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The Privy Council has handed down judgment in the claim brought by the liquidators of Fairfield Sentry Limited ("Fairfield") against a number of redeemed investors, seeking to recover the amounts paid out to them on redemption.

Fairfield was the largest feeder fund into Bernard L.Madoff Investment Securities LLC ("BLMIS"). BLIMIS was discovered in late 2008 to have operated the largest Ponzi scheme in history. Shortly after the existence of the Ponzi scheme was discovered, the directors of Fairfield suspended calculation of Fairfield's net asset value per share ("NAV") and suspended redemptions. On 21 July 2009, the High Court of the British Virgin Islands ("BVI") placed Fairfield into liquidation.

The liquidators of Fairfield issued a large number of claims in the BVI against redeemed investors in late 2010. In these claims the liquidators argued that redemption proceeds paid to redeemed investors should be paid back to Fairfield because they were paid out under the mistaken belief that Fairfield had invested in valuable assets when, in fact, there were in reality no assets as a result of the Ponzi scheme.

On 20 April 2011, Justice Bannister in the Commercial Division of the High Court in the BVI, ordered that the case should be dealt with on the basis of four preliminary issues. The first three issues concerned, what has become known as the "Article 11" defence. This defence concerned whether or not certain documents which were issued to members of Fairfield and which recorded the NAV per share or the redemption price were binding on Fairfield under Article 11,

which deals with the effect of certain "certificates".

The fourth issue has become known as the "good consideration" defence and concerned whether the defendants had a good defence to any claim by the liquidators on the basis that by surrendering their shares they gave good consideration for the money that they received upon redemption.

Bannister J and the Eastern Caribbean Court of Appeal decided the Article 11 issue in favour of Fairfield and the good consideration issue in favour of the redeemed investors. In both of these courts, the two defences were treated, to a certain extent, as two separate defences. In the Privy Council, however, it was held that the two defences were so closely related that they had to be considered together.

The Privy Council noted the basic principles in relation to the defence of good consideration namely that the payee of money "cannot be said to have been unjustly enriched if he was entitled to receive the sum paid to him" (Kleinwort Benson Ltd v Lincoln City Council [1999] 2 AC 349 at 408B (Lord Hope)) and that "in general, an enrichment is not unjust if the benefit was owed to the defendant by the claimant under a valid contractual, statutory or other legal obligation" (Professor Burrows: Restatement of the English Law of Unjust Enrichment (2012) at 3(6)). The good consideration defence became tied to the Article 11 defence because Fairfield conceded (rightly in the Privy Council's view) that if the NAV per share or the redemption price, as recorded in the transaction documents, were binding then Fairfield's claim must fail.

The judgment therefore focused on whether or not Fairfield was contractually obliged to make the payments that were, in fact, paid out to the redeemed members. This in turn was said to depend on whether, on a proper construction of the Articles, Fairfield was bound to pay the true value of the NAV upon redemption (which Fairfield argued was nil or of nominal value) or the NAV per share which was determined by the directors at the time of redemption. Fairfield argued that the definition of Redemption Price and Subscription Price in the Articles to be "determined in accordance with Article 11" must mean "the NAV correctly determined". Moreover, Fairfield argued that the determination would only be definitive if a certificate was issued in accordance with Article 11(1)(c). The Privy Council considered this to be "an impossible construction." It noted that if this was correct then an essential term of both subscription and redemption (namely the price) would not be "definitively ascertained for an indefinite period." This would mean not only that redeemed investors would be exposed to an "open-ended liability to repay part of the price received if it subsequently appeared that the assets were worth less" but also that "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."

Accordingly, the Privy Council determined that if the subscription and redemption prices were to be definitively determined then the NAV per share must be the one determined by the directors at the time. This must also mean that the directors determination must be considered to be

conclusive either (a) whether or not there was a certificate or (b) because the reference to "certificate" in Article 11 (1) (c) must be read as referring to the ordinary transaction documents which record the NAV per share. The Privy Council considered that the correct approach was the second one and the ordinary transaction documents should be considered to constitute certificates.

In reaching its conclusion the Privy Council noted that a "certificate" has no standard meaning and that the question what constitutes a certificate is dependent on the commercial or legal context in which the certification clause appears. It was noted that a certificate ordinarily means: (i) a statement in writing; (2) issued by an authoritative source; (3) communicated to a recipient or class of recipients and intended to be relied upon; (4) conveys information; and (5) in a form or context which shows that it is intended to be definitive. It was stressed, however, that there is no reason to think that any additional formal requirements should be required. Accordingly the Privy Council held that the monthly email sent to investors, the contract notes and the monthly account statements all constituted "certificates." These documents were issued by an authoritative source (Citco on behalf of the directors) and the context shows that they were clearly meant to be definitive.

Throughout the decision there is the ever present focus on commercial reality. Indeed, how could any investor have continued to invest in funds if they would always be subject to a risk (obviously depending on the particular wording of the Articles of Association) that the NAV may be able to be revisited and redemption proceeds might have to be repaid? Thankfully, the Privy Council's decision goes some way towards putting investors' minds at rest.

Ogier acted on behalf of a number of the redeemed investors which included attending the Privy Council hearing. If you have any questions about the case then please contact Partner Brian Lacy (see under "key contacts").

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