

**IN THE GRAND COURT OF THE CAYMAN ISLANDS  
FINANCIAL SERVICES DIVISION**

**CAUSE NO FSD 27 OF 2013 – AJJ**

**Before the Honourable Mr Justice Andrew J. Jones QC  
In Open Court, 1 February 2016**

**IN THE MATTER OF THE COMPANIES LAW (2013 REVISION)  
AND  
IN THE MATTER OF HERALD FUND SPC (IN OFFICIAL LIQUIDATION)**

**BETWEEN**

**MICHAEL PEARSON**

**(as Additional Liquidator of Herald Fund SPC (in Official Liquidation))**

**Plaintiff**

**and**

**PRIMEO FUND (IN OFFICIAL LIQUIDATION)**

**Defendant**

**Appearances:**

Francis Tregear QC instructed by Matthew Goucke and Chris Keefe of Walkers on behalf of the Additional Liquidator of Herald Fund SPC (In Official Liquidation)

Michael Crystal QC and Tom Smith QC instructed by Peter Hayden, Rocco Cecere and Christopher Levers of Mourant Ozannes on behalf of Primeo Fund (In Official Liquidation)

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**RULING**

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**Introduction**

1. This is an application by Michael Pearson in his capacity as the additional official liquidator of Herald Fund SPC (In Official Liquidation) (“Herald” and “the Additional Liquidator”) for a direction whether, for the purpose of settling the list of the contributories of Herald (and adjusting the rights of contributories amongst themselves), the Additional Liquidator should be authorised to adjust the number of USD Class shares in Herald issued to Primeo Fund (In Official Liquidation) (“Primeo”) on 2 May 2007 (“the Shares”) in respect of its *in specie* subscription in Herald pursuant to (a) section 112(1) of the Companies Law and Order 12, rule 1 of CWR by reason of fraud or default as contemplated by Order 12 rule 2 of the CWR and/or if Primeo provided insufficient consideration for the issue of the Shares and/or pursuant to (b) section 112(2) of the Companies Law and Order 12, rule 2 of the CWR by reason of fraud or default as contemplated by Order 12, rule 2 of the CWR.
2. Directions were given for this matter (which has been described as “the Primeo *in specie* Issue”) to be tried as an *inter partes* proceeding between the Additional Liquidator as plaintiff and Primeo as defendant. Directions were given for the exchange of pleadings. The issue is to be tried on the basis of an Agreed Statement of Facts (supplemented by a statement of facts which are not agreed) and an agreed bundle of relevant documents.
3. As pleaded in his Statement of Case, the Additional Liquidator put his case on the basis that Herald’s share register should be rectified because the share subscription agreement made between Primeo and Herald is void for mistake. This judgment deals with the mistake claim. The Additional Liquidator also sought to argue that there was a separate basis arising under section 112 of the Companies Law (2013 Revision) which would allow the Court to determine the Primeo *in specie* Issue (“the Primeo s.112 Issue”). Primeo objected to the Primeo s.112 Issue being determined at this hearing and I ultimately decided the Primeo s.112 Issue should be dealt with at a

further hearing in July 2016, which would also determine certain outstanding issues related to the "Rectification Issues" (as defined in the June 2015 Ruling).



### The Law of Mistake

4. The common law attaches importance to the sanctity of contracts and to the related principles that contracts should be enforceable with predictability and certainty. One aspect of this is that once a contract has been entered into by the parties then the circumstances in which the law will be prepared to treat that contract as void and ineffective by reason of a common mistake on the part of the parties are very limited. In the leading case of *Bell v Lever Bros* [1932] AC 161 Lord Atkin said (at page 224)

*... it is of paramount importance that contracts should be observed, and that if parties honestly comply with the essentials of the formation of contracts – i.e., agree in the same terms on the same subject-matter – they are bound, and must rely on the stipulations of the contract for protection from the effect of facts unknown to them.*

5. There are three categories of mistake which may be relevant to a contract, namely a mistake about the *identity* of the parties, a mistake about the *terms* of the contract and a mistake about the *subject-matter* of the contract. A mistake about the subject-matter of a contract is conceptually different from the first two categories of mistake. Whereas a mistake as to *identity* or *terms* will mean that the necessary consent for consummating the contract in the first place was absent, this is not so in the case of a mistake about the *subject-matter* of the contract. In this case a valid agreement will have been formed but one party claims that there was a mistake as to subject-matter which is sufficiently fundamental that it should nullify the agreement, which would otherwise be valid and enforceable in accordance with its terms. The difference in underlying theory about why the contract is void gives rise to a different general approach to mistakes about subject-matter, as compared with mistakes as to terms or identity. As explained by Professor Cartwright in *Misrepresentation, Mistake and Non-Disclosure* (3<sup>rd</sup> Edition) paragraph 15-03 –

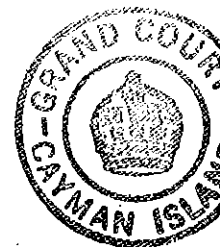
*Whilst the courts are cautious in admitting mistakes at all, given the overriding reluctance of English law to allow a party to rely on his own mistake in order to avoid his apparent obligations, the starting-point in a case where the parties were not in agreement about the terms, or where one party misunderstood who he was dealing with, is to say that the contract is void unless that failure of essential agreement between two intended parties can be overridden. Where, however, a party claims that the mistake, whilst not sufficient to*

*negative the agreement, should none the less be allowed to nullify it – and have the same legal consequences (the contract is void) – the starting point is the reverse. The reluctance to allow a mistake of itself to be sufficient to allow a party to escape from his apparent obligations is applied with full force, and the courts take a very restrictive view of actionable mistake.”*

6. The leading modern authority on the doctrine of mistake is the decision of the English Court of Appeal in *Great Peace Shipping Ltd v Tsavliris Salvage International Ltd* [2003] QB 679. Having reviewed the earlier authorities, in particular the well known speech of Lord Atkin in *Bell v Lever Bros* [1932] AC 161, the Court of Appeal identified five elements which are required to be present before a common mistake will avoid a contract. First, there must be a common assumption as to the existence of a state of affairs. Second, there must be no warranty by either party that that state of affairs exists. Third, the non-existence of the state of affairs must not be attributable to the fault of either party. Fourth, the non-existence of the state of affairs must render performance of the contract impossible. Fifth, the state of affairs may be the existence, or a vital attribute, of the consideration to be provided or circumstances which must subsist if performance of the contractual venture is to be possible.
7. The Court of Appeal also held that there is no equitable jurisdiction to grant rescission for common mistake, overruling the earlier decision in *Solle v Butcher* [1950] 1 KB 671.

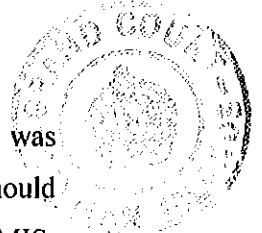
#### **The Factual Background and Common Assumptions of the Parties**

8. Before turning to the Additional Liquidator's arguments, I will summarise the relevant factual background based upon the Agreed Statement of Facts and the agreed bundle of relevant documents.
9. Both Primeo and Herald were established as open ended investment funds. Both companies placed substantially the whole of their funds, either directly or indirectly, for investment with Bernard L. Madoff Investment Securities Inc. (“BLMIS”) in New York. Prior to the share subscription which is the subject of this application, Primeo had placed funds directly with BLMIS via its custodian, HSBC Securities Services (Luxembourg) S.A. (“HSSL”). HSSL delegated its custodial functions to BLMIS pursuant to a sub-custody agreement. BLMIS therefore acted as Primeo's broker,



investment manager and sub-custodian. BLMIS opened and maintained an account in the name of HSSL for Primeo designated as *BLMIS Account No. 1FN092 – HSBC Securities Services (Luxembourg) SA Special Custody Account for Primeo Fund Class B* (“Primeo’s BLMIS Account”). Primeo’s BLMIS Account recorded shares, options, US Treasury bills and cash purportedly acquired or held by BLMIS.

10. The relationship between Primeo and BLMIS was governed by three contracts made on or about 1 March 1996, namely a customer agreement, an option agreement and a trading authorization limited to purchases and sales of securities (collectively, “the BLMIS Contracts”).
11. BLMIS also performed exactly the same functions for Herald. At all material times BLMIS acted as sub-custodian, broker and investment manager in respect of funds that Herald placed with BLMIS, also via the same custodian, namely HSSL. From its inception in March 2004, Herald placed substantially all of its funds directly with BLMIS which recorded the investments in an account maintained with HSSL designated as *BLMIS Account No. 1FR109 – HSBC Securities Services (Luxembourg) SA Special Custody Account for Herald Fund SPC – Herald USA* (“Herald’s BLMIS Account”).
12. HSSL not only acted as custodian for both Primeo and Herald, it also acted as administrator for both companies in which capacity it was responsible for the determination of their respective NAV per share as at each month end. Since Herald placed substantially the whole of its funds for investment directly with BLMIS and Primeo also placed substantially the whole of its funds for investment with BLMIS, both directly and indirectly via a shareholding in Herald, the determination of their respective NAVs involved HSSL doing essentially the same work for both companies. It also follows that the investment performance of both Primeo and Herald was wholly dependent upon the performance of BLMIS which is why they have both been referred to colloquially as “Madoff feeder funds”.
13. The only distinction between the investments made by the two companies is that, in addition to placing funds directly with BLMIS, Primeo also had an investment in Herald. Primeo first subscribed for shares in Herald in August 2004. In May 2007 Primeo changed its investment advisor from BA Worldwide Fund Management



(“BAWFM”) to Pioneer Alternative Asset Management Limited (“Pioneer”). It was this change of investment adviser which led to the decision that Primeo should become 100% invested in Herald and cease to place any funds directly with BLMIS. Whilst this decision necessitated an amendment of its offering memorandum (which contained a restriction against investing more than 30% of Primeo’s assets in any one issuer), in substance Primeo’s investment strategy remained the same because Herald would continue to place substantially the whole of its funds with BLMIS. The result is that Primeo’s investment performance would continue to be 100% exposed to BLMIS’ performance. This point was made in an exchange of e-mails on 27 March 2007 between David Allen (Pioneer) and Catherine Huet (HSSL). He said –

*Re: Primeo our advice on the restriction is this:*

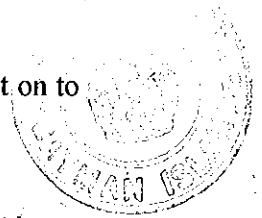
1. *There is no material change to the substance of the investment. The investors were 100% invested in Madoff [meaning BLMIS] and they remain 100% invested in Madoff through investment in Herald.*
2. *The Herald fund contains a similar restriction which can be relied upon by Primeo fund as the performance of this restriction is intended at the trading (ie managed account) level.*
3. *When we re-draft the prospectus [meaning the Offering Memorandum] on May 1 we will amend this restriction to eliminate any confusion.*

14. The rationale for the change, from Pioneer’s perspective, is explained in an e-mail sent the following day by Alberto La Rocca (another Pioneer executive) to Johan Strobl (an executive of Pioneer’s parent company). He says that the change from a managed account with BLMIS to a shareholding in Herald is a “far superior arrangement for the investors” in Primeo for the following reasons –

1. *It allows Primeo investors [to] share in a larger pool of assets invested with Madoff. Herald is a \$750m fund now. That should lead to greater efficiency in trading and lower transaction costs to all.*
2. *A clear barrier of limited liability at the Herald level is inserted between investors in [Primeo] and the Madoff managed account.*
3. *Herald is in a unique position to perform more comprehensive, insightful and complete ongoing review and due diligence on Madoff, given the long and special relationship between Sonja Kohn and Bernie Madoff.*

When read in the context of the entire e-mail, it seems probable to me that Pioneer was focused on the third of these points. Pioneer wanted the investment to be restructured on BAWFM’s advice with effect from 1 April 2007, one month *prior* to

the effective date of its appointment as investment adviser. Mr La Rocca went on to say –



*From [Pioneer's] perspective an investment in Herald more appropriately fits with our structure as a manager of fund of hedge funds. The proposed April 1 switch will fit more appropriately with our corporate governance model. Upon our appointment as investment adviser to [Primeo] on May 1 we intend to ratify the switch decision accordingly.*

In this way, by terminating the managed account and treating Primeo as a fund of funds, Pioneer was attempting to distance itself from any responsibility for on-going review and due diligence in respect of BLMIS. In the event, Pioneer's appointment appears to have taken effect prior to May 1, 2007 but this e-mail nevertheless explains the motivation for the transaction. From Pioneer's perspective, it was a risk management decision which could be justified from the investors' perspective on grounds of greater efficiency in trading, lower transaction costs and a potential dilution of counter-party risk.

15. The decision to "switch" Primeo's investment from a managed account with BLMIS to an equity investment in Herald could have been carried out in either of two alternative ways. Primeo could have given notice to terminate the BLMIS Contracts and called for the total net balance as at 30 April 2007 (US\$463,353,186.26) to be paid out in cash. Substantially the same amount could then have been used to subscribe for shares in Herald at its 30 April NAV for a value date of 1 May 2007. Alternatively, but only with the consent and co-operation of BLMIS, the transaction could be done on the books of BLMIS by transferring Primeo's account balance to Herald in consideration for the issue of shares by Herald to Primeo as at the 30 April NAV for a 1 May 2007 value date. Neither party has adduced any direct evidence from any of the individuals involved in the transaction to explain why it was structured as an *in specie* subscription. However, with the benefit of hindsight and knowing as we now do that BLMIS was a *Ponzi* scheme, it is easy to understand why Madoff would have encouraged an *in specie* subscription rather than a cash transaction.

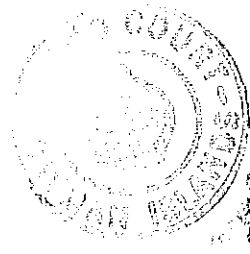
16. The Additional Liquidator pleaded his case on the basis of an assertion that, immediately prior to the *in specie* subscription, Primeo was the legal and/or beneficial



owner of the actual securities reflected in its BLMIS Statement of Account for 30 April 2007, or at least that the parties assumed that this was the case, and that the consideration for the *in specie* subscription was to be the transfer of such legal and/or beneficial title to the relevant securities from Primeo to Herald. The argument is summarized in paragraph 74(a) of his thirteenth affidavit as follows -

*The fundamental basis upon which the Primeo in specie Subscriptions were made and accepted by or on behalf of Herald was that Primeo legally and/or beneficially owned and Herald would receive legal and/or beneficial ownership of the actual shares, options, US treasury bills, cash, and any other type of securities reflected in the BLMIS account statement as being held on behalf of Primeo (Account No. 1-FN092-3-0).*

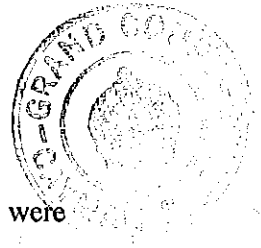
17. In my view, the Additional Liquidator's analysis of the transaction is plainly wrong. Furthermore, on the basis of the documents put in evidence and in the absence of any testimony either from the professional service providers or the individual directors of Herald and Primeo, it is not reasonable to infer that they actually characterised the transaction as a transfer of the legal and/or beneficial title to specific securities, in other words as a purchase and sale agreement.
18. It is an agreed fact that BLMIS was a *Ponzi* scheme. It is agreed that it never in fact bought and sold any securities at all. It is an agreed fact that the statements of account, trade slips and other documents generated by BMLIS which reflect securities trading on behalf of its clients, including Primeo and Herald, were all bogus. It is also an agreed fact that Primeo and Herald and their respective directors and service providers, in particular HSSL, did not know that BLMIS was a *Ponzi* scheme until December 2008 when Madoff confessed to his crimes. They assumed that it was carrying on a legitimate business as a broker dealer and investment manager. As industry professionals, they must have assumed that BLMIS was the beneficial owner of a pool of securities and that it could and would deliver equivalent securities or their cash value to its clients in accordance with its contractual obligations – in the case of Primeo, in accordance with its obligations under the BLMIS Contracts.
19. Primeo and Herald (acting by their respective service providers and directors) must have known (or would have assumed) that BLMIS had an account with the Depository Trust Company ("DTC") which is the world's largest securities depository and serves as a clearing house in the United States for the settlement of securities trades and performs custodian services for its participating banks and broker dealers.



It is agreed that BLMIS did in fact maintain an account (numbered 0646) with DTC. I infer from the agreed facts and documents that Primeo and Herald must have assumed that BLMIS carried out bulk trades which were settled through DTC. They must have assumed that the DTC held a pool of securities for the account of BLMIS which in turn allocated securities, on its own books, to the managed accounts of its various clients, including Primeo. If they had applied their minds to the legalities rather than the economics of the *in specie* subscription, they would have assumed that legal title to the pool of securities was vested in DTC (or its nominee company). Having regard to the fact that those acting for Primeo and Herald are themselves industry professionals, it is impossible to infer they assumed that Primeo held legal title to the securities reflected in its BLMIS statements of account. Similarly, cash held by BLMIS for its clients, including money placed with BLMIS for investment by Primeo, was held in a series of linked bank accounts maintained with JP Morgan Chase in New York. BLMIS did not maintain a separate nominated bank account for each individual client.

20. Any rights of Primeo to the securities held by the DTC would be governed by New York law as the *situs* of those securities. (See *Macmillan v Bishopsgate Investment Management* [1996] 1 WLR 387 and Dicey, Morris and Collins, *The Conflict of Laws*, 14<sup>th</sup> ed., 22-042 to 22-043). Similarly, any rights of Primeo to the chose in action represented by the cash held in the JP Morgan Chase accounts would be governed by New York law. (See *Macmillan* at pp.400-401). The same analysis applies to any rights of Primeo in respect of option contracts made on its behalf pursuant to its option agreement with BLMIS. The Additional Liquidator has not sought to adduce any evidence of New York law to the effect that Primeo is to be treated as the legal and/or beneficial owner of specific securities. In the absence of such evidence, I am entitled to assume that the application of New York law leads to the same result as if the *situs* of the property in question was the Cayman Islands and the BLMIS Contracts were governed by Cayman Islands law. Primeo's rights comprised a right as against BLMIS to receive equivalent securities (or their market value) and an equivalent amount of cash to that recorded in its statement of account which reflects a net balance.

**The mechanics of the in specie subscription**



21. Both legally and commercially, the mechanics of the *in specie* subscription were simplified by the fact that substantially all of Herald's funds were placed for investment with BLMIS and that Herald and Primeo shared the same administrator which was responsible for determining the NAV of both companies as at 30 April 2007.

22. Article 16(3)(f) of Herald's articles of association provides that –

*The Company may, but shall not be obliged to, accept payment for Participating Non-Voting Shares other than in cash by way of transfer to it of assets and securities (collectively "Acceptable Securities") upon such terms and conditions as the Directors in their discretion may from time to time determine.*

23. Herald's Offering Memorandum elaborates on this power in the following way (at page 12) –

*The Company, in the Director's sole discretion, may, in certain circumstances, accept subscriptions for Shares in specie. The value of such subscriptions in specie will be the fair market value of such securities as determined by the Investment Manager on the effective date of the subscription. In addition, such in specie investments may be accepted by the Directors in their absolute discretion provided that (i) for such purpose such investments shall be valued on the same basis as if they comprised investments in the Company; and (ii) the acquisition of such investments by the Company is consistent with the policy and objectives of the Company as set out in this Offering Memorandum and must not cause any investment limitation contained in the offering document to be breached.*

Having regard to the fact that Herald was already 100% invested with BMLIS and that HSSL was doing the valuations for both Primeo and Herald, compliance with the requirements of this provision could not have been more straightforward.

23. On 27 March 2007 Herald's directors signed a unanimous written resolution as follows –

*that the company will accept the transfer of shares, options, US treasury bills, cash, and any other type of securities as the case may be, from the [Primeo] account at [BLMIS] into the account of [Herald] at BLMIS.*

Whether they expected the subscription to be done at the 31 March NAV or the 30 April NAV is unclear because the resolution does not specify a value date. Either



way, the directors of Herald would not have known when signing this resolution precisely what securities would be held to the credit of Primeo's BLMIS Account on the date in question. They did not need to review the list of securities reflected in Primeo's statement of account, because the composition did not matter to them. What mattered for the purpose of meeting the criteria specified in Herald's Offering Memorandum was that the assets in question were being managed by the same investment manager in accordance with the same investment strategy as its own assets<sup>1</sup> and that they were being valued by the same administrator using the same valuation methodology. In my view it would be artificial to infer from the language of this resolution, an assumption on the part of Herald's directors that they would acquire a legal or beneficial interest in any specific securities. Commercially, all that mattered was the valuation, which was bound to be uncontroversial because it was being done by HSSL in exactly the same way as it was valuing Herald's own assets.

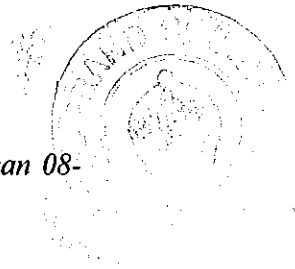
24. In the circumstances of this transaction the "Acceptable Securities" within the meaning of article 16(3)(f) of Herald's articles of association were the contractual rights of Primeo against BLMIS. These rights were transferred to Herald by means of debits and credits made on their respective BLMIS accounts.

25. On 25 April 2007 Primeo's board of directors resolved to approve the transfer of the investment advisory function from BAWFM to Pioneer. It also resolved "*to note the decision of [Pioneer] to switch all current and future investments of [Primeo] from a managed account with [BLMIS] to an investment in Herald.*"

26. On the same day, Pioneer sent two instructions on behalf of Primeo to HSSL (as Primeo's custodian and administrator). First, it instructed HSSL to *Transfer total assets held at B.L. Madoff managed account (Account No. 1-FN092-3-0) to Herald Fund managed account at B.L. Madoff managed account (Account No. 1-FR109-3-0)*. Second, it instructed HSSL to *subscribe for shares in Herald on behalf of Primeo Equivalent to the value of the assets transferred by Primeo Select Fund from its managed account held at B.L. Madoff to Herald Funds managed account held at*


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<sup>1</sup> The securities reflected in Primeo's and Herald's statements of account as at 30 April 2007 are not the same, but it is apparent on the face of the documents that the investment criteria supposedly employed by BLMIS on their behalf must have been substantially the same.



*B.L. Madoff for trade date 01 May 2007 (Amount to be advised no later than 08-MAY-07).*

27. On 27 April 2007 HSSL duly sent an instruction to BLMIS to transfer HSSL's *total holding* in Primeo's BLMIS Account to the Herald's BLMIS Account.
28. On 1 May 2007, a debit in the amount of US\$465,824,061 was entered against Primeo's BLMIS Account with the description "*TRANS TO IFR10930 (IFR1-09)*" and a corresponding credit was entered on Herald's BLMIS Account with the description *TRANS FROM FN09230 (IFN092)*.
29. The holding in Primeo's BLMIS Account was valued by Herald at US\$463,353,186.26 and, on the basis of Herald's NAV as at 30 April 2007, this equated to 371,604.1272 USD class shares in Herald. HSSL was acting as administrator for both parties but, for the purposes of this transaction, HSSL must be taken to have valued the holding in Primeo's BLMIS Account on behalf of Herald in accordance with the requirements of article 16(3)(f) and Herald's Offering Memorandum. This valuation was less than the amount transferred on the books of BLMIS because it did not take into account an additional sum of US\$2m placed with BLMIS by Primeo close to the month end.
30. On 9 May 2007 HSSL (as agent of Primeo) sent an instruction to HSSL (as administrator of Herald) entitled *Intent to Subscribe* requesting it to make an investment of US\$463,353,186.26 in Herald for a dealing date of 2 May 2007.
31. On 10 May 2007, HSSL (as administrator of Herald) sent a confirmation to HSSL (as agent of Primeo) confirming that 371,604.1272 USD class shares in Herald had been issued for a trade date of 2 May 2007 at a subscription price of US\$1,246.90 per share for a "*Value/Cash Date*" of 10 May 2007 and that total consideration in the amount of US\$463,353,186.26 had been received. Since the amount actually credited to Herald's BLMIS Account was more than US\$463,353,186.26, HSSL (as administrator of Herald) subsequently allotted additional shares to Primeo for a dealing date of 2 May 2007 at the prevailing NAV.

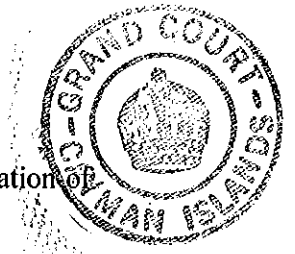


32. The transaction was done on the books of BLMIS which did not purport to be the legal owner of the underlying securities. The DTC supposedly held legal title to a pool of securities for the benefit of BLMIS which in turn allocated those securities to its client by means of book entries on its own client accounts. No attempt was made to transfer legal or beneficial ownership of the underlying securities or cash to Herald. This is consistent with the fact that the consideration for the subscription was the transfer of Primeo's rights against BLMIS, not ownership rights in any underlying securities or cash.

#### **The Additional Liquidator's case**

33. The Additional Liquidator's argument is based upon a mischaracterisation of the consideration for the *in specie* subscription. He characterises the consideration as the transfer by Primeo to Herald of the legal and/or beneficial ownership to the actual shares, options, Treasury bills and cash purportedly held by BLMIS. He then says that, because these securities did not exist, there was a common mistake as to the existence of the subject-matter of the subscription agreement which renders that agreement void.

34. In my view, a proper analysis of the mechanics of this transaction (which must have been understood perfectly well by all concerned) leads to the conclusion that the consideration for the issue of shares in Herald was the assignment of Primeo's contractual rights as against BLMIS which principally consisted of the right to delivery of equivalent securities and payment of equivalent cash as recorded in Primeo's BLMIS Account. The correct construction of the documents by which the transaction was carried out shows that Primeo was transferring to Herald its "holding" in Primeo's BLMIS Account as at the specified valuation date. The "holding" is a net balance on the account comprising not only the market value of the securities and cash reflected in the statement of account as at 30 April 2007, but also debits and credits subsequently made to the account for value on that date (which in this case consisted of tax and dividends). In the event, the subsequent adjustments resulted in a credit balance in favour of Primeo being transferred to Herald, which in turn led to an additional issue of shares to Primeo. Had those adjustments resulted in the transfer of

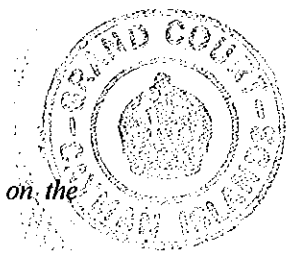


a credit balance in favour of BLMIS, the result would have been the cancellation of shares rather than the issue of additional shares by Herald.

35. The fact that BLMIS was operated as a *Ponzi* scheme rather than as a legitimate business did not make it impossible for Primeo to transfer its contractual rights against BLMIS to Herald. Primeo's rights against BLMIS did exist and the contract was performed. Those rights were transferred and the validity of the transfer was recognised by BLMIS's Trustee. It subsequently turned out that the value of the rights transferred to Herald was substantially less than the amount of HSSL's valuation. For the purposes of calculating Herald's net equity claim in the liquidation of BLMIS, the Trustee attributed a value of US\$149,753,024 to the claim which Primeo would have been entitled to assert against BLMIS had it not transferred its rights to Herald. This amount is included in Herald's customer claim which has been admitted to proof pursuant to the terms of a Settlement Agreement made on 12 November 2014 by and between the Trustee of the BLMIS estate, Primeo and Herald. I agree with counsel for Primeo that the whole premise which underlies the Additional Liquidator's case, namely that Primeo agreed to transfer legal and/or beneficial ownership of specific securities which did not exist, is wrong. Having concluded that the correct characterisation of the consideration for the *in specie* subscription was the transfer of Primeo's rights against BLMIS, there is no basis for the subscription agreement being void for common mistake because such rights did exist and were transferred.

36. It seems to me that Primeo and Herald (acting by HSSL and their respective directors) must have understood that the consideration for the issue of shares was the transfer of Primeo's contractual rights as against BLMIS. There was no mistake about their existence. The relevant matter about which they were mistaken was the *value* of those rights. I agree with counsel for Primeo that where a contract, expressly or impliedly, allocates the risk of the relevant matter to one or other of the parties, there is no room for the doctrine of mistake to operate. As the Court of Appeal stated in *The Great Peace* (at [75]) -

*Just as the doctrine of frustration only applies if the contract contains no provision that covers the situation, the same should be true of common mistake. If, on true construction of the contract, a party warrants that the subject matter of the contract exists, or that it will be*



*possible to perform the contract, there will be no scope to hold the contract void on the ground of common mistake.*

37. The question of whether a contract provides for who bears the risk of the relevant mistake is logically a prior question to the application of the doctrine of mistake. As Steyn J. said in *Associated Japanese Bank (International) Ltd v Crédit du Nord SA* [1989] 1 WLR 255, 268 –

*Logically, before one can turn to the rules as to mistake, whether at common law or in equity, one must first determine whether the contract itself, by express or implied condition precedent or otherwise, provides who bears the risk of the relevant mistake. It is at this hurdle that many pleas of mistake will either fail or prove to have been unnecessary. Only if the contract is silent on the point, is there scope for invoking mistake.*

38. In circumstances where Herald did not seek or obtain any warranty from Primeo, it necessarily took the risk that the value of the rights transferred by Primeo might be less than anticipated. Herald must have considered the counter-party risk associated with BLMIS to have been acceptable otherwise it would not have placed its own assets for investment by BLMIS. This explains why no warranty was sought. In the absence of any warranty, the general law is caveat emptor. See *William Sindall plc v Cambridgeshire County Council* [1994] 1 WLR 1016 in which Hoffmann LJ said (at page 1035) -

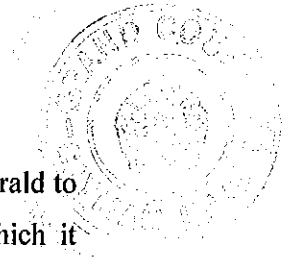
*When the judge speaks of the contract allocating risk 'by express or implied condition precedent or other' I think this includes rules of general law applicable to the contract and which, for example, provide that, in the absence of express warranty, the law is caveat emptor.*

39. The principle of *caveat emptor* is not limited to contracts for the sale of goods. In *Macquarie International Investments Ltd v. Glencore UK Ltd* [2009] EWHC 2267 Andrew Smith J. observed (at paragraph 237) that –

*When interpreting and giving effect to an agreement such as the [share purchase agreement] the court proceeds on the basis that the parties intended to distribute risks [relating to the financial condition of the company] according to the terms of the contract, and, unless the parties agree otherwise, the principle of "caveat emptor applies".*

In the absence of any express or implied warranty given by Primeo, it must necessarily follow that Herald assumed the risk that the value of the rights it received from Primeo might turn out, for whatever reason, to be less than the amount of the

valuation done on its behalf by HSSL. It follows that there is no scope for Herald to rely upon the doctrine of mistake in relation to the value of the rights which it acquired.



### Conclusion

40. Having concluded that the correct characterization of the consideration for the *in specie* subscription was the transfer of Primeo's rights against BLMIS, there is no basis for the subscription agreement being void for common mistake because such rights did exist and were transferred. The fact that the parties' assumption about the value of the rights turned out to have been mistaken does not alter the subject matter of the contract in a way which makes performance impossible. Further, the risk that the value of Primeo's rights against BLMIS might turn out to be less than the parties assumed was allocated under the contract to Herald.

41. For these reasons I conclude that the subscription agreement is not void for mistake with the result that the Additional Liquidator is not entitled to rectify Herald's register of members accordingly. The related issue of whether or not there is some other basis upon which the Additional Liquidator may rectify the register of members in connection with the Primeo *in specie* Issue i.e. the Primeo s.112 Issue (as defined and described at paragraph 3 above) will be determined at a further hearing in July 2016.

DATED this 18<sup>th</sup> day of February 2016

A handwritten signature in black ink, appearing to read 'A. Jones', is written over a horizontal line.

The Honourable Mr Justice Andrew J. Jones  
Judge of the Grand Court