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UPDATE

Privy Council Upholds Weavering Preference Claim

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The Judicial Committee of the Privy Council has upheld both the Grand Court and the Cayman Islands Court of Appeal's decisions in *Skandinaviska Enskilda Banken AB (PUBL)* (**SEB**) v *Conway and Shakespeare (as Joint Official Liquidators of Weavering Macro Fixed Income Fund Limited)* in which it was held that redemption payments made shortly prior to the collapse of Weavering Macro Fixed Income Fund (**Weavering** or **Fund**) constituted preferences over the Fund's other creditors and must be repaid.

The Facts

Weavering was placed into liquidation in March 2009 following the discovery of fraudulent activities of the Fund's principal investment manager, Mr Magnus Peterson. At the heart of his fraud, Mr Peterson used fictitious interest rate swaps to give the impression that the Fund was returning steady profits when in reality the swaps had the effect of masking huge trading losses. This was done by attributing significant value to the swaps notwithstanding the fact that they were worthless. Following the collapse of Lehman Brothers in September 2008, a significant number of Weavering's investors sought to redeem their shares. As a consequence, redemptions totalling US$138.4m, US$54.7m and US$30m became due on each of the 1 December 2008, 2 January 2009 and 2 February 2009 redemption days, respectively. As a result of Mr Peterson's fraud, Weavering was never in a position to meet these redemption obligations, and was rendered hopelessly insolvent. However, rather than suspending redemptions, or otherwise taking steps to cease the Fund's business, Mr Peterson implemented a policy for the payment of redemptions – albeit only to those investors who redeemed their shares on 1 December 2008 (the **December Redeemers**).

In short:

1. Six of the December Redeemers were to re-invest their redemption proceeds with a related fund, and their redemption proceeds (totalling US$7.6m) were paid out, in full, on 19 December 2008.
2. In relation to the remaining December Redeemers (of which there were 43) (i) an interim payment of 25 per cent of the redemption sums due was made to each investor in early January 2009; and (ii) thereafter, investors were selected on an ad hoc basis to be paid the balance of their redemption proceeds, albeit with those investors who were owed 'smaller' sums being paid ahead of those investors who were owed 'larger' sums.
3. By the time Weavering was placed into liquidation in March 2009 all but three of the December Redeemers had received their redemption proceeds, in full.
4. No redemption proceeds were paid to those investors who redeemed their shares on 2 January (the **January Redeemers**) and 2 February (the **February Redeemers**) 2009, despite the January and February Redeemers becoming creditors of the Fund as and from their respective redemption day.

In all, redemption proceeds totalling US$90.2m were paid out by the Fund during December 2008, January and February 2009 to the December Redeemers. As at the commencement of its liquidation, the Fund still owed in excess of US$132.9m of redemption obligations: US$48.2m to the three December Redeemers who remained unpaid, US$54.7m to the January Redeemers, and US$30m to the February Redeemers. SEB received a total of US$8.2m in redemption proceeds, via three separate payments. Weavering's liquidators

sought the return of these payments on the basis that they constituted preference payments in contravention of section 145(1) of the Companies Law. That section provides:

145(1) Every conveyance or transfer of property, or charge thereon, and every payment obligation and judicial proceeding, made, incurred, taken or suffered by any company in favour of any creditor at a time when the company is unable to pay its debts within the meaning of section 93 with a view to giving such creditor a preference over the other creditors shall be invalid if made, incurred, taken or suffered within six months immediately preceding the commencement of a liquidation.

Weavering's liquidators (Mr Jess Shakespeare and Mr Simon Conway of PricewaterhouseCoopers) were successful at both first instance and on appeal, with both courts making orders requiring SEB to repay the redemption proceeds it received. SEB appealed to the Privy Council. SEB relied on a number of separate grounds of appeal. Those grounds, and the Privy Council's approach to each of them, are summarised below.

The Fraud Point

SEB argued that the NAVs upon which the redemption payments were based were not binding because, as a consequence of Mr Peterson's fraud, there was no proper 'valuation' of the Fund's assets in accordance with its Articles of Association. If the NAVs were not binding (or were binding only to the extent that they represented the Fund's 'true' value) there would have been no redemption obligations owed to investors and, in turn, the Fund would not have been insolvent at the time the payments were made to SEB. In response, the liquidators principally relied on the Privy Council's decision in *Fairfield Sentry Ltd v Migani* [2014] UKPC 9 in that the NAVs were binding irrespective of Mr Peterson's fraud.

In dismissing the Fraud Point, the Board re-enlivened the distinction between an 'internal' fraud and one 'external' to the Fund (albeit the Board's position on this issue was not expressed in unanimous terms, with Sir Donnell Deeny (with whom Lord Wilson agreed) giving a short judgment of his own, albeit reaching the same conclusion as the majority). That distinction was first recognised by Jones J in *Primeo Fund v Pearson* [2015 (1) CILR 482]; however, the Court of Appeal in these proceedings found that the distinction was one of little significance. The majority of the Board went on to hold that given the fraud here was internal (because it was perpetrated by Mr Peterson who was authorised by the directors to provide valuations of the Fund's assets to the Fund's administrator (who in turn calculated the NAV)), the NAVs could be avoided, albeit that would require separate proceedings to be brought by a party aggrieved by the fraud. Given that SEB benefitted from the fraud because it received the redemption proceeds based on an inflated NAV, it would not be open to SEB to do so. For that reason alone, the Privy Council dismissed the Fraud Point.

The 30 Day Point

The Fund's offering memoranda provided that redemption payments would generally be made within 30 calendar days following the relevant redemption day. SEB sought to argue that the effect of this provision was to give the Fund a 'grace period' such that its obligation to pay redemption proceeds did not arise until this period had expired. In doing so, SEB argued that in relation to the payments which were made by the Fund on 19 December 2008 (including one to SEB), given sums due to the December Redeemers were not then due (i.e. a period of 30 days was still yet to pass from the 1 December redemption day), those sums were not debts which were capable of rendering the Fund insolvent.

In response, the liquidators argued that the redemption sums became a liability of the Fund on 1 December 2008 and were due on that day. In doing so they relied on the Privy Council's earlier decisions in both *Culross Global SPC Ltd v Strategic Turnaround Master Partnership Ltd* [2010] UKPC 33 and *Pearson v Primeo Fund* [2017] UKPC 19 arguing that reference to payments being made generally within 30 days was simply a reference to a supplementary procedure which did not affect the liability from accruing on 1 December 2008. The Board agreed with the liquidators, and noted that proceedings could have been commenced by redeeming investors for the payment of their redemption sums as and from 1 December 2008.

The Future Debts Point

Given this point was contingent on SEB succeeding on the 30 Day Point, the Board was not required to deal with it. Accordingly, the position as set out in the Court of Appeal's decision remains good law in the Cayman Islands. Briefly:

5. The test for insolvency in the Cayman Islands is the cash flow test, i.e. whether a company can pay its debts as they fall due (as opposed to a balance sheet test).
6. SEB sought to argue that this means that only debts which have actually fallen due for payment can be taken into account when determining whether a company is solvent on any given date, and that future debts are irrelevant.
7. The Court of Appeal rejected this analysis, holding that the cash flow test in the Cayman Islands is not confined to consideration of debts that are immediately due and payable, and that it also permits consideration of debts that will become due in the reasonably near future.

The Intention to Prefer Point

As a matter of Cayman Islands law, for there to be a preference the payment in question must have been made with the 'dominant intention to prefer'. While central to the proceedings, the Board disposed of the point swiftly by confirming (i) a dominant intention to prefer can be inferred from the evidence, and (ii) there was sufficient evidence here for the inference to be made. Moreover, an inference of this type can be made by applying general principles of inference from the available evidence, upholding the Court of Appeal's approach that dishonesty or impropriety is not a necessary ingredient.

Repayment Issues

Unlike its counterpart under the English Insolvency Act, s.145(1) does not provide a statutory direction for the return of payments (or other relief) which are found to have been made in contravention of it. It merely states that the payments are invalid. SEB argued that the liquidators' right to recovery was grounded in restitution, which arose under the common law and was based on unjust enrichment. In turn, SEB argued that it was entitled to defend the claim on the basis that (i) it had not been enriched, since it had received the payments as the nominee of underlying investors, and (ii) it had changed its position on the faith of the payments, by remitting them to its clients, and would suffer an unjust detriment if it were now required to repay them given it was unable to now recover those payments.

These issues attracted the most attention from the Board. It was held as follows:

1. Section 145 does not create a statutory right to recover the property or payment in question. The section merely renders the relevant transfer or payment voidable.
2. A payment avoided by operation of s.145 entitles liquidators to restitution of the payment in question on the ground of unjust enrichment.
3. At its heart, the analysis of the relevant injustice giving rise to the unjust enrichment is not between the company and the recipient, but rather between the recipient and the other creditors.
4. Restitution in the context of a preference payment requires restitution of the money to the liquidation estate for distribution by the liquidators among the company's creditors. It is for this reason that the common law imposes an obligation on the recipient to repay the money, with a corresponding right to rank as a creditor for the amount owed to it, but only upon repayment.
5. While a party receiving monies as agent for a principal has been held not to have been sufficiently enriched for the purposes of unjust enrichment, and while similarities can be drawn between a party acting as an agent and one acting as a trustee or nominee, there are important distinctions. Here, although SEB was acting as a nominee for its underlying clients, it was nonetheless SEB who was the registered shareholder and to whom the redemption sums were owed. At common law, the Fund was entitled to ignore the relationship which lay beneath SEB's legal ownership of the shares in question. Thus while SEB did, upon receipt of the redemption sums, pay them on to its underlying clients, for the purposes of unjust enrichment SEB did receive payment of the redemption monies in its own right, and not merely as an agent.
6. As a matter of public policy, a defence of change of position is not available to defeat a preference claim.

Discussion

It is perhaps this last point which will attract the greatest interest given the propensity for investors in Cayman Islands investment funds to invest via professional nominees and custodians. There is no question that, as a matter of fact, SEB is now unable to recover the redemption sums from its clients. While SEB did have in place indemnities with its clients, Clifford J at first instance found those indemnities to be worthless. Thus by repaying the monies to the liquidators SEB will be left 'out of pocket' for the entire sum, albeit with

a claim to prove in the liquidation for this. In reaching the position it did, the Board expressly recognised that the absence of a change of position defence could lead to harsh results. In so doing the Board remarked that '*Whether it would be desirable to provide a measure of protection under the law of the Cayman Islands, either to creditors of the company or to third parties dealing with such creditors, may be a question worthy of consideration, but is not a matter for the Board*.' Time will tell whether the legislature takes the opportunity to do so.

The other enduring feature of the decision is the avenue which the Board has alluded to in circumstances of internal fraud for aggrieved parties to apply for orders setting aside otherwise binding NAVs which have previously been determined. This aspect of the decision marks a distinct departure from the Court of Appeal's decision, and from the position which was previously thought to have existed following *Fairfield Sentry*. Sir Donnell Deeny's minority judgment on point, with whom Lord Wilson agreed, serves only to demonstrate that the parameters of this complex area of law remain unfixed, even at the highest level.

Mourant acted for the successful liquidators.

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