IN THE CAYMAN ISLANDS COURT OF APPEAL **CICA NO 2 OF 2016**

ON APPEAL FROM THE GRAND COURT OF THE CAYMAN ISLANDS

FINANCIAL SERVICES DIVISION

FSD 98 OF 2014 (NRLC)

IN THE MATTER OF THE COMPANIES LAW (2013 Revision)

AND IN THE MATTER OF WEAVERING MACRO FIXED INCOME FUND LIMITED (IN LIQUIDATION)

BETWEEN:

SKANDINAVISKA ENSKILDA BANKEN AB (PUBL)

Appellant

- and-

(1) SIMON CONWAY
(2) DAVID WALKER
(as Joint Official Liquidators of Weavering Macro Fixed Income Fund Limited)

Respondents

BEFORE:

THE HON JOHN MARTIN QC, JA
THE HON DENNIS MORRISON, JA
THE HON SIR RICHARD FIELD, JA

Appearances: David Chivers QC instructed by Sam Dawson and Kai McGriele of Solomon Harris appeared for the Appellant. Jeremy Goldring QC and Shaun Folpp instructed by Mourant Ozannes appeared for the Respondents.

Hearing: 20 April 2016
Judgment: 18 November 2016

JUDGMENT

MARTIN JA:

Introduction

1. This is an appeal against an order dated 5 January 2016 of Clifford J. By that order, he declared that certain payments (amounting in total to US $8,217,761.54) made by Weavering Macro Fixed Income Fund Ltd ("the Company") to the appellant Skandinaviska Enskilda Banken AB (Publ) ("SEB") were invalid as preferences over the other creditors of the Company; and he ordered SEB to pay an equivalent amount to the respondents (who are the joint official liquidators of the Company – "the JOLs"), together with interest and costs.

2. The order was made pursuant to section 145 (1) of the Companies Law (2013 Revision) ("the Law"). That subsection is in the following terms:

> "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".

3. The Company went into liquidation (initially voluntary liquidation, but subsequently subject to the supervision of the Court) on 19 March 2009. The payments were made on 19 December 2008, 2 January 2009 and 11 February 2009, and so were made within six months of the commencement of the liquidation. The judge found that the Company was unable to pay its debts when the payments were made, and that they were made with a view to giving SEB preference over the other creditors. He held that the appropriate remedy was repayment to the Company, and rejected defences raised by SEB based on unjust enrichment, change of position, illegality and public policy.

4. SEB challenges the judge's conclusion that the Company was insolvent when the redemption payments were made. It asserts that he calculated the Company's liabilities by reference to valuations that were the product of fraud and so did not accurately state the amount of the liabilities; that he failed to recognise that the Company had a 30 day period, or a reasonable time, in which to make redemption payments, and accordingly took into account liabilities that were not yet due; and that he wrongly took into account future debts without considering future assets. It challenges the judge's conclusion that the Company intended to

prefer SEB on the basis that the judge misinterpreted the law; that he failed to have proper regard to uncontradicted evidence and drew impermissible inferences of fact; and that he wrongly included future creditors in the class of those he held the Company intended to prefer. Finally, SEB challenges the judge's rejection of its defences.

Background

5. The Company was incorporated in the Cayman Islands on 2 April 2003. It carried on business as an open-ended investment company trading mainly in interest rate derivatives. It had two directors, Stefan Peterson and Hans Ekstrom. It was part of a group of companies that included Weavering Capital (UK) Limited ("WCUK"), an English company that was the Company's investment manager and undertook its trading activities; and Weavering Capital Fund Limited ("WCF"), a BVI company that was counterparty to interest rate swaps entered into by the Company. There were other corporate entities within the Weavering group, including a Swedish investment vehicle into which investors could invest.

6. The chief executive officer and principal investment manager, and a director, of WCUK was Magnus Peterson, the brother of Stefan Peterson and the stepson of Hans Ekstrom. The judge found that it was Magnus Peterson who was the controlling mind of the Company, both generally and specifically in relation to the payments made to SEB, and there is no appeal against that conclusion.

7. The judge also found that the interest rate swaps conducted between the Company and WCF were, to the knowledge of Magnus Peterson, worthless. He said this (judgment paragraph [35]):

> "i. The Swaps were worthless paper transactions entered into with WCF, which was never in a position to honour its obligations pursuant to them. WCF … had no realisable assets and did not trade other than as counterparty to the Swaps.
>
> ii. Magnus Peterson used the existence of the Swaps to show a sustained growth over the life of the Company. Large monthly adjustments were made to Swaps exposures through the full or partial closing out of existing Swaps and the opening of new Swaps so as to avoid generating the impression of too large profits that the Swaps would otherwise have showed on paper, but not in reality, and to avoid defeating the impression of the Company as relatively low risk. The result was that the Company was able to show the relatively modest but positive month on month

performance expected by its investors.

iii. No gains were ever realised by the Company in relation to the Swaps (even when some of the Swaps were closed out). They were simply used to present a picture of a fund showing sustained growth when in fact the unrealised gains represented by the Swaps were fictitious.

iv. The reality was that the Company was suffering large losses through its options trading (that were masked by the Swaps) and expending considerable sums on management and performance fees and brokerage fees largely to WCUK."

8. Persons wishing to invest in the Company acquired redeemable Participating Shares in it. SEB, a Swedish financial institution, acquired such shares. It did so as custodian for, among others, two Swedish mutual funds: HQ Solid ("HQ Solid") and Catella Stiftelsefond ("Catella"). Between April 2006 and November 2007, SEB subscribed for US$8.5 million Participating Shares on behalf of HQ Solid, and the Company issued 56,836.96 Participating Shares to "SEB Merchant Banking as nominee for HQ Solid". In March 2008, SEB subscribed for US$1 million Participating Shares on behalf of Catella; and the Company issued 5,926.98 Participating shares to "SEB Merchant Banking as nominee for Catella Stiftelsefond". The Company subsequently issued equalisation shares to SEB, again as nominee, so that SEB's total holding on behalf of Catella increased to 5,953.99 Participating Shares. Despite the reference to nomineeship, SEB was registered as the holder of all the shares in the Company's register of members.

9. Under the terms of the Company's offering memoranda (the latest of which was published on 24 September 2008), Participating Shares could be redeemed as follows:

"Redemption of Company Shares

Shareholders can redeem their Shares, in whole or in part, in a minimum amount of US$50,000 (subject to the discretion of the Board of Directors to redeem lesser amounts), on one calendar month's prior written notice (subject to the discretion of the Board of Directors to waive such notice), on each Redemption Day. To effect a redemption, a Request for Redemption of Shares, obtained from the Company must be received by the Company by 5pm Dublin time one calendar month before any Redemption Day, accompanied by the share certificates, if any, duly endorsed and in a form for redemption acceptable to the Board of Directors.

Redemptions are made at a price per Share equal to the NAV per Share of the Company, as of the close of business on the relevant Valuation Date, to the nearest whole US cent (the "Redemption Price").

Payment of Redemptions

Redemption payments are generally made within 30 calendar days after the Redemption Day. No interest is paid from the Redemption Day to the payment date. Payment is made by telegraphic transfer (with transfer charges to the account of the recipient) to the Remitting Bank/Financial Institution or to another account in the name of the shareholder."

"Redemption Day" meant the first business day of each calendar month, and "Valuation Day" meant the business day immediately preceding each Redemption Day.

10. On 9 October 2008 SEB gave notice of redemption in accordance with these provisions of all the shares it held as nominee for Catella, and on 28 October 2008 it gave notice of redemption of all its unredeemed shares held as nominee for HQ Solid. The Redemption Day first occurring one month after these notices was 1 December 2008, and the relevant Valuation Day was 30 November 2008. On 19 December 2008 the Company paid SEB US$1,096,903.58 in respect of the first notice ("the First SEB Redemption Payment"); on 2 January 2009 it paid SEB 25% of the amount due in respect of the second notice, US$1,780,214.29 ("the Second SEB Redemption Payment"); and on 11 February 2009 the Company paid SEB the remaining 75% due in respect of the second notice, US$5,340,643.47 ("the Third SEB Redemption Payment").

11. The redemption notices given by SEB were far from being the only notices of redemption received by the Company in October 2008 and subsequent months. This was a time of turmoil in the financial markets following the collapse of Lehman Brothers in September 2008. Notice was given for 1 December 2008 in respect of shares totalling (at the 30 November 2008 NAV) US$138.4 million (of which the SEB shares amounted to some US$8.22million). Persons giving notice for 1 December 2008 are referred to as "December redeemers". For the 2 January 2009 and 2 February 2009 redemption dates, the equivalent figures were US$54.7 million and US$30 million.

12. On 19 December 2008 a total of about US$7.6 million was paid to the December redeemers. The First SEB Redemption Payment was part of that total. No further payments were made

in December 2008 to the December redeemers. Towards the end of the month, Magnus Peterson decided that the Company should initially pay only 25% of the amount due to the December redeemers, the remainder being paid by the end of January 2009. A letter to that effect, dated 31 December 2008 but not in fact sent until 7 January 2009, was sent to shareholders. The judge found that Magnus Peterson must have known by the end of December 2008 that the Company would not be in a position to pay all the December redeemers, by instalments or otherwise, let alone the amounts about to fall due at the beginning of January 2009.

13. Those amounts, totalling US$54.7 million, fell due on 2 January 2009. On that day, the Second SEB Redemption Payment was made, and partial payments were made to other December redeemers (seemingly on an ad hoc basis, according to the judge). Additional partial payments were made on 5 and 13 January 2009; and later in January 2009 most of the December redeemers (but not SEB and six others) were paid the outstanding amounts due to them.

14. On 2 February 2009 further redemption payments totalling US $30 million fell due. The Third SEB Redemption Payment was made on 11 February 2009, and three of the remaining December redeemers received the outstanding amounts due to them on 4, 11 and 26 February 2009 respectively. The other three December redeemers received no further payments. By the end of February 2009, the overall position was that, of the approximately US$138.36 million due in respect of the December, January and February redemption dates, about US$90.16 million had been paid (US$7.6 million in December 2008, US$72.33 million in January 2009 and US$10.23 million in February 2009), leaving a shortfall of some US$48.2 million.

15. Finally, on about 5 March 2009, the directors became aware of the true nature of the swaps and the likely effect on the solvency of the company. They resolved to suspend determination of the NAV and the issue and redemption of shares with immediate effect. On 19 March 2009, the Company was put into liquidation. In January 2015 Magnus Peterson was convicted in England of fraud and sentenced to 13 years' imprisonment.

Issues

16. There are two main issues as to the application of section 145(1) of the Law. First, at the times that the Company made the three redemption payments to SEB, was the Company unable to pay its debts within the meaning of section 93 of the Law? This issue, which contains three sub-issues, is known as the Solvency Issue. Secondly, were the three SEB redemption payments made with a view to giving SEB a preference over the other creditors? This is known as the Preference Issue.

17. If the Solvency Issue and the Preference Issue are resolved against SEB, there are further issues about the obligation of SEB to make repayment to the Company. I refer to these issues as the Repayment Issues.

The Solvency Issue

18. It is a condition of the application of section 145 (1) of the Law that at the date of a relevant payment the Company should have been unable to pay its debts within the meaning of section 93. In the circumstances of this case, the only part of section 93 that is relevant is paragraph (c), by which a company is deemed to be unable to pay its debts if "it is proved to the satisfaction of the Court that the company is unable to pay its debts". It was common ground that inability to pay debts was to be judged by reference to commercial or cash flow insolvency, not balance sheet insolvency. Applying that test, the judge held on the evidence that the JOLs had discharged the burden of proving that on each of the dates when redemption payments were made to SEB the Company was unable to pay its debts. SEB does not challenge the judge's assessment of the evidence; but it asserts that he failed to take into account the fact that the relevant NAVs were the product of fraud ("the fraud point"), wrongly disregarded a 30 day period of grace available to the Company for payment of redemptions ("the 30 day point"), and wrongly took into account future debts ("the future debts point").

<u>The fraud point</u>

19. SEB contends that the published NAVs, which assumed that the swaps had the value fraudulently attributed to them by Magnus Peterson, were not valuations within the meaning of the Company's articles; that in consequence none of the shareholders redeeming on the December 2008, January 2009 and February 2009 redemption dates was entitled to be paid by reference to the relevant published NAV; that the figures put forward by the JOLs to establish the Company's insolvency wrongly assumed that the redeemers

were entitled to be paid by reference to the published NAVs; and that in the absence of any alternative figures stating the Company's true asset value there was no material on which the court could be satisfied that the Company was unable to pay its debts on any of the SEB Redemption Dates.

20. SEB accepts that, if this argument is correct, it means that it should not have received any of the SEB Redemption Payments. It suggests that the JOLs might once have been in a position to recover the payments as made by mistake, but any such claim is now statute-barred; and it says that, since the JOLs have chosen to attack the payments as preferences, SEB is entitled to assert that an essential condition of a preference claim, namely that the company was unable to pay its debts, has not been established.

21. In dealing with these arguments, the judge started by referring to article 34 of the Company's articles of association, which is in the following terms:

> "The assets of the Company shall be valued in accordance with such policies as the Directors may determine. Any valuations made pursuant to these Articles shall be binding on all persons".

He noted SEB's argument that a fraudulent valuation could not be a valuation made pursuant to the articles, particularly in the light of article 32, which requires the directors in calculating the NAV to "apply such generally accepted accounting principles as they may determine". He recorded SEB's reference to cases such as *Socimer International Ltd v Standard Bank London Ltd* [2008] 1 Lloyd's Rep 558 as supporting the proposition that a valuation to be carried out by a contracting party must be carried out rationally and in good faith, and to the Cayman case of *Primeo Fund v Pearson* [2015(1)CILR 482], in which Jones J had suggested that an NAV would not be binding if some conduct of an agent that could properly be imputed to a company had the effect of vitiating the contract between the company and its members. He noted SEB's submission that since Magnus Peterson was the controlling mind of the Company his fraud must be treated as that of the Company and that, in the light of these authorities, the published NAVs must be regarded as invalid. The judge then recorded the submissions of the JOLs, in particular that SEB's argument was inconsistent with the decision of the Privy Council in *Fairfield Sentry v Migani* [2014] UKPC 9, [2014] 1 CLC 611 ("*Fairfield Sentry*") to the effect that a published NAV is binding, and that it was wrong to attribute Magnus Peterson's state of mind to the Company, whether generally or in relation to implementation of the redemption procedure. The judge stated that he preferred the arguments made by the JOLs, and in conclusion said this [133-4]:

> "However, I think that it is necessary to guard against the issue in relation to the NAV being weighed down by too much analysis. What it all comes down to in the end can be summarised quite simply. In my view, certainly for the purpose of this case, the NAV is binding in accordance with article 34 of the articles of association. The fact that it has emerged that the NAV is affected by fraud is not by itself sufficient to vitiate the NAV for the reasons explained by Lord Sumption in *Fairfield Sentry* and referred to by Jones J in *Primeo*. It seems to me that the claims in relation to the redemptions in this case have to be resolved by reference to the NAV which gave rise to their payment. The NAV remains binding (in accordance with article 34) for this specific, and perhaps limited, purpose, even though it has subsequently, after payment of the redemptions, proved to be affected by fraud. This I believe is the sensible and rational approach which avoids an unacceptable outcome".

22. On appeal, SEB largely repeated the submissions it had made to the judge, whilst complaining that the judge had not given any, or any adequate, reasons for rejecting them below. It complained that the judge had allowed himself to be influenced by his view that SEB's submissions were "unattractive" and resulted in "SEB benefiting from Magnus Peterson's fraud to the detriment of other redeemers". It pointed out that SEB was an unconnected shareholder with no knowledge of the fraud, and that if there were any detriment to other redeemers it was a consequence of the JOLs having elected to pursue the wrong cause of action against SEB. It reasserted its construction points on articles 34 and 32, in particular that a valuation based on fraud could not be a valuation "pursuant to the articles", which was the only sort of valuation stated by article 34 to be binding. It again referred to cases such as *Socimer International Ltd v Standard Bank London Ltd* for the proposition that a valuation to be carried out by a contracting party must be carried out rationally and in good faith, and cited the following statement of Teare J in *WestLB AG v Nomura Bank International plc* [2010] EWHC 2863 (Comm) (upheld on appeal: [2012] EWCA (Civ) 495):

> > "There is no dispute that in determining the NAV of the Reference Fund and the Redemption Amount the Second Defendant as the Calculation Agent was bound to act in good faith and not to exercise its discretion in a manner which was irrational, that is, capricious, arbitrary, unreasonable (in the public law sense) or perverse. It was further common ground that its determination would not be binding in the

event of manifest error which meant an oversight or blunder so obvious as to admit of no difference of opinion."

SEB submitted that these and similar cases suggested that the contract between the Company and the redeemers should not be construed as containing an agreement that the parties would be bound by a NAV notwithstanding that it was tainted by fraud. It required clear and unmistakable terms for a party to a contract to exclude the ordinary consequences of fraud. The judge had wrongly rejected SEB's submission, based on the statement of Jones J in *Primeo Fund v Pearson* that for a NAV not to be binding there must be "some conduct on the part of the company itself or conduct on the part of an agent which can properly be imputed to the company that has the effect of vitiating the contract with its members", that there was a distinction between internal fraud, which would vitiate a valuation, and external fraud, which would not. In the present case, the NAV had been calculated by the administrator but had been based on false information supplied by Magnus Peterson through WCUK, and it was right to impute Magnus Peterson's knowledge of the falsity of the information to the Company. This was accordingly a case of internal fraud. The judge had also wrongly dismissed the significance of Order 12, rule 2 of the Companies Winding Up Rules which, by requiring an official liquidator to rectify the register of members if "the company has from time to time issued redeemable shares at prices based on misstated net asset value which is not binding upon the company by reason of fraud", recognised that a fraudulent NAV would not be valid. If the JOLs had adopted the Order 12, rule 2 procedure, there could have been a general adjustment of the rights and obligations of the shareholders (although SEB again conceded that its own position would have been unaffected). The judge was wrong to take the view that *Fairfield Sentry* provided an answer to these points; that case did not concern a NAV that was the product of fraud, and said nothing about whether such a valuation was binding.

23. The JOLs' position on the appeal was that the judge was right to apply *Fairfield Sentry* and hold that the NAVs were binding in favour of redeemers and conclusive at the time of the SEB Redemption Payments, notwithstanding that because of Magnus Peterson's fraud they proceeded on the false basis that the swaps were valuable. The argument advanced by SEB was equivalent to an argument rejected in *Fairfield Sentry* as "impossible". Properly construed, the articles required the published NAV to be binding in respect of both acquisition and redemption of shares: they could not be construed as conferring on the Company an ability to adjust the NAV from time to time in the light of new information. Such

an approach to the articles would render the rights of shareholders entirely uncertain. Cases like *Socimer International Ltd v Standard Bank London Ltd* were concerned with implied terms prohibiting a party that abused a contractual discretion from binding the innocent party; whereas SEB's contention that the Company's wrongful conduct prevented it from becoming liable to innocent redeemers was in effect the reverse. A construction of the articles that meant that the innocent party suffered and the Company benefited from its own wrong was commercially unsustainable. The statement in *Primeo Fund v Pearson* was unclear: it spoke of vitiating the contract between a company and its members, but such language was more appropriate to the inception of the contract than to the consequence of a step taken in the course of its performance. Moreover, it was in any event wrong to attribute Magnus Peterson's fraud to the Company: it was not he, but the administrator, that was the relevant agent for the purpose of calculation of the NAV. As to Order 12, rule 2, it was not concerned with the position prior to rectification and had no impact on the question of whether the NAV was at that time binding.

24. In common with the judge, it seems to me that the appropriate place to start is article 34. It provides that any valuation of the Company's assets made in accordance with the articles is to be binding on all persons. Such a provision is fundamental to the mechanism by which investors in the Company acquire and redeem shares.

25. A similar provision was in issue in *Fairfield Sentry*. In that case, Fairfield Sentry Limited ("the Fund") was a BVI mutual fund that invested almost exclusively in Bernard L Madoff Investment Securities LLC ("BLMIS"). BLMIS operated a notorious Ponzi scheme. Investors in the Fund participated indirectly in the investments with BLMIS by subscribing for shares in the Fund at a price dependent on the Fund's NAV, and were entitled to withdraw funds by redeeming their shares under the provisions of the Fund's articles of association. In December 2008, when Madoff's frauds were discovered, the Fund's directors suspended determination of the Fund's NAV, thereby terminating redemption of shares. The proceedings were brought by the Fund at the instance of its liquidators against a number of financial institutions that were shareholders in the Fund but redeemed some or all of their shares before December 2008. The purpose of the proceedings was to recover from the defendants the amounts paid out to them on redemption, on the basis that they were paid out in the mistaken belief that the underlying assets were as stated by BLMIS when in fact

there were no assets. Any amounts recovered were intended to be distributed rateably between all members, irrespective of when or whether they had redeemed.

26. Two main issues fell to be decided: whether documents issued to members of the Fund recording the NAV or redemption price were binding on the Fund under article 11 of its articles of association, which provided that any certificate as to the NAV or redemption price given in good faith by or behalf of the directors should be binding on all parties ("the article 11 question"); and whether the defendants had a defence on the ground that by surrendering their shares they gave good consideration for the money that they received on redemption ("the good consideration question"). At first instance, the article 11 question was decided in favour of the Fund on the basis that no formal certificate had ever been issued, but the good consideration question was decided in favour of the defendants. Both elements of the decision were upheld on appeal to the Eastern Caribbean Court of Appeal. In the Privy Council, however, both the article 11 question and the good consideration question were determined in favour of the defendants.

27. The judgment of the Judicial Committee of the Privy Council was delivered by Lord Sumption. At [19], he said the following:

> "[T]he Fund's claim to recover the redemption payments depends on whether it was bound by the redemption terms to make the payments which it did make. That in turn depends on whether the effect of those terms is that the Fund was obliged upon a redemption to pay (i) the true NAV per share, ascertained in the light of information which subsequently became available about Madoff's frauds, or (ii) the NAV per share which was determined by the directors of the time and redemption. If (ii) is correct then, the shares having been surrendered in exchange for the amount properly due under the articles, the redemption payments are irrecoverable."

At [21], Lord Sumption set out the scheme of the Fund's articles. They included provision for the subscription price and the redemption price to be set at the NAV per share "determined in accordance with article 11", with the redemption price being paid as soon as practicable, normally within 30 days. The summarised provisions are different in form from, but in substance the same as, those contained in the Company's articles. Lord Sumption concluded his summary by saying: "It will be apparent from this summary that the whole of this scheme

depends upon the price being definitively ascertained by the dealing day and known to the parties shortly thereafter. It is unworkable on any other basis."

28. The substance of the Privy Council's decision is contained in paragraphs [22] to [24]. They are in the following terms.

> "[22] The Fund's case is that when article 10(2) defines the redemption price as the NAV per share "determined in accordance with Article 11", it means the NAV correctly determined by dividing the NAV of the Fund by the number of shares in issue in accordance with articles 11(1)[b], 11(2) and 11(3). If this is right, the same must be true of article 9(1)(c), which fixes the subscription price by reference to the same provisions of article 11. The directors' determination of the NAV per share as at the valuation day, under article 11, was not definitive according to this analysis unless a certificate was issued pursuant to article 11(1)[c], and that would happen only if the directors chose to issue one.
>
> [23] In the Board's opinion, this is an impossible construction. If it were correct, an essential term of both the subscription for shares and their redemption, namely the price, would not be definitively ascertained at the time when the transaction took effect, nor at the time when the price fell to be paid. Indeed, it would not be definitively ascertained for an indefinite period after the transaction had ostensibly been completed, because unless a certificate was issued it would always be possible to vary the determination of the NAV per share made by the directors at the time and substitute a different one based on information acquired long afterwards about the existence or value of the assets. This would not only expose members who had redeemed their shares to an open-ended liability to repay part of the price received if it subsequently appeared that the assets were worth less than was thought at the time. It would confer on them an open-ended right to recover more (at the expense of other members) if it later appeared that they were worth more. Corresponding problems would arise out of a retrospective variation of the subscription price long after the shares had been allotted. Indeed, it is difficult to see how the directors could perform their duty under article 9(1)(b) not to allot or issue a share at less than the subscription price if the latter might depend on information coming to light after the allotment had been made.
>
> [24] *If, as the articles clearly envisage, the subscription price and the redemption price are to be definitively ascertained at the time of the subscription or redemption,*

then the NAV per share on which those prices are based must be the one determined by the directors at the time, whether or not the determination was correctly carried out in accordance with articles 11(2) and (3). That means either (i) that the directors' determination at the time must be treated as conclusive whether or not there is a certificate under article 11(1)[c]; or else (ii) that article 11(1)[c] 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 some special document issued at the discretion of the directors. The Board considers, for the reasons given below, that in a case where a provision for certification such as article 11(1)[c] has been included as part of the mechanics of subscription and redemption, the correct approach is the second one" (emphasis added).

29. In my view, the judge was right to regard this reasoning as applicable to the present case. It is true that in *Fairfield Sentry* neither the Fund nor any of its agents was complicit in Madoff's fraud, and to that extent SEB is right to say that the reasoning is not directly applicable. Nevertheless, the practical reasons that underlie the decision in *Fairfield Sentry* apply equally to a situation in which the NAV is affected by fraud. It is essential to the operation of an investment vehicle such as the Company that permits investment through the acquisition and redemption of shares that there should be certainty on a day-to day basis as to the price at which shares are to be purchased or redeemed. It may be that, as in the present case, the subscription price and the redemption price are largely or entirely artificial, but it is nevertheless important that they are calculated on a consistent basis. That is the purpose of article 34, which is to be construed as referring to a valuation purportedly made in compliance with the articles. Otherwise, the problems identified in paragraph (23) of the judgment in *Fairfield Sentry* will arise. It is important to note that many investors are likely to have acquired and redeemed shares before any fraud and resulting insolvency becomes apparent. Although those transactions will with hindsight be seen to have been conducted on an artificial basis, the position of the investors is similar to that of investors in a Ponzi scheme, about which Lord Sumption said in *Fairfield Sentry* (at [3]):

> "It is inherent in a Ponzi scheme that those who withdraw their funds before the scheme collapses escape without loss, and quite possibly with substantial fictitious profits. The loss falls entirely on those investors whose funds are still invested when the money runs out and the scheme fails".

This is not to say that fraud has no relevance. If the company is complicit in the fraud, it may entitle an investor to claim that he became a shareholder only as a result of a fraudulent misrepresentation, and claim damages in the liquidation for the difference between the price he paid and the true value of the shares he obtained. It may found a claim in conspiracy against the directors. If the company is innocent of the fraud, it may have a claim against the fraudster; and investors may have a provable claim for damages for negligence or innocent misrepresentation inducing them to acquire shares. Whether or not the company is complicit in it, the existence of a fraud may give rise to additional remedies in a winding-up, such as that afforded by Order 12, rule 2 (which by section 112 of the Law applies only in the case of a solvent winding-up, something that the judge accepted was at least a possibility in the present case). Apart from any remedies specific to a winding-up, such as the avoidance of preferences, however, it is not in my view permissible to reopen a NAV retrospectively on the ground of fraud, whether or not the company was complicit in it. It follows that I do not accept the suggestion in *Primeo Fund v Pearson* that conduct by the company or its agent "that has the effect of vitiating the contract with its members" will invalidate a NAV. A contract is capable of being vitiated at its inception, for example by misrepresentation; and in the sense that, whether the company was a participant in the fraud or not, an investor is likely to have a claim based on misrepresentation, the existence of a fraud may be said to be capable of vitiating the contract between the company and the investor consequent on the acquisition of shares. Redemption of shares once acquired, however, is an incident of the existing contract and brings it to an end according to its terms. It is not possible to regard it as giving rise to a new contract capable of being vitiated. Nor is vitiation an appropriate description for a breach of contract, however severe; and it is in any event not on the face of it permissible for the company to rely on its own misconduct to terminate a contract. There is in my view no difference between an internal and an external fraud in terms of the binding nature of a NAV: the whole scheme of the Company's articles requires its business to be conducted on the basis that the NAV is binding, whether it is accurate or not.

30. Accordingly, I would hold that the fraud point fails.

<u>The 30 day point</u>

31. Article 55 of the Company's articles of association provided that the Company should remit redemption proceeds "within such period as the Directors shall determine". The Company's

offering memoranda stated that "Redemption payments are generally made within 30 calendar days after the Redemption Day". SEB contended that this meant that, as part of an investor's contract with the Company, the Company was allowed at least 30 days in which to make payment, and would not be in breach of contract until that period expired without payment. On that basis, the First SEB Redemption Payment could not be a preference, since the Company had at least until 30 December 2008 to make redemption payments to the December redeemers, there was no evidence that it owed money to anybody else on 19 December 2008 when the First SEB Redemption Payment was made, and accordingly there was no basis on which the court could be satisfied that the Company was unable to pay its debts on that date. [It is to be noted that this argument is not available in respect of the Second SEB Redemption Payment or the Third SEB Redemption Payment, since by the time they were made there were on any basis substantial amounts owed to the December redeemers.]

32. The judge dealt with this point primarily by reference to article 36 of the Company's articles of association, which is in the following terms:

> "The price to be paid for Participating Shares which are to be redeemed shall be deemed to be a liability of the Company from the Valuation Point on the Redemption Day until the price is paid".

He pointed out that in *Culross Global SPC Ltd v Strategic Turnaround Master Partnership Ltd* 2008 CILR 447 ("*Strategic Turnaround*") this Court held that an article containing similar wording created a provable debt owed to the redeeming investor from the redemption day. In relation to the statement in the Company's offering memoranda that redemption payments would generally be made within 30 calendar days, and an alternative submission from SEB that in the absence in articles 36 and 55 of a specified time for payment a reasonable time would as a matter of general law be implied, he referred to *Strategic Turnaround* in the Privy Council (2010 (2) CILR 364. In *Strategic Turnaround*, the relevant provisions were that the price payable for redeemed shares should be deemed to be a liability of the company from close of business on the redemption day until the price was paid, and that redemption proceeds would be remitted within such period as the directors should determine. Lord Mance, delivering the opinion of the Board, said this (at [20]):

> "The focus of these provisions is on the redemption date, by reference to which the redemption price payable is crystallised and from which the price is deemed to be a liability of the respondent. The remittance of the "redemption proceeds" is treated

as a matter of supplementary procedure, although it may be refused on particular money-laundering grounds. Both stages may be said to be part of a continuing process, but it does not follow that "redemption" within the meaning of arts. 55 and 32 only occurs at the conclusion of that whole process".

The judge then said this (at [110]):

"In my view much the same can be said here. The allowance of a grace period of 30 days for redemption payments was a purely practical measure to allow the orderly payment of sums which had become due on the redemption date. It had no legal bearing on the liability which arose at that date. Subsequent payment in accordance with the grace period was, mirroring the words of Lord Mance, no more than a matter of supplementary procedure. Nor is there any need, as suggested by Mr Chivers [for SEB], to consider implying terms as to payment."

33. On appeal, SEB's primary contention was that the judge had misinterpreted *Strategic Turnaround*: that case did not decide when redemption proceeds became due and payable but merely whether the company had the power to suspend redemptions after the relevant redemption date had passed. In particular, the passages from Lord Mance's judgment on which the judge relied were not intended to identify when the redemption proceeds became due and payable but rather the point at which redemption occurred, after which point it would be impossible to suspend the redemption process. By treating the 30 day grace period as purely a practical measure, the judge had deprived the Company of any benefit of that period. To hold that the redemption proceeds became due on the Redemption Day meant that the Company would be in breach of contract if it did not pay them then, despite the intention that it should have a further period to allow for orderly payment. The judge should have construed the articles and the offering memoranda together or, if he was not prepared to do so, should have recognised that on ordinary principles a reasonable time for payment was to be implied into articles 36 and 55. If the grace period was available to the Company, nothing was due to the December redeemers at the date of the First SEB Redemption Payment, and the Company was not insolvent. That SEB had received the First SEB Redemption Payment before it could legally have insisted upon its payment did not alter that fact.

34. In my view, the judge was right to regard this issue as concluded by *Strategic Turnaround*. In that case, a redeeming shareholder petitioned to wind up the company on the ground of

non-payment of the redemption price. The company applied to strike out the petition, asserting that between the redemption date and payment the company had validly suspended redemptions, with the result that there was no present debt due to the petitioner capable of founding the petition. The Grand Court refused to strike out the petition, holding that the petitioner had become a creditor on the redemption date and the purported suspension had been beyond the company's powers. This Court allowed an appeal on the basis that the suspension had been valid, but upheld the Grand Court's decision that the petitioner had become a creditor on the redemption date. The Privy Council restored the Grand Court's decision. Thus all three courts held that the petitioner became a creditor on the redemption date, with an immediate right to present a petition, the difference in outcome depending on the effect of the purported suspension. It is in that light that paragraph [42] of this Court's decision, relied on by SEB in relation to the future debts point, is to be viewed. That paragraph is in the following terms:

> "For these reasons, therefore, it seems to me that the respondent did not have the locus standi to petition on the "unable to pay its debts" ground as a creditor with a future debt. The respondent's debt was one that was not presently due and payable. It had been suspended under the articles and the CEM for an indeterminate period. Plainly, Mr McDonough is right in saying that the debt still exists, even if it has been validly suspended. But it is not presently due and payable in the sense that it is a debt "for which a creditor may go at once to the company's office and demand payment." Mr McDonough can also validly say that, under the Insolvency Rules, r. 12.3, a future debt is provable in the liquidation. That does not, however, make the debt automatically capable of founding a valid creditor's petition."

This paragraph is to be contrasted with paragraphs [23] to [25] of this Court's judgment, dealing in terms with the date on which the petitioner became a creditor. The conclusion on that issue, expressed at [25], was as follows:

> "I am, therefore, entirely satisfied that Smellie, C.J. was right to hold (as I believe he did) that the respondent became a creditor of the company on March 31, 2008 in the amount of the redemption value of the redemption shares that was yet to be quantified. It is wrong, in my judgment, to suggest that there was no debt until April 30, 2008, relying on the terms of the CEM that make 90% of the debt payable on that date. The respondent was, as Smellie, C.J. held, a creditor on March 31 by virtue of the clear provision of art. 53" [deeming the redemption price to be a liability of the company from the redemption date until payment].

35. In paragraph [1] of the opinion of the Privy Council, Lord Mance identified the issue as follows:

> "Whether the petition was an abuse of process depends upon whether, at the date of its issue, the appellant was a current creditor, with standing to issue it, or at best only a prospective creditor, in which case it would have no such standing".

Accordingly, paragraph [20] of Lord Mance's judgment, quoted by the judge and set out in paragraph 32 above, involves a clear rejection of the proposition that a statement in an offering memorandum or similar document indicating when payment of a redemption price would be made does not prevent an immediate liability arising – as, indeed, article 36 expressly provides. The judge was in my view correct to treat what SEB described as the period of grace as merely a practical matter, and correct to hold that the redemption prices due to the December redeemers fell due on 1 December 2008. Those amounts were accordingly properly taken into account by him for the purpose of determining whether the Company was insolvent at the date of the First SEB Redemption Payment. I would hold that the 30 day point fails.

<u>The future debts point</u>

36. The future debts point arises out of paragraph [113] of the judgment under appeal, in which the judge said this:

> "In point of fact, however, Mr Lord [for the JOLs] contends that it does not matter whether or not those debts are regarded as payable on 31 December 2008 or on 1 December 2008, as long as the Court is satisfied that on 19 December 2008, on the balance of probabilities, the Company would not have been able to pay all of the 1 December 2008 redemptions on 31 December 2008. It is submitted that the evidence amply demonstrates that the Company on 19 December 2008 had no prospect of being able to pay all the 1 December 2008 redemption payments on 31 December 2008. I have no hesitation in accepting this to be the position."

SEB contends that the judge was wrong to treat the Company as having been insolvent at the date of the First SEB Redemption Payment because it had no prospect of paying debts that did not become due until the end of the same month.

37. Because this was merely an alternative basis for rejection of the 30 day point, and I have indicated that I consider that the judge's primary basis for rejection of that point, namely

that the amounts due to the December redeemers fell due on 1 December 2008, was correct, I can deal with the future debts point shortly.

38. SEB contended, rightly, that *Strategic Turnaround* in this Court had established that the test of solvency in the Cayman Islands was the cash flow test, approving *In re European Life Assurance Society* (1869) L R 9 Eq 122 and quoting the headnote in the Law Reports as follows:

> "The Court will not order a company to be wound up under the just and equitable clause by reason of any liabilities not immediately payable unless it is reasonably certain that the existing and probable assets will be insufficient to meet the existing liabilities, and will not in any case take into account the possible liabilities or profits which may accrue in respect of future business".

SEB asserted that this was to be contrasted with the position in England and Wales, where insolvency could be proved by reference to the balance sheet test. Further, in England and Wales the cash flow test was differently expressed, requiring proof to the satisfaction of the court "that the company is unable to pay its debts as they fall due". The words "as they fall due", which do not appear in the Cayman legislation, introduced an element of futurity; without them, insolvency had to be assessed by reference to debts that were immediately due and payable. However, if it was right to take into account future debts, it was also necessary to take into account future assets; and there was no evidence as to the Company's ability to raise finance to meet the December redemptions.

39. The JOLs contended that the additional words "as they fall due" merely made express what was inherent in any cash flow test, including that applicable in the Cayman Islands. Any such test required a flexible and fact-sensitive approach to the question of a company's ability to pay its debts. They referred to the statement of Lord Walker in the UK Supreme Court decision *BNY Corporate Trustee Services Ltd v Eurosail-UK 2007-3BL plc* [2013] 1 WLR 1408 ("*Eurosail*") at [37] that "the cash-flow test is concerned, not simply with the petitioner's own presently-due date, nor only with other presently-due date owed by the company, but also with debts falling due from time to time in the reasonably near future. What is the reasonably near future, for this purpose, will depend on all the circumstances, but especially on the nature of the company's business"; and they pointed out that in that case the decision in *In re European Life Assurance Society* had been criticised.

40. In my view, the cash flow test in the Cayman Islands is not confined to consideration of debts that are immediately due and payable. It permits consideration also of debts that will become due in the reasonably near future. The approval of *In re European Life Assur. Socy.* by this Court in *Strategic Turnaround* does not prevent that conclusion: that case was primarily concerned with winding up on the just and equitable basis, not on the basis of inability to pay debts; and the headnote quoted by this Court refers to debts resulting from future business, not to future debts resulting from existing business. Nor does paragraph [42] of this Court's judgment in *Strategic Turnaround* (quoted in paragraph 34 above) suggest otherwise. If, as this Court erroneously thought, the suspension of redemptions was valid, the petitioner's debt would not be payable for an indeterminate period; and if the period could not be determined it was impossible to say that the debt would fall due in the reasonably near future. I do not regard the words "as they fall due" as adding anything of substance. In *Eurosail*, Lord Walker, after noting that the words "as they fall due" were introduced for the first time in the Insolvency Act 1985, said (again at [37]) that despite the difference in form they made little significant change in the law and served to underline that the cash flow test was concerned both with presently-due debts and with debts falling due in the reasonably near future. Any other conclusion leads to artificiality: if a company is able to pay a small debt due on a particular day, but will inevitably be unable to pay a much larger debt due on the following day, it is artificial to say that on the first day it is not unable to pay its debts. As to SEB's suggestion that there was no evidence about the Company's ability to finance the December redemptions, the fact is that no such finance was obtained, and it is a proper inference that none was available. I would hold that the future debts point fails.

The Preference Issue

41. A further condition of the application of section 145 (1) of the Law is that the payment said to be a preference is made to a creditor "with a view to giving such creditor a preference over the other creditors".

42. The judge approached this part of the case by first identifying the relevant legal principles. He referred extensively to English authority, much of which had been summarised in this jurisdiction by Smellie CJ in *RMF Market Neutral Strategies (Master) Ltd v DD Growth Premium2X Fund* [2013] 2 CILR 361; and at the end of that summary he said this (at [170]):

> "In the end all this analysis leads back to *DD Growth*. Applying those principles, it is plainly necessary, in my view, for the JOLs to prove to the satisfaction of the Court that the redemption payments were made with the intention of preferring SEB over other creditors. It is competent for the Court to draw the inference of an intention to prefer from all the facts of the case. However, the intention to prefer, which must be proved, must be the principal or dominant intention. There is no mention, in the final analysis by the Chief Justice, of there being a need for evidence of dishonesty, which is understandable in that the relevant statutory provision has moved away from fraudulent preference to voidable preference. But in reaching his conclusions the Chief Justice did appear to accept that the dominant intention must be to prefer a particular creditor, although I see no reason why that could not be a class of particular creditors."

SEB takes issue with only one element of this analysis, namely the implicit rejection of the need to find some evidence of dishonesty. I refer to this as the Dishonesty Point.

43. At [117] of the judgment, the judge identified what he described as the critical point of difference between the parties, namely "whether payment of the redeemers in the knowledge that the Company was unable to pay its debts is of itself sufficient (in the absence of any other explanation such as pressure) to infer objectively the necessary intention of preference or whether there must be proof of something more, specifically a subjective dominant intention to prefer particular creditors over others". In the end, having decided that the Company had a specific intention to prefer SEB, the judge came to the conclusion (at [188]) that it was not necessary for him "to decide whether, absent such specific intention, the required intention of preference can be inferred objectively from the fact of such payments being made when the Company was commercially insolvent". This conclusion is challenged in a Respondents' Notice filed by the JOLs. I should record that, in the course of the hearing of this appeal, we received a letter from Maples and Calder dated 18 April 2016 referring to the fact that the issue raised in the Respondents' Notice was due to be litigated against other redeemers in the Grand Court at the instance of the JOLs, and suggesting that we should defer consideration of it.

44. The judge then considered whether there was evidence of a specific intention to prefer SEB in relation to the First SEB Redemption Payment. He referred to an e-mail sent by Magnus

Peterson to the Company's administrators (PNC) on 17 December 2008, which was in the following terms:

> "Hi Gillian,
>
> We have a few Swedish investors that have switched into our SEK based Fund as at 1st December.
>
> We need to pay them value tomorrow please.
>
> On the attached spreadsheet I have highlighted those investors in yellow. It is approximately US$7.6 million that needs to be paid.
>
> SEB are sending funds today to PNC so there should be no problem executing it.
>
> Best regards
>
> Magnus".

The reference in that e-mail to SEB sending funds is explained by the fact that, quite separately from its capacity as shareholder, SEB provided clearing and brokerage services to the Company. However, one of the investors highlighted in yellow on the spreadsheet was "SEB Merchant Banking as nominee for Catella Stiftelsefond"; although it appears that in fact SEB never subscribed for, or expressed an interest in subscribing for, shares in the Swedish fund on behalf of Catella, HQ Solid or anyone else. At [179], the judge expressed his conclusion on this topic as follows:

> "I find on the evidence that there was an intention to pay the Swedish Redeemers on the basis that they were investors, or potential investors, in the Swedish fund. The fact that there may have been a mistake about this matters not. What does matter is the subjective intention of Magnus Peterson in acting, as I have found, as the Company's controlling mind. The intention appears to have been a principal or dominant intention to prefer a particular class of creditors. This resulted in a preference in fact of a particular creditor".

SEB challenges this conclusion on the basis that, in the absence of any direct evidence from Magnus Peterson as to how the mistake had occurred, it was equally plausible that he had simply highlighted the wrong investor and had never had any intention to prefer SEB. I refer to this as the Mistake Point.

45. In relation to the Second SEB Redemption Payment, the judge said this (at [181-182]):

> "The question which has occurred to me is whether the intention in relation to the first payment continued beyond then. There is evidence that it did because of the email of 20th January 2009, when Magnus Peterson selected for payment three

more Swedish investors who were said to have switched into the Swedish fund. This was actually after the Second SEB Redemption Payment. It is also right to note that after the First SEB Redemption Payment (which resulted in payment in full to SEB as nominee for Catella) there was no specific mention of paying SEB as nominee for HQ Solid. However, nor is there anything to suggest that any distinction was made in the mind of Magnus Peterson as to the different capacities in which SEB was acting. The evidence rather indicates that there was a continuing general intention on his part to make preferential payments to the various Swedish Redeemers (SEB included) as a class thought, rightly or wrongly, to be re-investors in the Swedish fund.

The matter does not rest there. There is also the point that the Second SEB Redemption Payment appears to have been made with the intention of complying with the policy set out in the 31st December 2008 letter. That policy arguably had the effect of reinforcing the decision which had been made to pay SEB, resulting in a preference over other creditors. Thus it appears that in the absence of any other explanation for the Second SEB Redemption Payment (and there is none) that it was made with a view to prefer SEB."

The e-mail of 20 January 2009 was a further request from Magnus Peterson to the Company's administrator, saying: "Just like last month we have 3 Swedish investors who have switched into our SEK based Fund. We need to pay them tomorrow please". SEB was not one of the investors referred to. The letter of 31 December 2008, which was not in fact sent until 7 January 2009 but represented a decision made by Magnus Peterson at the end of December 2008, notified investors that "in order to effect an orderly liquidation of the Fund's assets to meet the requested redemptions, the directors have decided to pay at the end of this month 25% of all redemptions requested at the end of November on a pro-rata basis. The remaining redemption amounts will be paid out in one or more instalments as market conditions improve as the directors in their absolute discretion determine, and the directors envisage this improvement will take place by the end of January".

46. In relation to the Third SEB Redemption Payment, the judge said this (at [184]-[186]):

> "Nor is it right that the Third SEB Redemption Payment rests solely upon the effect of preference. It can be taken to have been paid pursuant to what I have found to be a continuing general intention to make preferential payments to the particular Swedish Redeemers as a class.

It may well be, as pointed out by Mr. Chivers, by reference to the relevant schedule previously referred to, that in the meantime various other redeemers had in fact been paid ahead of SEB. The reasons for this are not presently apparent and may well have to be investigated in the context of any claims pursued in relation to other preferences of these particular redeemers. But none of this detracts from the intention which there appears to have been to make the preferential payment to SEB.

Moreover, if an inference is to be drawn, there appears to be nothing here to displace the "inference of intention" in the analysis of Lord Evershed MR in *Re Cutts*. The same can be said of the Second SEB Redemption Payment. Additionally, it appears from the Board Minutes of the 22nd February 2009 that the payment may have been made pursuant to an intentional policy to prefer smaller investors over larger investors. Again this may have had the effect of reinforcing the decision which had been taken to pay SEB. The policy was one which could lead to the recipients being preferred over the other investors who had redeemed but were not paid in full or were not paid at all."

The schedule there referred to demonstrated that other redeemers had received their payments in full before SEB. The Board Minutes included the statement that "where one redemption request is of such a size that it can only be satisfied in a number of payments or in one deferred payment (a "Large Redemption"), the Directors may satisfy all other contemporaneous or prior redemption requests in full before paying the redemption proceeds for the Large Redemption in order best to protect the Net Asset Value of the Fund and the interests of the remaining Shareholders".

47. The reference to *Re Cutts* [1956] 1 WLR 728 is to the following passage:

"For if a debtor deliberately selects for payment A in preference to all his other creditors, it cannot, to my mind, matter, in the absence of other relevant circumstances, whether A is the debtor's oldest friend, closest relative or best client. On the other hand, where a debtor, owing money in all directions, has also robbed his employer's till, he may, knowing himself to be insolvent, elect to reimburse the till in order that, when the crash comes, the damaging fact of his robbery may not be discovered. Or a debtor may elect to make a particular payment under pressure of some threat, or to obtain for himself some immediate and material benefit or to fulfil some particular obligation. In these cases the reason for the payment affects,

essentially, the intention in making it. In the instances given the intention, that is the real dominant intention, will no longer be to "prefer" (that is to pay, as it were, out of turn) but will be to avoid the detection of a criminal act; to relieve the threat; to get the benefit and postpone the evil day; or to satisfy the particular obligation. Though the question of pressure in some form or another has, in the reported cases, often been the crux of the matter, it is plain that an inference of intention to prefer may be displaced in many other ways than by showing that the debtor acted under pressure. Examples are indeed legion. But in the present case the examples that I have given provide the closest analogies to the suggestions on the society's side; and the real question before us is whether, upon the evidence and the findings of the county court judge, the true inference is intention to prefer or whether an inference of some other kind similar to those in the examples given is, at the least, not equally legitimate."

48. Finally, at [187], the Judge summarised his views as follows:

> "I am satisfied that each of the SEB redemption payments was made with the principal or dominant intention of preferring SEB as a member of a particular class of creditors, the Swedish Redeemers. Here there was not mere selection, but the added dimension of conscious decision making resulting in particular selection for payment. This was clearly the case, in my view, in relation to the First SEB Redemption Payment. It is less clear in relation to the Second and Third SEB Redemption Payments, although, on balance, I think that it is reasonable to draw the inference that these further payments were made as part of a continuing general intention to make preferential payments to the Swedish Redeemers. Furthermore, the intention in this regard appears to have been reinforced by particular decision making in relation to the payments."

49. SEB challenges these conclusions on the ground that there was no evidence to support the judge's inference of a "continuing general intention" to prefer SEB. The First SEB Redemption Payment related to shares held by SEB as nominee for Catella, whereas the Second SEB Redemption Payment and the Third SEB Redemption Payment were in respect of shares held as nominee for HQ Solid, and there was nothing to suggest that Magnus Peterson thought that SEB in its capacity as nominee for HQ Solid would reinvest in the Swedish fund. There was uncontested evidence that SEB was obliged to act on the

instructions of its nominee, so that the judge could not properly have concluded that an intention to prefer SEB as nominee for Catella had any relevance to an intention to prefer SEB as nominee for HQ Solid. Moreover, the Second SEB Redemption Payment and the Third SEB Redemption Payment were made after substantial payments had been made to other investors, and there was no evidence of intention to prefer in relation to those investors; and SEB was not preferred in the application of the Company's policy to pay 25% of liabilities immediately and the balance later. I refer to these contentions as the Continuing Intention Point.

50. SEB also contends that the judge, when deciding whether SEB was preferred over other creditors, ought to have concluded that the only relevant creditors were current creditors with debts that were already due and payable, not future creditors. There is nothing in this point. At [196], the judge stated that he did not need to decide whether he could take future creditors into account. That was because he had already concluded that the amounts due to redeeming shareholders were liabilities of the Company from the redemption date; and, as I have said, in my view he was right to do so. On that basis, he identified at [197] the creditors over whom SEB was preferred by the First SEB Redemption Payment as being the other December redeemers who received no payment on 19 December 2008; those over whom SEB was preferred by the Second SEB Redemption Payment as being the unpaid December redeemers and all the January 2009 redeemers; and those over whom SEB was preferred by the Third SEB Redemption Payment as being the unpaid December redeemers and all the January 2009 and February 2009 redeemers. Those creditors were all current creditors at the date of the relevant SEB Redemption Payment.

51. By amendment to the Grounds of Appeal SEB also contended that, if it succeeded in relation to the Second SEB Redemption Payment and the Third SEB Redemption Payment but would otherwise fail in relation to the First SEB Redemption Payment, the First SEB Redemption Payment was nevertheless not liable to be set aside. That was because if the payment had not been made on 19 December 2008 it would have been paid in the ordinary course of payments made to the December redeemers during January 2009, and consequently would not have been a preference. The point is based on *Lewis v Hyde* [1997] BCC 976. I refer to it as the Amendment Point.

<u>The Dishonesty Point</u>

52. It is SEB's contention that it is necessary that an intention to prefer within section 145 (1) of the Law should carry with it a "taint of dishonesty". That contention is based upon the decision of the English Court of Appeal in *Re Kushler Ltd* [1943] 1 Ch 248, in which Lord Greene MR said the following (at p252):

> "The statute is directing the court to ascertain the state of mind of the payer in relation to a particular transaction. A state of mind is as much a fact as a state of digestion and the method of ascertaining it is by evidence and inference, and I can see nothing in the language of the section which justifies the view that the problem which the legislature sets the court is to be dealt with on any principles different from those commonly employed in drawing inferences of fact. It must, however, be remembered that the inference to be drawn is of something which has about it, at the least, a taint of dishonesty, and, in extreme cases, much more than a mere taint of dishonesty. The court is not in the habit of drawing inferences which involve dishonesty or something approaching dishonesty unless there are solid grounds for drawing them."

This passage does not bear the weight SEB seeks to place on it. It does not say that a payment can be a preference only if it is made dishonestly; and neither section 145 (1) of the Law nor the equivalent English legislation contains any requirement of dishonesty. What the passage appears to me to be doing is to make explicit the element of legislative disapproval that is implicit in a provision intended to avoid preferences. The idea underpinning insolvency legislation is that limited assets should be shared pari passu among the creditors, so that each bears a share of the loss that corresponds to the proportion that his debt bears to the total indebtedness. Preferring one creditor over the others means on the face of it that the preferred creditor suffers no loss, and the other creditors suffer more than their proportionate share. That subverts the principle of pari passu distribution; and intentionally giving an advantage to one creditor is something that is to be frowned on. It is perhaps not surprising that in 1943, when the relevant legislation still spoke of a "fraudulent" preference, this disapproval was regarded as akin to dishonesty (although it was well-established by then that fraud in its ordinary meaning was not necessary to bring a preference within the legislation: see for example *Re Patrick and Lyon Ltd* [1933] 1 Ch 786, 790); but in my view it is a misdescription of the disapproval implicit in section 145 (1) of the Law. I would hold that the Dishonesty Point fails.

<u>The Mistake Point</u>

53. The Mistake Point arises out of the fact that Magnus Peterson appears to have been mistaken in identifying SEB (in its capacity as nominee of Catella) as an intending investor in the Swedish fund. To my mind, this is irrelevant. The e-mail of 17 December 2008 and the accompanying highlighted spreadsheet show precisely why the First SEB Redemption Payment was made. It was because Magnus Peterson wanted early payment to be made to a particular class of redeemers, and he identified SEB as a member of that class. His direction to PNC was the cause of the payment to SEB. It is merely speculation that he might have intended some other investor to benefit; the fact of the matter is that he identified SEB as a person to whom payment should be made in priority to other creditors. It is impossible to suggest that his expressed intention was not the operative one. I would hold that the Mistake Point fails.

The Continuing Intention Point

54. The judge found in terms (at [187]) that "each of the SEB redemption payments was made with the principal or dominant intention of preferring SEB as a member of a particular class of creditors, the Swedish Redeemers". That conclusion is not challenged by SEB in relation to the First SEB Redemption Payment (except by reference to the Mistake Point, which I have already said should be rejected); but it is challenged in relation to the Second SEB Redemption Payment and the Third SEB Redemption Payment. As I have indicated, SEB contends that there was nothing to suggest that Magnus Peterson regarded SEB, in its capacity as nominee for HQ Solid, as a Swedish Redeemer; the Second SEB Redemption Payment and the Third SEB Redemption Payment were made after substantial payments had been made to other investors; and SEB was not preferred in the application of the Company's policy to pay 25% of liabilities immediately and the balance later.

55. In my view, there was insufficient material to enable the judge to infer a dominant intention throughout to prefer SEB on the grounds that it intended, as Magnus Peterson appears to have believed, to invest in the Swedish fund. Whilst that plainly was, as I have said, the reason for the First SEB Redemption Payment, it cannot be said to be the case in respect of either of the Second SEB Redemption Payment or the Third SEB Redemption Payment. That is partly because, although SEB was the registered shareholder in respect of all the shares it held, the company and Magnus Peterson understood that it held some of those shares as nominee for Catella and some of them as nominee for HQ Solid. That understanding is particularly evident in the highlighted spreadsheet that, with the e-mail of 17 December

2008, provided the instruction for the First SEB Redemption Payment, where SEB was specifically referred to as nominee for Catella. As SEB contends, there is no reason to suppose on the evidence that Magnus Peterson can have thought that SEB in its capacity as nominee for HQ Solid intended to invest in the Swedish fund. Indeed, the e-mail of 20 January 2009 suggests the contrary: on the face of it, there was an intention to prefer the investors named in that e-mail, but SEB was not one of them. The judge pointed out that by the time of that e-mail the Second SEB Redemption Payment had been made; but, whilst that is true as a matter of fact, it is at best neutral for the purpose of establishing a continuing intention to prefer SEB as a Swedish Redeemer. Moreover, there was no evidence to indicate that the redeemers who had received payment in full before SEB did so because they were understood to be intending to invest in the Swedish fund; indeed, the judge described the payments to them as having been made seemingly on an ad hoc basis. But the absence of that evidence, or evidence of some reason for those payments which did not conflict with the idea of an intention to prefer Swedish investors, calls into question the hypothesis of such a continuing intention. In truth, all the evidence establishes is that Magnus Peterson intended to give preference to redeemers intending to transfer to the Swedish fund; but, except in relation to the First SEB Redemption Payment, there is nothing to indicate that he regarded SEB as such a redeemer.

56. The matter does not, however, end there. The judge did not rely only on an intention to prefer Swedish Redeemers: he said (again at [187]) that "the intention in this regard appears to have been reinforced by particular decision making in relation to the payments". He was referring to the policy set out in the letter dated 31 December 2008 of paying the December Redeemers 25% initially and the balance later, and that set out in the board minutes dated 22 February 2009 of giving priority to redemptions that were not "Large Redemptions". Although the judge regarded these merely as reinforcing his view that the payments to SEB were made pursuant to a policy of giving preference to investors in the Swedish fund, it seems to me that the letter dated 31 December 2008 at least has a significance of its own. By the time the Second SEB Redemption Payment, representing 25% of the amount outstanding, was made on 2 January 2009, the sums due to the January Redeemers had already fallen due and notice of redemption had been given by the February Redeemers. The judge found that Magnus Peterson knew that the Company had no prospect of paying the January Redeemers and the February Redeemers in full. The proper course would have been to suspend redemptions (if that were by then possible) or liquidate the Company. He

nevertheless caused the Company to adopt a policy designed to allow the December redeemers to be paid before other redeemers. The Second SEB Redemption Payment and the Third SEB Redemption Payment were made pursuant to this policy, and had the intended effect of preferring SEB (as one of the class of December redeemers) over the body of January redeemers. SEB says that it was not preferred in the application of the policy, but that does not answer the point. Although the policy may have been applied consistently in relation to the December redeemers, so that SEB gained no advantage over them, it did give SEB an advantage over the January redeemers and (in the case of the Third SEB Redemption Payment) over the February redeemers, all of whom were to the knowledge of Magnus Peterson unlikely to be paid. That is in my opinion sufficient to justify the judge's conclusion of a specific intention to prefer. As the judge recorded at [78], SEB did not put pressure on the Company to pay, or even request payment after giving notice of redemption, so there was nothing to displace the inference that SEB was paid pursuant to that intention. Accordingly, although for slightly different reasons from those expressed by the judge, I would hold that the Continuing Intention Point fails.

57. That conclusion deals to some extent with the Respondents' Notice, which made specific reference to the letter dated 31 December 2008 and the February 2009 board minutes. I do not, however, find it necessary to address the more general question raised by the Respondents' Notice, namely whether the fact of payment in knowledge of insolvency is sufficient without more to found an inference of intention to prefer. In light of the letter from Maples and Calder to which I have referred, I also think it would be undesirable to do so.

The Amendment Point

58. The Amendment Point is expressly contingent on SEB having succeeded in relation to the Second SEB Redemption Payment and the Third SEB Redemption Payment. Since it has not, it is not necessary to consider the point further.

The Repayment Issues

59. The Repayment Issues related to the judge's rejection of SEB's analysis that the remedies available in a case to which section 145 (1) of the Law applied were common law remedies, to which common law defences such as the absence of unjust enrichment, and change of

position, applied; and his rejection of SEB's contention that the JOLs' claim was founded on illegality and was contrary to public policy.

60. The judge dealt with these matters at [200] to [245] of his judgment. At [211], and again at [218], he held that common law defences were not available to a statutory claim under section 145 (1) of the Law, and at [212] he said this:

> "Mr Lord [for the JOLs] submits, and I accept, the absence of any discretion built into the section reflects the policy behind it of restoring value to the company for the benefit of its creditors which overrides the common law rules on unjust enrichment and change of position as between parties to a private transaction. The cause of action derives from the section itself: pursuant to statute the payment is invalid, therefore, the recipient is obliged to repay what he received. There is no question of having to consider unjust enrichment, rather the recipient has received something he should not have received and is obliged to pay it back."

At [219] and [229], he held that SEB had not in any event made out a defence of change of position on the facts: SEB was always a nominee, and passing the redemption payments to Catella and HQ Solid did not amount to a change of position; and such indemnity as SEB had was, on the evidence, unaffected by that payment or by events that occurred subsequently. As to illegality and public policy, the judge said (at [244]):

> "There is a compelling reason why the NAV must stand to allow recovery of redemption payments made in accordance with it which are found to be invalid. The public policy, in my view, is very much in support of such recovery, rather than against it."

61. SEB challenged these conclusions on the ground that section 145 (1) said nothing about the legal basis for recovering a preference, and the judge should have held that the appropriate remedy was a common law claim in unjust enrichment; that he should have recognised the existence of a change of position defence to a preference claim; that he was wrong as a matter of fact to reject the change of position defence; and, in relation to illegality and public policy, on the ground that –

> "Contrary to the Judge's view, the JOLs' claims were based on fraud: those claims were founded on an allegation that other creditors were themselves entitled to a pari passu share of funds which were, by reason of Magnus Peterson's fraud,

extracted from the Company. The judge ought to have held that it was repugnant to public policy to allow those claims."

62. In oral argument, SEB pointed out that section 145 (1) of the Law merely avoids a preference, whilst saying nothing about the consequence of avoidance. Since the statute did not provide an explicit remedy, the only way in which the JOLs could recover the payments was by asserting a restitutionary remedy. The policy behind the section, namely to restore value to a company for the benefit of its creditors, was the same as the policy behind provisions avoiding transactions designed to defraud creditors; but in the latter case the possibility of a change of position defence was recognised: see the English High Court decision of *Rose v AIB Group (UK) plc* [2003] 1 WLR 2791. Moreover, in a further English High Court decision, *Charles Terence Estates Ltd v The Cornwall Council* [2011] EWHC 2542 (QB) local councils failed to recover payment of rent made under leases that were void against them (because they had been entered into in breach of fiduciary duties to council taxpayers) on the grounds that the landlords had a common law defence of change of position. This demonstrated that the fact that there were public policy reasons for invalidating a payment did not prevent an innocent recipient from relying on a change of position defence.

63. In response, the JOLs contended that a claim under section 145 (1) of the Law was not part of the common law of restitution or unjust enrichment, but was a long-standing part of the statutory law of insolvency aimed at protecting the interests of all creditors. It followed that the claim was not based on a creditor's unjust enrichment, but on vindicating the statutory regime for the benefit of all creditors. They referred to the following statement of Lord Browne-Wilkinson in *Lewis v Hyde* [1997] BCC at 979:

> "The effect of the section, if applied, is to require the preferred creditor to repay what he has received, the monies recovered being applicable pari passu between the creditors in the liquidation. The underlying purpose is to ensure compliance with the basic principle of insolvency law, viz. pari passu distribution of the insolvent estate."

They also made reference to the decision of the Court of Appeal of Alberta on provisions (which, unsurprisingly but unfortunately, were not set out in the report) of the Canadian Bankruptcy and Insolvency Act, *Principal Group v Anderson* (1997) 147 DLR 4th 228, 231-4, the effect of which (as summarised in the headnote) is as follows:

"The defence of change of position does not apply to statutory proceedings such as those set out in the Act, which impose a duty on the trustee to treat all creditors equally and to collect the property of the bankrupt. These duties are incompatible with the defence of change of position."

64. In my view, it is implicit in section 145 (1) of the Law that, where the conditions of that section are satisfied, a preferential payment is automatically avoided and it (or its equivalent) is to be returned. The section makes the payment invalid without more, leaving no room for the possibility that a change of position defence might cause it not to be invalidated at all. Any other conclusion would be at odds with the underlying purpose of the section identified in *Lewis v Hyde*. Although it is not necessary to decide the point, I would expect the same principle to apply to a case of a transaction in fraud of creditors, and accordingly I do not regard *Rose v AIB Group (UK) plc* as a reliable guide to the construction of section 145 (1). In my view, the judge was right to reject the possibility of common law defences.

65. I also consider that he was entitled to conclude that, as a matter of fact, the claimed defences were not available to SEB. SEB was the Company's shareholder, regardless of the capacity in which it held shares. By receiving the SEB Redemption Payments when it should not have done, it was – as between itself and the Company – unjustly enriched. It claims to have changed its position by paying the proceeds to Catella and HQ Solid in circumstances where it now has no ability to recover them; but the position in fact was that it paid them over on terms that included contractual indemnities. The deterioration in SEB's position stems not from its payment of the proceeds but from the fact that the indemnities have, according to the evidence, always been worthless. SEB's failure to procure a valuable indemnity or otherwise protect its position cannot be said to amount to a change of position sufficient to afford a defence to the preference claim.

66. So far as questions of illegality and public policy are concerned, it appears to me that the policy underlying section 145 (1) again prevents them arising. The relevant public policy is that underpinning the whole insolvency regime, namely the necessity to procure pari passu distribution of available assets; and it is difficult to see what type of illegality would prevent a liquidator taking advantage of the preference avoidance provisions. In any event, however, I consider that SEB mischaracterises the position. As explained in paragraph 86 of its skeleton argument, SEB's contention was as follows:

> "Contrary to the judge's view, the JOLs' claims to recover the three SEB Redemption Payments were founded on Magnus Peterson's fraud. This was because the JOLs' claims were to recover the proceeds of that fraud not for the benefit of the company (the victim of the fraud) but, rather, for the benefit of unpaid redeeming shareholders. Put shortly, the JOLs' claim was to deprive one beneficiary of the fraud (SEB) of the proceeds of the fraud for the purpose of distributing such proceeds among other beneficiaries (the unpaid redeemers)".

Whoever the beneficiaries of the fraud were (and they will have included Magnus Peterson, at least until his imprisonment, and shareholders who managed to redeem at inflated NAVs more than six months before the commencement of the liquidation), they do not include unpaid redeemers. They will have suffered from the fraud by acquiring their shares at inflated prices, and will not have been able to extricate themselves. What available assets there are will have to be distributed pari passu amongst them, and for that purpose it is immaterial whether they prove by reference to the inflated redemption values which they expected to receive but did not, or by reference to some revised NAV – at least so long as there is consistency among them. By contrast, however, SEB is (as it acknowledges) currently a beneficiary of the fraud, having received redemption payments by reference to the inflated NAV; and, to the extent that anyone is relying on illegality, it is SEB by asserting its entitlement to retain the inflated redemption values. I would hold that the Repayment Issues are to be resolved against SEB.

67. For the sake of completeness, I should record that the illegality point was argued on the basis of the law as it was understood prior to the United Kingdom Supreme Court decision in *Patel v Mirza* [2016] UKSC 42; [2016] 3 WLR 399. Having regard to the way in which I consider the point is to be resolved, nothing turns on this.

Conclusion

68. For the reasons I have given, which largely coincide with those set out by the judge in his commendably clear and comprehensive judgment, I would dismiss this appeal.

MORRISON JA:

69. I agree.

FIELD JA:

70. I also agree.