

Court of Appeal Hands Down Judgement in Fairfield

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History of the Case

On 13 June 2012, the Court of Appeal handed down its judgment in the claims that have been brought by the liquidators of Fairfield Sentry Limited ("Fairfield") against a number of investors that redeemed out of the fund. The Court of Appeal has upheld the decision of the trial judge albeit, in some instances, for different reasons.

Fairfield was a fund that invested into Bernard L. Madoff Investment Securities LLC ("BLMIS"). As a result of the collapse of BLMIS, liquidators were appointed over Fairfield on 21 July 2009. The liquidators then issued a number of claims against investors that had redeemed out of Fairfield before the discovery of the fraud within BLMIS and the suspension of redemptions. The liquidators of Fairfield claimed that the payments made to the redeemed investors had been made under a mistake of fact because, as a result of the fraud in BLMIS, the net asset value per share ("NAV") was in reality nil or of nominal value. The liquidators therefore claimed that the redeemed investors had been paid the redemption monies under a mutual mistake and had been unjustly enriched.

In April 2011, a number of the defendants applied for the claims to be dealt with by way of a preliminary issues hearing (the "PI Defendants"). Justice Bannister, in the Commercial Court, accepted this proposal and formulated two preliminary issues to be dealt with at trial on 28 and 29 July 2011. The two preliminary issues were:

- the "Article 11 Defence": the PI Defendants argued that because of the provision contained in article 11 of Fairfield's articles of association that stated "any certificate as to the Net Asset Value per Share or as to the Subscription Price or Redemption Price therefore given in good faith by or on behalf of the Directors shall be binding on all parties", the determination of the NAV was binding on the parties and could not now be re-visited by the liquidators; and

- the "Good Consideration Defence": the PI Defendants argued that by surrendering their shares they had provided good consideration for their redemption payments so that they could not now be set-aside.

Judgment was given by the Commercial Court on the preliminary issues on 16 September 2011. Justice Bannister found in favour of the liquidators on the Article 11 Defence and in favour of the PI Defendants on the Good Consideration Defence. On 10 October 2011, following an application brought by ABN Amro on behalf of the other PI Defendants, Justice Bannister also considered the question of mutual mistake and found in favour of the PI Defendants. He therefore gave summary judgment for the PI Defendants.

Both the liquidators and the defendants appealed to the Court of Appeal which considered the issues at a hearing on 17 and 18 January 2012.

Article 11 Defence

Mitchell J.A., giving judgment on this point on behalf of the Court of Appeal, held that the documents upon which the defendants relied (contract notes, monthly statements, emails and information contained on a website) did not amount to certificates. Unlike the trial judge, he did not, however, consider that in order to be a certificate, a document had to be signed. Mitchell J.A. did, however, agree with the trial judge that a certificate "must be something more than a simple statement" and that it must contain "some formal stamp." Ultimately Mitchell J.A. agreed with the trial judge that "none of the Documents met the key element of putting a formal and binding stamp to the NAV."

Mitchell J.A. considered that it could not be "right that every statement of a precise NAV...amounts to a certification." He also thought that the fact that Article 11 says "any" certificate suggests that it was not obligatory for a certificate to be issued. There could therefore be an uncertified determination that was not binding. Further, Article 11 provided that the certificate had to be issued by the directors or by some agency to which the power to certify had been delegated. The directors delegated some of their functions to Fairfield Greenwich and Citco, Fairfield's Administrators, but Mitchell J.A. was of the view that although the directors had delegated the calculation of the NAV they had not delegated the functions of determination and certification.

Good Consideration Defence

Pereira, J.A. also upheld the trial judge's conclusion on the Good Consideration Defence albeit again via a different route. She characterised the transaction as one in which the "exercise by a shareholder of his right of redemption would trigger contractual obligations on the part of Sentry, which were to redeem or purchase the shares and pay the redemption price." The mistake was the determination of the NAV by Fairfield but by this time Fairfield's obligation to pay the redeeming

investor had already arisen. Pereira, J.A. concluded that Fairfield's contractual obligations gave rise to a debt obligation and the defendants in surrendering their rights to the shares, fully performed their side of the contract and gave good consideration which defeated Fairfield's restitutionary claim. She therefore considered that the case fell "squarely within the principle 2(b) set out in *Barclays Bank v W.J. Simms*." Principle 2(b) is that if a person pays money under a mistake of fact then he is prima facie entitled to recover unless "the payment is made for good consideration, in particular if the money is paid to discharge, and does discharge, a debt owed to the payee."

Pereira J.A. further considered that, on "the payment of the redemption price Sentry got precisely what paid for - the shares." Accordingly the contract was not impossible to perform. Indeed, Fairfield's mistake as to the NAV was not a mutual mistake but Sentry's own mistake. She noted that "mistake as to the quality of the thing contracted for would not affect assent unless it was the mistake of both parties."

Finally, Pereira J.A. considered the position with regard to the "allocation of risks" and noted the importance of certainty in commercial transactions. She considered that the risks to both parties had been allocated in the contract and noted that "throughout all the case law and modern treatises on restitutionary remedies ...such remedies invariably always give way to contractual obligations."

Conclusion

The result of the defendants winning on the Good Consideration Defence means that, as matter stand, the claims should all be dismissed against the redeemed investors. The matter is, however, unlikely to end in the Court of Appeal as both sides have applied for leave to appeal to the Privy Council. The redeemed investors are therefore likely to have a longer road to travel before they can be sure that they will not be required to pay back any redemption monies paid to them.

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