upon what she had been told about it by Mr Amirkhanian.
- [43] The reply came from Mr Korontsvit. He told Ms Lokteva that when he had mentioned the figure of US\$1 million, he had been referring to operational profit, as he had understood Mr Amirkhanian to have been when he had told him that he expected Mercury's profit for 2010 to be zero. He also told Ms Lokteva that the management accounts had 'cleaned out' (i.e. had brought into account) US\$300K-worth of 'presents' to clients. He predicted an improvement in September/October but told her that an order from a large client ('ROPA') had suffered a one third reduction, which Ms Lokteva was able to work out would depress its profits by some US\$316K. Mr Korontsvit accepted that what he told Ms Lokteva on this occasion was significant and intended to be relied upon.
- [44] Mr Korontsvit said in evidence that this explanation was not intended to be a comprehensive explanation of the difference between the official statements and the management accounts. He said that the management accounts included all black cash and 'personnel', including salary (i.e. all off the books payments made to management and staff). He said that Mr Altynov had explained the differences to Ms Lokteva and had given her the correct figures. He said that Mr Altynov had explained that the 31 August management accounts took into account all black cash payments

reported from the regional offices to that date and that while the official statements included fictitious sales the management accounts did not. The 31 August management accounts brought black payments into account, except for some US\$300K which would be 'replaced' by assets to an equivalent value by the year end. He insisted that the 31 August management accounts were a reliable guide to actual profit.

- [45] Ms Lokteva said that she was working on bottom line rather than operating profit. If that was so before 13 October 2010, she plainly had no justification for doing so thereafter and it is clear from the evidence of Mr Amirkhanian that she had been mistaken in doing so in the past. He never had any difficulty with accepting that the discussion on 21 August 2010 had been about operating profit. She did note, however, that Mr Korontsvit did not revise his original forecast downwards, so that she had assumed that it remained the same apart from the adjustment which needed to be made in consideration of the reduction in the ROPA contract. I shall have to return to this point.
- [46] The management accounts to 31 August 2010 showed a gross margin of US\$3.246 million (after bringing into account certain receivables which did not appear in the management account statement because the goods in question had yet to be delivered to the customers), down from the figure of US\$3.893 million which Ms Lokteva had identified from the official statements for the same period and which she had further adjusted to US\$3.778 million, in order to take account of certain expenses which she considered needed to be deducted from the gross margin in the official statements. The resulting difference in gross margin between that in the official statements (as adjusted by Ms Lokteva) and that in the management accounts (as adjusted by Ms Lokteva) is US\$532K. This figure is significant, because although she was supplied with subsequent official statements, Ms Lokteva never received any management accounts for Agrosnab after those for 31 August 2010. Mr Korontsvit said that no management accounts were in fact produced subsequently, since Agrosnab was too busy with the merger. In default of management accounts, Ms Lokteva adopted the practice of applying her US\$532K deduction to the gross margin shown in the official reports with which she was subsequently supplied and deriving her own operating profit/EBITDA from the official reports in this way. She appears to have treated the US\$532K deduction as an invariable constant, not subject to fluctuation month by month.
- [47] Mr Korontsvit complained that Ms Lokteva had never disclosed to him or to Mr Altynov that she was using this method to interpret the official statements which she subsequently received. He did not – and could not – suggest that she was under any obligation to do so, but he said that had she checked her working with him or Mr Altynov corrections could have been made where necessary to the assumptions which she was making.
- [48] Mr Amirkhanian's evidence was that if the 31 August 2010 management accounts were genuine (which he did not accept) then there can have been no intention on the part of Agrosnab to hoodwink Mercury and Agrosnab might have been on track for a year end operating profit of US\$1 million. He said that the accounts were not genuine because, in his view, Agrosnab was trading on fake inventory.
- [49] Also on 14 October 2010 Mr Korontsvit, in answer to a query from Ms Lokteva, told her that he had reduced the amount of fake inventory from RR80 million down to about half of that sum. On 20 October 2010 Ms Lokteva was sent official reports to 30 September 2010. Using the methodology described above, she calculated that Agrosnab's actual operating profit had come in at US\$201K.

- [50] On the same day Ms Lokteva was sent a revised 'fake spares' list which showed that some RR46 million had been eliminated from false inventory through the shadow banking system. She asked Mr Altynov whether that had been achieved by cash payments or 'returns.' Payments in cash would be off the books payments which could be explained as inventory purchases, while 'returns' would simply be yet another form of false accounting predicated on the supposition that real goods had been returned to the fictitious sellers. Mr Altynov's reply was 'goods return mainly – let's discuss details personally.'
- [51] East Pine pleads that this response was false and deceitful. It is not pleaded that East Pine relied upon the statement to act or to refrain from acting in any particular way or that it caused East Pine any loss.
- [52] In cross examination Mr Altynov said that the bulk of the 'returns' were entered into Agrosnab's books as sales with what he described as a 'technical' (i.e. fraudulent) mark up of 2.5%. The reason for the mark up was to convince the auditors that these were indeed genuine sales. The result was to produce a fictitious profit of about RR1 million (about US\$33K). Mr Altynov said that fake 'returns' (as opposed, presumably, to fake sales) were impossible to achieve and in any case he could see no difference between a sale and a return, both being imaginary disposals of the underlying asset. Given the fact that the whole of this exercise was completely illusory, it is impossible, at one level, not to agree. In addition to these notional sales, Mr Altynov said that about RR2 million did pass in cash and that there were some returns to other suppliers. At the end of the day, it does not seem to me to matter. Mr Altynov had been asked whether the reductions had been effected by way of cash or returns. What Mr Altynov was saying was that by and large the reduction was not the result of cash payments but by way of false accounting, which was the thrust of Ms Lokteva's question. In that sense the answer was accurate.
- [53] On 22 October 2010 the parties signed a term sheet setting out the mechanics of the transaction, including terms by which the US\$2 million down payment to Mr Korontsvit and Mr Altynov and the deferred US\$2 million for the Agrosnab shares were to be routed to Tawney through Guildron. The term sheet envisaged an exit date of 2013 and an exit price of upwards of US\$40 million.
- [54] On 29 October 2010 Mr Altynov sent Ms Lokteva a list of wire transfers showing payments made to shadow banking 'partner' companies during 2010 down to the end of October. They totaled some RR80 million. Ms Lokteva said that she had asked for this list because she had been concerned that Mr Korontsvit might be siphoning cash out of Agrosnab prior to the merger. That appears to be a very odd reason for asking someone to send a list of wire transfers. Be that as it may, Mr Korontsvit's evidence was that not all of these wire transfers represented current year outgoings of black cash. Some included prior year obligations for bonuses, which would not affect the current year operating profit and some represented pre-payments (in effect) in respect of genuine spare parts which, when received, would form part of Agrosnab's real inventory.
- [55] On 23 November 2010 Ms Lokteva was sent Agrosnab's latest official reports. Using the method described above, she calculated Agrosnab's operating profit to 31 October 2010 as US\$251K. She says in her witness statement that it was clear that Mr Korontsvit's prediction of Agrosnab's operating profit was inaccurate. Even allowing for the predicted later surge, she says that at best the annual operating profit would be at the lower end of the revised figure of US\$700,000 to

US\$1.2 million. The reference to revision must be to the loss of a portion of the ROPA contract which Mr Korontsvit had mentioned to Ms Lokteva on 14 October 2010. Mr Amirkhanian's evidence was that at around this time he and Ms Lokteva considered that Agrosnab's operating profit would be between US\$600 and US\$900k at the year end – which he said was not too big a difference from US\$1 to US\$1.5 million, although at this stage Mr Amirkhanian said that he personally was aware only of the figures to 31 August. When asked, he said that Agrosnab might have made a profit of US\$170K in each of November and December - adding that it was not possible to predict results from one month to another. Neither Mr Amirkhanian nor Ms Lokteva took Mr Korontsvit to task about this and Mr Amirkhanian said that he personally did not make any calculations of possible year end profit at this time. He added that even if the predicted outcome at this time had been an annual operating profit of US\$500K, that 'would not have been a problem,' provided that the figure had a logical explanation.

[56] On 24 November Mr Korontsvit wrote to Ms Kudriatseva (the newly appointed Mercury CFO of the intended combined MAST enterprise) and to Ms Lokteva telling them that Agrosnab needed to settle certain unavoidable commitments by means of black cash payments. He indicated that for the future resort to black cash payments would be avoided, but that the payments to which he was referring had to be made in this manner. The unstated reason was that the intended recipients had in the past insisted upon being paid in the way – something of which Ms Kudriatseva was only too conscious, as she made clear in an email sent by her to Ms Lokteva on 20 January 2011. Ms Lokteva said that she had not noticed Mr Korontsvit's warning about the need for the imminent black cash payments, saying that she was indisposed and concentrating on the imminent closing. Having listened to Ms Lokteva giving evidence and observed her keen intelligence and grasp of detail at work, I find it difficult to accept that this message went unremarked by her. It may be that she did not think it of much importance at the time, but I feel sure that she will have read it as it arrived.

[57] On 25 November 2010 the Share Subscription Agreement and the Shareholders Agreement were signed (although dated 24 November 2010). Important features of the Share Subscription Agreement for present purposes are that

- (a) by clause 5.1 it was provided that, together with the other transactional documents, it contained the whole agreement between the parties;
- (b) it contained no representation nor warranty about the profitability of Agrosnab;
- (c) it contained the warranty about insolvency referred to in paragraph [14] above; and
- (d) it was governed by English law.

[58] It was Mr Amirkhanian's evidence that he had expected that the Share Subscription agreement would contain, in addition to what he described as the usual representation about Agrosnab's solvency, 'something about Agrosnab's profitability' and that when he discovered that nothing of the sort had been included, he was so angry that he dismissed SI's lawyer. He also said in cross examination that he had given instructions that the Share Subscription Agreement should contain provisions for adjustment of the balancing payment after completion, a term which he said, but Mr Korontsvit denied, had been agreed during the negotiations.

- [59] Following the conclusion of the agreements, Agrosnab set about, as Mr Amirkhanian accepted, assisting Mercury in its business. It provided staff and resources and placed orders for the benefit of Mercury with a value of some US\$200 to US\$225K. This traffic was not one-way. On 1 December 2010 Mercury lent Agrosnab RR13.2 million to enable it to settle outstanding liabilities to suppliers. Mr Korontsvit said that this (and subsequent) loans became necessary because funding which Agrosnab was arranging with Nomos Bank was not finalized as soon as had been expected. Indeed, it was common ground that there had been difficulty over some property which was to be used as security for the lending.
- [60] On 15 December 2010 Mercury employees moved into Agrosnab's premises.
- [61] On 20 December 2010 Mr Lokteva calculated from Agrosnab's official reports that down to end November 2010 Agrosnab had made no profit. Mr Amirkhanian said he became aware of this fact only in January or February of 2011.
- [62] Some time between 20 December 2010 and 18 January 2011, Mr Korontsvit and Ms Lokteva signed a so-called 'Protocol' which set out a list of payments due or likely to become due from each of Agrosnab and Mercury and which the parties agreed should be paid in off balance sheet black cash derived from 'MAST' proceeds. For some reason the Protocol was dated 14 November 2010.
- [63] On 29 December 2010 Mercury lent Agrosnab RR13.8 million to pay a debt due to John Deere.
- [64] On 19 January 2011 Ms Lokteva complained to Mr Korontsvit that certain black cash payments to Mr Altynov had not hitherto been disclosed. Mr Korontsvit's reply was 'OK Let's put aside. I understand this is one of the most painful moments and it is better to discuss in person.' On the same day Mr Amirkhanian learnt that Mr Korontsvit was drawing a previously undisclosed and unaccounted for US\$30K per calendar month from Agrosnab's cash by way of supplement to his declared salary.
- [65] On 20 January 2011 Ms Kudriatseva sent Ms Lokteva a list (drawn up by Mr Denis Sergienko, the manager of Agrosnab's finance department) of off balance sheet black cash payments made by Agrosnab over the ten months ended 31 October 2010. It amounted to the rouble equivalent of some US\$1.3 million – or US\$1.6m if extrapolated over a full year. Ms Lokteva reacted by writing HORROR!!!! in capital letters in her email response. In her evidence she said that it represented payments of black cash previously unreported to Mercury and that had she seen the list earlier she would have advised against going in to the merger on the grounds that it showed that Agrosnab's culture was unsuitable. In this she was clearly referring to the need, if an advantageous exit was to be achieved, of having a merged company with a balance sheet that would bear scrutiny in an audit carried out to acceptable international standards. Ms Lokteva thought that these payments showed too entrenched a culture of under the counter payments – something which Ms Kudriatseva confirmed to be the case in her email response.
- [66] There was a heated meeting about this the next day, at which agreement was reached that all black payments (apart, presumably, from those referred to in the Protocol) must stop.
- [67] In his witness statement prepared for trial Mr Altynov had said that he considered that Agrosnab's true operating loss for 2010 was in the region of US\$300K. In a second witness statement,

produced shortly before he gave evidence, Mr Altynov said that he had remembered that, without having been instructed to do so, Mr Sergienko had produced management accounts for 2010 on 24 January 2011. Mr Altynov exhibited this document to a second witness statement, showing an operating loss for the year of some US\$333K. These accounts omitted black cash payments of some US\$210K, but Mr Altynov said that that did not affect the operating profit because the payments in question were in the nature of interest payable to the shadow banking partners and would come in below the operating profit line.

- [68] On 7 February 2011 Mercury lent Agrosnab a further RR4 million.
- [69] On 8 February 2011 Mr Korontsvit sent Ms Lokteva Agrosnab's official reports for 2010. They appeared to show an operating profit of US\$790K, but if the US\$1.6 million black cash derived from the list which Mr Sergienko had sent to Ms Kudriavtseva on 20 January 2011 is deducted, then Agrosnab's loss for the year before interest and depreciation comes out at around US\$800K.
- [70] Between around 11 and 15 February 2011 Mercury lent Agrosnab a further RR4.6 million.
- [71] On 24 February there was a so-called MAST board meeting – i.e. a joint meeting of the boards of the two enterprises. Financial statements for Agrosnab, drawn up for the purposes of the meeting by Ms Kudriatseva and her staff, show a net loss of some US\$1.5 million after taking account of RR16 million of fictitious profit and RR33 million of the then disclosed black cash payments. On the basis of those figures Agrosnab showed an operating loss of some US\$845K for 2010.
- [72] Under the terms of the tractor supply agreement Agrosnab was due to pay Mercury RR65.5 million on the tractor contract by 1 March 2011. As previously mentioned, Mercury itself sold and retained the proceeds of four of the tractors, reducing the debt accordingly, but Agrosnab had sold the other four for over US\$1 million. As a result of pressure from Ms Lokteva, Agrosnab did pay RR10 million on account of this liability on about 11 March 2011, but the balance remains unpaid and outstanding.
- [73] On 3 March 2011 Mr Korontsvit explained to Ms Lokteva that an additional RR17 million of hitherto undisclosed black cash payments, including RR6.6 million by way of commissions to the shadow banking partners, needed to be brought into account. On Mr Altynov's analysis, the latter would have been treated as being in the nature of bank interest and would have had no effect on operating profit, but the other black cash payments would have affected it.
- [74] On 4 March 2011 Mr Sergienko sent Ms Lokteva a schedule showing total black cash payments for 2010 as being, not the RR33 million brought into account in the financial statement presented to the 24 February 2011 MAST board meeting, but RR48 million. When Ms Lokteva queried the difference of RR15 million, Mr Sergienko replied that this sum had already been brought into account in other accounting lines.
- [75] Also on 4 March 2011 Ms Lokteva sent a report to the SI partners. In her covering letter she wrote: 'We have finalized our studies of relative values [Agrosnab] vs [Mercury] and according to our agreement with [Agrosnab] partners. Please let me know your opinions on how to proceed.'

- [76] The report which Ms Lokteva sent to the SI partners was a six page document. It opened by reproducing Mr Amirkhanian's table of August 2010 with its comparative weighted values for Mercury and Agrosnab respectively.¹⁰ Ms Lokteva then informs the SI partners that based on the table, with its main criterion of profitability, it had been determined that Agrosnab was worth half as much again as Mercury. She says that Agrosnab had carried out a similar exercise and concluded that Agrosnab was worth 1.75 times the value of Mercury and that because of the similarity in results Mercury accepted Agrosnab's figure and agreed in order to form a 50/50 partnership, to pay US\$3.75 million 'for their John Deere business,' with the other associated business being included at an additional price of 50% of US\$500K, making a total balancing payment of US\$4 million. Ms Lokteva then set out to review each line in Mr Amirkhanian's table. She recommended that changes be made to the values in only two lines – the profitability line and the risk line. In the case of profitability she suggested leaving Mercury unchanged at '3', but reducing Agrosnab from '7' to '2'; as to risk factor, she advised leaving Mercury with a '2', but reducing Agrosnab from '8' to '2'. The effect of these proposed adjustments was to leave Mercury with its original 261 points and to reduce Agrosnab from 393 to 313. The ratio thus generated, when applied to the US\$17 million SI investment in Matrix, produced a balancing payment of US\$1 million for the John Deere business, with the figure of US\$250K for the subsidiary left unchanged, a total of US\$1.25 million. On this basis she proposed to the SI partners that the Agrosnab shareholders should repay SI/East Pine US\$750K out of the US\$2 million which they had received.
- [77] It was Ms Lokteva's evidence that the suggested price reduction was only a first step, the ultimate intention of SI being to put Agrosnab into liquidation and acquire its assets free from the supposed taint of the black cash payments. When it was put to her that her report contained no mention of any such thing (nor, for that matter, does any other document put in evidence) she had no real answer. No such scheme was ever suggested by Mr Amirkhanian to Mr Korontsvit.
- [78] Ms Lokteva's report was sent to Mr Korontsvit for his consideration. On 7 March 2011 he sent an emotional letter to Mr Amirkhanian complaining that it was he, Mr Korontsvit, who had come to the rescue of SI by helping them out with what he described as its misguided acquisition of Matrix; attributing the cash flow difficulties suffered by Agrosnab to SI's insistence upon eliminating the black cash system, something which he said he would have comfortably continued with had he been left alone; and bitterly regretting his association with SI. So far as ascertainment of the amount of the balancing payment was concerned, Mr Korontsvit described Mr Amirkhanian's table as a sheet of paper which he had come up with in a few minutes because he (Mr Korontsvit) did not wish to climb down from a price of US\$5 – US\$6 million.
- [79] Mr Amirkhanian responded on the same day, promising to try to find solutions to the problems identified by Mr Korontsvit, but only once agreement had been reached on how to correct the valuation issue raised in Ms Lokteva's report of 4 March 2011. He said that the parties had reached agreement [meaning, as I read the letter, agreement as to the amount of the balancing payment] based on representations made to each other about their respective businesses. He also maintained that it had been specifically agreed that corrections would be made [again and as I read the letter, to the amount of the balancing payment] if it were to be discovered post merger that there was a discrepancy between representation and fact. He went on to tell Mr Korontsvit that he expected to receive his suggestions as to how to correct the discrepancy in a timely manner. He

¹⁰ see paragraph [25] above

set out a timetable: 10 March 2011 to resolve the valuation issue; 13 March 2011 to approve a budget; and 13 March 2011 to resolve other shareholder/Board related issues, including whether he, Mr Amirkhanian, should resign from it.

- [80] On 10 March 2011 Mr Korontsvit sent Ms Lokteva a copy of her 4 March 2010 report incorporating his comments.¹¹ He suggested that Mercury's score for political connections and current turnover needed adjustment downwards. He reserved his position on the profitability line. As far as risk was concerned, his position on the lending that had been made by Mercury to Agrosnab was that it had been under the overall control of Ms Kudriatseva and that in any event it was irrelevant since the intention was that the entities should be merged.
- [81] The valuation issue, as Mr Amirkhanian described it, was not resolved. On 15 March 2011 Mercury personnel left the Agrosnab offices, never to return. Mercury subsequently took proceedings for recovery of the loans and for payment of the balance due in respect of the four tractors sold by Agrosnab pursuant to the 29 September 2010 contract. Freezing orders and judgments were obtained.

East Pine's pleaded case in misrepresentation

- [82] After setting out the background to the merger, East Pine pleads that at the end of August or in early September 2010 Mr Korontsvit told Mr Amirkhanian that he believed that Agrosnab's operating profit (EBITDA) for 2010 would be between US\$1 and US\$1.5 million. This is described as 'the Representation about EBITDA.' Mr Korontsvit is alleged to have justified his forecast by saying that the current drought affecting Russia would be good for Agrosnab's end of year trading because the Government would grant subsidies and those farmers who had managed to harvest grain would obtain high prices for it and thus be in the market for acquiring foreign machinery. For these reasons, Mr Korontsvit is alleged to have told Mr Amirkhanian, Agrosnab's profit for the second half of 2010 would be greater than that for the first.
- [83] It is pleaded in paragraph 14 of the amended statement of claim that in reliance upon the Representation about EBITDA East Pine agreed to pay a consideration of US\$4 million based upon Agrosnab being 1.5 times more valuable than Mercury. Paragraph 44 of the amended statement of claim puts the matter somewhat differently. There it is pleaded that the 'price' of US\$4 million¹² was based principally upon the financial information that had been provided to Ms Lokteva and, in particular, upon 'the Representations,' i.e. all of the pleaded representations. It can be said immediately that there is no factual justification for the first limb of paragraph 44. The price was provisionally agreed on or before 10 September 2010 and was never revisited in the light of the financial material subsequently supplied to Ms Lokteva. Nor can it be said that the price was agreed in reliance upon all the pleaded representations. The price was agreed during a haggle over Mr Amirkhanian's points table.
- [84] It is then pleaded that Mr Korontsvit had disclosed to Mr Amirkhanian that Agrosnab engaged in the following categories of illegal transaction:

¹¹ email at C4/1093 of the trial bundles refers

¹² it is broken down differently, but that is the substance

- (1) the pretence of acquiring imaginary inventory from 'grey' suppliers so as to reduce Agrosnab's VAT liability;
- (2) (I paraphrase) the practice of transfer pricing through 'grey' offshore intermediaries who would sell the goods to Agrosnab at a fraction of true cost, thus reducing Agrosnab's VAT and custom's liabilities and which would themselves disappear having been reimbursed for the price differential, thus evading duty on a substantial portion of the true cost of Agrosnab's imports;
- (3) the illegal payment of a handful of commissions to buying agents of clients, payments of small commissions to supplier's top management and the making of occasional unauthorized withdrawals by Mr Korontsvit himself;

Mr Korontsvit is also alleged to have said

- (4) that Agrosnab was in a position to stop all illegal transactions, including 'black cash' payments for the new financial year following 'the merger.' The amended statement of claim does not define 'black cash' or 'the merger.'

These four representations are defined as 'the Representations about Payments.'

Black

- [85] East Pine goes on to plead that during the negotiations Mr Korontsvit and Mr Altynov provided Ms Lokteva with financial information which was not inconsistent with the Representation about EBITDA. It is alleged that 'the [Agrosnab] shareholders' represented that 'the profit figures in Agrosnab's 'official financial statements' could (subject to matters specifically drawn to the attention of East Pine), be relied upon. This representation, which is not alleged to have been made on behalf of Agrosnab, is referred to as 'the Representation about Profits.'
- [86] The pleading defines the Representation about EBITDA, the Representation about Black Cash Payments and the Representation about Profits as, together, 'the Representations.'
- [87] By paragraph 49 of the amended statement of claim it is pleaded that by clause 4.2 and paragraph 3.2 of Schedule 2 to the Share Subscription Agreement Tawney represented and warranted that it was neither insolvent nor unable to pay its debts.
- [88] Paragraph 45 of the amended statement of claim pleads that the Representations were false and known to be false by Tawney, Mr Korontsvit and Mr Altynov. Agrosnab was in the process of making a substantial loss for 2010 and the extent of its 'black cash' payments meant that they could not be eliminated following the merger. Given the figures, it is said that Mr Korontsvit could never have believed and did not believe that Agrosnab's EBITDA for 2010 would amount to between US\$1 and US\$1.5 million and knew that he had no reasonable grounds for making his representation or made it recklessly, careless whether it was true or false. The Representations are said to have been continuous in nature and made in the knowledge that East Pine would rely upon them when entering into the Share Subscription Agreement. East Pine¹³, it is said, would not have entered into the Share Subscription Agreement had it been provided with accurate

¹³ the allegation is pleaded in relation to Guildron, but given the way in which it is agreed that the case should be treated, it must be attributed to East Pine

information and an honest prediction of the 2010 EBITDA and accurate statements of black cash payments.

- [89] The amended statement of claim goes on to describe the production of financial information by Agrosnab to East Pine after the agreements had been concluded on 25 November 2010 and makes allegations about what they reveal about the state of Agrosnab's financial affairs and says that it is thus shown that Mr Korontsvit's prediction of profitability was not genuine but intended to mislead. It is said that Agrosnab's official financial statements were deliberately put forward as reliable when they were known not to be; that it was false to have alleged that there were only a handful of off the book payments; and that the extent of black cash payments was such as to make it impossible to stop making them and remain in business.

Analysis

A The representation about EBITDA

- [90] I find that Mr Korontsvit told Mr Amirkhanian, during the course of their dinner on 21 August 2010, that he believed that Agrosnab could turn in an operating profit of US\$1 million for the year ending 31 December 2010. I further find that Mr Korontsvit did not say that Agrosnab 'would' make an operating profit of US\$1 million in 2010, although for the reasons which follow my conclusion would have been identical if that had been the word used. I further find that Mr Korontsvit told Mr Amirkhanian that he was not a financial expert and that the final figure could be above or below his forecast. I do not accept that Mr Korontsvit mentioned any other figure than US\$1 million. In particular, I do not accept that he mentioned a figure of US\$1.5 million as a possible outcome. The US\$1 million figure is consistent with Ms Lokteva's reaction on being shown the 31 August 2010 management accounts. Mr Amirkhanian's explanation for referring to a higher figure in his letter of 10 September 2010 makes no sense and in my judgment he deliberately exaggerated the number in order to justify the price which had already been provisionally agreed (subject to partners' approval) between he and Mr Korontsvit.
- [91] It is elementary that a forecast of this sort is not actionable unless it is shown that its maker did not believe it at the time when he made it or that facts known to him when he made it mean that he cannot honestly have held the opinion which he gave. There is no evidence from which I can infer that on 21 August 2010 Mr Korontsvit did not believe that Agrosnab could make an operating profit of US\$1 million by the end of the year. Mr Korontsvit was clearly capable of bamboozling the Russian tax authorities and of bribing employees of his customers and suppliers, but having watched him give evidence, which he did with complete frankness (for example, his ready acceptance that the representation was serious and intended to be relied upon), I am not prepared to find in the absence of any probative evidence to the contrary that he would have deliberately misled a prospective business partner at the outset of their discussions by offering a potential profit forecast which he did not believe to be achievable, in accordance with the terms in which it was given ('could be more, could be less'), when he made it.
- [92] The worsening financial news which emerged as the year proceeded does not mean that on 21 August 2010 Mr Korontsvit was aware of facts which meant that his profit forecast must have been given dishonestly. It is true that he frankly accepted in cross examination that he should not have relied upon an upswing in trade during the latter part of the year when Agrosnab's actual turnover

corresponded to his prediction of US\$25 million (inclusive of VAT), but it does not follow from that that facts known to Mr Korontsvit at the time when he made his forecast meant that it must have been given dishonestly. All it shows is that the profit forecast and the turnover forecast were, in the events which happened, out of kilter. The whole attack made by Mr Parker QC on the profit forecast depended upon the assertion that *subsequent* events showed that Mr Korontsvit cannot have believed his prediction when he made it. That is not the law on this topic. If it was, weather forecasters, financial analysts and racing tipsters would spend their lives in the courts.

- [93] In my judgment, the forecast made by Mr Korontsvit on 21 August 2010 did not amount to a representation that would remain effective and could be relied upon as if repeated on whatever date in the future agreement might be concluded between the parties and whatever might be the circumstances when and if that were to happen. It had never been repeated as of continuing effect and most significantly there is no trace of it or of anything like it in Ms Lokteva's 4 March 2011 report, which was exclusively concerned with the quantum of the balancing payment. Nor is there any trace of it in the Share Subscription Agreement.
- [94] Nor, in my judgment, when he corrected Ms Lokteva on 14 October 2010 by stating that his representation had been about operating profit, rather than net profit, was Mr Korontsvit repeating the representation with present effect. He was merely saying that he had never forecast a net profit of US\$1 million. He was not providing an updated forecast.
- [95] In my judgment, therefore, Mr Korontsvit's profit forecast (or 'representation about EBITDA') is not actionable at the suit of East Pine.
- [96] I should, however, go on to consider the question of reliance. It is clear to me that, to the extent to which East Pine relied upon the forecast at all, it was as a factor in calculating the prospective balancing payment. That is how the matter is pleaded in paragraph 14 of the amended statement of claim; that is how Mr Amirkhanian expressed himself in cross examination ('I relied upon the representation to value the business'); and that is the reason that it was mentioned (although overstated) by Mr Amirkhanian in his letter to the SI partners of 10 September 2010.
- [97] The amount of the balancing payment (US\$4 million) had been provisionally settled, subject to the approval of the SI partners, by 10 September 2010. Despite the fact that East Pine had had every opportunity to do so, the figure was never revisited before it became binding upon conclusion of the Share Subscription Agreement.
- [98] SI/East Pine went so far as to claim that there had been an agreement to revisit the balancing payment in the light of future events. Apart from the fact that the existence of this alleged agreement would defeat any suggestion that East Pine was relying on Mr Korontsvit's profit forecast when it signed the Share Subscription Agreement, it finds no echo in any of the correspondence leading up to execution of the Share Subscription Agreement on 25 November 2010 and is not reflected in the agreement itself. In my judgment this alleged agreement was an after the event invention by East Pine. In any event, East Pine is precluded from relying upon any such agreement by the entire agreement provision in the Share Subscription Agreement itself.
- [99] Ms Lokteva and Mr Amirkhanian say that by 25 November 2010 they had deduced from the official reports with which they had been supplied that Agrosnab's year end figure would be in the region

of US\$600 to US\$700 million. Given the figures with which they had been supplied, this seems to be a wildly optimistic expectation and I do not believe that they truly thought at that stage that such an outcome was achievable. At no stage before conclusion of the Share Subscription Agreement did Mr Amirkhanian or Ms Lokteva reproach Mr Korontsvit about the prospective shortfall in operating profit.¹⁴ Indeed, Mr Amirkhanian said that an outfall of US\$500K would have been acceptable had there been a logical explanation for it. It is impossible to reconcile this evidence with continuing reliance upon the forecast of 21 August 2010. By the time the Share Subscription Agreement was signed no one was harking back to what had been said over dinner on 21 August 2010 or complaining that Agrosnab might make US\$300K or US\$400K or US\$500K (or indeed any other figure) less than the figure mentioned by Mr Korontsvit on that occasion. In my judgment, the forecast made by Mr Korontsvit on 21 August 2010 had been overtaken by events and become spent long before 25 November 2010.

- [100] The reasons why East Pine entered into the Share Subscription Agreement are set out in Mr Amirkhanian's letter of 10 September 2010 to the SI partners. The five grounds given at the end of the letter for Mr Amirkhanian's recommendation for merger do not include Agrosnab's anticipated future profitability. SI, in the view of Mr Korontsvit, as emotionally expressed in his email of 7 March 2011 to Mr Amirkhanian, had made a mistake in purchasing the Matrix assets and needed Agrosnab more than Agrosnab needed SI. Mr Amirkhanian himself told me that Mr Korontsvit had come to his rescue. East Pine did not conclude the Share Subscription Agreement on 25 November 2010 wholly or in part in reliance upon what Mr Korontsvit had said in the restaurant on 21 August 2010.

B The representations about Black Payments

- [101] I can deal with these representations quite shortly. The first three – manipulation of VAT through grey inventory; transfer pricing; and payments of secret and unaccounted for bribes – appear to me to be more in the nature of disclosures rather than representations. I cannot see what complaint can be made about them – except, perhaps, with the description of payments of bribes and additional drawings by Mr Korontsvit himself as amounting to 'a handful' of transactions. It was never proved that transactions in those categories amounted to more than 'a handful', which in my judgment is far too imprecise a remark upon which to found a claim in fraud. It is true that at trial East Pine emphasized that the full extent of black cash payments was unknown to it when the Share Subscription Agreement was concluded on 25 November 2010. That is certainly the case, as is clear from my earlier review of the evidence, but it seems to me that Mr Ayliffe QC is right when he says that that is in substance a complaint about non-disclosure rather than misrepresentation.
- [102] The fourth representation about Black Payments – that Agrosnab was in a position to stop all illegal and black cash payments by the start of the new financial year was in fact true, as Ms Lokteva accepted, although it is also true to say that in a refinement of this part of the case it is alleged that it was impossible for Agrosnab to eliminate all black cash payments and remain in business. It seems to me to be very difficult to see this as a representation of fact at all. In the context of discussions to eliminate black cash payments from each of Mercury and Agrosnab, with

¹⁴ Ms Lokteva's comment of 14 October 2010 was made in relation to net profit and was based on a misunderstanding of what Mr Korontsvit had said to Mr Amirkhanian on 21 August 2010

the evolution of the protocol, it seems to me that it can have amounted at most to an expression of intention. This is just not the sort of subject matter which gives rise to representations of fact on which commercial persons rely. No doubt Mercury hoped that these payments would by and large be eliminated and were led to believe that Mr Korontsvit would work towards doing so. They cannot have been relying upon what Mr Korontsvit said about them as representations of fact.

[103] Indeed, there is no evidence to support the pleaded allegation that it was impossible for Agrosnab to continue in business after eliminating the system of payment by way of black cash. It is true that in his letter of 7 March 2011 Mr Korontsvit spoke of the cash flow pressure which the elimination of black cash had caused for Agrosnab and it is true that Agrosnab was assisted over those difficulties by short term loans from Mercury. But that is a long way from establishing that Agrosnab was unable to carry on business without resorting to the black cash system.

[104] It is also true that in her evidence Ms Lokteva said that had she seen Mr Sergienko's list of black cash payments sent to her on 20 January 2011 (which caused her HORROR!!!! reaction) before entering into the agreement, she would have advised against entering into it on the grounds that it showed that Agrosnab's culture was unsuitable for SI's aims, but that is an allegation about non-disclosure rather than about representation. In fact, what followed the disclosure was a heated meeting at which it was agreed that all black cash payments must be stopped (as they were). Further disclosures were made by Mr Korontsvit on 3 March 2011. In no contemporaneous document, however, is it suggested that the extent of black cash payments, if known, would have been a deal breaker or that SI/East Pine had been misled into completing the Share Subscription Agreement as a result of this particular representation. There is nothing about it in Ms Lokteva's report of 4 March 2011 and nothing about it in Mr Amirkhanian's letter of 7 March 2011.

[105] It seems to me that in evaluating this part of the case it is important to bear in mind that it was Mercury's deliberate choice to dispense with due diligence. It was therefore taking the risk that what it subsequently found may not have been to its liking. That is not to say that East Pine is not entitled to make claims based upon on specific representations of fact upon which it may have relied when concluding the Share Subscription Agreement, but at the same time it cannot elevate into actionable misrepresentations or warranties non-specific statements about payments which it had been admitted before the agreement was concluded formed part of Agrosnab's business culture. Nor is it entitled to turn non-disclosures into representations.

[106] In my judgment, East Pine fails to establish a case on the basis of the representations about Black Payments.

C The representation about Profits

[107] East Pine says that Mr Korontsvit and Mr Altynov represented that the profit figures in Agrosnab's official statements could be relied upon (subject to any matters specifically drawn to the attention of East Pine). As the narrative set out earlier in this judgment makes clear, this allegation is not made out on the facts. SI/East Pine were well aware as at 25 November 2010 that Agrosnab's official statements could not be relied upon and indeed had been told as much.

D The warranty about solvency

- [108] There is no evidence that Tawney was insolvent on a balance sheet basis on 24 November 2010. Nor is there any evidence that it was unable to pay its debts as at that date. The price under the tractor contract did not fall due for payment until 1 March 2011. It is true that after conclusion of the Share Subscription Agreement, beginning on 1 December 2010, East Pine lent Tawney some R35.6 million (roughly US\$1.18 million), but that borrowing meant that Tawney was able to pay its debts and purchase equipment. The fact that a company may need loan finance in order to continue trading does not mean that it is unable to pay its debts.

Conclusion

- [109] For the reasons given above, this claim fails.

A handwritten signature in black ink, appearing to read 'H. J. Smith', is written over the judge's name.

Commercial Court Judge
18 September 2012