Hilary Term
[2020] UKPC 3
Privy Council Appeal No 0064 of 2018

JUDGMENT

Pearson (in his capacity as Additional Liquidator of Herald Fund SPC (in Official Liquidation)) (Appellant) *v* Primeo Fund (in Official Liquidation) (Respondent) (Cayman Islands)

From the Court of Appeal of the Cayman Islands

before

Lord Kerr
Lord Carnwath
Lady Black
Lord Briggs
Lady Arden

JUDGMENT GIVEN ON

27 January 2020

Heard on 29 October 2019

Appellant
Francis Tregear QC
Matthew Goucke
Chris Keefe
Maximilian Schlote
(Instructed by Walkers and Stephenson Harwood LLP)

Respondent
Tom Smith QC
Adam Al-Attar
Peter Hayden
Christopher Levers
(Instructed by Mourant Ozannes and Enyo Law LLP)

LORD BRIGGS:

The Issue

1. This appeal raises a short but important issue as to the interpretation and application to particular facts of section 112(2) of the Companies Law of the Cayman Islands ("Cayman Companies Law") (2018 Revision). It was newly inserted so as to come into force on 1 March 2009 and reads as follows:

> "(2) In the case of a solvent liquidation of a company which has issued redeemable shares at prices based upon its net asset value from time to time, the liquidator shall have power to settle and, if necessary rectify the company's register of members, thereby adjusting the rights of members amongst themselves."

2. The issue, which has divided the courts below, may be summarised as follows:

> "Is the liquidator's power to rectify the company's register of members confined to an alteration which brings the register into line with the members' underlying legal rights as at the commencement of the liquidation? Or is it wide enough to enable the liquidator to amend the register of members in a way which alters the members' legal rights, as at the commencement of the liquidation, so as to do what the liquidator conceives to be substantial justice as between the members, in a case in which, in the liquidator's view, justice would not be achieved by a distribution of the surplus assets of the company in accordance with their legal rights, as stated in the register?"

3. The judge, Jones J, decided that section 112(2) did give the liquidator power to rectify the register so as to alter the members' legal rights. The Court of Appeal (Goldring P, Martin and Newman JJA) concluded that it did not.

4. It will be immediately apparent from the text of section 112(2) that the extent of the new power of rectification which it contains is confined within narrow boundaries, namely the solvent liquidation of a company "which has issued redeemable shares at prices based upon its net asset value from time to time". This formula describes a characteristic feature of a Cayman Islands open-ended investment company, in which

investments are made by subscribing for the issue of redeemable shares, and then realised by the redemption of those shares, in each case at prices determined by reference to the net asset value ("NAV") of the company (or of a segregated fund within the company) from time to time, as declared by the company pursuant to its articles of association. Open-ended investment companies are common in the Cayman Islands, as a familiar and economically important vehicle for the establishment and conduct of mutual investment funds, since the subscription monies received by the company from its investors are pooled and used for the acquisition of one or more investment portfolios.

5. The solvent liquidation of an open-ended investment company may be regarded as less unusual than in relation to the liquidation of companies generally. This is because its incoming funds take the form of subscription for shares rather than forms of debt, secured or otherwise. Its external creditors may typically be modest in amount, save (perhaps) where the company goes into liquidation owing, but not yet having paid, redemption monies to investors who have recently redeemed their shares. In such a solvent liquidation, once all creditors have been paid, and liquidation expenses provided for, the usual task of the liquidator is to distribute the surplus rateably among the members of the company in accordance with the amount of their shareholdings, as recorded in the company's register of members, and applicable as at the date of the commencement of the liquidation. The register of members is therefore the governing document in determining how the net surplus realised by the conduct of the solvent liquidation of an open-ended investment company is to be distributed.

The Facts

6. Before examining section 112(2) in its legislative context it is convenient briefly to describe the facts which made it necessary for its meaning and effect to be determined. Herald Fund SPC ("Herald") is an open-ended investment company being wound up by order of the Grand Court made on 16 July 2013 on the petition of its principal investor, the respondent Primeo Fund ("Primeo"), by then also in liquidation. Herald is in solvent liquidation.

7. Herald was founded in March 2004 as an exempted segregated portfolio company and registered as a regulated mutual fund, to act as a feeder fund for investment in Bernard L Madoff Investment Securities LLC ("BLMIS"), the investment vehicle of the now notorious Bernard Madoff. BLMIS was from the outset operated as a fraudulent Ponzi scheme. While soliciting investments on the basis that he was operating an actively managed portfolio, Mr Madoff never made any such investments of BLMIS's funds at all. Rather, he accumulated them and used them from time to time to pay off departing investors, while at the same time publishing entirely fictitious reports of an apparently endlessly profitable portfolio. Mr Madoff is now serving a very long prison term in the USA.

8. As Lord Sumption put it in *Fairfield Sentry Ltd v Migani* [2014] UKPC 9; [2014] 1 CLC 611, para 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."

9. Both Herald and its investors were victims of Mr Madoff's Ponzi scheme, since Herald invested all its funds in BLMIS, and was still a substantial investor when BLMIS collapsed, and the fraudulent scheme was revealed, in December 2008. But it is common ground that Herald was in no sense a participant in the fraudulent scheme. It issued and later redeemed its investors' shares pursuant to NAVs calculated and declared in accordance with its articles, based in all innocence upon the fraudulent portfolio valuations published by BLMIS. It is common ground that, pursuant to its articles, the NAVs which it issued, and the results of which are reflected in its register of members, were binding as a matter of contract between Herald and its investing shareholders, both for the purposes of subscription and redemption of shares.

10. Primeo was, by 2007, a substantial investor in BLMIS, both directly and through Herald. As a result of a reorganisation of its portfolio in May 2007, Primeo re-routed its then direct investment in BLMIS through Herald. This was achieved by an assignment by Primeo to Herald of Primeo's investment in BLMIS, and its acceptance by Herald as a subscription in specie for redeemable shares in Herald, at a valuation (based upon BLMIS's fraudulent portfolio valuation) determined by Herald of US$465m odd. Primeo was allotted redeemable shares in Herald in accordance with Herald's then prevailing NAV of US$1,246.90 per USD class share.

11. It is now common ground, after an unsuccessful challenge rejected at first instance and not appealed, that the valuation of Primeo's in specie subscription in May 2007 is binding as between Primeo and Herald, as is the NAV which determined the number of redeemable shares in Herald which Primeo thereby received, for reasons already given.

12. BLMIS crashed in December 2008, shortly after the Lehman failure, because accumulated monies coming in from new investors were no longer sufficient to pay those realising their investments. It had, in short, run out of cash. But recoveries subsequently made by its liquidators mean that Herald stands to receive a substantial sum on account of its investment in BLMIS, albeit of course very much less than the amount reflected in BLMIS's fraudulent portfolio valuations. The liquidators of BLMIS admitted a net equity claim of Herald in the sum of US$1,639,869,943. To date Herald

has received distributions from the BLMIS liquidation in excess of US$580m. That is why Herald's liquidation is proceeding on a solvent basis.

13. Herald suspended the publication of NAVs and the issue and redemption of shares in December 2008, upon the discovery of the Madoff fraud. By December 2008 some of its investors had redeemed their investments in full, obtaining both a return of capital invested and supposed profits represented by the rising level of Herald's published NAVs between 2004 and 2008. Those investors, who may be supposed to be the main beneficiaries of the Ponzi scheme, are no longer recorded as members of Herald in its register of members.

14. Some investors in Herald had redeemed their investments in part, but remained members of Herald in respect of the balance. Those included Primeo, which was the biggest single investor in Herald. There remain other investors in Herald who (or which) have not redeemed any part of their investments, and who may therefore be regarded (within the Herald family of investors) as the principal victims of the BLMIS Ponzi scheme. Furthermore, within that class, those who invested late may be regarded as having suffered more grievously than those who invested early, due to the rising level of Herald's published NAVs, and therefore the smaller number of shares per cash invested which they received.

15. On 23 July 2013 the Grand Court appointed Mr Pearson as an additional liquidator of Herald, charged with the following functions:

> "settling the list of contributories pursuant to section 112(1) of the Companies Law and determining related issues, including whether [Herald]'s register of members should be restated pursuant to section 112(2) of the Companies Law and whether [Primeo's] shareholding in [Herald] should be adjusted on the ground that the consideration for the issue of its shares was the transfer to [Herald] of the portfolio of securities and/or cash held by Primeo in its account with BLMIS, the amount or value of which had been fraudulently overstated."

16. Pursuant to those instructions from the Court, Mr Pearson made proposals for a distribution of the net surplus in Herald's liquidation to its members designed to achieve what he regarded as a more just outcome from the adverse consequences of Mr Madoff's fraud than would be achieved by distributing in accordance with the shareholdings recorded in Herald's register of members. Article 155 of Herald's articles of association provides that, in a solvent liquidation, the surplus is first to be applied in paying to each holder of participating non-voting shares the nominal amount of their shares, and then in distributing the balance between them pari passu in proportion to the

number of such shares held by each member. He submits that a distribution on the basis of the register of members as it stands would be "to perpetuate or give effect to the Madoff fraud. Some of Herald's members would benefit from the fraud at the expense of all the other members". Although not his original preference, he proposes to the Board a method of distribution among Herald's members, called the "net investment method", which he submits is the same method as is being applied in the bankruptcy of BLMIS for the purposes of distribution among its members. In outline, the net investment method involves the following steps:

a) The identification of each member's net investment in Herald, ie the total amounts paid by them in any subscription less the total amounts received by them in any redemption.

b) The calculation of each member's net investment as a percentage of the total net amount invested in Herald by all of its members.

c) The restatement of the register of members in accordance with these percentages.

That would, he submits, produce a fair and equal division of the available surplus among Herald's investors, in which proper account would be taken of redemption monies already paid to investors, and distortions attributable to the different dates upon which members invested would be removed. It would treat each remaining member fairly and equally, vis-a-vis every other remaining member, by reference to the amount of each member's net investment. It is acknowledged that a scheme of this kind would give rise to a radical revision of the register of members which would not accord with their existing contractual rights as against Herald at the date of the commencement of Herald's liquidation.

17. Mr Pearson proposes to revisit the valuation of Primeo's in specie subscription in May 2007, upon the footing that the valuation then made was based upon a fraudulent overstatement by BLMIS of the value of its portfolio, and therefore of the value of Primeo's direct investment. The proposal is that the value of Primeo's in specie subscription should be reduced to the then net investment of Primeo in BLMIS, ie from US$465m odd to US$149m odd, with Primeo's net investment in Herald adjusted accordingly. It is, again, acknowledged that this would be contrary to Primeo's contractual right, as at the commencement of Herald's liquidation, to insist on the US$465m valuation.

18. In both respects where Mr Pearson's proposed scheme would contravene the contractual rights of members as against Herald, it is submitted that this is permitted by

section 112(2) by way of rectification "thereby adjusting the rights of members amongst themselves".

19. In the proceedings which followed the promulgation by Mr Pearson of his proposed scheme, Primeo was appointed as a representative of the class of investors whose interests would be served by adherence to their contractual rights. Mr Pearson was appointed to represent those who would, by contrast, obtain a more beneficial share of Herald's surplus under his proposed scheme.

20. The issue before the Board is not whether a redistribution of Herald's surplus in accordance with the net investment method would be fairer or more equitable as between Herald's members than a distribution in accordance with their contractual rights as at the commencement of the liquidation. The Board is prepared to assume that, disregarding for the moment the fact that the register of members reflects their contractual and proprietary rights, a net investment method of distribution would be regarded by most reasonable observers as offering a fairer, although still imperfect, method of allocating between members the consequences of having been caught up in a Ponzi scheme which was neither of their own, nor Herald's, making. The question for the Board is whether section 112(2) of the Cayman Companies Law permits any departure from members' contractual rights as at the commencement of the liquidation, as the basis for the distribution among them of the surplus. It is not suggested that any other provision of the Cayman Companies Law or the general law would permit such a departure, if section 112(2) is insufficient for the purpose.

Section 112(2) in its context

21. A reliable understanding of section 112(2) calls for it to be viewed in its context within the Cayman Companies Law as a whole. It is sometimes said that the historical analysis of the antecedents of a provision is unhelpful: see *Farrell v Alexander* [1977] AC 59, 73, per Lord Wilberforce. But in the case of complex legislation like the Cayman Companies Law which is frequently amended over time, recourse to the history is often a valuable guide to the intention of the legislative draftsman when using words, phrases and concepts that had, by the time of an amendment in question, acquired a settled meaning. A recent example where a historical analysis was decisive may be found in *Southwark London Borough Council v Transport for London* [2018] UKSC 63; [2018] 3 WLR 2059. As will appear the Board has found the historical context to be of considerable assistance in this case.

22. Recourse may also legitimately be had to contemporaneous implementing rules, enacted as subordinate legislation to give practical effect to a provision in the primary legislation which needs interpretation. This calls for caution, not merely because the primary legislation cannot be contradicted by subordinate legislation, but also because

the rules may reflect an imperfect or incomplete understanding of the meaning of the primary provision in the minds of the rule makers. In the present case both parties invited the court to scrutinise a new provision in the Cayman Islands Companies Winding Up Rules 2008 ("the Winding Up Rules") introduced (with one later exception) at the same time as the 2009 revision of the Cayman Companies Law, designed specifically to regulate the use of section 112(2).

23. Finally it may be a legitimate aid to the purpose and intent of a statutory provision to have regard to available travaux preparatoires, subject to well-known constraints. In the present case their relevance is more because of what they do not say. The Board will first set section 112(2) in its context within the Cayman Companies Law, then review the relevant legislative history, including the travaux, then consider the effect of the Rules, before setting out its analysis of the interpretative issue raised by this appeal.

24. The first stage is to consider section 112 as a whole. It reads as follows:

> "112(1) The liquidator shall settle a list of contributories, if any, for which purpose he shall have power to adjust the rights of contributories amongst themselves.
>
> (2) In the case of a solvent liquidation of a company which has issued redeemable shares at prices based upon its net asset value from time to time, the liquidator shall have power to settle and, if necessary rectify the company's register of members, thereby adjusting the rights of members amongst themselves.
>
> (3) A contributory who is dissatisfied with the liquidator's determination may appeal to the Court against such determination."

25. A number of points arise from a comparison between subsections (1) and (2). First, the differences: section 112(1) is of general application in all windings up, whereas section 112(2) is, as already noted, confined to a specific class of companies in solvent liquidation. Subsection (1) is about settling a list of contributories, whereas subsection (2) is about settling and, if necessary rectifying, the register of members. Contributories are persons who might be liable to contribute to the company's assets in a liquidation (eg because their shares are not fully paid up). They include members and may include former members. At first sight therefore, the two subsections are dealing with quite separate duties and powers of the liquidator, and are included in the same section for convenience.

26. But there are significant similarities. Both subsections speak of "settling" a document. Both speak of "adjusting the rights" of contributories and members respectively. Both confer functions (one a duty and the other a power) on the liquidator rather than the court.

27. Subsection (3) appears at first sight only to confer a right of appeal in relation to a determination under subsection (1) because it confers the right on contributories rather than members. But the Board's view is that it does confer a right of appeal from a determination under subsection (2) because every person who is a member at the relevant time is by definition also a contributory. By section 89 "contributory" includes both those liable to contribute in a winding up and every holder of fully paid up shares in the company. This is not contentious.

28. The important point about the similarities between subsections (1) and (2) is that it may be supposed that the common concept of "adjust[ing] the rights" was intended or assumed to have the same general meaning in both. The same may be said of the use of the common word "settle" although, as will appear, its use in relation to two very different documents (the list of contributories and the register of members) makes such a read-through less straightforward.

29. The next task is to set section 112 in its wider context within the Cayman Companies Law as a whole. Here the main point which emerges is that there is also a power to rectify the register of members, in section 46, which provides as follows:

> "If the name of any person is, without sufficient cause, entered in or omitted from the register of members of any company, or if default is made or unnecessary delay takes place in entering on the register the fact of any person having ceased to be a member of the company, the person or member aggrieved or any member of the company or the company itself may, by motion to the Court, apply for an order that the register be rectified; and the Court may either refuse such application with or without costs to be paid by the applicant or it may, if satisfied of the justice of the case, make an order for the rectification of the register, and may direct the company to pay all the costs of such motion, application or petition, and any damages the party aggrieved may have sustained. The Court may, in any proceeding under this section, decide any question relating to the title of any person who is a party to such proceeding to have his name entered in or omitted from the register, whether such question arises between two or more members or alleged members, or between any members or alleged members and the company, and generally, the Court may, in any such proceeding, decide any question that it may be necessary or

> expedient to decide for the rectification of the register: Provided that the Court may direct an issue to be tried, on which any question of law may be raised."

30. This is a power which is not limited to winding-up, and it is conferred on the court rather than on the liquidator. It is clear from its language that it is directed to ensuring that the register properly accords with the underlying legal rights (described as "title") of persons who are or should be recorded on it. As will appear, that conventional meaning of rectification is confirmed by settled authority about the statutory antecedent to section 46. It is therefore a necessary plank in Mr Pearson's case that rectification in section 112(2) has a different and much wider meaning than it does in section 46.

31. Section 48 is of some relevance. It provides that the register of members shall be prima facie evidence of any matters directed or authorised by the Cayman Companies Law to be inserted therein. Those matters include the identity of the company's members from time to time, and the number and class of shares held by each of them.

32. Finally, section 112 confers powers on all liquidators, that is, those appointed in a voluntary liquidation as well as those acting as officers of the court in a winding up by, or under the supervision of, the court.

33. Turning to the historical antecedents, Part V of the Cayman Companies Law (dealing with insolvency and winding-up) was until 2005 closely modelled on the companies legislation of the UK, in particular upon the Companies Act 1862 ("the 1862 Act") (25 & 26 Vict c 89). Section 35 of that Act conferred a power on the court to rectify the register of members in substantially the same terms as section 46 of the Cayman Companies Law. Section 98 of the 1862 Act extended that power of the court to a winding up, in the following terms:

> "As soon as may be after making an order for winding up the Company, the Court shall settle a list of contributories, with power to rectify the register of members in all cases where such rectification is required in pursuance of this Act, and shall cause the assets of the Company to be collected, and applied in discharge of its liabilities."

34. That section 98 extended the power to rectify in section 35 to a liquidation, without affecting its substance, was established in *In re London, Hamburgh and Continental Exchange Bank* (1867) LR 2 Ch App 431 and confirmed in *Sichell's* case (1867) LR 3 Ch App 119, where Lord Cairns LJ said, at 122:

> "In my opinion the reference in the 98th section to a rectification of the register cannot mean that the Court in winding up a company is to rectify the register ex mero motu suo; it must mean that the Court may exercise the judicial power conferred by the 35th section…"

35. In *Nilon Ltd v Royal Westminster Investments SA* [2015] 2 BCLC 1, the Board decided that the provisions for rectification of the register of members in force in the British Virgin Islands (which mirrored section 35 of the 1862 Act) could not be used as the vehicle for resolving a dispute about whether a person had a contractual right against another person to an allotment of shares. Nothing short of a legal right or title to shares carrying with it an immediate right against the company to be registered as their owner was sufficient for a claim to rectification of the register. At para 51, giving the judgment of the Board, Lord Collins said:

> "In the view of the Board, proceedings for rectification can only be brought where the applicant has a right to registration by virtue of a valid transfer of legal title, and not merely a prospective claim against the company dependent on the conversion of an equitable right to a legal title by an order for specific performance of a contract."

36. Until 2005, the position was just the same in the Cayman Islands. In the same way that section 98 of the 1862 Act enabled the Court's power to rectify under section 35 of that Act to be exercised in a liquidation, section 112(1) of the Cayman Companies Law did exactly the same in relation to the power to rectify in section 46, in relation to a winding up by, or under the supervision of, the court. It provided as follows:

> "Subject to subsection (2), as soon as may be after making an order for winding up the company, the Court shall settle a list of contributories and may rectify the register of members in all cases where such rectification is required in pursuance of this Law, and shall cause the assets of the company to be collected and applied in discharge of its liabilities."

Liquidators then had no power at all to rectify the register of members, and the Court's power to do so was limited to a correction of the register which reflected and implemented a member's legal rights, rather than overturned them.

37. The same was true in the UK. The old section 35 of the 1862 Act was re-enacted in the Companies Act 1948, and is now to be found in section 125 of the Companies Act 2006. The old section 98 is now to be found in section 148 of the Insolvency Act

1986. The only significant departure from the old model was that the Court's power to exercise some of its powers in a liquidation, including the power to rectify the register of members, could by rules be delegated to the liquidator, acting as an officer of the court under its supervision: see section 160 (1)(b) of the 1986 Act and (now) rule 7.79 of the Insolvency (England and Wales) Rules 2016 (SI 2016/1024), replacing provisions to similar effect in the Insolvency Rules 1986 (SI 1986/1925) and the Companies (Winding Up) Rules 1949 (SI 1949/330).

38. In April 2006 the Cayman Islands Law Reform Commission published a report *Review of the Corporate Insolvency Law and Recommendations for the Amendment of Part V of the Companies Law* ("the Report") proposing a comprehensive modernisation of corporate insolvency law, recommending that "the existing law and best practice be codified by re-writing Part V of the Companies Law" and attaching a draft Bill with an explanatory memorandum summarising its main provisions. The main criticism of the law as it stood was that (per para 1 of the executive summary):

> "The existing law suffers from being unduly complex because it is derived from a combination of 19th century legislation, inappropriate foreign rules and local case law."

A central theme in the Commission's advice was that there was a fundamental distinction between insolvent and solvent liquidation which was insufficiently recognised by the statute (although it was adopted in best practice). They recommended that, in general, insolvent liquidation should be carried out by or under the supervision of the court, whereas solvent liquidation could in the main be left to liquidators, and that this should be enshrined in Part V: see section 5 of the Report. This was in due course achieved by section 124, which requires the liquidator in a voluntary liquidation to apply for the liquidation to be continued under the supervision of the court, unless the directors sign a declaration of solvency within a stipulated time.

39. What is now section 112(2) appears for the first time in the draft Bill. The explanatory memorandum refers to section 112, but only in the following brief terms:

> "section 112 deals with the settlement of list of contributories by the liquidator."

Subsection (2) is not mentioned at all. Nor is there any mention, anywhere in the Report or the memorandum, of a desire to introduce, for the first time, a radically new form of rectification, capable of overriding stakeholders' legal rights, and conferring the power on the liquidator who, in a solvent liquidation, would usually not be acting under the supervision of the court.

40. Order 12 of the Winding Up Rules makes detailed but (it is agreed) non-exhaustive provision for a particular situation where it requires the liquidator to settle or rectify the register of members under section 112(2). Rule 2 reads as follows:

> "(1) The official liquidator shall exercise his power to rectify the company's register of members under section 112(2) if he is satisfied that -
>
> (a) the company is or will become solvent;
>
> (b) the company has from time to time issued redeemable shares at prices based upon a mis-stated net asset value which is not binding upon the company and its members by reason of fraud or default, with the result that the company has issued an excessive or inadequate number of shares in consideration for the prices paid by one or more subscribers; and/or
>
> (c) the company has redeemed shares at prices based upon a mis-stated net asset value which is not binding upon the company and its members by reason of fraud or default, with the result that the company has paid out excessive or inadequate amounts to former members in consideration for the redemption of their shares.
>
> (2) Subject to paragraph 3, for the purposes of rectifying the register of members in accordance with this Rule, the official liquidator shall determine the true net asset value of the company as at each relevant redemption date.
>
> (3) The true net asset value of the company shall be determined in accordance with the accounting principles specified for this purpose in its articles of association or, if none are specified, in accordance with whatever generally accepted accounting principles are adopted by the official liquidator.
>
> (4) The register of members, when rectified by the official liquidator in accordance with section 112(2) of the Law, shall state, as at each relevant redemption date -

(a) the identity of each subscriber, the amount of money subscribed and the number of shares which ought to have been issued to him (applying the true net asset value per share);

(b) the identity of each member who redeemed shares, the number of shares redeemed and the amount of redemption proceeds which ought to have been paid to him (applying the true net asset value per share);

(c) the identity of the company's members and the number of shares which ought to have been held by each member, had the subscriptions and redemptions been done at the true net asset value per share, and the company's share register shall be rectified accordingly.

(5) If the official liquidator considers that it will be impractical or not cost effective to rectify the company's register of members in accordance with paragraphs 2 and 3 of this Rule, he shall nevertheless rectify the register in such manner which is both cost effective and fair and equitable as between the shareholders."

Rule 2 was brought into force at the same time as section 112(2), except for paragraph 5, which was added a year later.

41. The important point about rule 2, for present purposes, is that it provides for the liquidator to exercise the section 112(2) power where the NAVs upon which the subscription for and redemption of shares are based are not binding. In such a case the register of members will not have been based upon enforceable legal rights, so that a distribution of the surplus in the solvent liquidation in accordance with the purported entitlements shown on the register of members will not be in accordance with the legal rights of the members as at the commencement of the liquidation. There will therefore be a lacuna which the liquidator will need to fill, by the process of reconstructing all the relevant NAVs (if that is practicable and cost-effective) as provided for by paragraphs 2 and 3, and then settling or rectifying the register of members in accordance with paragraph 4.

42. The obvious purpose of those processes is to enable the liquidator to establish by enquiry what are the true legal rights of the members, and then to bring the register of members into accordance with them, as the template for a proper distribution of the surplus. Paragraph 5 then provides, as an apparent afterthought, for a fair and equitable

substitute where the precise recreation of the NAVs proves to be an impracticable counsel of perfection.

43. Order 12 rule 2 is not of course applicable in the circumstances of the present case, where it is acknowledged that the relevant NAVs are all binding, and the register of members is therefore a proper reflection of the members' legal rights. But both parties to this appeal sought to pray it in aid in support of their case. For the appellant, Mr Francis Tregear QC pointed to paragraph 5 as demonstrating that rectification under section 112(2) was not limited to upholding members' legal rights but extended to any just and equitable scheme for distribution. Mr Tom Smith QC for Primeo submitted that rule 2, taken as a whole, demonstrated how section 112(2) was to be used to establish and vindicate the members' underlying legal rights, where the usual basis for them, namely the NAVs, were ineffective for the purpose, and had led to the creation of a register of members which mis-stated them.

Analysis

44. The persuasive submissions for the appellant Mr Pearson may be summarised as follows:

i) The power to rectify in section 112(2) was no mere extension to liquidation of the ordinary power to rectify in section 46, as had previously been achieved by section 112(1) in its pre-2009 form. On the contrary it was a bespoke new power, confined to a narrowly defined class of cases, and there was therefore no reason to give the word "rectify" the same traditional meaning as it has in section 46.

ii) The purpose of the power to rectify the register of members in section 112(2) is expressly to "adjust" the rights of members. This is supportive of an interpretation of the power to rectify as going beyond the mere implementation of the members' underlying legal rights.

iii) Jones J (who as Mr Andrew Jones QC had led the committee which originally proposed the relevant reforms) had rightly described section 112(2) as bringing about a notable change in the law. If "rectify" in section 112(2) had only the conventional meaning contended for by Primeo it is hard to see what it added to section 46, which would be available for that purpose in any event.

iv) The right of appeal to the court in subsection (3) ensured that liquidators could not ride roughshod over members' rights without appropriate restraint from the court.

v) The specific scheme in Order 12 rule 2 for rectification where a company's NAVs were not binding did not cover the whole of the ground covered by section 112(2), which was available even where (as here) the NAVs were binding, and paragraph 5 showed clearly that the rules committee (which also included Jones J) recognised that the power could be used to create a fair and equitable scheme which did not simply reflect members' legal rights.

vi) The power in section 112(2) was tailor-made for doing justice and equity between those blighted by the common misfortune of having invested in a fraudulent Ponzi scheme, where the enforcement of their legal rights would merely give unfair effect to it, by enabling some to profit at the expense of others.

45. Those submissions persuaded Jones J. But (like the Court of Appeal) the majority of the Board considers them to be wrong, albeit not without some regret. The correct analysis is as follows.

46. Section 112(2) is a provision with no direct antecedent. It undoubtedly makes new law by giving powers to the liquidator which were formerly vested in the court. But it does so by using words, phrases and concepts which, in 2005 when the new provision was drafted, already had long-settled meanings. The key part of subsection (2) is "settle and, if necessary, rectify the company's register of members, thereby adjusting the rights of members amongst themselves."

47. Putting rectification on one side for the moment, the phrase "settle… the register of members" is adapted from the immediately preceding phrase "settle a list of contributories" in subsection (1). There, it contemplates the creation of a document which will identify what contributories are liable to contribute to the assets of an insolvent company (for example because their shares are only partly paid) or, in a solvent liquidation, the amounts which need to be taken into account as a debit or set-off against what they would be otherwise entitled to receive from the surplus as members. As subsection (1) expressly contemplates, this may well involve adjusting the rights of the contributories among themselves. This is not because their legal rights are being altered or overridden, but because their legal rights as members are being tempered by taking into account their legal obligations to contribute. In other words the process contemplated by subsection (1) is (in a solvent liquidation) concerned with the identification of their net legal entitlement to share in the surplus. For a clear explanation of this now rather archaic process see *In re Shields Marine Insurance Association* (1868) LR 5 Eq 368, 372 per Lord Romilly MR.

48. At this point it is instructive to note that, in the version of section 112(1) in force in 2005, the court's duty to settle a list of contributories lay alongside a power to rectify the register of members. This was drawn almost word for word from section 98 of the

1862 Act, so that the twin concepts of settling and rectifying had by 2005 been bed-fellows for more than 140 years. But they applied to two different documents, namely the list of contributories and the register of members respectively. There is nothing surprising about this. A company does not maintain as such a list of contributories before it goes into liquidation, so such a list has to be created for the first time: ie it has to be settled. But a company must maintain a register of members, so that there will be such a document when the liquidation starts. If it is inaccurate (because it does not correctly identify the legal rights of the members), then it will need to be put right: ie rectified, so that it can be used to identify what each member should receive from any surplus.

49. Thus instructed, as the expert committee which drafted what is now section 112(2) would have been, it is now possible to revisit the key words and phrases which they chose to use, wearing, as it were, the committee's spectacles. First the power to "settle and, if necessary rectify" is used in relation to the same document, namely the register of members. This is at first sight surprising, since it would be most unusual for an open-ended investment company not to have a register of members when going into solvent liquidation. Why should it need to be "settled"? This was not a point focussed upon in argument, but it needs to be addressed, because this is the first power conferred, with rectification only if necessary.

50. In the Board's view this composite power to settle and if necessary rectify the register of members is designed to enable the liquidator to make sure that the register is a reliable basis for distributing the surplus, because it fully and accurately reflects the members' legal rights. The register might prove to be perfectly satisfactory, so that there is no need that it be either settled or rectified, although it could still usefully be settled in the sense that, after due scrutiny, the liquidator formally approved it for use in the distribution of the surplus. But it might be incomplete (if for example there was a management failure shortly before liquidation) so that it needed to be settled in the sense of being completed, or it could be complete but just plainly wrong, so that it did need to be rectified. That would be to use the familiar concept of rectification in its ordinary and time-honoured sense, as used in section 46, namely to correct an error in a document so as to bring it into line with the underlying legal rights of the parties affected by it.

51. This understanding of the key phrase is in no sense undermined by the reference which follows to adjusting the rights of the members among themselves. As already explained, this is a well-known concept in liquidation, in which "adjustment" does not involve a departure from the legal rights of the persons concerned. That is plainly how the concept continues to be used in section 112(1). An adjustment takes place whenever the register of members is either completed (ie settled) or put right (ie rectified) because otherwise it would still stand as prima facie evidence of the members' rights at the commencement of the liquidation (see section 48) but lead to a distribution of the surplus which conflicted with those rights, in much the same way in which a distribution which ignored a contributory's obligations would also do.

52. The Board reaches those conclusions simply from a properly contextual reading of the language of section 112(2). But the following additional considerations support the same conclusion. First, Order 12 rule 2 points the same way. If there is a solvent liquidation of an open-ended investment company which has published NAVs which are not binding (eg because of an internal fraud which unravels all), then the register of members will not necessarily (or even probably) be a reliable reflection of the members' legal rights if, as is usual, it has been compiled on the basis of the invalid NAVs. So the liquidators will have no reliable basis for distributing the surplus. They will either have to carry out the painstaking process of reconstructing the NAVs in order to determine what those rights are or, if that is impracticable, have to apply a fair and equitable proxy for those rights, and then in either case rectify the register of members accordingly. Looking at paragraph 5 on its own is to ignore its status as a last resort where the relevant legal rights cannot practicably be ascertained, quite apart from the gap in time between the introduction of section 112(2) and its formulation a year later. In fact the thinking which led to section 112(2) was complete by 2005, some five years before paragraph 5 was formulated.

53. Secondly the construction advanced by the appellant would work a very large and unprecedented change in the law, by empowering liquidators to impose a scheme of fair distribution of their own devising in substitution for the members' legal rights, without providing liquidators with any principled guidance either about when it would be appropriate for them to do so, or as to the contents of such a scheme. The conferral of a right of appeal to the court by subsection (3) does not begin to address those difficulties. The fact that the Ponzi scheme in the present case may be regarded by many as a prime candidate for such a legislative code does not resolve the "when" question as a matter of interpretation, since section 112(2) confers the power in relation to every open-ended investment company in solvent liquidation.

54. Such a radical change would be all the more surprising in light of the fact that it is not mentioned at all in the Report or in the explanatory memorandum accompanying the draft Bill. Furthermore the new power is given to liquidators whereas the more conventional power to rectify the register of members under section 46 is left with the court, if indeed it is preserved at all in a liquidation. It is a curiosity of section 112, read as a whole, that the longstanding power of the court to rectify the register of members in any liquidation, present in the old section 112(1), has simply disappeared. The liquidator only inherits the power to rectify in the context of a very small class of liquidations. Counsel could offer no explanation for this curiosity when it was raised by the Board. It must be left to an occasion when it matters, but the best answer is likely to be that, in the absence of a statutory power, the common law supplies the deficiency by means of the equitable remedy of rectification, which lies in the inherent jurisdiction of the court.

55. Thirdly the supposed new power would run counter to the fundamental principle applicable to liquidation in the Cayman Islands and in most comparable jurisdictions

that the assets of the company are to be applied pari passu among the classes of stakeholders (creditors and members) in accordance with their legal rights as at the commencement of the liquidation. That is not to say that there can be no exceptions, but only that an exception might be expected to be enacted in the clearest of terms.

56. Fourthly it cannot be said that section 112(2) was introduced with the mischief of a Ponzi scheme which did not unravel the NAVs of a feeder fund like Herald in mind. Although it came into force shortly after the Madoff fraud was exposed, it took until 2014 before the issue as to the consequential effect upon the NAVs of a feeder fund was resolved, in the *Fairfield Sentry* case. More to the point, the new provision was formulated by the Law Reform Committee in 2005, well before the financial conflagration which culminated in the Lehman crash, and which brought the risks facing investors in open-ended investment companies like Herald to wide public attention.

57. These considerations are sufficient to dispose of the main case of the appellant. No separate consideration affects the application of the true meaning of the power to rectify in section 112(2) to the issue about Primeo's in specie subscription in 2007. Since it is now common ground that Primeo is contractually entitled to insist upon the valuation of its investment in BLMIS upon which its subscription in Herald was based, that is a right which the liquidator cannot disturb by rectification of the register of members under section 112(2).

58. For those reasons the Board will humbly advise Her Majesty that this appeal should be dismissed.

LADY ARDEN:

Introduction

59. This appeal, which is brought by the additional liquidator ("the liquidator") of Herald Fund SPC ("Herald"), principally concerns his proposal to implement "the net investment method" as the basis for distributing the surplus assets of Herald to its members (other than the holders of its management shares, which are not relevant for the purposes of this judgment). The holders of those shares subscribed for them for different amounts of premium and those premiums had been calculated by reference to the net asset value ("the NAV") of the shares from time to time. On winding up, however, the contractual rights of the holders of the relevant shares, following repayment of paid up capital, are to have those assets attributable to their particular class of shares distributed to them in accordance with the number of shares held. Some holders had also redeemed some of their shares at the NAV of those shares at the date of redemption. The liquidator's proposal seeks to align the rights of shareholders to

participate in the surplus assets with the net cost of their investment. His proposal has essentially two elements:

> (1) working out the amount which each member of Herald at the date of the liquidation has invested in Herald and deducting therefrom the amount of any redemption monies which they have received or to which they are entitled ("the first element"); and
>
> (2) altering the register of members so that each member becomes entitled to that proportion of the surplus assets, to which his class of shares is entitled, which his investment bears to the sum of all the investments made by all holders of shares of that class calculated in accordance with the first element (this process of alteration being "the second element").

60. The Court of Appeal of the Cayman Islands (Sir John Goldring P, Newman and Martin JJA) held that the liquidator has no power to implement this proposal. They held that the liquidator's statutory power to rectify the register of members of Herald under section 112 of the Companies Law of the Cayman Islands (2018 Revision) ("CLCI") only enabled him to rectify the register in accordance with the contractual rights of the members. Newman JA, with whom Sir John Goldring P and Martin JA agreed, giving the only reasoned judgment of the Court of Appeal, summed up the position as follows:

> "Whether a mis-stated NAV can be rectified depends upon what the contract between the shareholder and the company has stipulated should be binding between the parties and what measures have been authorised by statute to give effect to the rights of the members." (para 40)

61. Lord Briggs would uphold the judgment of the Court of Appeal.

62. The contractual rights of contributories are set out in the articles of association of the company. By virtue of section 25(3) of the CLCI, the articles constitute a contract between the company and its members:

> "(3) When registered the said articles of association shall bind the company and the members thereof to the same extent as if each member had subscribed his name and affixed his seal thereto, and there were in such articles contained a covenant on the part of himself, his heirs, executors and administrators to conform to all the regulations contained in such articles subject to this Law; and all monies payable by any member to the company in pursuance

> of the conditions or regulations shall be deemed to be a debt due from such member to the company."

63. In my judgment, the conclusion of the Court of Appeal was too narrow. I agree that rectification is not authorised except for substantial compliance with the members' legal rights, but, because section 112 also confers on the liquidator power to adjust the rights of the contributories (who are for present purposes the members), rectification is not confined to contractual rights. The point is that the liquidator can also take account of any obligation which the member has to the company, however arising. That would include an obligation to repay any proceeds of redemption if they were not entitled to retain those proceeds for any reason. The liquidator would in that instance be able to deduct redemption proceeds in accordance with the first element of his proposal. I will develop that point below.

64. In Part B of this judgment, I set out some background about the liquidation, the background to the adoption of the net investment method in the liquidation of Bernard L Madoff Investment Securities LLC ("BLMIS"), Herald's capital structure and some general points about section 112 of the CLCI. In Part C I discuss the allotment of shares for non-cash consideration to Primeo and its implications. In Part D I explain why it is possible that the liquidator may be able to deduct redemption proceeds. In Part E I set out my conclusion.

B. Background about (1) the liquidator's appointment (2) adoption of the net investment method in the liquidation of BLMIS (3) Herald's capital structure (4) Primeo Fund and (5) some general points about section 112

(1) The liquidator's appointment and the liquidation of BLMIS

65. The order of the Grand Court of the Cayman Islands for the appointment of the liquidator limited his functions to settling the list of contributories under section 112(1) and related issues, "including whether the Company's register of members should be restated pursuant to section 112(2) of the Companies Law."

(2) Background to the adoption of the net investment method in the liquidation of BLMIS

66. The "net investment method" which the liquidator proposes to use is almost identical to the method used for the distribution of surplus assets in the liquidation of BLMIS. Herald was a "feeder fund" for BLMIS and its portfolio of investments consisted of securities in BLMIS.

67. The relevant office holder of BLMIS adopted the net investment method in a desire to produce a fairer basis of distributing the surplus assets having regard to the discovery that BLMIS was a Ponzi scheme. As I explained in my judgment in *In the matter of Stanford International Bank Ltd* [2019] UKPC 45, para 82:

> "A number of Ponzi schemes have come to light in different jurisdictions since the global financial crisis in 2008. Such schemes usually involve investors and assets located in many different jurisdictions. Faced with a massive insolvency, as in this case, some courts have sought to make, and in some cases have gone on to make, orders to facilitate an equal distribution between private investors, past and present. For example, in the United States courts have made orders that the claims of private investors are admitted to prove in the liquidation, not for the amount that the scheme declared to be the amount of their investment but according to the amount of their cash investment less amounts repaid ('the net investment method') (see, for example, *In re Bernard L Madoff Inc Sec*, (2011) 654 F 3d 229). Other methods to achieve equal distribution have also been used. In the United States, at least, this appears to have been achieved under special legislation, the Securities Investor Protection Act ('SIPA'), which requires a trustee to distribute the property of 'customers' and otherwise satisfy the net equity claims of investors in a process that operates in combination with a liquidation process but to the exclusion of certain dealers in securities who are creditors in the liquidation."

68. The Board understands that some US bankruptcy courts have not applied the net investment method to investors in feeder funds. Nonetheless the liquidator considers that it should be adopted in the case of Herald.

69. The liquidator wishes to adopt the net investment method of distribution for the surplus assets of Herald because, as his grounds of appeal explain:

> "Every subscription and redemption of shares in Herald occurred on the basis of reported NAVs which were misstated by reason of BLMIS's fraud. As a result, the shareholdings shown in the register of members are the product of subscriptions and redemptions which took place at arbitrary prices based on the fraudulent information provided by BLMIS."

70. The proposal made by the liquidator is a modest one. It merely amounts to equalising the claims of those who are still members of Herald by removing the advantage which some of them may have had by redeeming some of their shares at artificial prices, and also by ensuring distribution is made on a basis which treats every member's investment on the same basis, ie a dollar for dollar basis, and not as affected by the erroneous certificates as to value given by Herald's directors.

71. The advantage obtained by those who redeemed their shares can be seen by comparing the figures for recoveries in the liquidation of Herald with pre-liquidation reported values. At the date of its liquidation, the reported value of Herald's redeemable shares was US$1,874,066,134.18. Herald, in its capacity of a "customer" of BLMIS, filed a claim in the liquidation of BLMIS which has been admitted in the sum of US$1,639,896,943. Distributions to date on that claim amount to US$580,757,799.48 (with further distributions anticipated), and some or all of this amount constitutes the surplus now available for distribution to members.

72. On the basis of those figures there is an evident disparity between the extent to which investors who have to look to the distribution of surplus assets in the liquidation can recover their investment in Herald, and the extent to which those who redeemed their shares before the winding up can recover their investment. Investors in the first group will only receive a fraction (perhaps in the region of 30-40%) of the value given in their last statement before the winding up whereas investors who redeemed their shares before the winding up would have received the whole of the then current statement value of their investment for the shares redeemed, or thereabouts.

73. The debts and liabilities of Herald and the expenses of its liquidation have been paid or provided for. The distribution of the surplus assets is governed by section 140(1) of the CLCI, which provides:

> "140. Distribution of the company's property
>
> (1) Subject to subsection (2), the property of the company shall be applied in satisfaction of its liabilities pari passu and subject thereto shall be distributed amongst the members according to their rights and interests in the company."

74. The rights and interests of the holders of Herald's redeemable shares are governed by article 155 of Herald's articles of association. As I have explained, the capital rights of the holders of Herald's redeemable shares is to a distribution of surplus assets attributable to a particular class of shares among the holders of that class of shares in proportion to the number of shares held. The basis of distribution is not, therefore, in

accordance with the net investment of each holder in Herald. Although article 155 does not so state, the distribution of surplus assets would appear to apply only to participating non-voting shares ("PNV shares") which are fully paid. Although the nominal amount of those shares in this case is trifling (see the next para), in other cases it could have been substantial and therefore shares generally have to be fully paid before they can benefit from the distribution of surplus assets pari passu with fully-paid shares.

(3) Herald's capital structure

75. Herald was an exempted segregated portfolio company incorporated with limited liability under the laws of the Cayman Islands on 24 March 2004 pursuant to the Companies Law of the Cayman Islands (2003 Revision). Its original authorised share capital comprised US$100 divided into 100 management shares of US$1 each, US$10,000 divided into 10m PNV shares of US$0.001 each and €10,000 divided into 10m PNV shares of €0.001 each. The Board has not been provided with details of Herald's paid-up share capital. The management shares were held by the investment manager.

76. Where a company is formed as a segregated portfolio fund, only the holders of the same class of shares participate in surplus assets representing the proceeds of investments in their segregated portfolio so far as the law of any particular jurisdiction where the assets are situate recognises that segregation.

77. The business of Herald was to act as a mutual fund investing in other securities. It described itself as "a type of umbrella company". It fell within the definition of "regulated mutual fund" for the purposes of the Cayman Islands law. It was, therefore, subject to the supervision of the Cayman Islands Monetary Authority. There are apparently many mutual funds registered in the Cayman Islands.

(4) Some general points about adjusting the rights of contributories

78. Section 112 of the CLCI provides

> "112(1) The liquidator shall settle a list of contributories, if any, for which purpose he shall have power to adjust the rights of contributories amongst themselves.
>
> (2) In the case of a solvent liquidation of a company which has issued redeemable shares at prices based upon its net asset value from time to time, the liquidator shall have power to settle and, if

> necessary rectify the company's register of members, thereby adjusting the rights of members amongst themselves.
>
> (3) A contributory who is dissatisfied with the liquidator's determination may appeal to the court against such determination."

79. I agree with the written case of the respondent that section 112(2) is not wholly new, but it is based on section 98 of the Companies Act 1862 (25 & 26 Vict c 89), which was replicated in section 112(1) of the Cayman Islands Company Law (2007 Revision). Section 112(1) in that version read as follows:

> "(1) Subject to subsection (2), as soon as may be after making an order for winding up the company, the court shall settle a list of contributories and may rectify the register of members in all cases where such rectification is required in pursuance of this Law, and shall cause the assets of the company to be collected and applied in discharge of its liabilities."

80. But the fact that a provision of CLCI is derived from the Companies Act 1862 does necessarily mean that it will bear the same meaning as it did in that Act. That depends on whether it has for instance been modified by some provision of the law of the Cayman Islands. The parties are agreed that the reference to subsection (2) in section 112(1) of the 2007 revision of the CLCI is not relevant on this appeal.

81. Section 46 of the CLCI, set out at para 29 above, confers on the court the power to rectify the register of members but it does not confer a power to adjust the rights of members and so the scope for rectification under that section is different from that under section 112. As this judgment seeks to demonstrate, the power of adjustment goes beyond the contractual rights of the contributories.

82. To rectify the register of members means to change the words or figures which appear in the register of members or to supply omissions in them. The register of members was required to comply with section 40 of the CLCI. Under that section, the details in the register of members had to include the amount paid or agreed to be considered as paid, on the shares of each member. I will assume for the purposes of this judgment that the amounts so paid or considered as paid would include both the amount paid on account of nominal amount and that paid on account of premium. The liquidator, therefore, on that basis potentially has power under section 112(2), in an appropriate case, to alter the NAV, which represented the premium paid on the issue of the PNV shares, with which the judgment is concerned.

83. Section 112 appears to duplicate section 46 of CLCI. The same would have been true of section 35 of the Companies Act 1862 which contained a power of rectification matching that of section 46 of CLCI. There are several explanations as to why section 98 of the Companies Act 1862 was included in addition to section 35. As I explained in *AWH Fund Ltd v ZCM Asset Holding Co (Bermuda) Ltd* [2019] UKPC 37, paras 62-63, the various steps taken in proceedings before the court in winding up were and are treated as a single proceeding. Section 98 may well have conferred power to rectify so that the court which was in charge of the winding up could consider whether it was necessary to rectify the register at the same time as settling the list of contributories. It was more convenient that rectification issues should be dealt with in the winding up proceedings. That is reinforced by the fact that, once the company was in liquidation, a shareholder would be unable to bring proceedings under section 46 because one of the effects of the winding up would be to prevent any new actions without the court's leave (section 87 of the 1862 Act, section 97(1) of the CLCI). Leave would not normally be given where the matter could more appropriately be dealt with in the winding up proceedings.

84. However, the more obvious reason for the power of rectification in section 112 is that it does not have the same scope as section 46. It has in my judgment a wider scope by virtue of the fact that it is linked to the adjustment of rights of members between themselves. In the margins, nothing turns on the fact that section 112(2) refers to members and section 112(1) refers to contributories. The old authorities discuss this difference and treat it as of no consequence. It is curious that the drafter of section 112(1) as amended in CLCI did not include a power to rectify the register of members, but that point is not relevant to this appeal.

85. The powers conferred by section 112(2) were previously vested in the court, but the vesting of those powers in the liquidator does not deprive the contributories of any right to challenge the acts of the liquidator. There is an express right of appeal in section 112(3).

86. There is no reason why former members, for example those who have transferred or redeemed all their shares, cannot be brought back on to the register of members by rectification in appropriate cases for the purpose of adjusting their rights vis-a-vis continuing members. It would not matter that they were not shown in the register of members as the holders of the shares in question at the date when the liquidation commenced. The liquidator could include the names of such persons in the register of members as rectified.

87. Order 12 rule 2 of the Cayman Islands Winding Up Rules 2008, other than paragraph 5, came into force simultaneously with the Cayman Companies Law. Paragraph 5 of Order 12 rule 2 came into force one year later but nothing turns on this for present purposes. No party to this appeal contends that rule 2 is ultra vires CLCI. If

it is not ultra vires, the circumstances in which rectification may take place under section 112 must now include the circumstances set out in Order 12 rule 2. It provides:

> "2(1) The official liquidator shall exercise his power to rectify the company's register of members under section 112(2) if he is satisfied that -
>
> (a) the company is or will become solvent;
>
> (b) the company has from time to time issued redeemable shares at prices based upon a mis-stated net asset value which is not binding upon the company and its members by reason of fraud or default, with the result that the company has issued an excessive or inadequate number of shares in consideration for the prices paid by one or more subscribers; and/or
>
> (c) the company has redeemed shares at prices based upon a mis-stated net asset value which is not binding upon the company and its members by reason of fraud or default, with the result that the company has paid out excessive or inadequate amounts to former members in consideration for the redemption of their shares.
>
> (2) Subject to paragraph 3, for the purposes of rectifying the register of members in accordance with this Rule, the official liquidator shall determine the true net asset value of the company as at each relevant redemption date.
>
> (3) The true net asset value of the company shall be determined in accordance with the accounting principles specified for this purpose in its articles of association or, if none are specified, in accordance with whatever generally accepted accounting principles are adopted by the official liquidator.
>
> (4) The register of members, when rectified by the official liquidator in accordance with section 112(2) of the Law, shall state, as at each relevant redemption date -

(a) the identity of each subscriber, the amount of money subscribed and the number of shares which ought to have been issued to him (applying the true net asset value per share);

(b) the identity of each member who redeemed shares, the number of shares redeemed and the amount of redemption proceeds which ought to have been paid to him (applying the true net asset value per share);

(c) the identity of the company's members and the number of shares which ought to have been held by each member, had the subscriptions and redemptions been done at the true net asset value per share, and the company's share register shall be rectified accordingly.

(5) If the official liquidator considers that it will be impractical or not cost effective to rectify the company's register of members in accordance with paragraphs 2 and 3 of this Rule, he shall nevertheless rectify the register in such manner which is both cost effective and fair and equitable as between the shareholders."

C. Primeo Fund: allotment of Herald PNV shares for non-cash consideration to Primeo and its implications

88. Primeo originally held securities in BLMIS directly but with effect from 2 May 2007 it transferred BLMIS securities, valued at $463,353,186.26, to Herald in exchange for the issue to it of 371,604.1272 US$ class shares at a subscription price of US$1,246.90 per share. (Primeo may also have transferred at about the same time and on similar terms a small number of additional BLMIS securities which it was found to have.) Primeo subsequently subscribed for further US$ class shares and 9,674.2954 Euro class shares for cash. Primeo later sold some of its shares and redeemed other shares for value on 1 December 2008. The redemption proceeds for these shares were to be paid as soon as practicable thereafter. In its judgment in *Pearson v Primeo Fund* [2017] UKPC 19 ("*Pearson v Primeo (No 1)*"), the Board confirmed that the redemption of these shares had been completed before the Board of Herald suspended redemptions on 1 December 2008 with the result that Primeo became a deferred creditor in the winding up of Herald in respect of the redemption monies.

D Possibility of the deduction of redemption proceeds in accordance with the first element of the liquidator's proposal

89. The liquidator in a solvent liquidation is entitled to "adjust" the rights of any contributory under section 112(1). So, for example, if some shares in the company are partly paid (or nil paid) and the rest are fully paid, and there are surplus assets, the liquidator has no power to make calls on the partly paid (or nil paid) shares because there are no debts or liabilities of the company or expenses of the liquidation to be met. Nonetheless, it is established that he can make a call for the purpose of equalising the amounts paid up and settling the list of contributories prior to a distribution of surplus assets among the members: see for example *In re Anglesea Colliery Co* (1866) LR 1 Ch App 555. This is but one example of the adjustment of the rights of contributories among themselves.

90. It is to be noted that the liquidator is not obliged to adjust the contractual rights of contributories and rectify the register of members under subsections (1) or (2) of section 112. There is a residual discretion in the liquidator (subject to the control of the court), just as the court under section 46 is not to make an order for rectification unless it is "satisfied of the justice of the case." The latter formula is wide enough to introduce equitable considerations affecting legal rights, such as delay.

91. Rights can be adjusted not simply to reflect the contributories' contractual rights as holders of shares in issue at the date of the winding up but also to ensure that all debts due from the contributory to the company are paid before the contributory becomes entitled to share in the surplus assets. Under the principle in *Cherry v Boultbee* (1839) 4 My & Cr 442, a person cannot receive a distribution from a fund to which he is bound to contribute. This principle applies to the distribution of surplus assets to contributories: see *In re Peruvian Railway Construction Co Ltd* [1915] 2 Ch 144. Thus the liquidator can adjust the rights of contributories to take account of other indebtedness from the contributory. This adjustment is not the result of some contractual right of the contributories but the application of an equitable principle. Where the indebtedness in question arises from a wrongful payment by the company, and the liquidator is able to rely on his ability to adjust the rights of contributories, he would arguably be using the principle in *Cherry v Boultbee* rather than any claim in restitution or constructive trust.

92. Under the liquidator's proposal the liquidator wishes to set off against the sums to be paid to a contributory the amount of any redemption monies to which he is entitled. This cannot be done where the contributory is entitled to retain those proceeds.

93. However, there may be circumstances in a case such as this where the contributories are not entitled to retain the redemption monies to which they have

become entitled because they were not lawfully paid. Redemption monies would not be lawfully paid if for instance they were not paid in the manner permitted by the CLCI. The permitted modes of redemption of the nominal amount and premium are set out in section 37(3) of CLCI as follows:

> "(e) The premium, if any, payable on redemption or purchase must have been provided for -
>
> > (i) out of either or both of the profits of the company or the company's share premium account, before or at the time the shares are redeemed or purchased; or
> >
> > (ii) in the manner provided for in subsection (5).
>
> (f) Shares may be redeemed or purchased out of profits of the company, out of the share premium account or out of the proceeds of a fresh issue of shares made for the purposes of the redemption or purchase or in the manner provided for in subsection (5)."

94. It is sufficient for the purposes of this judgment for me to refer to the premium paid on shares that were redeemed. The premium payable on redemption, which in this case was the material element of the redemption monies as the nominal amount of the shares was comparatively minor, could only be paid out of profits or share premium account or in the manner set out in section 37(5). The last option was not available because section 37(5) enables shares to be redeemed out of capital only if the company's articles authorised it to do so and a solvency test was met. Herald's articles apparently did not authorise redemption out of capital. The meaning of section 37(5) was considered by the Board in *DD Growth Premium 2X Fund v RMF Market Neutral Strategies (Master) Ltd* [2017] UKPC 36; [2018] Bus LR 1595 and in that case the Board accepted a concession by the liquidator that shares could be redeemed even if the manner of redemption was unlawful. That question, therefore, was common ground and was not decided by the Board in that case.

95. If there were no sufficient profits, redemption would depend on the share premium account being in credit in a sufficient sum (section 37(3)(e)(i) above). The balance on share premium account represents the total share premiums received by the company less any already used for some other purpose. Here, Herald shares had been issued to subscribers at a premium. In the case of issues for non-cash consideration consisting of BLMIS shares, as in the case of Primeo, it is now known that the value of the BLMIS shares was overstated.

96. Where shares are issued at a premium, the issuer is obliged to carry a credit equal to "the aggregate amount of the value" of the premiums to a special reserve called the share premium account. Section 34 of CLCI provides:

> "Share premium account
>
> 34(1) Where a company issues shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount of the value of the premiums on those shares shall be transferred to an account called 'the share premium account'. Where a company issues shares without nominal or par value, the consideration received shall be paid up share capital of the company."

97. The 2004 and 2007 revisions of the Companies Law of the Cayman Islands contained the equivalent provision.

98. Section 34 does not say that the "value" in this case is by reference to the directors' bona fide assessment of the value of the non-cash consideration. Moreover, article 18(f) of Herald's articles of association, which makes the determination of NAV by the directors binding on shareholders, appears only to apply to valuations made pursuant to the articles, not to valuations under CLCI. The reference to "value" of the premiums in section 34(1) would therefore appear to be to the value which the company actually received.

99. In my judgment, there may be a point of distinction between a case such as this and the case considered by the Board in *Fairfield Sentry Ltd v Migani* [2014] UKPC 9; [2014] 1 CLC 611 to which I now come. In that case the respondent, which was also an open-ended mutual fund, at the instance of its liquidators, brought proceedings to recover from its members or former members the proceeds of redemption of their shares paid out before the date of which such redemptions were suspended in December 2008 on the footing that those monies were paid out in the mistaken belief that the assets were as stated by BLMIS, when there were in fact no such assets. It is not stated whether or not the fund was solvent. The shares had been redeemed at their "net asset value" and article 11 of the articles of association of the respondent provided that the certificate of the directors was binding. In material part, article 11 provided:

> "Any certificate as to the Net Asset Value per Share or as to the Subscription Price or Redemption Price therefor given in good faith by or on behalf of the Directors shall be binding on all parties."

100. There was an issue as to whether certain documents were "certificates" for this purpose and it was accepted by the parties in *Fairfield Sentry* that, if the appellants succeeded on that issue and the certificates were binding, the proceedings would fail. Lord Sumption, giving the Advice of the Board, held that it was rightly so accepted.

101. *Pearson v Primeo (No 1)* may also be distinguishable on other grounds. In that case the Board held that, because the articles of association of Herald provided that the directors' valuation of the net assets for the purpose of redemption should be binding on all concerned, claims to redemption proceeds based on a calculation as to NAV performed under Herald's articles and due to be paid before the liquidation commenced gave rise to provable debts. As Lord Mance said:

> "No basis has been suggested on which Herald could on this analysis disturb the valuation by reference to which such redemption proceeds were calculated."

102. In the case of an issue of shares at a premium in exchange for shares in BLMIS, it may be said that at the date of the issue in question the premiums would have had a value because the market did not know that BLMIS was carrying on a Ponzi scheme, and so the allottee could have sold his shares in the market. However, if the value referred to in section 34 is the true or intrinsic value, it may be that no amount should have been credited to share premium account. The share premium account might therefore have to be adjusted downwards with retrospective effect.

103. If that were so, it may turn out that shares in Herald were not redeemed in accordance with CLCI. Attention can be confined to those who redeemed only some of their shares and remain members of Herald as they are the only persons affected by the liquidator's proposal, and I proceed on that basis. Despite the concession in *DD Growth*, the House of Lords has held that a purchase of shares by a company which is not authorised by the Companies Acts is unlawful and ultra vires: *Trevor v Whitworth* (1887) 12 App Cas 409. I therefore proceed on the basis that a redemption which purports to take place in a manner not authorised by the CLCI would be unlawful and void. As the House of Lords explained in that case, capital can only be returned to a member of the company if that return is authorised by the Companies Acts. The House held that a transaction for that purpose in breach of the Companies Act 1862 was unenforceable. Share premium is treated as capital in the CLCI.

104. The liquidator would then (as it provisionally seems to me) have the option of rectifying the register of members to reinstate the holders of redeemed shares and demand repayment of the redemption monies paid to them. He would not have to go that far because, in lieu of enforcing that demand, he could potentially depart from shareholders' strict legal rights and adjust entitlements to repayment of capital using

both section 112(1) and section 112(2) and (if he wished) sue for any balance. He would have to give credit for the rather smaller sum to which the reinstated holders would have been entitled on distribution of the surplus assets if their names had been reinstated in the register of members.

105. If the misstatement of the share premium account were a "default" for the purposes of Order 12 rule 2(1)(c) (para 87 above), that rule might be triggered. But it is not necessarily critical to achieving every part of the liquidator's proposal that Order 12 rule 2 should apply. Moreover, once one sees that the power to adjust rights may involve a departure from contractual rights and strict legal rights, it is perhaps possible to see Order 12 rule 2 in a different light.

106. The share premium account may be a current account, and the rule in *Clayton's* case (1816) 1 Mer 572 may apply to it, for the purpose of determining which if any shares were unlawfully redeemed out of it, subject to the observations of Lord Briggs in para 78 of his judgment in *Stanford*.

107. Primeo argues that the need for investor certainty overrides other considerations. However, it is also an important policy objective with regard to the redemption of shares that the capital of a company is reserved for the payment of creditors and not distributed to members in any shape or form unless that is authorised by the CLCI. The lawfulness of any payment to members is therefore to be judged at the time it is made.

108. The idea that the liquidator may be able to bring into account redemption monies if wrongly paid out to investors is not incompatible with the principle that any rectification should be in accordance with legal rights following *In re Sichell's* case (1867) LR 3 Ch App 119. However, it is clear from the above example that rectification may go beyond contractual rights and strict legal rights provided that it does not in substance exceed the legal rights of the members affected at the stage of adjusting the rights of contributories.

109. Accordingly, in my judgment, the liquidator goes too far when he states (in his written submissions at para 19(2)) that "nothing in [the language of section 112(2)] indicates that the liquidator's power to settle and rectify the register of members can be exercised only in order to give effect to *pre-existing* legal rights." There is no need for the rights to pre-exist the winding up. But again Primeo goes too far when it submits in its written submissions that the liquidator's submissions are a "distortion of the well understood and well established concept of rectification of a company's share register". The power of rectification conferred by section 112, which is linked to the power of the liquidator to adjust the rights of contributories among themselves, is wider than the power of rectification conferred by section 46 as the above scenario demonstrates.

110. If the liquidator were to find that it was virtually impossible to work out the rights of individual members, then unless he could bring the case within Order 12 rule 2 (on which I express no view) he might have to promote a scheme of arrangement in section 86 of CLCI. The important point is that if the legal rights of investors in a winding up are to be adjusted further than in my judgment they can be so adjusted under section 112 and other than with the individual consents of the investors concerned, there must be a scheme of arrangement: see *In re Trix Ltd* [1970] 1 WLR 1421, where in the absence of a scheme of arrangement Plowman J refused to sanction a compromise with creditors proposed to be made by a liquidator which might not have given creditors their entitlement in a liquidation; and see also *In re Calgary and Edmonton Land Co Ltd* [1975] 1 WLR 355, where Megarry J refused to sanction a stay of a liquidation to which not all members had consented. As I explained in *Stanford*, these cases demonstrate the rigour with which the statutory scheme in winding up is required to be followed. In addition, these cases show the importance of the safeguards in the statutory provisions relating to schemes of arrangement: in particular, there must be meetings convened by the court, a special majority and the sanction of the court.

111. Lord Briggs makes the point that the Cayman Islands Law Reform Commission did not refer to section 112(2) in its explanatory notes to the draft bill leading to CLCI. I agree that it curious, but the fact remains that Order 12 rule 2 was adopted, and the courts must do their best to interpret it.

E. Conclusion

112. I agree with the order proposed by Lord Briggs on the liquidator's proposal as presented to us, though my analysis of the effect of section 112 differs substantially from his, in some respects in areas which were not necessary for him to consider. I would, however, make it clear that so far as I am concerned the order on this appeal applies to the liquidator's proposal in its present form and as a composite whole. Individual elements of it may be achievable as I have indicated (without expressing a final view) by way of the examples given in this judgment, which use (among others) the powers in section 112 on which he relies.