

UPDATE

Fairfield Sentry claims refused by the Privy Council

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On 16 April 2014, the Judicial Committee of the Privy Council (the **Privy Council**) handed down its decision in the trial of certain preliminary issues in *Fairfield Sentry Limited (in Liquidation) v Migani and Others* (the **Fairfield Redeemer Claims**).

Fairfield Sentry Limited (in Liquidation) (the **Fund**) was a BVI company and was the largest of a number of feeder funds which invested in the now infamous Bernard L Madoff Investment Securities LLC (**BLMIS**). As is now well known, BLMIS was a Ponzi scheme, possibly the largest in history, and returns to investors were fictitious. Between 1997 and 2008, approximately 95 per cent of the Fund's assets (totalling US\$7.2 billion) were invested in BLMIS. Members of the Fund subscribed for shares in the Fund and were entitled to redeem their shares at a price dependent on the Fund's net asset value per share (**NAV**). The Fund subsequently increased or reduced its investment in BLMIS by the amount of subscriptions or redemptions by its own investors.

On 18 December, the Directors of the Fund suspended the Fund's NAV, stopping any future redemption of its shares. The Fund was placed into liquidation by the High Court of the Virgin Islands on 21 July 2009.

Kenneth Kryz, the liquidator of the Fund (the **Liquidator**) has issued claims in the name of the Fund against a number of members or former members of the Fund who had redeemed some or all of their shares before 2008 (the **Redeemers**). The Liquidator's claims were founded in restitution and based on the premise that the amounts paid to the Redeemers were paid out on the basis of a mistake as to the value of the Fund's assets (and, in turn, based on a mistakenly calculated NAV). The Liquidator's stated intention was to collect in the moneys which had been paid out to the Redeemers (the **Redemption Payments**), so that any recoveries could then be distributed between all of the members of the Fund, whether or not they had redeemed before December 2008.

The value of the Fairfield Redeemer Claims is substantial, with the total value of the claims issued in the BVI exceeding US\$1 billion. These are but the thin end of the wedge, however, and similar claims have been issued in other jurisdictions, including in the United States where the Fund is claiming over US\$6 billion. The claims in the United States have been stayed pending the Privy Council's judgment.

In April 2011, following an application by the Redeemers which was opposed by the Liquidator, the Commercial Division of the High Court of the Virgin Islands ordered the trial of four preliminary issues. The first three can together be summarised as 'whether any of certain documents produced by the Redeemers constituted a certificate within the meaning of Article 11 of the Fund's articles of association (as set out below), so that Fairfield was contractually estopped from claiming restitution'. The fourth preliminary issue was 'whether, by surrendering their shares, the Redeemers gave good consideration for the Redemption Payments'.

Article 11(1)(c) of the Fund's articles of association provides that 'Any certificate as to the Net Asset Value per Share or as to the Subscription Price or Redemption price therefore given in good faith by or on behalf of the Directors shall be binding on all parties' (**Article 11**).

In September 2011, Bannister J sitting in the Commercial Division of the High Court of the Virgin Islands held that:

- none of the documents relied upon by the Redeemers was a certificate within the meaning of Article 11; but
- in surrendering their shares and the rights which attached to them, the Redeemers had given good consideration for the Redemption Payments. The Liquidator was, therefore, precluded from claiming repayment of the Redemption Payments.

The first instance decision was upheld by the Eastern Caribbean Supreme Court of Appeal and was subsequently appealed to the Privy Council. The Liquidator appealed the finding that the Redeemers had given good consideration for the Redemption Payments. The Redeemers appealed the finding that none of the documents relied upon constituted a certificate for the purposes of Article 11.

The Privy Council heard the matter on 18 and 19 March 2014 and judgment was delivered by Lord Sumption on 16 April 2014. Although the two issues were argued separately, Lord Sumption held that the two must be considered together. The Court explained that the Redeemers could not have been said to be unjustly enriched if they were entitled to receive the moneys paid to them. The Fund's claims depend, therefore, on whether the Fund was bound to make the payments it made. Lord Sumption summarised the question as 'whether the Fund was obliged, on redemption, to pay (a) the true NAV per share (as could later be ascertained); or (b) the NAV determined by the Directors at the time of the redemption'.

The Court examined the Fund's articles of association, setting out the way in which subscription and redemption figures were calculated, noting that both depended on the NAV determined according to Article 11 of the Fund's articles of association (in its entirety) and that once a NAV was determined and subscriptions and redemptions took place, that in itself would affect the determination of the NAV for the following month. The Court concluded that 'the whole of this scheme depends upon the price being definitively ascertained by the [date of redemption of shares] and known to the parties shortly thereafter. It is unworkable on any other basis'.

The Court held that it was essential that the price for subscription and redemption must be definitively ascertained at the time when the transaction took effect. As a result, the Court held that the reference in Article 11 to a certificate 'must be read as referring to the ordinary transaction documents recording the NAV per share or the Subscription or Redemption Price which will necessarily be generated and communicated to the Member at the time, and not to some special document issued at the discretion of the Directors'.

The Court went on to set out what constitutes a certificate, holding as follows:

- what constitutes a certificate is dependent on the commercial or legal context in which the certification clause appears;
- as a matter of language, a certificate ordinarily means:
- a statement in writing;
- issued by an authoritative source;
- which is communicated by whatever method to a recipient or class of recipients intended to rely on it; and
- conveys information in a form or context which shows that it is intended to be definitive.

The Court held that there is no reason that a document must satisfy any further formal requirements unless its purpose or legal context plainly requires them.

The Court concluded that the monthly email, contract notes and statements of account relied upon by the Redeemers all satisfied the requirements set out above and were certificates.

The decision will be a blow to a number of liquidators of similar funds, in the British Virgin Islands and elsewhere, who had been watching the progress of the Fairfield Redeemer Claims in anticipation of launching similar claims. It will, however, be welcomed by investors, whose potential liability under similar

types of claims could have been very substantial. Whether the Privy Council's decision represents a death knell to these types of claims remains to be seen. The decision itself turned on the proper construction of the Fund's constitutional documents. Whether or not the same result would have been reached had these documents been worded differently is not yet known; however, as matters currently stand, the recovery of redemption proceeds paid out by mistake appears to be a bridge too far for the common law.

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