Clawback claims succeed against Weavering investors

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The Cayman Court provides further clarification as to when redemption payments can be recovered as a voidable preference.

Introduction

In December 2015, Mr Justice Clifford QC published his reasons for determining that certain redemption payments made by Weavering Macro Fixed Income Fund Limited (**Weavering**) to Skandinaviska Enskilda Banken AB (Publ) (**'SEB'**) were invalid (*In the Matter of Weavering Macro Fixed Income Fund Limited (in Liquidation)* (unreported) FSD 98/2014 – 4 December 2015). It is the first time that a Cayman Islands court has ordered the repayment of redemption proceeds pursuant to the voidable preference provisions of the Companies Law.

The case follows the recent decision of the Chief Justice in *RMF Market Neutral Strategies (Master) Limited* v *DD Growth Premium 2X Fund* [2013] 2 CILR 361, and provides further guidance for investors in Cayman funds as to when payments are potentially vulnerable to clawback.

Mr Justice Clifford QC confirmed that a payment would be regarded as invalid when it was made with the intention of preferring one creditor (or a sub-set of creditors) over other creditors. It was further affirmed that the intention to prefer must be the principal or dominant intention; however, this intention did not require there to be any element of dishonesty on the part of the director.

Facts

Weavering was put into liquidation on 19 March 2009 after it was discovered that the NAV was being calculated on the basis of worthless interest rate swaps entered into with an affiliate as counterparty. The 'controlling mind' of Weavering, Magnus Peterson, was subsequently convicted of fraud in the UK and sentenced to 13 years imprisonment.

The Joint Official Liquidators (**JOLs**) commenced proceedings in order to recover approximately $8 million paid to SEB pursuant to three redemption requests in October 2008. The requests were submitted at the same time as other shareholders. However, even though other redeeming shareholders were putting pressure on Magnus Peterson and companies affiliated to Weavering, SEB's payments were made in full whilst a large number of shareholder requests went unsatisfied.

The Joint Official Liquidators sought to recover the payments made to SEB on the basis that, (i) payments were made in the knowledge that the Company was unable to pay its debts, which was in and of itself sufficient to infer objectively the necessary intention of preference, and (ii) there was a specific intention to prefer SEB because Magnus Peterson thought that SEB would re-invest in another Swedish fund that he was establishing.

Court's Decision

Mr Justice Clifford QC found that the redemption payments to SEB were made in circumstances where Magnus Peterson knew that the Company was unable to pay its debts and that this was sufficient to establish an inference that there was the necessary intention of preference. It was also found, in the alternative, that Magnus Peterson specifically intended to prefer SEB because of his belief that SEB would invest in his new fund.

In response to an argument by SEB that the unpaid redeemers were not creditors at the time the redemption payments were made (SEB having argued that the other redeemers were only prospective creditors because the offering documents stated that payment of redemption would "generally be made within 30 calendar days") Mr Justice Clifford QC affirmed the principles in *Strategic Turnaround* [2010] 2 CILR 362 that although redemption was a continuing process, the debt crystallises on the redemption date and the time specified in the offering documents stating by when payment would generally be made is merely a matter of supplementary procedure.

SEB had also sought to argue that because the NAV was calculated on the basis of a fraud, the NAV calculation was not binding and there were, as a matter of fact, no creditors over which SEB could be preferred. The court rejected this argument, relying on the Privy Council's decision in *Fairfield Sentry* [2014] UKPC 611 and the fact that Weavering's articles of association provided that the valuation of the company's assets were binding on all persons.

Finally, SEB argued that as a matter of public policy the court should not be allowed to lend its aid to a litigant whose cause of action was founded on an illegal act (the fraud of Magnus

Peterson). In rejecting this argument, the Judge found that the fraudulent act in the present case was not the calculation of the NAV but the fraudulent valuation of the interest rate swaps by Magnus Peterson (upon which the NAV calculations were made). Accordingly, there was no reason to impute Magnus Peterson's fraud to the fund itself.

Interestingly the Court roundly rejected the attempt to put forward a 'change of position' defence. Mr Justice Clifford QC held that common law defences are not available in respect of statutory voidable preference claims. Where restitutionary and unjust enrichment type claims are brought, a change of position defence affords a recipient who has changed their position in reliance on the overpayment by, for example, paying the money on to a third party, with a complete defence to the claim. Such defences have acted as a deterrent to liquidators in the past– as any nominee or custodian receiving redemption proceeds will invariably be paying those funds almost immediately on to the holder of the beneficial interest. However Mr Justice Clifford QC has held that even if common law defences were available in respect of the statutory claims, a change of position defence would not be available to nominees and custodians. He held that the obligation to pay the proceeds over to their clients does not constitute a change of position but is, rather, merely the consequence of being a nominee.

Points of interest

One of the main issues between Weavering and SEB centred on what Weavering had to prove in order to establish that there had been an intention to prefer SEB. Weavering argued that a payment made to redeemers when the company was unable to pay its debts was sufficient to infer, objectively, the necessary intention; whereas SEB argued that Weavering also had to prove a subjective dominant intention to prefer.

Unlike *RMF Market Neutral Strategies (Master) Limited* in which the Chief Justice found that a redemption payment was made due to unrelenting pressure and not a dominant intention to prefer, there was no evidence that SEB had brought pressure to bear against Weavering or Magnus Peterson, nor was there any evidence to displace the inference that the preference of SEB was not the dominant intention of Magnus Peterson. In these circumstances the Judge did not feel it necessary to resolve whether or not there needed to be evidence of a subjective intention.

Whether this issue will raise its head in the future will very much depend on the circumstances of a particular case and whether a redeemed shareholder can point to an alternative reason for the company making the redemption payment to them.

It is also of note that the Cayman Islands courts have once again confirmed the principles in *Strategic Turnaround* and *Fairfield Sentry* which provides a welcome consistency of approach in relation to issues arising out of liquidations.

Conclusion

Before *RMF Market Neutral Strategies (Master) Limited* there was very little Cayman Islands case law on how the courts will interpret and apply section 145 of the Companies Law (2013 Revision). *In the Matter of Weavering Macro Fixed Income Fund Limited (in Liquidation)* provides additional and useful guidance on how the court will interpret section 145, especially in circumstances where the defendant cannot point to an alternative reason for making a redemption payment.

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