Weavering Overturned: Lessons for Directors, Litigators and Liquidators

The Cayman Islands' Court of Appeal has overturned the first instance *Weavering* decision[1], which had held a hedge fund's former non-executive directors liable for $111m on the basis they had acted with "wilful neglect and default" in failing to spot that the fund's main "assets" were fictitious swap agreements purportedly worth $637 million, but which in fact were made with a related counterparty which had no assets to satisfy its liabilities under those agreements.

In a well-reasoned judgment, the Court of Appeal concluded that although the non-executive directors had acted negligently, they were not guilty of wilful default because there was no evidence that they had ever intended to breach their duties, nor that they had even *suspected* that they were failing to meet their obligations. The trial judge was wrong to have drawn inferences of wilful default from evidence of the directors' failures to carry out certain functions which he took the view should have been carried out by them.

The consequence of this ruling is that the directors are able to rely upon an exemption from liability in the fund's articles of association, whereas the liquidators have secured no recoveries for investors – rather, they are facing a hefty costs bill.

What lessons may be learned by fund directors, litigators and liquidators?

For directors, particularly non-executives, the appeal judgment gives some comfort that the common exemption provision in a hedge fund's articles, excluding liability for conduct falling short of wilful default or neglect, will apply unless any breach of duty is shown clearly to be intentional (or reckless, in the sense that the directors had been conscious that they might be acting in breach, but then continued regardless). However, while the Court of Appeal did not comment upon the trial judge's exposition of certain specific actions which all hedge fund directors should take to comply with their duties to the fund (rather it re-affirmed that the scope of directors' duties is fact sensitive in every case), it confirmed that the non-executive directors should have (for example) read the fund administrator's reports carefully and fully, in order to check whether the fund was complying with its investment restrictions. A further useful lesson is that, when analysing the scope of the directors' duties, the Court of Appeal paid particular attention to the objectives that the directors had recorded in board minutes early in the life of the fund. So, non-executive directors should be careful to fulfil any tasks that they have previously outlined for themselves to perform, in their service agreements, board meetings or otherwise, as well as complying with their general high-level duty to supervise the fund's service providers.

For litigators, the first point is that the judgment upholds and applies established law, rather than breaking new ground. The first instance judgment was overturned because the Court of Appeal held that the trial judge had made erroneous findings of fact – in particular, that the directors had intentionally acted in breach of duty in failing to read an important section of the administrator's report concerning the swap agreement pricing and counterparty – and drawn illegitimate inferences of intentional default from examples of the directors' failings to carry out other functions. Secondly, the Court of Appeal hinted that the liquidators' claim was pleaded too loosely, in terms of its allegations of breach. Thirdly, the case highlights the importance of challenging witnesses about evidence that is in dispute; failure to do so can mean that the judge has no basis for reaching a conclusion that is contrary to the witnesses' evidence – especially if there is also a lack of documentary evidence one way or the other. On the facts, the critical evidence concerned the directors' assertions that they had "simply missed" the key sentence of the administrators' report, whereas the liquidators' case (and the trial judge's finding) was that the directors had not bothered to read the report at all – but that assertion was never put to the directors in cross-examination.

For liquidators, the case highlights the need to take sound strategic advice before pursuing litigation. On the face of it, this was always a case where it would be hard to achieve meaningful recoveries for investors, because (1) if (as the Court of Appeal found) the directors were liable in negligence only, the exemption from liability would apply and (2) even if they *had* been liable for wilful default, the directors' insurance policy would almost certainly not have responded; so any recoveries could only come from the directors' own resources and would have been modest. As matters stand, the fund now faces a costs award for the whole of this long-running litigation. It is not yet known whether the liquidators intend to appeal further.

[1] The Court of Appeal decision is: Weavering Macro Fixed Income Fund Limited (in liquidation) v (1) Stefan Peterson and (2) Hans Ekstrom CICA 10 of 2011 (unrep., 12 February 2015). The first instance decision is: Weavering Macro Fixed Income Fund Limited (in liquidation) v (1) Stefan Peterson and (2) Hans Ekstrom 2011 (2) CIRL 203.

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The directors were represented by Campbells; www.campbellslegal.com.

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