

# Madoff Feeder Fund

## Fairfield liquidators suffer major court reversal

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In a series of decisions before the BVI (British Virgin Isles) Commercial Court and Eastern Caribbean Court of Appeal, the liquidators of Fairfield have suffered significant reversals in their claims against investors.

The decisions are important for a number of reasons. First of all, the value of the claims is staggering; the BVI claims and related actions in the US Courts claim in the region of \$7.5 billion. Secondly, the defendants are a who's who of the world's financial institutions, and thirdly the legal issues raise very important issues for offshore feeder funds and liquidators.

### Background

Fairfield was one of the main feeder funds which invested in Bernard L. Madoff Investment Securities Limited ("BLMIS") and therefore one of the largest victims of that colossal fraud. Fairfield filed hundreds of claw back claims against investors who redeemed shares before the Madoff fraud was uncovered, both in the BVI and New York.

Fairfield alleges that before Madoff's arrest, investors redeemed based on a Net Asset Value (NAV) which itself was calculated on a now-mistaken value of BLMIS, meaning that all redemption payments should be returned.

### The BVI Commercial Court Judgments

The defendants took the slightly unusual step of applying to the BVI Court for a trial of two preliminary issues and the court agreed to proceed in this way. The liquidators challenged this decision and applied for leave to appeal but the full panel of the Court of Appeal refused to grant it and the trial on preliminary issues proceeded.

In that trial, the court decided that it was not open to Fairfield to now seek to recover the price it had paid for the purchase of the shares of redeeming shareholders. This was simply because Fairfield's calculation of the NAV was based on information which subsequently proved to be unreliable for reasons unconnected with any of the redeemers. The decision was grounded on the finding that the redeemers had given Fairfield good consideration in redeeming the shares and this was an absolute bar on the claim. (Referring to *Aiken v Short* [1856] 1H&N 210 and *Barclays Bank v WJ Simms Son* [1980] QB 677.)

The court found in favour of Fairfield on the second preliminary issue on an interpretation of what documents constituted certificates as to the NAV in the articles of association. However the defendants only needed to be successful on one of the two preliminary issues to strike out most parts of the Statement of Claim. The defendants then issued

a further application in the BVI Commercial Court requesting that the remaining claim be dismissed.

In a second judgment, the court held that its previous findings on the preliminary issue of consideration disposed of all but the last paragraph of the Statement of Claim which Fairfield argued was an alternative claim in mutual mistake. Although the court expressed doubt as to whether such a claim was properly pleaded, it was concluded that even a properly drafted mutual mistake claim was not sustainable on those facts.

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Referring to *Bell v Lever Bros* [1932] AC 161, the court found that even if there had been a mistake that the investor and Fairfield shared as to the underlying investment in BLMIS, Fairfield could still perform its obligations to the investors on redemption.

Accordingly the court found that Fairfield's case on common mistake confused:

- (1) a shared assumption of truth which is a necessary condition for the performance of a particular contract with
- (2) a shared mistaken assumption about the background against which it was expected that the contract was to be performed.

The former case will mean that no contract can, as a matter of law, be concluded. The latter will not.

### The Court of Appeal

The liquidators appealed against the two judgments and the defendants appealed the second preliminary issue. In a very detailed judgment, the Court of Appeal essentially agreed with the Commercial Court decisions that following *Bell v Levers Bros*, and *Great Peace Shipping v Tsavliris Salvage* [2003] QB p679, the mutual mistake claim was unsustainable. The Court of Appeal also adopted the dictum of Lord Goff in *Scandinavian Trading Co v Flota Petrolera Ecuatoriana* [1983] QB p529 emphasising the importance of commercial certainty. The Court of Appeal said that "It cannot be doubted that certainty is key in commercial transactions. Many modern day commercial transactions have a global dimension with far reaching consequences. Parties must be able to know what their legal position is and to make decisions based on that knowledge."

The Court of Appeal held that there were specified contractual redemption obligations to be fulfilled by Fairfield and shareholders, which the shareholders had performed.

Although it did not affect the end result, the Court of Appeal found in favour of Fairfield on the second preliminary issue, that the NAV had not been finally certified under the articles of association. The Court of Appeal did not say that it was not possible for a fund to bind itself to a final NAV, but stated only that on the facts of this case, Fairfield had not done so.

This obviously has important consequences to the BVI claims which have been found to be unsustainable by both the first instance and appeal courts. It should also be of great importance to the US proceedings as, although it might be necessary for the US Court to rule on the issue, the US claims seem to be unsustainable for the same reasons.

The decisions also have the positive consequence that investors who have innocently redeemed can be more certain that those transactions are final. **THF**

### ABOUT THE AUTHOR

#### PHILLIP KITE

Phillip Kite is Head of the Litigation Department at Harneys and specialises in large scale commercial litigation and contentious insolvency matters. A partner since 2001, Phillip has acted in many of the largest claims brought before the BVI courts.