IN THE COURT OF APPEAL OF THE CAYMAN ISLANDS

CICA 10 of 2011

BEFORE

The Rt Hon Sir John Chadwick, President
The Hon Dr Abdulai Conteh, Justice of Appeal
The Rt Hon Sir Anthony Campbell, Justice of Appeal

ON APPEAL FROM THE GRAND COURT
FINANCIAL SERVICES DIVISION
(Cause No 113 of 2010 AJJ)

BETWEEN

WEAVERING MACRO FIXED INCOME FUND LIMITED
(IN LIQUIDATION)

Claimant/Respondent to Appeal

-and-

(1) STEFAN PETERSON
(2) HANS EKSTROM

Defendants/Appellants

Mr. Ben Valentin with **Ms. Kirsten Houghton** of Campbells for the Appellants, Stefan Peterson and Hans Ekstrom
Mr. David Lord QC with **Mr Shaun Folpp** of Ogier for the Respondent to the Appeal, Weavering Macro Fixed Income Fund Limited (in liquidation)

Hearing: 3, 4 and 5 April 2012
Judgment: 12 February 2015

JUDGMENT

Sir John Chadwick, President:

1. This is an appeal from an order made on 26 August 2011 by Justice Andrew Jones QC in proceedings brought by Weavering Macro Fixed Income Fund Limited (formerly known as Weavering Fixed Income Fund Limited), a company in insolvent liquidation acting by its Joint Official Liquidators, ("the Company" or "the Macro Fund") against its former directors, Stefan Peterson and Hans Ekstrom (together "the Directors"). It is alleged on behalf of the Company that, during the whole of the period that they held office, the Directors acted in breach of their duties to exercise independent judgment, to exercise reasonable care and skill and to act in its best interests. The judge upheld that allegation.

2. In particular, it is alleged that the Directors acted in breach of their duties in failing to inform themselves of the identity of the counter-party to substantial Interest Rate Swap ("IRS") contracts into which the Company had entered in 2005 and thereafter. The judge upheld that allegation. He held that the Directors ought to have discovered, not later than early November 2008, that the counter-party to the IRS contracts then outstanding was Weavering Capital Fund Ltd ("WCF").

3. Further, the judge held that, had the Directors discovered in early November 2008 that WCF was the counter-party to the IRS contracts then shown as assets of value in the unaudited interim balance sheet of the Company, they would have appreciated that the values attributed to those contracts could not be justified; that the Company was seriously insolvent; and that it should be put into immediate liquidation. He found that, in the period between early November 2008 and March 2009 (when voluntary liquidators were appointed), the Company had paid out to investors, by way of irrecoverable redemption payments, sums in excess of US$141 million; and that this had led to a loss to the Company (being the difference between what was actually paid out in respect of redemptions and what would have been payable based on a realistic Net Asset Value after taking account of the true value of the IRS contacts) of not less than US$111 million.

4. In those circumstances, the judge expressed himself satisfied that the loss suffered by the Company by reason of what he had held to be the Directors' wilful neglect or default was at least US$111 million; and he gave judgment against each of them in that sum. The Directors appeal from the order which gave effect to that judgment.

The underlying facts

5. The following facts were agreed between the parties for the purposes of the trial:

   (1) The Company was incorporated in April 2003 under the laws of the Cayman Islands as an exempted company. It was established in order to carry on business as an open-ended investment fund. The share capital of the Company was US$50,000 divided into 100 management shares of US$1.00 each and 4,990,000 participating shares of US$0.01 each. The participating shares were admitted to listing on the Irish Stock Exchange; and the Company was subject to the Irish Stock Exchange Listing Requirements. At all material times from its

incorporation Mr Stefan Peterson and Mr Ekstrom were the sole directors of the Company.

(2) By a written agreement dated 30 July 2003 ("the Administration and Accounting Services Agreement") the Company appointed PNC Global Investment Servicing (Europe) Limited ("PNC"), a company incorporated in the Republic of Ireland, as its administrator and PNC International Bank Limited as its custodian.

(3) By a written agreement dated 31 July 2003 ("the Advisory Agreement") the Company appointed Weavering Capital (UK) Limited ("WCUK"), a company incorporated in England and Wales, as its advisor and investment manager. Mr Magnus Peterson, the elder brother of Mr Stefan Peterson and the stepson of Mr Ekstrom, was a director and the chief executive officer of WCUK and was its "Principal Investment Advisor".

(4) In 2007 the structure established by the Advisory Agreement was altered; at least in form. By a written agreement dated 30 January 2007 ('the IM Agreement') the Company appointed Weavering Capital Management Ltd ("WCM") as its investment manager. WCM had been incorporated in the Cayman Islands on or about 7 July 2006. The directors of WCM were, at all material times, Mr Stefan Peterson and Mr Ekstrom. Also on 30 January 2007 the Company, WCM and WCUK entered into an Investment Advisory Agreement ("the IA Agreement") pursuant to which WCUK was appointed as the Investment Advisor. In practice, the introduction of WCM as the Company's investment manager – and the formal insertion of WCM between the Company and WCUK - made no difference to the manner in which the affairs of the Company were conducted.

(5) The Directors appointed Ernst & Young ("EY") to be the Company's auditor. EY's Cayman office was the Company's statutory auditor for the purposes of the Mutual Funds Law. The appointment was upon terms recorded in letters of engagement exchanged between EY and the Directors. In connection with the audit of the 2005, 2006 and 2007 financial statements, the Directors signed representation letters addressed to EY (in June of the year following the financial year under audit). With each of the financial statements there was a Directors' Report signed by the Directors in which they reviewed the development of the

Company's business and explained the investment objective and strategy and the results, activities and future developments.

(6) The Company issued Offering Memoranda inviting investors to subscribe for participating shares in the Company.

(7) Until early 2005, the Company's trading assets comprised, in the main, interest rate derivatives referenced to the London Interbank Overnight Rate ("LIBOR"): in particular, its trading assets included futures and options contracts traded through the London International Financial Futures and Options Exchange ("LIFFE") (together "Exchange Traded Instruments") and LIBOR referenced Future Rate Agreements ("FRAs").

(8) From 2005 onwards, the Company continued to trade in Exchange Traded Instruments; but it began, also, to enter into LIBOR referenced IRS contracts with WCF. At all material times Mr Ekstrom was a director of WCF. Mr Stefan Peterson was a director of WCF until early 2006.

(9) Shortly before they entered into the first of the IRS contracts, the Company and WCF purportedly entered into an ISDA 2002 Master Agreement dated 20 January 2005 in anticipation of entering into swap transactions. Over the following three years, the Company purportedly entered into thirty IRS contracts with WCF. The reported combined value of the IRS contracts rose from US$2.6 million in February 2005 to US$637.1 million in the draft statement of Net Asset Value as at 28 February 2009. The IRS contracts were not Exchange Traded Instruments: they were "over the counter" contracts. They were not traded on public exchanges; but were direct contractual transactions between party and counter-party with no financial intermediary.

(10) Between February 2005 and February 2009 the Company purportedly entered into forty three termination or "step down" transactions. Under each such transaction one of the IRS contracts was either terminated outright (as was the case in twenty six of the transactions) or the notional value was reduced. In the twenty six transactions under which an IRS contract was terminated outright, no payments were made from the Company to WCF or from WCF to the Company. The only payments that were made pursuant to the IRS contracts were alleged interest payments (amounting to £8 million or thereabouts) made by the Company

to WCF between July 2006 and September 2007. In 2007 and 2008 the Company made substantial losses in respect of options trading on LIFFE. But, nevertheless, the value attributed to the IRS contracts was such as to cause the Net Asset Value ("NAV") of the Company to increase over that period.

(11) From October 2008 – following the failure of Lehman Brothers - the Company received a large volume of redemption requests from investors. Redemption payments were to be made within 30 calendar days after the "Redemption Day"; which was defined as the first business day of each calendar month. Redemption requests totalling US$138.4 million were processed on the 3 November 2008 Redemption Day; redemption requests totalling US$54.7 million were processed on the 1 December 2008 Redemption Day; and redemption requests totalling US$30 million were processed on the 1 January 2009 Redemption Day. The Company was unable to make the redemption payments in respect of those redemption requests in full; but it was able to make (and did make) redemption payments of US$7.6 million in December 2008, US$72.3 million in January 2009 and US$10.2 million in February 2009.

(12) On 13 December 2008 the Directors, pursuant to article 38 of the Company's Articles of Association, determined that redemption payments would be "deferred to such time as liquidity returned to the fixed income market and assets could be realised at fair value on the basis of an orderly liquidation". Further redemption requests received by the Company in January and February 2009 had the effect that the Company's liquidity problem increased.

(13) In early March 2009, the Company's legal advisors, at the instigation of WCUK, approached PricewaterhouseCoopers UK hedge fund restructuring team to seek advice on possible restructuring options. A draft balance sheet as at 27 February 2009 indicated (i) that the Company had cash balances of US$22,248,842; (ii) that the value of Company's non-cash assets, other than the IRS contracts to which WCF was stated to be the counterparty, was approximately $7.2 million; (iii) that the IRS contracts to which WCF was stated to be the counterparty had an aggregate value (on a mark-to-market basis) of $637,121,094; (iv) that redemptions payable to third party shareholders totalled $132,622,413; and (v) that the Company's Total Net Assets totalled $506,307,035. Following advice that a high proportion of the assets in the draft balance sheet were fictitious – or, at the

least, substantially over-valued - the Directors concluded that steps should be taken to place the Company in voluntary liquidation.

(14) On 19 March 2009 the Company's sole voting shareholder, Codan Trustees (BVI) Limited, as a trustee of the M.P. Number One Trust, resolved that the Company be wound up. Ian Stokoe and David Walker of PricewaterhouseCoopers Finance & Recovery (Cayman) Ltd were appointed as joint voluntary liquidators. They applied under section 124 of the Companies Law to have the liquidation brought under the supervision of the Grand Court: that application was made on the basis that the Directors had confirmed that they would be unable to provide a declaration of solvency. On 3 April 2009 the Grand Court granted a Supervision Order; and Mr Stokoe and Mr Walker were appointed as Joint Official Liquidators of the Company.

(15) On 24 April 2009 an order for the provisional liquidation of WCF was made in the British Virgin Islands. On 2 June 2009, an order was made for the winding up of WCF.

(16) On 19 March 2009 WCUK went into administration. Subsequently it was ordered to be wound up by the High Court of England and Wales. On 8 October 2009 liquidators of WCUK were appointed. They commenced proceedings in the High Court against Mr. Magnus Peterson, and others, seeking various forms of relief.

The IRS Contracts

6. As I have said, from early 2005 the Company entered into thirty over-the-counter IRS contracts with WCF. Under these contracts WCF agreed to pay interest based upon a predetermined fixed rate on a specified notional amount, in consideration for the Company's agreement to pay interest on the same notional amount based upon a floating rate referenced to one year sterling LIBOR. The value of an IRS contract to the floating-rate payer increases when (during the term of the contract) interest rates decline; and - given that, in the events which happened, there was a general decline in interest rates over the term of these contracts (and a sharp decline in 2008) - these IRS contracts were (on paper) very profitable for the Company (as the floating rate payer). Quarterly Reports prepared by PNC showed that the aggregate market value of outstanding IRS contracts rose from US$15.9 million at the end of 2005 to US$86.8

million by the end of 2006, to US$195.6 million by the end of 2007 and to US$626.6 million by the end of 2008. The percentage of the Company's reported NAV represented by the aggregate value of the IRS contracts fluctuated from time to time; but, from and after mid-2006, it was generally in excess of 70%.

7. The judge recorded (at paragraph 46 of his judgment) that it was not disputed that the IRS contracts with WCF were fictitious. The contracts were (he said) the mechanism by which Mr Magnus Peterson "dressed up" the balance sheet of the Company to inflate its NAV; and so give the impression that it was making a steady return, when in fact it was suffering substantial losses. Although it was not, I think, necessary for the judge to decide (if he did so) that the IRS contracts were "sham" (in the strict sense), there are a number of factors which support the view that the judge was correct to reach the conclusion that they were made for the purpose which he identified:

   (1) WCF, a company incorporated in the British Virgin Islands in 1999 was the vehicle through which Mr Magnus Peterson originally promoted his investment fund business. The investment manager of WCF was WCUK. The directors of WCF, from its incorporation, were Mr Ekstrom and Mr Stefan Peterson. Their evidence was that they had thought that WCF had been dormant from 2003.

   (2) The IRS contracts with WCF purported to be made under the ISDA 2002 Master Agreement. That agreement, dated 20 January 2005 appeared to bear the signatures of Mr Ekstrom (on behalf of the Company) and Mr Stefan Peterson (on behalf of WCF); but, in their evidence at trial, both Mr Ekstrom and Mr Stefan Peterson stated that they had no recollection of signing that document and had not become aware of it until March 2009 (when the Company went into liquidation). The judge was told by counsel that it was Mr Magnus Peterson's case, in the proceedings brought against him in the High Court of England and Wales by WCUK (acting by its liquidators), that he signed the document by copying the signatures of Mr Ekstrom and Mr Stefan Peterson and that he was authorised by them to do so.

   (3) Mr Stefan Peterson was said to have resigned as a director of WCF in 2006. Mr Ekstrom continued to be a director until WCF was put into liquidation by order of the BVI Court in April 2009. Mr Ekstrom had stated in his witness statement

that:

> "My recollection now of WCF, my role as a director and what I did in that capacity is very limited indeed. I remember that WCF was a relatively small fund and believe that it was relatively volatile, initially making but then losing money".

The unchallenged evidence of Mr Nicholas Carter, the joint official liquidator of WCF, was that WCF had no assets (or at least no assets having a realizable value) other than a receivable of about £250,000 in respect of a loan due from a former employee of WCUK and secured on a residential property in England.

(4) IRS contracts were listed in the PNC Quarterly Reports, in the section headed "Portfolio Analysis". From 30 September 2006 each IRS contract was identified by a distinctive "Security ID". By comparing successive reports, it can be seen that, from time to time, IRS contracts shown to have had a substantial market value ceased to appear on the list; indicating that those contracts had been closed out. On 26 occasions between February 2005 and February 2009 documentation was generated to show that IRS contracts, recorded in the balance sheet of the Company as having a positive value, were closed out for nil consideration; and, on 17 other occasions in the same period, the specified notional amount was reduced (which had the effect of reducing the value of the IRS contract to the Company). But, as the judge pointed out in his judgment, if a profitable IRS contract were closed out before maturity – or if the specified notional amount were reduced - the Company should have received a payment in respect of the reported value. The judge found that, in the events which happened, the Company received no payments from WCF.

The judge concluded that the reason for the continued existence of WCF after 2003 was that it was the vehicle through which (by means of the IRS contracts) Mr Magnus Peterson manipulated the Company's balance sheet; that IRS contracts were closed out "because the greater the amount of fictitious assets reflected on the balance sheet [of the Company], the greater the risk for Mr Magnus Peterson that his fraud would be discovered"; and that apparently valuable contracts were closed out without payment because WCF had no assets (or no assets of substance) from which such payments could be made.

8. Although there is obvious force in the judge's view that the IRS contracts were "fictitious" – in the sense that they were the means by which Mr Magnus Peterson

"dressed up" the balance sheet of the Company to inflate its NAV and so give the impression that it was making a steady return, when in fact it was suffering substantial losses – the case against the Directors in these proceedings does not turn upon a finding (or a concession) to that effect. The case against the Directors turns on the judge's finding of fact that the Directors ought to have discovered, not later than early November 2008, that the counter-party to the IRS contracts then outstanding was WCF; and on his further finding of fact that, had the Directors discovered in early November 2008 that WCF was the counter-party to the IRS contracts then shown as assets of value in the unaudited interim balance sheet of the Company, they would have appreciated that the values attributed to those contracts could not be justified, that the Company was seriously insolvent and that it should be put into immediate liquidation.

The management structure

9. The Amended and Restated Articles of Association of the Company, adopted on 5 August 2003, required (by article 121) that there should be a board of directors consisting of not less than two persons; and provided (by article 122) that, subject to the provisions of the Companies Law (2003 Revision), the Memorandum of Association and the Articles and to any directions given by Special Resolution, the business of the Company should be managed by the directors who might exercise all the powers of the Company. Article 5 gave the directors power to appoint any person to act as the Manager of the Company's business affairs. Article 6 provided that the directors might "entrust to and confer upon the Manager any of the functions, duties, powers and discretions exercisable by them as Directors upon such terms and conditions . . . and with such powers of delegation and such restrictions as they think fit".

10. Article 182 of the Amended and Restated Articles of Association was in these terms:

> "182. Every Director, agent or officer of the Company shall be indemnified out of the assets of the Company against any liability incurred by him as a result of any act or failure to act in carrying out his functions other than such liability (if any) that he may incur by his own wilful neglect or default. No such Director, agent or officer shall be liable to the Company for any loss or damage in carrying out his functions unless that liability arises through the wilful neglect or default of such Director, agent or officer."

11. WCUK was appointed to act as manager of the Company's affairs on 31 July 2003; and, notwithstanding the subsequent appointment of WCM as Manager on 31 January 2007, it has been common ground in these proceedings that, in practice, WCUK continued in that role until the Company ceased to trade in March 2009. The appointment was made by clause 2 of the Advisory Agreement:

> "2. The Fund (subject to the overall supervision of its Directors) hereby appoints the Advisor [WCUK] to manage the affairs of the Fund until its appointment shall be terminated as hereinafter provided and the Advisor hereby accepts such appointment and agrees to assume the obligations set forth herein."

Clause 3 of the Advisory Agreement provided that:

> "3. . . . The Advisor shall observe and comply with all instructions of the Fund . . . the then current Memorandum and Articles of Association of the Fund and with the applicable provisions of any Private Placement Memorandum or any other document relating to the Fund distributed by or on behalf of the Fund and all resolutions of the Directors of the Fund of which it has notice and other lawful orders and directions given to it from time to time by such Directors. Such instructions will be acknowledged by the Advisor and all activities engaged in by the Advisor hereunder shall at all times be subject to the control of and review by such Directors and any specific or general direction given by such Directors in writing shall override the general authorisation given to the Advisor hereunder.

Clause 4 provided that, subject to the provisions of clause 3, WCUK should be entitled to exercise each of the powers duties and discretions vested in the Company. In particular, WCUK was to manage the investment and reinvestment of the assets of the Company, with power at its discretion "to purchase, subscribe for or otherwise acquire investments and to sell redeem, exchange, vary or transpose the same with a view to achieving the then current investment objectives of the Fund as laid down from time to time by its Directors".

12. The obligations of WCUK as Advisor (or investment manager) under the Advisory Agreement ceased on 30 January 2007; and were formally replaced by the obligations of WCM under the IM Agreement of that date. As I have said, Mr Ekstrom and Mr Stefan Peterson were the sole directors of WCM. Clause 6 of the IM Agreement was in these terms:

> "6. Subject to the investment objectives and policies and investment restrictions as set out in the Offering Memorandum, to the overall supervision of the Company and to the directions given by the board of directors of the Company, during the term of the Management Agreement the Manager [WCM] shall have complete discretion in the investment and reinvestment of

> the Investments with full power and authority to make such purchases and sales, or to issue directly to a broker or dealer orders for such purchases and sales of Investments."

Clause 8 provided that the board of directors of the Company might at any time give to WCM written guidelines and/or directions relating to the investments generally or with regard to specific matters.

13. At the same time (30 January 2007), the Company, WCM and WCUK entered into an agreement (the IA Agreement) under which WCUK was appointed as Investment Advisor. It was recited in that agreement that:

> "The Company has appointed the Manager and the Manager has agreed subject to the overall supervision of the Directors, to act as the manager of the Company, and to be responsible for the Company's investment management and marketing; and furthermore the Manager wishes to delegate to the Investment Advisor responsibility for advising on the investment of the assets of the Company."

Clause 4 of the IA Agreement provided that:

> "4. Subject to the investment objectives and policies and investment restrictions as set out in the Offering Memorandum, the Investment Advisor shall have no authority to sign, execute or enter into any purchase or sales of Investments on behalf of the Company or Manager unless with the specific authority in writing to the extent provided for by the Manager."

Clause 5 required that, in carrying out its duties, WCUK should observe the investment objectives and policies and investment restrictions set out in the Offering Memorandum and the Articles or as those objectives, policies and restrictions were amended and from time to time communicated to it in writing by the Company or the Manager; and, with regard to all matters, exercise such judgment which a prudent adviser to an investment portfolio would reasonably exercise in the proper discharge of its duties. Clause 6 provided that the board of directors of the Company (and/or the board of directors of WCM) might give to WCUK (as Investment Advisor) written guidelines and/or directions relating to the Investments generally or with regard to specific matters. As I have said, it has been common ground that, in practice, the interposition between the Company and WCUK of WCM as Manager made no difference to the way in which the affairs of the Company were conducted.

14. PNC's obligations as Administrator were defined in the Administration and Accounting Services Agreement of 30 July 2003. Clause 7(b) of that agreement required that PNC should keep books of account and records of the transactions in

securities effected by the Company: clause 9 required that PNC should act as liaison with the Company's independent public accountants, provide account analyses, fiscal year summaries, and other audit-related schedules with respect to the Company and take all reasonable action in the performance of duties "under this Agreement" to assure that the necessary information was made available to such accountants for the expression of their opinion, "as required by [the Company]" Clause 14(a) was in these terms:

> "[PNC] shall he under no duty hereunder to take any action on behalf of [the Company] except as specifically set forth herein or as may be specifically agreed to by [PNC] and the [Company] in a written amendment hereto."

Clauses 15 and 16 described, respectively, the accounting and administrative services which PNC was to provide. Those included the preparation of statements of assets and liabilities, the calculation of capital gains and losses, the calculation of the market value of the Company's investments and the computation of NAV; and the preparation of monthly transaction listings, the supply of "normal and customary Fund statistical data as requested on an ongoing basis" and "such additional administrative duties relating to the administration of the [Company] as may subsequently be agreed upon in writing between the [Company] and PNC."

15. In a section of the Offering Memorandum dated 24 September 2008, headed "Management of the Company: The Administrator, Registrar and Transfer Agent", which was issued by the Company, the role of PNC, as Administrator, was described in these terms:

> " . . . The Administrator [PNC] is a service provider to the Fund and will not have any responsibility or authority to make investment decisions, nor render investment advice, with respect to the assets of the Fund. *The Administrator has no responsibility for monitoring compliance by the Fund or by the Investment Manager with any investment policies or restrictions to which they are subject. The Administrator is only responsible and liable for the administration services that it provides to the Fund pursuant to the Administration Agreement,* The Administrator accepts no responsibility or liability for any losses suffered by the Fund as a result of any breach of such policies or restrictions by the Fund or the Investment Manager." [Emphasis added]

The investment restrictions set by the board of directors

16. As I have said, the Company was incorporated in April 2003. The first meeting of the board of directors, attended by Mr Ekstrom and Mr Stefan Peterson, was held on 16

June 2003. The minutes of that meeting record (at item 18) that the directors considered it to be in the best interests of the Company for the participating shares to be admitted to the Official List of the Irish Stock Exchange. It was a listing requirement of the Irish Stock Exchange that no more than 20% of the value of the Gross Assets of the Company be lent to or invested in the securities of any one issuer or exposed to the creditworthiness or solvency of any one counterparty.

17. In a section of the Offering Memorandum dated 27 August 2004, headed "Investment Restrictions", which was issued by the Company, it was stated that:

> "The Company endeavours to adhere to the following investment restrictions:
>
> - no more than 20% of the value of the Gross Assets of the Company is lent to or invested in the securities of any one issuer . . . or is exposed to the creditworthiness or solvency of any one counterparty;
> - the company may not take legal or management control of the issuer of any of its underlying investments;
>
> . . .
>
> Where the investment restrictions set forth in the first paragraph above is breached, the Investment Advisor and the Manager will monitor and the Manager will ensure that immediate corrective action is taken . . ."

The immediately preceding section, headed "Risk Management of the Fund", was in these terms:

> "In order to meet its commitment to capital preservation, the approach to risk management is rigorous. Pro-active risk management provides early indications of any changes that need to be made within the portfolio. In adopting this pro-active approach to risk management any delay between making decisions and taking corrective actions in the portfolio is minimized."

Those statements appeared, in the same terms, in the Offering Memorandum dated 24 September 2008.

18. The second meeting of the board of directors was held on 29 August 2003. The minutes of that meeting record (amongst other matters) that the Company had been successfully launched on 8 August 2003, that it had been decided that the directors would meet quarterly in October, February, April and July in each year. Those minutes also record that:

> "At each meeting we will assess the performance of the Company and the work done by the investment manager. It is essential that the investment manager acts within the guidelines and investment restrictions set by the Board. This will be closely looked upon at each board meeting and the Directors will have weekly discussions with the investment manager about the Company's

positions and fixed income markets in general."

19. The next meeting of the board of directors was held on 24 October 2003. The minutes of that meeting record that it was noted that:

> "... the investment manager had been acting within the guidelines and investment restrictions set by the Board."

A note in the same terms appeared in the minutes of all quarterly meetings of the board of directors held subsequently; save that, in the minutes of the meeting of the board held on 30 July 2004, the note was qualified by the words "... apart from one temporary exposure to another counterparty resulting in a holding representing 28% of total assets as at 30th June....".

Quarterly Reports

20. The Directors received Quarterly Reports from PNC, at least from and after April 2005. The Quarterly Reports contained information presented under headings which included "Net Asset Valuation", "Shares in Issue", "Shareholder Register", "Portfolio Analysis", "Errors and Breaches" and "Administrative Issues"; and, typically, extended over six or seven pages. They did not contain either monthly or quarterly management accounts. The only accounts seen by the Directors were the annual audited financial statements and the six monthly unaudited interim financial statements which were published to the investors. The six monthly unaudited interim financial statements were appended to the next Quarterly Report.

21. The Quarterly Report for the quarter ended 31 March 2005 (Q1 2005) disclosed, as the first item in the Portfolio Analysis, that the Company's assets include a single IRS contract, having a market value of US$1,507,795. By 31 December 2005, the assets (as disclosed in the Q4 2005 Quarterly Report) included two IRS contracts, having an aggregate market value of US$15,902,477. By 30 June 2006, the number of IRS contracts disclosed (in the Q2 2006 Quarterly Report) had increased to five, having an aggregate market value of US$42, 269,263; and, by 30 December 2006, the aggregate market value of the five IRS contracts disclosed in the Q4 2006 Quarterly Report had increased to US$87,759,646. By that stage, it would have been apparent from the Quarterly Reports that the aggregate value of the IRS contracts was approaching (if it did already exceed) 20% of the Gross Asset Value of the Company; but there was nothing in the Quarterly Reports to indicate, as was, in fact, the case, (i) that the IRS

contracts had been made with the same counterparty or (ii) that the counterparty to each of the IRS contracts was WCF.

22. By 30 June 2007 the aggregate market value of the three IRS contracts disclosed in the Q2 2007 Quarterly Report had increased to US$130,105,178; and, by the end of that year (as disclosed in the Q4 2007 Quarterly Report), the Company's assets included six IRS contracts having an aggregate market value of US$194,804,280. It would have been apparent to an informed reader of the 2007 Quarterly Reports – that is to say, to a reader who knew the identity of the counterparty to each of the IRS contracts disclosed as assets in those reports – that the Investment Manager (by then WCM, a company of which Mr Stefan Peterson and Mr Ekstrom were the directors) and the Investment Advisor (WCUK) were in breach of the investment restrictions which the board of directors of the Company had sought to impose: in that (i) more than 20% of the value of the Gross Assets of the Company was exposed to the creditworthiness or solvency of a single counterparty and (ii) that that counterparty (as issuer of the underlying investments) was under the management control of the Directors. Further, it would have been apparent to an informed reader who knew, also, that WCF was dormant and had no, or no substantial, assets that the value of the IRS contracts disclosed as assets in those reports was substantially overstated.

23. The judge recorded (at paragraph 46 of his judgment) that it was common ground that PNC knew that WCF was the counterparty to the IRS contracts; but that neither that fact, nor whatever concerns PNC may have had as to the financial status of WCF, were communicated to the Directors.

24. The first time that PNC included the information that WCF was the counterparty to the IRS contracts in a report to the Directors of the Company was in the Q3 2008 Quarterly Report.

25. The Q3 2008 Report comprised seven pages (other than attached spreadsheets addressing "Administrative Issues"). On the first of those pages, under the heading "Net Asset Valuation", were performance figures and a graph in respect of GAV and NAV from 1 July 2008 to 30 September 2008 and a statement of "Shares in Issue". The second, third and fourth pages contained a copy of the Shareholder Register as at 30 September 2008. The fifth, sixth and (in part) the seventh page contained a

"Portfolio Analysis"; which concluded with the statement that the Total Net Assets of the Macro Fund as at 30 September 2008 were US$723,144,763. The first ten items of the "Portfolio Analysis are described as "Interest Rate Swaps", and are shown to have a market value, in aggregate, amounting to US$550,828,166 (or thereabouts); the next 105 items are described as "Options"; the next five items are described as "Futures" and a further eleven GNMA items are described as "Asset Backed".

26. On the seventh and final page of the Q3 2008 Quarterly Report, immediately following the "Portfolio Analysis", there is section headed "Prices". No section under that heading had appeared in any of the previous PNC Quarterly Reports. The section was in these terms:

> "PRICES
>
> The prices are sourced as follows for this fund:
> Futures and Options are all sourced from Bloomberg
> The GNMA positions are priced from Martin Brokers in London
> *The Interest Rate Swap Positions are priced from the counterparty which is Weavering Capital Fund Limited*" [emphasis added]

Board Meetings

27. As I have said, the minutes of the board meeting held on 29 August 2003 record that the Directors had decided that they would meet as a board, quarterly, in October, February, April and July in each year. The documents disclosed in the proceedings include minutes of board meetings which suggest that effect was given to that decision: those minutes record (or purport to record) that there were quarterly board meetings and that those meetings were held in or about the prescribed months.

28. Those minutes are in common form; as if prepared from a template. As the judge explained (at paragraph 29 of his judgment) the minutes include eleven "standard" paragraphs; and are occasionally extended to include a twelfth paragraph. Paragraph 1 is always in the same form: recording that "The Chairman declared the meeting opened". Paragraphs 2 and 3 record that the (previous) quarterly and annualized returns, respectively, have been "noted". Paragraph 4 refers to the investment manager's performance fee. Paragraph 5 records that some macro-economic comment (taken from the monthly investors' reports) has been "noted". Paragraph 6 records that it has been "noted" that the investment manager (or, from May 2008, the investment advisor) has been acting within the guidelines and

restrictions set by the Board. Paragraph 7 records that it has been "noted that the administrator had been quick and efficient in calculating and distributing the Net Asset Value of the Company to our investors". Paragraph 8 records the number of investors and the amount subscribed. Paragraph 9 (when included) usually refers to the fact that the annual audit is in progress or that the audited financial statements have been filed. Paragraph 10 sets the dates for the next meeting and paragraph 11 records that "There being no further issues the Chairman closed the meeting. Mr Ekstrom and Mr Stefan Peterson are recorded in the minutes as present at the meeting.

29. Minutes signed by Mr Ekstrom on 23 December 2008 purport to record proceedings at meetings of the directors of the Company held on 29 July 2008 and 28 October 2008. The minutes of each of those meetings purport to record (amongst other matters) that Mr Magnus Peterson was in attendance at the meeting; that the minutes of the previous meeting were approved; that it was noted that the Investment Advisor had been acting within the guidelines and investment restrictions set by the Board and that no compliance breaches were reported for the period; that the Administrator's report was reviewed; and the date on which the next board meeting would be held (28 October 2008 or 17 February 2009). In addition the minutes of the October meeting purport to record that the interim financial report of the half year financial statements for the Company (for the period 1 January 2008 to 30 June 2008) were approved.

30. It is common ground that no board meeting of the Company took place on 29 July 2008 or on 28 October 2008; or, indeed, on any date between 22 May 2008 and 23 December 2008. Further, although documents purporting to be the minutes of board meetings held on 29 July 2008 and 28 October 2008 were signed by Mr Ekstrom on 23 December 2008, there is no document which purports to be the minutes of a board meeting which was held on that date; although the minutes of the meetings which bear the dates, respectively, 29 July 2008 and 28 October 2008 each have a manuscript annotation "23/12" against those dates.

The judge's criticisms of the Directors

31. At paragraph 2 of the judgment which he delivered on 26 August 2011, the judge described the Company's management structure as "entirely conventional, except in

respect of the composition of its board of directors". He observed (at paragraph 4 of that judgment) that PNC was responsible for maintaining the Company's accounting records, preparing its financial statements and determining its NAV per share. As he explained:

> "It [PCN] prepared the annual financial statements, in respect of which it had an obligation to liaise with the auditors and provide them with whatever analyses, fiscal summaries or audit-related schedules might be required of them. It prepared the interim unaudited financial statements published to investors. It also determined the NAV at the end of each month, for which purpose it would have to prepare monthly financial statements."

He went on to observe that PNC had no responsibility for monitoring compliance by the Fund or WCUK with the investment guidelines and restrictions; that this was disclosed in the Offering Memorandum; and that the Administration and Accounting Services Agreement provided for PNC to take instructions only from "authorized persons" (a phrase which, as he said, was defined to mean any officer of the Fund and must include the Directors themselves). He pointed out that:

> ". . . it was clearly open to the Directors to communicate directly with PNC and instruct PNC to provide them with copies of the monthly accounts and any other information or reports relating to the Fund's financial condition which they might require in order to perform their supervisory duties".

32. At paragraph 5 of his judgment, after explaining that Mr Ekstrom and Mr Stefan Peterson were close family relatives of the Company's promoter and principal investment manager, Mr Magnus Peterson, the judge said this:

> "At the time of his appointment, Mr Ekstrom was about 79 years old and had, by then, been retired from his position as head of the Trustee Department of Skandinaviska Enskilda Banken for about 13 years. . . . At the time of his appointment, Mr Stefan Peterson was a fulltime employee of Storebrand Investments, a large insurance company, for whom he was working in the company's Oslo office as a portfolio manager of its credit hedge fund. Because its participating shares were listed on the Irish Stock Exchange, the Macro Fund had to have at least two independent directors. On paper both Mr Ekstrom and Mr Stefan Peterson had appropriate professional credentials and met the [Irish Stock Exchange's] independence requirement. . . ."

But he went on:

> ". . . With the benefit of hindsight, I find it difficult to avoid the conclusion that Mr Magnus Peterson chose to appoint his relatives as a means of meeting the minimum legal requirements without burdening himself with a real board of directors who could be expected to perform their supervisory role in an ordinary businesslike manner."

33. The judge's criticisms of the manner in which Mr Ekstrom and Mr Stefan Peterson had performed "their supervisory role" in relation to the Company are set out, at length and with some particularity, in paragraphs 14 to 50 of his judgment. Paragraphs 15 to 19 relate to the period (April to August 2003) during which the Macro Fund was established. Paragraphs 20 to 40 (under the heading "Ordinary Course of Business") relate to the period from August 2003 until October 2008. And paragraphs 41 to 50 ("Financial crisis and Liquidation") relate to the period following the collapse of Lehman Brothers (in September 2008) and leading up to the decision (in March 2009) that the Company be put into liquidation.

34. It is, I think, unnecessary in this judgment to refer in detail to the judge's criticisms in so far as they relate to the period during which the Macro Fund was established. In so far as the judge's criticisms relate to the "Ordinary Course of Business" period between August 2003 and September 2008 it sufficient to refer to the following matters:

    (1) The judge explained (at paragraph 20 of his judgment) that the Company's pleaded case was that "the Directors did nothing other than attend board meetings (at which no discussion or debate took place and whose purpose was solely to rubber stamp what the Directors had been told about [the Macro Fund's] performance) and on occasion carry out an administrative task such as signing a document when requested to do so by WCUK"; and that the Directors' case was that they held regular board meetings, usually on a quarterly basis, at which they discussed the affairs of the Macro Fund in a substantive manner for one and three hours at a time. He observed that the Directors had emphasized the fact that they did discuss the Macro Fund with Mr Magnus Peterson at other times; but that (in his view) the board meetings were relied upon as the single most important way in which the Directors claimed to have discharged their functions. In those circumstances it was, he said, important to analyze exactly what took place at these meetings; what was the actual result of the meetings; and what was it that the Directors were attempting to achieve at these meetings.

    (2) The judge referred to the minutes of the meeting of the board of directors held on 29 August 2003; to the decisions, recorded in those minutes, that the board would meet quarterly in October, January, April and July in each year and would, at each meeting, "assess the performance of the Company and the work done by the investment manager"; and to the formal acknowledgment, also recorded in those

minutes, that it was essential that the investment manager acted within the guidelines and investment restrictions set by the Board. He said this (at paragraph 21 of his judgment):

> "21. This was a self-serving resolution drafted by Mr Magnus Peterson. When cross-examined, Mr Stefan Peterson's explanation for having approved this resolution was that 'We *wanted to be ambitious here . . . we want this fund [to] operate well and to make an effort to make it to be a good company'*. I do not believe this evidence. [The Directors] never made any attempt to comply with this resolution and, to the extent that they applied their minds to the contents of the minutes at all, I do not believe that, ever they intended to comply." [emphasis in text cited]

(3) He went on (at paragraph 22 of his judgment) to say this:

> "22. One would ordinarily expect an agenda to be prepared and circulated in advance of each meeting, reflecting input from the investment manager, the administrator and the directors themselves. I would expect the agendas to specify the matters for discussion, the reports to be presented and the individual officers of WCUK or PNC who will participate, either in person or by telephone. In particular, I would expect the agenda to provide for a representative of PNC to attend (at least occasionally) for the purpose of reviewing the Macro Fund's monthly or quarterly management accounts with the Directors. The evidence reflects that the Directors never in fact asked for any reports to be prepared or for any representative of PNC, Ernst & Young or WCUK (other than Mr Magnus Peterson) to attend any board meeting, which points to the conclusion that they never attempted to perform their supervisory duty, let alone do anything on their own initiative."

(4) The judge observed (at paragraph 23 of his judgment) that, although the Directors never asked for any reports to be produced, in the events which happened, they did receive Quarterly Reports from PNC, at least from April 2005 onwards. He pointed out that, on the final page of the Q2 2005 Report, under the heading "Administration Issues", PNC asked the Directors to "Please confirm what information you would like reported on"; but observed that there was no evidence that the Directors ever responded to this question.

(5) The judge emphasized (at paragraph 24 of his judgment) that it was important to understand that the PNC Quarterly Reports did not contain either monthly or quarterly management accounts. He pointed out that the Directors knew that the NAV was determined monthly, that redemptions and subscriptions were accepted and paid monthly and that, for that purpose, PNC must have been producing monthly management accounts; but that, nevertheless, the only accounts ever seen by the Directors were the annual audited financial statements

and the six monthly unaudited interim financial statements which were published to the investors. He said this (*ibid*);

> "24. . . . It is the duty of the directors of an investment fund to inform themselves about its investment activities and have a proper understanding of its financial condition, for which purpose it seems to me that these Directors ought to have reviewed the most recent management accounts at each quarterly board meeting. As I have already said, I do not believe that either Mr Magnus Peterson or the Directors ever intended to 'have weekly discussions with the investment manager about the [Macro Fund's] positions and fixed income markets in general' as stated in the minutes of the first board meeting. In reality, these Directors could not be expected to supervise WCUK's trading activities and they did not have the skill set to be able to do so, but they could and should have reviewed the financial results of that trading at their quarterly board meetings. The fact that they never once asked to see the management accounts and never once asked Mr Frank Barden to attend a board meeting (either in person or by phone) for the purpose of talking them through the Macro Fund's financial position, is evidence that they were not attempting to perform their duties."

(6) The judge recorded (at paragraph 25 of his judgment) that Mr Ekstrom had said in evidence that he received the Quarterly Reports directly from PNC about a week in advance of each meeting. The judge noted that, in answer to the question (put to him during the course of his interview with the Joint Liquidators) whether he had read the Quarterly Reports, Mr Ekstrom had said "Not all of it. As you know I have no experience of these papers so I didn't pay any attention to that". The judge observed that Mr Ekstrom had expanded that answer (by reference to the Q2 2008 Report) when, under cross-examination at the trial, he had said that he generally read the first few pages of the Quarterly Reports - containing the published performance statistics and the share register - and then glanced at the portfolio analysis, but admitted that he never studied any of these reports in detail. The judge commented (*ibid*):

> "25. . . . It is clear that he never attempted to make any use of these reports as a means of acquiring any real understanding of the Macro Fund's financial condition. He did express interest in whether the Macro Fund was complying with its anti-money laundering obligations, but not to the extent of asking PNC to explain its procedures. Put shortly, by his own admission Mr Ekstrom never really applied his mind to the content of the PNC Quarterly Reports. If he had been making any attempt to perform a supervisory function, one might have expected him to have Mr Frank Barden [an employee of PNC] talk him through the Macro Fund's financial condition. The fact that he never once, throughout the six years of the Macro Fund's existence, asked Mr Barden or any other officer of PNC to attend a board meeting suggests that he was not attempting to perform his role as a director at all, let alone in an ordinary businesslike manner."

(7) The judge held (at paragraph 26 of his judgment) that "Mr Stefan Peterson's approach towards the PNC Quarterly Reports was slightly different, at least after he had joined the Weavering group as a fulltime executive". The judge accepted his evidence that, from 2006 onwards, he participated in frequent telephone conversations and face to face meetings between the staff of WCUK and Weavering AB; as the judge observed, during this period Mr Magnus Peterson visited the Gothenberg office and Mr Stefan Peterson visited the London office for a whole day on four or five occasions each year. The judge accepted that Mr Stefan Peterson participated in WCUK's weekly or bi-weekly investment committee meetings; which, as he said, took the form of telephone conference calls attended by various different people. The judge accepted that the affairs of both the Macro Fund and the Opportunities Fund were discussed at these meetings; but he went on to say that it was clear that Mr Stefan Peterson participated in those telephone conference calls in his capacity as chief executive officer of Weavering AB with responsibility for managing the investments of the Opportunities Fund and not in his capacity as a director of the Macro Fund. Nevertheless, the judge accepted that Mr Stefan Peterson's general knowledge of the Macro Fund's investment portfolio and performance gained through these conference calls affected his approach to the information contained in the PNC Quarterly Reports; and that, from his perspective the main purpose of the reports (specifically, those for Q4 2007 and Q1-4 2008) was to provide independent verification of what he already knew about the Macro Fund's investments and performance. The judge said this (*ibid*):

> "26. . . . However, he does not appear to have stood back, put on his director's hat, and made any attempt to satisfy himself about the Macro Fund's financial condition. Having listened to him give evidence, it was plainly obvious that he knew how to perform the directors' supervisory role in an effective way, but the evidence leads to the conclusion that he never attempted to do so. *Whilst he repeatedly said in evidence that he understood that he had a supervisory responsibility in his capacity as a director, he never in fact behaved as if he had any intention of performing this duty.* This explains why he obviously did not apply his mind to the content of the PNC Quarterly Reports. If he had any intention of satisfying himself about the Macro Fund's financial condition, he would surely have asked to see the monthly management accountants. This failure had serious consequences for the Macro Fund because Mr Stefan Peterson admitted in evidence that if he had reviewed these accounts, he would have appreciated that profitable interest rate swaps ('IRS') were (apparently) being closed out for no consideration. This discovery would

have set in motion a line of enquiry leading, almost inevitably, to the revelation that Weavering Capital Finance ('WFC') was the counterparty), and that the value of Macro Fund's assets had been materially overstated." [emphasis added]

(8) The judge observed (at paragraph 27 of his judgment) that the minutes of the board meeting held on 29 August 2003 correctly recorded the importance of complying with the investment criteria and restrictions set out in the Macro Fund's Offering Memorandum. He went on to say this (*ibid*):

> "27 . . . Even though I do not believe the Directors ever intended to comply with the resolution stated in the minutes of their first board meeting, these Directors had an on-going duty to satisfy themselves that the Macro Fund's investment manager was operating within the stated investment criteria and restrictions. Paragraph 6 of the pro-forma minutes signed by Mr Ekstrom as chairman of the meetings states that 'It was also noted that the investment manager had been acting within the guidelines and investment restrictions set by the Board'. This statement is repeated in identical terms in every set of board minutes, bar one, throughout the six year life of the Macro Fund. However, the fact that this point was 'noted' in the minutes does not imply that there was any discussion about the matter or that the Directors had applied their minds to the issue. Mr Stefan Peterson's evidence is that from 2006 onwards they did put the question to Mr Magnus Peterson but they never asked Chas Dhabia [an employee of WCUK]. Even if Mr Magnus Peterson told them that there had been compliance with the investment restrictions, it cannot he said that they discharged their duty by repeatedly signing pro-forma minutes in which this assertion was 'noted'. It was the Directors' duty to ensure that someone who understood the criteria was performing a proper analysis. They could have delegated this task to Mr Frank Barden (of PNC) or Mr Chas Dhabia (of WCUK), in which case they would have been entitled to rely upon them to perform the work honestly and competently. *However, these Directors never made any attempt to satisfy themselves that the Macro Fund was complying with the investment restrictions, even after it should have been apparent from the PNC Quarterly Reports that the restrictions were being ignored.*" [emphasis added]

The judge explained the basis for his view that "it should have been apparent from the PNC Quarterly Reports that the restrictions were being ignored" by referring to evidence given at the trial by Mr Stokoe, one of the Joint Official Liquidators, that the IRS contracts constituted 61.44% of reported gross assets as at 31 December 2007. That, as the judge observed, was three times the 20% limit, "assuming that there was only one counterparty which is what Mr Magnus Peterson told PNC". The judge accepted that "it may not have been possible to perform this calculation on the basis of the information contained in the PNC Quarterly Reports alone"; but, he said that it was perfectly straightforward to calculate the value of the IRS contracts as a percentage of the NAV; and that, by 31 December 2007 that percentage was 86.99% and by 30 June 2008 was 89.88%. The judge went on (*ibid*):

> "27. . . . However, Mr Stefan Peterson said in evidence that he believed that each of the IRS transactions had been done with a different major bank. I do not accept this evidence. One cannot believe something without having thought about it. The evidence leads to the conclusion that Mr Stefan Peterson never applied his mind to the investment restrictions and never paid any attention to the content of the PNC Quarterly Reports. If he had done so, he would have appreciated that two IRS transactions were *individually* valued at about 38% of NAV at 31st December 2007. If the Directors had read and thought about the information in these PNC Quarterly Reports, they could not have 'noted' that the Macro Fund was complying with the investment restrictions without making enquiry, but they never did so. The explanation for their behavior is that they were willing to sign whatever board minutes Mr Magnus Peterson put in front of them and did so without caring whether or not the content was true."

(9) The judge observed (at paragraph 29 of his judgment) that the directors of investment funds had a duty to conduct their board meetings in a businesslike manner; and that that included a duty to arrange for minutes to be taken of the meeting which fairly and accurately recorded the matters which were considered and the decisions which were made. He said that the discussion should be summarized, at least to the extent that it was necessary for the reader to understand the basis upon which the decisions were made; and that, having been approved and signed by whoever was acting as chairman of the meeting, the minutes should be kept on the fund's minute book. He went on to say this (*ibid*):

> "29. . . . In my judgment these Directors failed to perform this most basic duty. Mr Magnus Peterson produced a series of minutes for meetings intended to be held quarterly from August 2003 onwards. Both Mr Ekstrom and Mr Stefan Peterson said that these minutes were typed up by Mr Magnus Peterson shortly after each meeting. I do not believe this evidence. These minutes appear to be pro forma documents, produced by making amendments to a template. Their form and content is such that they could have been produced, and probably were produced, in advance of the meetings and were signed in the standard form irrespective of the discussion which might actually have taken place. The minutes purport to record the dates on which the meetings were held. They are intended to create the impression that meetings were held regularly close to the end of January, April, July and October each year. In fact many of the recorded dates are false and the directors relied upon Mr Ekstrom's diary entries to establish the dates upon which meetings actually took place. . . . The evidence is that Mr Magnus Peterson was in fact present at every meeting and that they only happened if and when he visited Gothenberg. However, the minutes do not record his presence at any meeting prior to 22nd May 2008. . . ."

After describing the "template" on which the minutes of the directors' meetings was based – to which I have referred earlier in this judgment – the judge went on (*ibid*):

> "29. . . . This template is used repeatedly without reference to any actual discussion which might have taken place. The Directors' evidence that they did have meetings in Gothenberg with Mr Magnus Peterson is not challenged, but I do not accept that any real business was ever done at these meetings. Having listened to the evidence of Mr Ekstrom in particular, I was left with the impression of an elderly gentleman sitting at home chatting to his two stepsons in a congratulatory way about Mr Magnus Peterson's apparently successful investment fund business. If they had ever attempted to perform their duty as directors, one would expect to see occasional e-mails identifying matters for discussion or reflecting decisions made. In fact, there is no documentary evidence reflecting that these Directors ever sought to discuss or enquire about any subject at all throughout the period of almost six years that they held office. In my judgment the minutes of these meetings are nothing more than a self-serving 'note' prepared by Mr Magnus Peterson for the file. At least from January 2005 onwards (when he forged the ISDA Master Agreement and carried out the first of the fictitious interest rate swap transactions), Mr Magnus Peterson had an incentive to ensure that no serious business would be conducted at any directors' meeting. *The way in which the meetings were conducted and documented suggests that the Directors met his needs and never attempted or intended to conduct any real business.*" [emphasis added]

35. I turn, now, to the period ("Financial crisis and Liquidation") following the collapse of Lehman Brothers (in September 2008). It was in this period that the causative breach or breaches of duty by the Directors (as found by the judge) – that is to say, the breaches of duty which led to the loss to the Company in respect of which the judge found the Directors liable - took place. The judge observed (at paragraph 41 of his judgment) that the way in which the Directors behaved during the financial crisis following the collapse of Lehman Brothers was, in his judgment, "the most compelling evidence that they never intended to perform their duties as directors."

36. At paragraphs 34 and 35 of his judgment the judge had described the manner in which, as he found, Mr Ekstrom and Mr Stefan Peterson dealt with the unaudited interim financial statements of the Company, which had to be filed with the Irish Stock Exchange by 31 October 2008. He had explained that Sarah Davies of PNC had sent the drafts to WCUK by e-mail on 15 October 2008; that Mr Magnus Peterson had responded the following day, saying that "they seem fine to me"; that, on 16 October 2008 Ms Davies had sent him the "finalised draft for distribution to the

Board"; and that the matter had rested there until 27 October 2008, when PNC sent a reminder and Mr Magnus Peterson forwarded the documents to Mr Stefan Peterson (but not to Mr Ekstrom). The judge had gone on to find that, on 28 October 2008 at 11.35am (Dublin time), PNC sent a further e-mail to Mr Magnus Peterson, asking whether he could provide confirmation that the directors have approved the financial statements "so that we can arrange for the ISE filing". At 1.13pm (London time) Mr Magnus Peterson sent an e-mail to Mr Stefan Peterson asking him to confirm directly to PNC that: "We have today approved the financial statements for the Weavering Macro Fixed Income Fund for the six months to 30 June 2008". At 1.40pm (Gothenberg time) Mr Stefan Peterson sent an e-mail to PNC, giving the confirmation of approval in the terms requested by Mr Magnus Peterson. Mr Ekstrom was copied in on that e-mail; but he had not been copied in on any of the previous exchanges. The judge recorded that Mr Stefan Peterson's oral evidence at the trial was that he and Mr Ekstrom did meet earlier in the morning of 28 October 2008 at the Gothenberg office; and that they then they reviewed and approved the unaudited financial statements which had been sent to Mr Stefan Peterson on the previous day. He recorded, also, that Mr Ekstrom said in his witness statement that he had no specific recollection of these events; that he had no entry in his diary; but that he thought it likely that he and Mr Stefan Peterson had "got together" on the morning of 28 October 2008. On 2 November 2008 - that is to say, after the unaudited financial statements had been signed and filed with the Irish Stock Exchange - Mr Ekstrom sent an e-mail to Mr Magnus Peterson in which he said that he had "dutifully reviewed the financial statements for the first half of the year . . .". After setting out those findings, the judge had observed (at paragraph 35 of his judgment) that:

> "35. Even if Mr Ekstrom did go to the Gothenberg office on the morning of 28th October to review the financial statements and sign a management representation letter sent to Mr Stefan Peterson the previous evening, the evidence shows that the Directors' approach to their task [which, in relation to the adoption of the 2004 audited accounts in June 2005, the judge had criticized at paragraph 33 of his judgment] had not changed since 2005, in spite of the fact that these events took place only about six weeks after the bankruptcy of Lehman Brothers in the midst of the most serious financial crisis in recent memory. They signed what they were asked to sign by Mr Magnus Peterson without taking any steps to satisfy themselves that it was appropriate to do so. Mr Stefan Peterson was even told by his brother exactly what he should say to PNC and he duly obliged. In my judgment these Directors made no attempt to perform their duties in relation to the

> Macro Fund's financial statements. They signed what was put in front of them without making any enquiry. They did so because they were doing a favour for Mr Magnus Peterson without any intention of performing their duties as directors."

37. I have referred, earlier in this judgment, to the Q3 2008 Report sent to the Directors on 6 November 2008; and to the fact that it was common ground that it was in that report that, for the first time, PNC included the information that WCF was the counterparty to the IRS contracts. As I have said, the information was to be found in a sentence in the "Prices" section on the seventh and final page of the Q3 2008 Quarterly Report. The sentence was in these terms: "The Interest Rate Swap Positions are priced from the counterparty which is Weavering Capital Fund Limited".

38. The judge found that, if either Mr Ekstrom or Mr Stefan Peterson had read that sentence, he would have been alerted to the fact that the value of the Company's principal asset was dependent upon WCF's ability to pay what was due from it under the IRS contracts.

39. Mr Ekstrom accepted that he received the Q3 2008 Quarterly Report on 6 November 2008 as an attachment to an e-mail; but that he did not open the e-mail and print out the attachment until the following day. The judge observed that, when he was asked in the course of cross-examination to identify which parts of the Q3 2008 Quarterly Report he had read, Mr Ekstrom said this:

> "A. Well, I read this first page and the second were the shareholders. And yes, and the third and fourth, and I had a quick look over these — all these different kinds of securities. That's all."

The judge's understanding of that answer (as he said at paragraph 43 of his judgment) was this:

> "What he meant was that he read page one of the report and the list of shareholders (which is at pages 2-4) and had a 'quick look' at the portfolio analysis (which is pages 5-7). It was clear that he did not pay any more attention to the Q3 2008 Report than he had to any of the previous ones."

And the judge went on to say (*ibid*) that Counsel had put the question this way:

> Q. . . . .You read the pages dealing with the shareholder register, and whilst you might glance at the portfolio analysis and the rest of the pages. . .
> A. Correct.
> Q. You didn't study them in any detail whatsoever ?
> A. No
> Q. Was that simply because you knew that you wouldn't be able to take any benefit from any study of them ?

A. Yes, and I knew that Stefan was very clever this.
Q. So in effect, the review of the pages from portfolio analysis onwards you left to Stefan Peterson?
A. Yes."

The judge said this (*ibid*):

> "I regard this explanation as a disingenuous one because Mr Ekstrom must have known that Mr Stefan Peterson was paying no more attention to the PNC Reports than he was himself. In spite of the extraordinary events of the preceding two months which had prompted redemption requests from Macro Fund shareholders valued at $138.4 million (and processed on 3rd November), Mr Ekstrom still paid no more attention to the Q3 2008 Report than he had to any previous ones. He never suggested to Mr Stefan Peterson that they might convene the board meeting planned for 28th October and call upon PNC to provide them with up to date management accounts and WCUK to report on the redemption requests and liquidity position. His failure to read the key part of the Q3 2008 Report or do any of the things which one might expect a director to do in these circumstances, is evidence pointing to the conclusion that he never intended to perform his duties as a director."

40. The judge was no less critical of Mr Stefan Peterson. He observed (at paragraph 44 of his judgment) that, at the relevant time (November 2008), Mr Stefan Peterson was Chief Executive Officer and a full time employee of Weavering AB, with responsibility for managing the Opportunities Fund; that he communicated with Mr Magnus Peterson on a regular basis; and that he knew that the Macro Fund had received substantial redemption requests in September and October. The judge noted that Mr Stefan Peterson had said in the course of his evidence that he was concerned about illiquidity in the market but not about the Macro Fund's counterparty risk:

> "A. I was not concerned pre-Lehman, but after Lehman, I understood all counterparties, all instruments were illiquid in the market. That's why I was concerned. I was not concerned since I assured myself that the Macro Fund did not have any exposure to weak financial institutions. That they had an okay financial institution on the other side of the swaps, and that they could in due time deliver on the swaps. That was my belief"

The judge did not accept that answer: in particular he did not accept Mr Stefan Peterson's statement that he had assured himself that the Macro Fund was not exposed to financially weak counterparties. The judge said this (at paragraph 44 of his judgment):

> "There is no evidence that he [Mr Stefan Peterson] made any enquiry before or after receiving the Q3 2008 Quarterly Report. If he did read it at all, it is plainly obvious that he could not have applied his mind to its content, otherwise he would have noticed that WCF was said to be the counterparty to all the IRSs. He did not convene the board meeting which was supposed to take

> place on 28th October. He did not ask for the September or October management accounts. He did not ask WCUK to provide him with a counterparty risk analysis. He knew that substantial redemption requests had been received and says that he was concerned about the Macro Fund's cash position, but he did not ask for a cash flow projection or any report about the way in which WCUK intended to meet the redemption requests. Whilst he says that he spoke to his brother on a regular basis, he has not said that he specifically asked Mr Magnus Peterson to identify the counterparties to the IRSs (and that Mr Magnus Peterson lied to him). He did not speak to Mr Frank Barden [an employee of PCN] about the Macro Fund, in spite of the fact that he did communicate with him about the Opportunities Fund for which PNC was also the administrator. There is no evidence that Mr Stefan Peterson took any steps at all, even after the bankruptcy of Lehman Brothers, to assure himself that the Macro Fund would be able to meet its obligations. He repeatedly said in evidence that he understood that, as a director, he had a supervisory role, but the evidence is that he never made any attempt to perform this role, which leads me to the conclusion that he never intended to perform his duties. He behaved as if he was doing a favour for his brother by acting as a director of the Macro Fund in name only."

41. I have referred to the judge's observation, at paragraph 41 of his judgment, that the way in which the Directors behaved during the financial crisis following the collapse of Lehman Brothers was the most compelling evidence that they never intended to perform their duties as directors. Earlier in that paragraph the judge had said this:

> "41. Mr Ekstrom signed minutes purporting to show that a board meeting had been held in Gothenberg with Mr Magnus Peterson present on 29th July 2008 and that all the usual matters had been duly discussed and 'noted'. The Directors admit that this meeting never in fact happened. These fictitious minutes stated that the 'next' board meeting would be held on 28th October 2008. In the meantime, Lehman Brothers went into bankruptcy on 15th September 2008 and the consequential credit crunch developed into the most serious financial crisis in recent memory. The crisis would have impacted adversely on Macro Fund in any event, even if its balance sheet had not contained fictitious assets, which were valued at US$589 million (representing 79% of NAV) in October 2008. It seems to me that, if these Directors were attempting to perform their supervisory role, even in the most superficial way, they would have been concerned that these events might cause problems for the Macro Fund, such as substantial redemption requests or even counter-party failure. . . ."

At paragraph 42 of his judgment, the judge referred to his finding that, on 23 December 2008, Mr Ekstrom had signed minutes purporting to show that a board meeting had taken place in Gothenberg on 28 October 2008 at which with Mr Magnus Peterson had been present and at which all the usual matters were "noted". He went on to say this (ibid):

"42. . . . Even if Mr Ekstrom and Mr Stefan Peterson did get together at the Gothenberg office on the morning of the 28th [October] for the purpose of signing off on the financial statements, it is admitted that the meeting reflected in these minutes never took place."

42. The judge accepted (at paragraph 48 of his judgment) that a meeting took place on 23 December 2008 at the home of Mr Ekstrom, at which Mr Stefan Peterson and Mr Magnus Peterson were present; but he was not persuaded that that meeting could be described as a board meeting at which those present attempted to address the problems then actually facing the Company. In particular, the judge found nothing to suggest that those present at the meeting discussed counterparty risk or the redemption problem: as he said (*ibid*):

"48. . . . I find it difficult to believe that they could have had a serious discussion about the Macro Fund's counterparty risk without reference to the Q3 2008 Quarterly Report or the IRS positions."

And he went on to say this (*ibid*):

"48. . . . However, on this same day [23 December 2008] Mr Ekstrom did sign minutes of meetings purportedly held on 29th July and 28th October. These meetings had never taken place. My conclusion is that these Directors were simply accommodating Mr. Magnus Peterson by signing fictitious minutes intended to give the impression that proper board meetings were being still being held at quarterly intervals."

43. The judge made further findings as to matters which took place on and after 31 December 2008:

(1) He found (at paragraph 42 of his judgment) that the Directors signed waiver forms on 31 December 2008 and 1 January 2009 authorizing payment of 25% of the November 2008 redemptions; and that, on 6 or 7 January 2009 Mr Stefan Peterson signed a letter, back-dated to 31 December 2008, stating that "the Fund's directors have exercised their discretion to postpone a pro rata proportion of existing redemptions until market conditions improve". He said this (*ibid*):

"42. . . . There is no evidence that the Directors ever met or gave any consideration to the issue and it appears that Mr Stefan Peterson simply signed it at Mr Magnus Peterson's request, without reference to Mr Ekstrom."

And he observed (at paragraph 50 of his judgment) that the statement in a subsequent board minute (at paragraph 11 of the minutes of the final meeting of the board said to have been held on 19 February 2009) that:

"Using the powers under Article 50 the Directors determined on 30th December that redemption payments due by the end of December would be deferred to such time as liquidity returned to fixed income markets. . . ."

was inconsistent with what the investors had been told in the letter dated 31 December 2008.

(2) He found (at paragraph 49 of his judgment) that, on 28 January 2009, Mr Frank Barden forwarded to Mr Ekstrom and Mr Stefan Peterson an e-mail chain in which he asked Mr Magnus Peterson to explain how he proposed to pay outstanding redemptions of about US$98 million. He asked if cash would be raised by closing out some of the IRS contracts, which had a reported market value as at 31 December 2008 of about US$626 million; and represented 107% of NAV. Mr Barden made the point, in express terms, that "previously there has been no gain/loss on closing out any of these positions". The judge found, also, that about two hours later PNC sent the Q4 2008 Quarterly Report to Mr Ekstrom and Mr Stefan Peterson. That report revealed what the judge described as "an extraordinary picture". It showed that seven of the ten IRS contracts included in the Q3 2008 Quarterly Report (which then had had a reported value of about US$353 million) had been removed from the list. The three that remained had increased in value by a huge percentage; as a consequence of the dramatic fall in the one year sterling LIBOR rate during the previous quarter. For example the IRS contract identified as "GBP 08-11-15" had increased in value from about £25.8 million to £243 million. The Q4 2008 Report stated that:

> "The Interest Rate Swap positions are priced from the counterparty which is Weavering Capital Fund Limited Limited (*sic*). The value of the Interest Rate Swap positions as at 31st December 2008 are $626,567,149."

The judge did not accept the evidence of Mr Ekstrom and Mr Stefan Peterson that they had read the e-mail chain and the Q4 2008 Quarterly Report, Each had stated in his witness statement (which, as the judge observed, had been made in identical terms) that:

> "As it was, I simply did not pick up the reference made to WCF in the last two administrator's reports. I am certain that this is the case because I distinctly remember it coming as a complete surprise to me to learn from PNC's fax of 5th March 2009 that the counterparty was in fact WCF".

The judge observed that that was not a credible explanation for their failure to react in any way to what they were being told.

(3) He found (paragraph 50 of his judgment) that the final board meeting of the Company was held on 22 February 2009 - because, as he surmised, Mr Magnus

Peterson visited Gothenberg on that day - notwithstanding that Mr Ekstrom had signed minutes purporting to show that the meeting had been held on 19 February 2009, as planned. Clause 7 of those minutes (which, in general follow the template) contained the statement that:

> "It was noted that the investment adviser had been acting within the guidelines and investment restrictions set by the Board. . . . No compliance breaches were reported for the period".

The judge found that that statement was "blatantly untrue". He pointed out that Mr Frank Barden had reported that the exposure to WCF was 107% of NAV. Clause 8 of those minutes contained the statement that "The administrator's report was reviewed . . .". The judge found it impossible to believe that statement: given that, as he pointed out, the Directors did not react to the contents of the PCN Quarterly Report in any way whatsoever. He observed that:

> "In spite of the fact that the Directors obviously appreciated that the Western World was in the midst of a serious financial crisis, they continued to go through the motions of holding meetings and Mr Ekstrom continued to sign minutes designed to give the impression that they were functioning as a board of directors, whereas in reality they had not read the materials sent to them and had made no attempt to understand the Macro Fund's financial condition."

The judge's conclusions

44. It was on the basis of his findings that – in failing to convene a board meeting following the failure of Lehman Brothers or to read or apply their minds to the information in the Q3 2008 Quarterly Report that WCF was the counter-party to the IRS contracts - both Mr Ekstrom and Mr Stefan Peterson were in wilful neglect of their respective duties as directors of the Company that the judge made the order that he did. His conclusions are expressed at paragraphs 51 and 52 ("Conclusion") and 53 to 55 of his judgment ("Causation and quantum of damage").

45. At paragraph 51 of his judgment the judge concluded:

> "51. In my judgment the evidence in this case leads, unequivocally, to the conclusion that both of these Directors are guilty of wilful neglect or default because they consciously chose not to perform their duties to the Macro Fund, or at least not in any meaningful way. Given their business backgrounds and experience, they must have known that the directors of an investment fund whose shares were listed on the Irish Stock Exchange, would be expected to act in a businesslike manner and that they could not discharge their duty by signing whatever documents were put in front of them (including standard form minutes of meetings) without reading them, or if

they did read them, without applying their minds to their content. They claim to have appreciated that they had a high level supervisory duty, yet they never once, in six years, asked any of those whom they were supposedly supervising to give them a written report or attend a board meeting to provide them with an oral report. Every board meeting took the form of a discussion with Mr. Magnus Peterson and no one else. There were no agendas and there is no record of the discussion. The board minutes were created by Mr. Magnus Peterson, but they are standard form documents intended to constitute a 'note' for the file and create the impression that the Directors were reviewing the affairs of the company on a regular quarterly basis, whereas there is no evidence that any real business was ever in fact conducted at these meetings. It is clear that these Directors consistently signed financial statements, management representation letters, side letters and other documents without making any enquiry whatsoever. In 2007 they signed sham investment management and advisory agreements either without reading them or, if they did, knowing that the agreements would never be acted upon. This modus operandi was so firmly entrenched that not even the bankruptcy of Lehman Brothers and the ensuing financial crisis was sufficient to prompt them into convening board meeting or reading the Q3 2008 Quarterly Report which contained damning information about the identity of the IRS counterparty. This failure cannot be treated as an error of judgment or negligence, because Mr Ekstrom subsequently signed minutes which falsely asserted that a meeting *did* take place and that they *did* review the administrator's report." [emphasis in text cited]

And he went on, at paragraph 52 of his judgment, to say this:

> "52. . . . The evidence clearly points to the conclusion that they both subordinated themselves to Magnus Peterson's wishes. They were motivated by a desire to keep him happy by going through the motions of appearing to act as independent directors of his investment fund. If they had applied their minds for a moment, they would have appreciated that their behavior was wrong. In my judgment their behavior in December 2008, when Mr Ekstrom signed fictitious minutes of two meetings which never took place, leads unequivocally to the conclusion that they knew perfectly well that their behavior was wrong."

46. The judge then turned to causation and damage. He said this (so far as material):

> " 53. . . . It is said [on behalf of the Joint Official Liquidators] that if the Directors had not acted in wilful neglect or default of their duties, they would have discovered that WCF was counterparty to the IRS transactions, with the result that the sequence of events which actually played out in March 2009 would have played out at a much earlier stage in the life of the Macro Fund, certainly no later than November 2008 when they received the Q3 2008 Quarterly Report from PNC. I adopt the following statement of Briggs J. in *Lexi Holdings Plc v Luqman* [2008] 2 BCLC 725, at page 735 as the correct approach to be adopted towards causation in this type of case:
>
> > The question whether a breach of duty constituted by total inactivity causes a particular loss raises issues of law, fact and hypothesis. The law serves to define the relevant duty, and the steps which that duty

> required these defendants to take is ascertained by the application of those legal principles to the relevant factual background, including, importantly, the particular knowledge, experience and skill which each [defendant] actually had. Thereafter, the court must construct a necessarily hypothetical edifice so as to ascertain what would probably have happened if the relevant duties had been performed, so as to ascertain whether in that event the losses actually suffered by [the company] would, probably, not have been suffered. Subject to any relevant questions of remoteness . . . , the difference between [the company's] actual financial position and its hypothetical financial position derived from the assumption that the relevant duties had been performed represents the measure of loss caused by the defendants' breach of duty.'

54. The first question I must ask myself is when and how would the Directors have discovered that WCF was the IRS counterparty if they had performed their duties? Mr Lord [Counsel for the Company] provided me with a list of events, occurring at a time when the reported value of the IRSs was material to the balance sheet, which would have led the Directors to make relevant enquiries had they performed their duties. Whilst there is evidence to support the allegation that the discovery would have been made as early as June 2006 when the Directors signed the 2005 audited financial statements, Mr Lord chose to put his case on the basis of the events which occurred at the beginning of November 2008 and so I do not need to consider any earlier scenario. If the Directors had read the Q3 2008 Quarterly Report, it would have set off alarm bells. An emergency board meeting would have been convened at which Messrs Frank Barden, Magnus Peterson, Chas Dabhia and possibly others would have been required to attend. Mr Frank Barden would have discovered that the Directors believed that WCF was dormant and claimed to be unaware that it was the counterparty to the IRS transactions. I do not know what Magnus Peterson had previously told him about WCF, but it must have been wholly inconsistent with what he would have been told by the Directors. It would have been immediately apparent to all concerned that they had been misled by Magnus Peterson. The Directors would have instructed lawyers who would have advised that the Macro Fund be put into liquidation. Even if the company had not been put into liquidation immediately, it is inconceivable that any directors, properly advised, would have permitted the pending redemptions to have been paid because (no matter what explanation might have been offered by Magnus Peterson) it would have been plainly obvious to all concerned that the published NAV per share was seriously overstated because it would soon have become apparent that there was no possibility of WCF being able to pay $589 million, which was the reported market value of the IRSs as at 30th October 2008.

55. The second question is what loss was suffered by the Macro Fund as a result of this scenario not having played out at the beginning of November 2008 as a result of the Directors' wilful neglect or default of their duties? Mr Lord did not pursue the proposition that the loss caused by the Directors' breach should be determined by reference to the net trading losses incurred during the 'extended period of trading', that is to say during the period from the date on which the Macro Fund's business would have been terminated

(sometime shortly after 6th November 2008) until the date on which it was actually terminated (on or shortly before 19th March 2009). He put his case on the more straightforward basis that the loss suffered by the company is the amount of the irrecoverable redemption payments made during the 'extended period of trading' on the basis of falsely inflated NAV calculations. A total amount of US$141,600,490 was paid out by way of redemptions between 24th November 2008 and 26th February 2009, based upon a grossly inflated NAV per share. The difference between what was actually paid and what would have been payable based upon a realistic NAV (taking into account the true value of the IRSs) is said to be not less than $111 million. The unchallenged evidence of Mr Carter, WCF's official liquidator, is that the company's realizable assets are minimal. Counsel stated that the Macro Fund's loss is 'not less than' this amount because the Official Liquidators have deliberately done their calculations in a manner most favourable to the Directors.

47. It was for those reasons that the judge (at paragraph 56 of his judgment) expressed himself satisfied that the Company's loss caused by the Directors' wilful neglect or default was at least US$111 million.

The grounds of appeal

48. The grounds of appeal are set out in the Memorandum of Grounds of Appeal, dated 27 September 2011, under three main heads:

(1) The judge erred in holding that the Directors were guilty of "wilful neglect or default" (and in holding that they were not entitled to rely on Article 182 of the Company's Articles of Association).

(2) The judge erred in holding that the Directors had breached the duties which they owed as directors.

(3) The judge erred in his approach to, and evaluation of, the evidence generally (with the result that the Court of Appeal is free to take its own view of the oral evidence the judge heard).

Those heads were developed in the Memorandum of Grounds of Appeal itself; in very full written submissions (comprising 246 paragraphs extending over 146 pages); and in oral submissions at the hearing of the appeal.

The respondent's notice

49. In reaching his conclusion that the Directors were not entitled to rely on the exemption from liability provided by Article 182 the judge had referred to what he described as "the classic formulation of what is meant by 'wilful neglect or default' in the context of a company's articles of association" in the judgment of Mr

Justice Romer in *Re City Equitable Fire Insurance* [1925] Ch 407, at 434:

> "An act, or an omission to do an act, is wilful where the person of whom we are speaking knows what he is doing and intends to do what he is doing. But if that act or omission amounts to a breach of his duty, and therefore to negligence, is the person guilty of wilful negligence? In my opinion that question must be answered in the negative unless he knows that he is committing, and intends to commit, a breach of his duty, or is recklessly careless in the sense of not caring whether his act or omission is or is not a breach of duty."

The judge pointed out that Mr Justice Romer's test comprised two distinct limbs: a director will not be liable for breach of duty on the basis of wilful neglect or default unless either (i) he knows that he is committing, and intends to commit, a breach of his duty, or (ii) he is recklessly careless in the sense of not caring whether his act or omission is or is not a breach of duty. He observed (at paragraph 13 of his judgment) that ". . . The case against these Directors is put fairly and squarely under the first limb of the test." He noted that counsel were not in agreement as to whether the second limb required that the director whom it was sought to hold liable appreciated that his or her conduct might be a breach of duty and made a conscious decision that, nevertheless, he or she would do (or omit to do) the act complained of without regard to the consequences. The judge said that he was inclined to agree with counsel for the Company that the facts of this case were such that he did not need to resolve that issue; and, in the event, he did not do so.

50. The Company filed a respondent's notice on 7 October 2011 in which it is said that the judge could and/or should have found that the Directors were not entitled to rely on Article 182 of the Articles of Association because they fell within the second limb of the test set out by Mr Justice Romer in the *City Equitable* case: in that they were recklessly careless whether they were in breach of duty. It is said that, on a proper understanding of the second limb of the test, it is not necessary to show an appreciation on the part of a director that his conduct might be a breach of duty coupled with a conscious decision to carry on regardless of the consequences; but that, in any event, if (contrary to that submission) that limb does require such an appreciation or conscious decision, that requirement is met in the present case.

The issues for determination in this Court

51. It is important to keep in mind that the judge made the order that he did on the basis of his finding of fact that the Directors ought to have discovered, in early November

2008, that the counter-party to the IRS contracts then shown as assets of value in the unaudited interim balance sheet of the Company was WCF and on his further finding of fact that, had the Directors discovered in early November 2008 that WCF was the counter-party to those IRS contracts, they would have appreciated that the Company was seriously insolvent and should be put into immediate liquidation. The Directors were not held liable for loss (if any) suffered by the Company as a result of any of the other breaches of duty which the judge identified in the course of his judgment. The first issue for determination on this appeal is whether the judge was correct to make the first of those two findings of fact; if he were, it is not suggested that he was wrong to make the second of those two findings.

52. If the judge were correct to make those findings of fact, then the second issue on this appeal is whether the judge was also correct to take the view that the failure of each of the Directors to discover (as and when they should have done) that the counter-party to the IRS contracts was WCF arose as a result of his own wilful neglect or default; with the consequence that he was denied the protection from liability at the suit of the Company that would otherwise have been available to him under Article 182 of its Articles of Association.

53. The third issue – which would arise if, but only if, the judge were correct to make the findings of fact to which I have referred but wrong to take the view that the failure of each of the Directors to discover (as and when they should have done) that the counter-party to the IRS contracts was WCF arose as a result of his own wilful neglect or default within the first limb of Mr Justice Romer's test in the *City Equitable* case – is whether, on a proper understanding of the second limb of the test, the judge ought to have held that the failure of each of the Directors to discover (as and when they should have done) that the counter-party to the IRS contracts was WCF arose as a result of his own wilful neglect or default within that second limb.

The first issue: were the Directors in breach of duty in failing to discover, in early November 2008, that WCF was the counter-party to the IRS contracts?

54. At paragraphs 6 to 11 of his judgment, the judge had addressed the question: what duties does the law impose upon directors of a Company? He had explained (at paragraph 6) that directors owe fiduciary duties to their companies to act bona fide in what they consider to be the best interests of the company, to exercise their powers

for the purposes for which they are conferred and not to place themselves in a position where there is a conflict between their personal interests and their duty to the company. But, he observed, it was not alleged that Mr Ekstrom or Mr Stefan Peterson acted in breach of these fiduciary duties: the case against them in these proceedings was that they had acted in breach of their duty to exercise independent judgment, to exercise reasonable care, skill and diligence and to act in what they considered to be in the interests of the Company.

55. The judge explained (at paragraph 7 of his judgment) that a director must exercise his powers independently; without subordinating the exercise of those powers to the will of others, except to the extent that powers have properly been delegated. He went on to say this:

> "7. The Cayman Islands investment fund industry works on the basis that investment management, administration and accounting functions will be delegated to professional service providers and a company's independent non-executive directors will exercise a high level supervisory role. It is not disputed that these functions were properly delegated to WCUK and PNC. Nor is it disputed that, in spite of having properly delegated these functions, the Directors did retain a supervisory duty. Furthermore, their evidence is that they both appreciated that they did have such a duty."

The judge observed that the nature and scope of the "high level supervisory duty" which the law imposed could only be determined by reference to the actual circumstances of this case, "even though the overall management structure might not appear to be materially different from countless other open ended investment funds". He referred to observations made by Mr Justice Jonathan Parker in *Re Barings PLC, Secretary of State for Trade and Industry v Baker (No 5)* [1999] 1 BCLC 433, 439:

> "(i) Directors have, both collectively and individually, a continuing duty to acquire and maintain a sufficient knowledge and understanding of the company's business to enable them properly to discharge their duties as directors.
>
> (ii) Whilst directors are entitled (subject to the articles of association of the company) to delegate particular functions to those below them in the management chain, and to trust their competence and integrity to a reasonable extent, the exercise of the power of delegation does not absolve a director from the duty to supervise the discharge of the delegated functions.
>
> (iii) No rule of universal application can be formulated as to the duty referred to in (ii) above. The extent of the duty, and the question whether it has been discharged, must depend on the facts of each particular case, including the director's role in the management of the company."

The judge held that those observations – which had been approved by the Court of Appeal of England and Wales on the appeal in *Barings (No 5)* – were no less pertinent in this jurisdiction.

56. The judge went on to explain (at paragraphs 8 and 9 of his judgment) that a director's duty to exercise reasonable care, skill and diligence comprised both an objective and a subjective element. As to the former (objective) element, a director must exercise the care, skill and diligence that would be exercised by a reasonably diligent person having the general knowledge, skill and experience reasonably to be expected of a person acting as an independent non-executive director of an open-ended investment fund incorporated in this jurisdiction. He said this:

> "8 . . . Whilst independent non-executive directors rarely have the technical expertise and experience to be able to monitor sophisticated investment strategies and trading techniques in a direct hands-on manner, they are expected to satisfy themselves (on a continuing basis) that the investment manager's strategy is fairly described in the offering document and that the investment manager is complying with whatever investment criteria and restrictions have been adopted by the fund."

He accepted that Mr Ekstrom and Mr Stefan Peterson were not expected to supervise WCUK's trading activities; but, he said, they were expected to satisfy themselves that WCUK was complying with the investment restrictions. They were also expected to acquire a proper understanding of the financial results of the investment and trading activity; without which they would not be in a position to perform an overall supervisory role. He went on to say this (*ibid*):

> "8. . . .It is the duty of the independent non-executive directors to satisfy themselves that there is an appropriate division of function and responsibility between the investment manager and administrator, the absence of which will necessarily impose greater responsibility upon themselves. They need to satisfy themselves, on a continuing basis, that the various professional service providers are performing their functions in accordance with the terms of their respective contracts and that no managerial and/or administrative functions which ought to be performed are being left undone."

57. As to the latter (subjective) element, the judge explained that a director must exercise the knowledge, skill and experience which he or she actually possesses. It was for that reason (as the judge pointed out at paragraph 9 of his judgment) that the

professional qualifications and business experience of the directors of an open ended investment fund is material information which needed to be disclosed in its offering document; and that directors had a duty to ensure that the disclosure is accurate and not misleading. It is relevant, therefore, to have in mind that, in the present case it was stated in the Offering Memoranda that Mr Stefan Peterson had a PhD in economics; that he had worked for the Swedish National Debt Office as a credit analyst; that, subsequently, he had joined Volvo's corporate finance department; and that, since 2000, he had worked as a senior credit strategist at Storebrand Investments. The Offering Memoranda stated that Mr Ekstrom had had over 40 years'experience in the financial industry; and that he had held senior positions within Skandinaviska Enskilda Banken AB between 1960 and 1995, primarily as head of its Trust Department. As the judge observed (at paragraph 9 of his judgment):

> "9. . . . Although both of them have made the point that they had no experience of trading financial instruments of the kind in which the Macro Fund was investing (or at all), it seems to me that they were held out as possessing, and actually possessed, qualifications and business experience of a kind which would have enabled them to perform their supervisory function in an effective way, had they chosen to do so."

58. The judge went on to explain (at paragraph 10 of his judgment) that a director had a duty to exercise an independent judgment. He referred to the observations of Lord Woolf, Master of the Rolls, in *Re Westmid Packing Services Ltd* [1998] 2 BCLC 646, 653b-c:

> "Each individual director owes duties to the company to inform himself about its affairs and to join with his co-directors in supervising and controlling them. A proper degree of delegation and division of responsibility is permissible, and often necessary, but total abrogation of responsibility is not. A board of directors must not permit one individual to dominate them and use them . . ."

The judge observed that, in the context of open-ended investment funds, investment management, administration and accounting functions were invariably delegated to contracted professional service providers; but, he said, the exercise by the directors of their power of delegation in this way did not absolve them from the duty to supervise the delegated functions.

59. The Directors do not dispute that the duties which, as directors, they owed to the Company included (i) a duty to exercise independent judgment; (ii) a duty to

exercise reasonable care, skill and diligence; and (iii) a duty to act in what the directors (not the Court) consider to be the best interests of the company; but, it is said, that there is no express finding in the judgment that they were in breach of any of those general duties.

60. In particular, it is said that there are no findings in the judgment to justify a conclusion that they breached the general duty they owed as directors to act in what they considered to be the best interests of the company. It is submitted that the scope of that duty is subjective: in the sense that it is a duty to act in what the director, not the court, consider the best interests of the company. The relevant question is not whether, viewed objectively by the court, the particular act or omission which is challenged was, in fact, in the interests of the company; rather the question is whether the director honestly believed that his act or omission was in the interests of the company. It is said that the judgment contains no express findings that the Directors did not honestly believe that they were acting in the best interests of the Company; and so it must be taken that that was not the basis on which the judge held them liable for breach of duty.

61. It is submitted that, on a true analysis, the judge's finding against the Directors was that they were in breach of what the judge described as their high-level supervisory duty. The Directors accept (consistently, it is said, with the authorities) that they did owe a high level supervisory duty to the Company; but they submit that the judge was wrong in his identification and specification of the scope of that duty. It is submitted that "supervision" is a term the meaning of which will depend on the context in which it is used: the extent of the duty to supervise the discharge of delegated functions, and whether that duty has been discharged, must be determined by the facts, including, the particular role the director was performing in relation to the management of the company. Although, it is said, the judge was right to direct himself (at paragraph 3 of his judgment) that the precise scope of the Directors' high-level supervisory duty was an important issue which he had to decide; it is submitted that, in carrying out that task, he fell into error, in that: (i) he took little or no account of the specific factual context of this case, including the Directors' very limited role in the day-to-day management of the Company; and, in particular, the extent to which the Directors relied, and were entitled to rely, on PNC (as

Administrator), WCUK (as Investment Manager or Investment Advisor) and EY (as auditor) to perform their duties honestly and competently; (ii) he gave little or no weight to the fact that the Directors genuinely trusted PNC, WCUK and EY and never had any reason to distrust them; (iii) he gave little or no weight to the very limited expectations of the Company's investment manager, investors, shareholders, auditors or external service providers as to the role which the Directors would perform; and (iv) he approached the issue of duty on a rigid and overly prescriptive basis, derived (as is said to appear from the judgment) on little more than his own subjective expectations of what he thought was required of all independent directors of investment funds. Overall, it is said, the judge's identification of the duties owed by the Directors was fundamentally unsound because it largely involved retrospectively imposing responsibilities on the Directors which it was, in practice, impossible for them ever to have discharged; and which no-one dealing with the Company ever expected them to discharge or believed they were discharging.

62. In amplification of the first of those criticisms - failure to consider the scope of the Directors' duties in their context - it is accepted that the judge was correct to observe (at paragraph 6 of his judgment) that it was "necessary to analyse the scope of these duties in the context of the Macro Fund" because, as (it is said) the authorities make clear, the scope of the duties a director owes to a company is inherently situation-specific; and this is particularly so where the court is concerned with the so-called "high-level duty to supervise" delegated management functions. It is accepted, also that the judge was correct to observe (at paragraph 7 of his judgment) that "the nature and scope of this duty can only be determined by reference to the actual circumstances of this case"; and was right to hold that the observations of Mr Justice Jonathan Parker in *Barings (No.5)* that:

> "...The extent of the duty, and the question whether it has been discharged, must depend on the facts of each particular case, including the directors' role in the management of the company."

should be treated as a correct statement of the law in the Cayman Islands. It is submitted that the rationale for this flexible fact-specific approach is that the standard to which a director is held will always depend on the natural expectations and reliance placed by the shareholders on the experience and skill of the particular director. Reliance is placed on observations of the Supreme Court of New South Wales in *Daniels v Anderson* (1995) 16 ACSR 607, 668:

> "A person who accepts the office of director of a particular company undertakes the responsibility of ensuring that he or she understands the nature of the duty a director is called upon to perform. That duty will vary according to the size and business of the particular company and the experience or skills that the director held himself or herself out to have in support of appointment to the office. None of this is novel. It turns upon the natural expectations and reliance placed by shareholders on the experience and skill of a particular director . . . The duty includes acting collectively to manage the company."

It is said that these observations support the proposition that determination of the scope of this "high-level supervisory duty" - and in particular, whether it has been discharged or breached - will require a detailed consideration of all the relevant facts in any particular case; including a detailed consideration of the functions that the director is to perform. The scope of the duty will vary according to the size and business of the particular company and the experience or skills that the director professes to have as fitting him for appointment to the office.

63. It is submitted on behalf of the Directors that the judge fell into error in that he failed to consider and give weight to all the relevant circumstances in determining the extent of the duty the Directors owed in this case: rather, it is said, he approached his task by setting out in his judgment "what amounts to a set of rules of universal application to the directors of all 'the countless other open ended investment companies incorporated in this jurisdiction and registered pursuant to the Mutual Funds Law'". In particular, it is said, the judge failed to give any or any adequate weight to the following contextual factors (none of which were in dispute at trial): (i) the Directors were not performing an executive role; they were non-executive directors; (ii) the Directors received no remuneration for performing their non-executive role; (iii) the Company was established and run throughout on the basis of a delegated management structure with a professional investment manager and a professional administrator discharging the executive management role; (iv) this delegated structure was in standard form and complied with Cayman Islands industry standards; (v) the structure and the very limited role the Directors played in it, was fully disclosed to the Company's administrator and auditors, to its statutory regulator (CIMA) and to external investors; (vi) although the Company was incorporated in the Cayman Islands, the Directors lived in Sweden, while the

Company's administration and audit were carried out in Dublin and its investment management in London; (vii) the Directors did not perform, and did not profess to perform, a risk management function in relation to the Company's day-to-day trading or investment activities; (viii) there is nothing in the evidence to suggest that the administrator or auditors ever expected that the Directors would perform any additional role in relation to the operation of the Company than the role that they in fact performed; and (ix) there is nothing in the evidence to suggest that the limited role the Directors performed inhibited in any way the discharge by both the administrator and the auditors of their contractual and other responsibilities. It is said that the contextual factors which I have enumerated – and which were developed at some length in the Directors' written submissions – should have led the judge to conclude that the scope of the Directors' high-level duty to supervise was very limited in this case.

64. In amplification of the second of those criticisms – failure to give any or any adequate weight to the fact that the Directors trusted PNC, WCUK and EY – the Directors submit that it is a fundamental principle that, where appropriate delegation has taken place, a company director will not be expected to supervise every aspect of the delegate's activities because the director is entitled to place trust in his delegates, as well as in his other directors. Reliance is placed on the observations of the Earl of Halsbury, Lord Chancellor, in *Dovey v Cory* [1901]AC 477, 485-6:

> "The charge of neglect appears to rest on the assertion that Mr. Cory, like the other directors, did not attend to any details of business not brought before them by the general manager or the chairman, and the argument raises a serious question as to the responsibilities of all persons holding positions like that of directors, how far they are called upon to distrust and be on their guard against the possibility of fraud being committed by their subordinates of every degree. It is obvious if there is such a duty it must render anything like an intelligent devolution of labour impossible. Was Mr. Cory to turn himself into an auditor, a managing director, a chairman, and find out whether auditors, managing directors, and chairmen were all alike deceiving him? . . . it comes to this, that he ought to have discovered a network of conspiracy and fraud by which he was surrounded, and found out that his own brother and the managing director . . . were inducing him to make representations as to the prospects of the concern and the dividends properly payable which have turned out to be improper and false. I cannot think that it can be expected of a director that he should be watching either the inferior officers of the bank or verifying the calculations of the auditors himself. The business of life could not go on if people could not trust those

who are put into a position of trust for the express purpose of attending to details of management."

65. It was pointed out on behalf of the Directors that the judge had held (at paragraph 7 of his judgment) that the investment management, administration and accounting functions were properly delegated to WCUK and PNC. It was said that the Directors' evidence - that they genuinely relied on WCUK, PNC and EY to perform their contractual functions honestly and competently and never had any reason to believe that they were not performing those functions honestly and competently - was not challenged by the Joint Official Liquidators on behalf of the Company. In particular, it is said, the Directors relied, in good faith, (i) on WCUK, as investment manager, to ensure that the Company's Macro Fund investments were made honestly and competently, and in compliance with the investment objectives and restrictions stated in the Offering Memorandum, and to draw any departure from the investment restrictions to the Directors' attention; (ii) on PNC, as administrator, to keep the Macro Fund's books and records, to liaise with EY and to provide them with all necessary information to enable the auditor to prepare the annual and semi-annual financial statements and express an audit opinion, to perform various accounting services competently and on a continuous basis (including the preparation of the Statement of Assets and Liabilities; the calculation of the Macro Fund's capital gains and losses; the calculation of the market value of the Macro Fund's investments in accordance with applicable valuation policies or guidelines and the calculation of the Net Asset Value of the Macro Fund in accordance with the provisions of the Offering Memorandum) and to draw to the Directors' attention any matters of concern arising from their day-to-day administration of the Macro Fund's assets and investments; and (iii) on EY, as the Macro Fund's auditors, to perform the audit in a competent and honest manner, consistent with their contractual responsibilities and to draw to their attention any matters of concern.

66. It was submitted that the judge erred in that he found - notwithstanding the clear evidence of the reliance which the Directors genuinely placed, and believed that they were entitled to place, on WCUK, PNC and EY, and the absence of any evidence that might have given the Directors cause not to trust these professional external service providers – that, nonetheless, the Directors were in breach of their duties in (i) failing to request monthly management accounts from PNC for review

at each quarterly board meeting; (ii) failing to request a PNC employee (specifically, Mr Frank Barden) to attend board meetings for the purpose of talking the Directors through the Macro Fund's financial position or having other discussions with him in relation to the audit; (iii) failing to ask Mr Dhabia whether the Macro Fund was complying with the applicable investment restrictions; (iv) failing to ask PNC or WCUK for information, to seek a long form report from EY, or to make other enquiries of EY in connection with the 2004 audit; and (v) signing the 2007 management agreements and two "side letters" in reliance on assurances from WCUK (on the basis of legal advice obtained by WCUK) that it was appropriate for the Company to execute the documents. It is said that those findings were all made in error because they gave no weight (or at least no adequate weight) to the principle that, where appropriate delegation has taken place, a director is entitled to place trust in his delegate and is not expected to supervise every aspect of the delegate's activities. It is said to be "a complete answer" to many of the criticisms made of the Directors by the judge in respect of their alleged breach of duty in failing to "satisfy themselves" as to matters relating to the management of the Company's Macro Fund that the Directors were in fact "satisfied" as to those matters because they relied, and were entitled to rely, on those to whom such matters had been appropriately delegated.

67. As I have said, the Directors treated the third of their criticisms of the judge's approach – failure to give any or any adequate weight to the very limited expectations of the Company's investment manager, investors, shareholders, auditors or external service providers as to the role which the Directors would perform – as a contextual matter. By way of amplification it is said only that the judge made no reference to the fact that there was no evidence to suggest that any of those responsible for managing, administering and auditing the Macro Fund ever expressed the belief that the Directors were performing a greater role than they in fact performed; or that the manner in which the Directors discharged their limited role inhibited in any way the discharge by both the administrator and the auditors of their contractual and other responsibilities.

68. In amplification of the fourth of the criticisms – that the judge approached the issue of duty on a rigid and overly prescriptive basis, derived on little more than his own

subjective expectations of what he thought was required of all independent directors of investment funds – it is said that the judge fell into error in two respects. First, it is said that the judge's own subjective expectations were not an appropriate basis on which to define the scope of a director's duty in a particular case; and, second, it is said that to determine the scope of a director's on the basis that, if certain steps had been taken at certain times, things would have turned out differently, is contrary to the principle that a court should avoid applying hindsight when considering issues involving directors' duties.

69. The Directors point to a number of passages in the judgment in which it is said that the judge identified the scope of the Directors' duty by reference to his own expectations of what should have occurred. It is, I think, sufficient to refer to a passage (at paragraph 22), already cited earlier in this judgment, by way of example:

> "22. One would ordinarily expect an agenda to be prepared and circulated in advance of each meeting, reflecting input from the investment manager, the administrator and the directors themselves. I would expect the agendas to specify the matters for discussion, the reports to be presented and the individual officers of WCUK or PNC who will participate, either in person or by telephone. In particular I would expect the agenda to provide for a representative of PNC to attend (at least occasionally) for the purpose of reviewing the Macro Fund's monthly or quarterly management accounts with the Directors."

Other instances of the judge's own expectations of what the Directors should – or should not – have done are found at paragraphs 24, 26, 29 and 43 of his judgment. It is said on behalf of the Directors to be unclear whether the judge's "expectations" were based on his own experience (as a practitioner in this jurisdiction) or derive from some other source; but that, whatever the basis of these expectations, such an approach to the determination of the scope of the Directors' high-level duty to supervise was inappropriate. It is pointed out: (i) that no evidence was adduced at trial as to what "best practice" was or might have been at the relevant time in relation to the duties of non-executive directors of Cayman Islands investment funds; (ii) that (as the judge acknowledged) the management of the Company was set up and structured in accordance with Cayman Islands industry standards and there was no evidence that the Directors had ever received any advice to the effect that their high-level duty to supervise required them to take the steps which met the judge's expectations; and (iii) that the one objective indication which the judge did have available to him as to how the management of a Cayman Islands investment fund was conducted in practice - the expert evidence recorded in the judgment of Chief Justice Smellie QC in *Re Bristol Fund* [2008] CILR 317, at 329 ([24]-[26]) - was to the effect that it was seldom the case that boards of directors required any of the information which the judge held that he would have expected the Directors, as a matter of their legal duty, to have requested in the present case.

70. It is submitted on behalf of the Directors that a court should approach the task of determining whether it has been established that directors have acted in breach of duty without recourse to hindsight. Reliance is placed on observations of Sir Ernest Pollock, Master of the Rolls, in *Re City Equitable Fire Insurance* [1925] Ch 407, at 503:

> "It is not easy to reconstruct the true position as it stood before the auditors when they were called upon to do their duty in the three successive years in which their conduct is challenged. It is also proper to remember that when a big disaster has occurred, such as the failure of this company, which, as I have said, was a notable company in its day, there is, on the part of some, a desire to find a scapegoat who can be made responsible, and possibly to make good some of the losses which have occasioned disaster to so many. But it is the duty of the Court, as far as possible, to endeavour to ascertain what was the problem presented to the auditors, and what was the knowledge available to them at the time."

It is said that many of the criticisms of the Directors which the judge made in his judgment are to the effect that, if they had acted differently, the Company would have been placed into liquidation at an earlier stage; with the consequence that the losses incurred by continued trading would have been reduced. It is accepted that, with the benefit of hindsight, the conclusion that, had the Directors acted as the judge held they should have acted, the Company would have been put into liquidation earlier (and losses avoided) is incontrovertible; but, it is said, the judge erred in allowing hindsight to infect the judicial process of identifying what the Directors should, as a matter of duty, have done (at the time) in discharging their high-level supervisory responsibility. Passages relied upon by the Directors in this context are found at paragraphs 26, 28 and 43 of the judgment.

71. It is submitted on behalf of the Directors that the criticisms of the judge's approach to which I have referred in the preceding paragraphs of this judgment reflect errors of law which led the judge to an incorrect evaluation of the evidence at trial; and to

conclusions in relation to the scope of the Directors' duties and whether they were breached which were unsupported and often contradicted by the evidence and wrong in law.

72. It will be necessary to return to the general criticisms made of the judge's approach in the context of addressing the question whether the judge was correct to take the view that the failure of each of the Directors to discover (as and when they should have done) that the counter-party to the IRS contracts was WCF arose as a result of his own wilful neglect or default. But in the context of the first issue to be determined on this appeal – were the Directors in breach of duty in failing to discover, in early November 2008, that WCF was the counter-party to the IRS contracts – those general criticisms are not, I think, sufficiently focussed to provide any real assistance.

73. In addressing that question - were the Directors in breach of duty in failing to discover, in early November 2008, that WCF was the counter-party to the IRS contracts – it is, I think, appropriate to have in mind (i) the terms in which the relevant allegation of breach of duty was pleaded on behalf of the Company in the Amended Statement of Claim, dated and filed on 31 January 2011, and (ii) the terms in which the Directors responded to that allegation in the Amended Defence, dated 16 February and filed on 18 February 2011.

74. At paragraph 48(4) of the Amended Statement of Claim – in amplification of the allegation in paragraph 46(2) that the Directors were in breach of their duty to exercise reasonable care, skill and diligence – it is said (so far as material in the present context) that, in the PCN Q3 2008 Quarterly Report (which it is alleged, but wrongly - in that, if the October 2008 board meeting had taken place, it would have been held before the Q3 2008 Quarterly Report was sent - was sent to the Directors in advance of the October 2008 board meeting), "express reference is made to the fact that the counterparty to the Swaps was WCF" and that "Despite that express reference, the Directors did not question Mr Magnus Peterson or WCUK further about the Swaps or appreciate how seriously the Investment Restrictions were being breached." At paragraph 49(2) of the Amended Statement of Claim it is said that "The Directors knew but did nothing about the counterparty to the Swaps or alternatively failed to identify the counterparty even when, as explained in paragraph

48 above, that counterparty was expressly identified in the information provided to them".

75. The Directors' pleaded response to those allegations is found at paragraphs 41.5 and 42.3.2 of the Amended Defence. At paragraph 45.1 it is admitted that the Q3 2008 Report made reference to the fact that WCF was counterparty to the Swaps; but it is said that "The Directors did not pick up . . . that WCF was stated to be the counterparty to the Swaps" and that "These references appeared in brief notes at the foot of the portfolio analysis section of the administrator's reports and were simply missed". Further, it is admitted that ". . . the Directors did not, until shortly before the Company was placed into voluntary liquidation in March 2009, question Mr Magnus Peterson or WCUK further about the Swaps or appreciate that the Investment Restrictions might be being breached".

76. At paragraph 61 of his witness statement made on 13 April 2011 Mr Stefan Peterson said this:

> "114 With hindsight, I believe that the first reference to WCF as the swap counterparty that I might have picked up on was in the notes appearing at the bottom of the portfolio analyses in the administrator's reports for Q3 and Q4 of 2008 . . . I have obviously had, on many occasions since March 2009, to go back and look at the administrator's reports which were supplied to me on a quarterly basis. I note that no mention is made in any of them of WCF being the swap counterparty until the reports for Q3 and Q4 of 2008. The note in the Q3 administrator's report states for the first time: "the Interest Rate Swap positions are priced from the counterparty which is Weavering Capital Fund Limited". The note in the Q4 administrator's report states: "the Interest Rate Swap positions are priced from the counterparty which is Weavering Capital Fund Limited. The value of the Interest Rate Swap positions as at 31 December 2008 are: $626,567,149". I have no idea why PNC changed its practice over the many preceding years of not noting this pricing information. If it was because of newfound concern about the propriety of the swap transactions or the reliability of their pricing and valuations, I certainly would have expected PNC to draw this specifically to my attention and to do so much more directly than by simply adding a footnote to their portfolio analysis. It would have been very easy indeed for PNC to draw any such concerns specifically to my attention by email, but it never did so. As it was, I simply did not pick up the reference made to WCF in the last two administrator's reports. I am certain that this is the case because I distinctly remember it coming as a complete surprise to me to learn from PNC's fax of 5 March 2009 that the counterparty was in fact WCF."

Paragraph 114 of the witness statement made on the same day by Mr Ekstrom is in identical terms.

77. Mr Stefan Peterson's evidence that he "simply did not pick up the reference made to WCF" in the Q3 2008 Quarterly Report was not challenged in cross-examination at the trial. He was taken to the report and asked by counsel for the Company (transcript, 13 July 2011, page 135, line 14) whether he would have looked at the total net assets figure which appeared at the end of the portfolio analysis. His answer was "Yes". The transcript continues (*ibid*, page 135, line 20, to page 137, line 11):

> "Q. Right. And then you have some information under prices, would you have looked at that?
> A. Yes.
> Q. Right. And this is really all about valuations – isn't it?
> A. Yeah.
> Q. So it's telling you where the prices come from. So it's telling you that the futures and options come from Bloomberg. Ginnie Mae positions are priced from Martin brokers. And then it tells you about the interest swaps, and it says a price from the counterparty and identifies the counterparty. Now you would have read that, wouldn't you?
> A. I simply -- which I also [stated] in all the interviews and e-mail statement, I missed this note.
> Q. But normally you would read -- I mean – it really wouldn't take long. It's not as if there was a lot to read. You would read this information at the end of the portfolio analysis, wouldn't you?
> A. Yes. . . . But I as I stated, this note I have missed.
> . . .
> Q. And wouldn't the . . . even if Weavering Capital Fund didn't leap off the page . . . wouldn't the word counterparty have drawn your attention and you would have seriously focused on it?
> A. I admit, if I had read that, but I simply missed these two notes in these reports.
> Q. But you are sure, are you, that before the board meetings you did actually look at these quarterly reports?
> A. Yes.
> Q. Because obviously, if you had not looked at them at all, that would be a very clear explanation as to why you didn't pick this up, but your evidence is you did look at them?
> A. Yes."

In a latter passage (transcript, 14 July 2011, page 37, lines 16-20) it was put to him that by February 2009, he had already received two reports from PNC that expressly told him the identity of the counterparty to the IRS contracts. His response (which was not challenged) was "I admit that I missed those notes".

78. Nor was Mr Ekstrom's evidence that he "simply did not pick up the reference made to WCF" in the Q3 2008 Quarterly Report challenged in cross-examination. He was taken to the Report and asked by counsel (transcript, 14 July 2011, page 92, line 14) to

explain which parts of the report he had read. I have set out his answer (to which the judge referred at paragraph 43 of his judgment) earlier in this judgment: he said that he had read the first four pages (including the list of shareholders) and had had a "quick look" at the portfolio analysis on pages 5 to 7. He went on (*ibid*, page 92, line 25, to page 93, line 13) to give the answers which the judge set out at paragraph 43 (and to which I have already referred). In a later passage (*ibid*, page 95, line 25, to page 96, line 6) he was asked whether it would be fair to say that as far as the review of these quarterly reports was concerned, "in effect, between you and Mr. Stefan Peterson, you divided up responsibility so you had responsibility for the shareholder's register and he had responsibility for the portfolio analysis?" His answer was "Yes". Counsel for the Company returned to the point in the course of his cross-examination on the following day (transcript, 15 July 2015, page 44, lines 4-20). He asked Mr Ekstrom to confirm that, although he accepted that he had received the Q3 2008 Quarterly Report on 6 November 2008, he "didn't spot the reference to . . . Weavering Capital Fund". Mr Ekstrom gave the confirmation sought. The passage continued:

> "Q. Is that because you didn't read the report at all?
> A. As I . . . stated yesterday that I used to read the first page and then these shareholder register and had look on the investments but not much."

Later on that day, in the context of questions relating to the Q4 2008 Report, Mr Ekstrom was asked (*ibid,* page 60, lines 22-24) whether he had paid any attention to the portfolio analysis in that report. His answer was "I don't think so"; and he went on to say (*ibid*, page 61, lines 7-11) that he could not remember whether he would have been interested in the calculation of the total net assets which appeared at the end of the portfolio analysis. The passage continues (*ibid*, page 60, line 11, to page 61, line 3):

> "Q. You see, and then one gets to prices, and one has again the reference in the fourth sentence to the counterparty being Weavering Capital Fund Limited?
> A. Yes.
> Q. Now, is your evidence that you simply didn't bother to look at these two pages?
> A. Yes.
> Q. Despite the fact that at this time that the company -- there is a worldwide financial crisis and the company is facing difficulties in meeting its redemption payments?
> A. Yes.

Q. Why did you not then think that a five page document that is sent to you from the administrator is the document that you always say you have reviewed in your board minutes, was not something that you should at least have sat down and read from start to finish?

A. I can't tell you."

Mr Ekstrom was asked again (transcript, 15 July 2011, page 85, lines 8-15) why he did not read the entirety of the PCN Quarterly Report; and, again, he answered that he could not say. When asked (*ibid*) if he now accepted that it was important that he read it, his answer was "Of course. I should have."

79. On the basis of their own evidence it seems to me that the answer to the question "were the Directors in breach of duty in failing to discover, in early November 2008, that WCF was the counter-party to the IRS contracts" is plainly "Yes". I reach that conclusion for the following reasons:

(1) The Directors accept, correctly in my view, that the duties which they owed to the Company included a "high-level" supervisory duty in relation to the performance by the service providers – including, in particular WCUK - of the functions which had been delegated to them.

(2) That high-level supervisory duty required (at the least) that the Directors took the necessary steps to meet the objectives which they had set themselves at the time when the Company's Macro Fund was established. As recorded in the minutes of the board meeting held on 29 August 2003, they acknowledged that it was "essential that the investment manager acts within the guidelines and investment restrictions set by the Board"; they resolved that that requirement would be "closely looked upon at each board meeting"; and they decided that board meetings were to be held quarterly, in October, February, April and July in each year.

(3) The only source – or, at the least, the only source independent of Mr Magnus Peterson and WCUK - from which the Directors sought to satisfy themselves on a quarterly basis that the investment manager (or, from January 2007, the investment advisor) was acting within the guidelines and investment restrictions which they had set were the Quarterly Reports which they received from PCN. Those Reports contained, on the final page, a section headed "Errors and Breaches"; and it was under that section, if at all, that the Directors could expect to find notice from PCN that investment restrictions had been breached.

(4) In those circumstances it was necessary, if they were to meet the objectives which they had set themselves in 2003, that the Directors read the final page of each Quarterly Report in order to satisfy themselves (i) that it did contain the usual section "Errors and Breaches"; and (ii) that no breaches of restrictions were reported. It was only by doing so that the Directors could properly record, in the minutes of quarterly board meetings, that "it was noted that the investment manager (or investment advisor) had been acting within the guidelines and investment restrictions set by the Board."

(5) It is impossible, in my view, to read the final page of the Q3 2008 Final Report (however cursorily) without noticing that, immediately above the section headed "Errors and Breaches" there is a section headed "Prices". The headings are each in upper case and bold type; and they are separated by no more than four lines of text (occupying no more than one inch on the page). A director who had any familiarity with previous Quarterly Reports would know that they had not contained a section headed "Prices".

(6) In those circumstances, the duty of care and skill (albeit in the context of a high-level role) required a director to read the four lines of text within the section headed "Prices" in order to inform himself (even in the most general terms) as to what the section contained. A director who did read those four lines of text could not fail to notice that the last of those lines contained the statement: "The Interest Rate Swap positions are priced from the counterparty which is Weavering Capital Fund Limited".

(7) A director who did notice that the text within the section "Prices" contained the statement that the counterparty to the "Interest Rate Swap positions" was WCF would know that he could not rely (at least, not without inquiry of PCN) on the statement, in the following section headed "Errors and Breaches" that "There have been no pricing errors on this fund" as confirmation from PCN that there had been no breach of the investment restrictions: in that (i) the aggregate value of the IRS contracts indicated a breach of the restriction against investment which exposed in excess of 20% of the Gross Assets of the Company to the creditworthiness or solvency of any one counterparty, (ii) that there was no basis for the view that WCF was a major bank and (iii) the name "Weavering Capital Fund" itself suggested that there was some association between the Company and the counterparty.

80. Mr Stefan Peterson's evidence was that he had read the Q3 2008 Quarterly Report – including the final page - and that he appreciated that there was information within the section headed "Prices". But, he said, he "simply did not pick up" or "missed" the reference to WCF in the last of the four lines within that section. In my view it is impossible to avoid the conclusion that he did not read the four lines of text within the section headed "Prices". In failing to do so (in the circumstances to which I have referred) he failed to exercise the degree of care and skill which the law required of him.

81. Mr Ekstrom's evidence – as it emerged under cross-examination – was that he did not read the final page of the Q3 2008 Quarterly Report: at most, he had "a 'quick look' at the portfolio analysis on pages 5 to 7". He was right to accept (transcript, 15 July 2011, page 85, line 15) that he should have read the entirety of the report. In failing to read the final page, he failed to take the step which he needed to take in order to satisfy himself that PCN had not reported any "Errors and Breaches" during the relevant period: he failed to take the step which – given the manner in which the Directors sought to meet the objectives which they had set themselves in August 2003 – it was necessary that he should take for that purpose. In that respect he failed to exercise the degree of care and skill which the high-level supervisory duty required of him.

The second issue: was the failure of each of the Directors to discover, no later than early November 2008, that the counter-party to the IRS contracts was WCF the result of his own wilful neglect or default within the first limb of Mr Justice Romer's test in the City Equitable case (as the judge found)?

82. As I have mentioned, earlier in this judgment, Article 182 of the Company's Articles of Association is in these terms:

> "Every Director, agent or officer of the Company shall be indemnified out of the assets of the Company against any liability incurred by him as a result of any act or failure to act in carrying out his functions other than such liability (if any) that he may incur by his own wilful neglect or default. No such Director, agent or officer shall be liable to the Company for any loss or damage in carrying out his functions unless that liability arises through the wilful neglect or default of such Director, agent or officer."

83. The judge recorded (at paragraph 12 of his judgment) that it was accepted on behalf of the Company that the Directors were entitled to rely on the exemption from liability contained in the second sentence of that Article; and that, in order to establish that

either Mr Stefan Peterson or Mr Ekstrom (as the case might be) was liable for any loss or damage suffered by the Company as a result of the manner in which he had carried out his functions, it was necessary for the company to establish that such loss or damage "arises through [his] wilful default or neglect". As I have said, the judge referred to what he described as "the classic formulation of what is meant by 'wilful neglect or default' in the context of a company's articles of association" in the judgment of Mr Justice Romer in *Re City Equitable Fire Insurance* [1925] Ch 407; which I have set out earlier in this judgment, but, for convenience, set out again:

> "An act, or an omission to do an act, is wilful where the person of whom we are speaking knows what he is doing and intends to do what he is doing. But if that act or omission amounts to a breach of his duty, and therefore to negligence, is the person guilty of wilful negligence? In my opinion that question must be answered in the negative unless he knows that he is committing, and intends to commit, a breach of his duty, or is recklessly careless in the sense of not caring whether his act or omission is or is not a breach of duty."

He observed that that test had been adopted in this jurisdiction by Harre J. in *Prospect Properties Limited (In Liquidation) v. McNeill* [1990-91] CILR 171.

84. The case pleaded against the Directors in respect of wilful default and neglect is found at paragraph 50 of the Amended Statement of Claim

> "50. Further and insofar as may be necessary it is averred and contended that the breaches of duty of the Directors (and each of them) arose as a result of their wilful default and neglect.
>
> (1) The breaches of duty are themselves so serious that they can only have been as a result of a conscious decision not to get involved in the trading activities of the Company and not to question WCUK and Mr Magnus Peterson's conduct.
>
> (2) No director acting in the way the Directors acted could have thought that he was complying with his duties as set out in paragraph 30 above.
>
> (3) Further or alternatively the Directors (and each of them) were recklessly careless as to whether or not they were complying with their duties. Neither of the Directors showed any interest in the trading activities of the Company and left all such matters entirely to WCUK and Mr Magnus Peterson who they wholly failed to supervise. They were appointed as Directors because of their family connections to Mr Magnus Peterson and left him (through WCUK) to run the trading activities of the Company without any scrutiny from the Directors at all".

The reference to "his duties as set out in paragraph 30" is in error. The duties owed by the Directors are pleaded in paragraph 32 of the Amended Statement of Claim. The pleaded allegation was in these terms (so far as material):

> "32. The Directors owed, inter alia, the following duties to the Company at law and in equity and pursuant to the fiduciary obligations they owed to the Company:
>
> . . .
>
> (6) A duty to obtain such information that was necessary to enable them to confirm whether or not the Company had complied with the Investment Objective, Investment Strategy, Investment Restrictions and approach to risk management."

The pleaded case against the Directors – so far as relevant to the causative breach of duty in respect of which they were held liable – was that their failure to read the Q3 2008 Quarterly Report with sufficient care to discover that the counter-party to the IRS contracts was WCF was the result of wilful neglect or default in that (i) the breach of duty was, of itself, so serious that it can only have been as a result of a conscious decision not to question WCUK and Mr Magnus Peterson's conduct or (ii) no director acting in the way the Directors acted could have thought that he was complying with his duty to obtain the information necessary to enable him to confirm whether or not the Company had complied with the investment restrictions or (iii) the Directors (and each of them) were recklessly careless as to whether or not they were complying with their duties.

85 As I have said, the judge pointed out (at paragraph 13 of his judgment) that Mr Justice Romer's test comprised two distinct limbs: a director will not be liable for breach of duty unless either (i) he knows that he is committing, and intends to commit, a breach of his duty, or (ii) he is recklessly careless in the sense of not caring whether his act or omission is or is not a breach of duty. He went on (*ibid*) to say this:

> "13. . . . The case against these Directors is put fairly and squarely under the first limb of the test. The case against them is that 'they did nothing' and carried on doing nothing for almost six years. If they knew that they had a duty to supervise — and they both claim to have been aware of this duty — but did nothing, then it seems to me that their neglect must be intentional. If the evidence establishes that directors have completely and utterly ignored their duty and made no serious attempt to perform their duty, in spite of being conscious of a duty to supervise, as I think it does in this case, then their default must be regarded as wilful. The purpose and intended effect of Article 182 is to protect directors who do their incompetent best. Those who *attempt* to perform their duty, but fail as a result of their carelessness, no matter how gross, are relieved from liability. Those who have an appreciation of their duty, but make no attempt, or at least no serious attempt, to perform the duty are not relieved from liability."

At paragraph 14 he said this:

> "14. The case against these Directors is that they went through the motions of appearing to hold regular quarterly board meetings but, in reality, did nothing in that these meetings served no purpose other than recording of information that was in large part apparent from the monthly statements sent to investors. In addition, it is said that they provided what counsel described as an 'administrative service' in that they signed documents or took responsibility for documents whenever asked to do so by Mr Magnus Peterson, without making any enquiry or any attempt to understand their content. . . ."

At paragraph 51 he said this:

> "51. In my judgment the evidence in this case leads, unequivocally, to the conclusion that both of these Directors are guilty of wilful neglect or default because they consciously chose not to perform their duties to the Macro Fund, or at least not in any meaningful way."

And, at paragraph 52, he said this:

> "52. . . . The evidence clearly points to the conclusion that they both subordinated themselves to Magnus Peterson's wishes. They were motivated by a desire to keep him happy by going through the motions of appearing to act as independent directors of his investment fund. If they had applied their minds for a moment, they would have appreciated that their behavior was wrong. In my judgment their behavior in December 2008, when Mr Ekstrom signed fictitious minutes of two meetings which never took place, leads unequivocally to the conclusion that they knew perfectly well that their behavior was wrong."

86 It is submitted on behalf of the Directors, by way of introduction (or overview), first, that – in the circumstances that it was accepted (both by the Joint Official Liquidators and by the judge) that the Directors were misled as to the true financial position of the Company and did not themselves profit in any way - a finding that the Company's losses were caused by deliberate wrongdoing on their part (which, it is said, a finding of "wilful neglect or default" necessarily entails) should not be made in the absence of "clear, compelling evidence and unimpeachable reasoning"; second, that what is said to be "such limited explanation as is given in the judgment for this serious finding" is lacking in any detailed analysis and was unsupported (and, in fact, contradicted) by the unchallenged evidence heard at trial; and, third, that (as set out in their Memorandum of Grounds of Appeal) the judge made a large number of errors, some of which were fundamental, and that, as a result, the judge's conclusion that the Company's losses were caused by their "wilful neglect or default" was flawed.

87 It is accepted on behalf of the Directors that the judge was correct to approach the question whether, in relation to the breaches of duty which (as he held) gave rise to the

loss in respect of which they were held liable in damages, the directors fell outside the exempting provisions in Article 182 by reason of their "wilful neglect and default" on the basis that the test to be applied was that formulated by Mr Justice Romer in the *City Equitable* case. But it is said that, although the judge identified the applicable test and accepted, correctly, that the burden rested on the Company to establish that the loss in respect of which they were held liable in damages was caused by the Directors' "wilful neglect or default", he fell into error when applying that test to the facts of this case. In particular, it is said, he fell into error in failing to appreciate the stringent requirements of the applicable test; and so in failing to evaluate the evidence against those requirements.

88 It is necessary, therefore, for this Court to address the question whether the judge erred in his understanding as to what the test formulated by Mr Justice Romer in the *City Equitable* case requires.

89 It is said, on behalf of the Directors, that it is self-evident that a director cannot knowingly and intentionally commit a breach of duty, as the first limb of Mr Justice Romer's formulation requires, unless he actually knows what his duty requires of him and consciously and deliberately breaches that duty. That essential requirement of intentional and deliberate wrongful conduct is said to be made clear by observations in the three earlier judgments from which Mr Justice Romer J derived his test: that is to say, the judgments in *Lewis v The Great Western Railway Company*. [1877] 3 QBD 195; *Forder v Great Western Railway Company* [1905] 2 KB 532; and *Leeds City Brewery Limited v Platts* [1925] Ch 532 (Note).

90 In the course of his judgment in the *City Equitable* case Mr Justice Romer observed ([1925] Ch 407, 436) that *Lewis v The Great Western Railway Company* was "authority for the proposition that a wilful act, which act amounts to negligence, is not wilful negligence unless there be a will to be negligent." In the *Lewis* case, the claimant, a cheese manufacturer sought damages against the defendant, a railway company, for negligently packing a consignment of cheeses, which (in the events which happened) were damaged in transit. The contractual conditions of carriage excluded the railway company's liability save for "wilful misconduct" of the railway's servants. The Directors rely on the following passages in the judgments in that case. First, in the judgment of Lord Justice Bramwell [1887] 3 QBD 195, 206- 207:

"'Wilful misconduct' means misconduct to which the will is a party, something opposed to accident or negligence; the *misconduct*, not the conduct, must be wilful. It has been said, and, I think, correctly, that, perhaps, one condition of "wilful misconduct" must be that the person guilty of it should know that mischief will result from it. But to my mind there might be other "wilful misconduct." I think it would be wilful misconduct if a man did an act not knowing whether mischief would or would not result from it. I do not mean a state of ignorance, but after being told, "Now this may or may not be a right thing to do." He might say, "Well, I do not know which is right, and I do not care; I will do this." I am much inclined to think that that would be "wilful misconduct", because he acted under the supposition that it might be mischievous, and with an indifference to his duty to ascertain whether it was mischievous or not. I think that would be wilful misconduct."

Further, in the judgment of Lord Justice Brett (*ibid,* 210 to 211):

"In a contract where the term wilful misconduct is put as something different from and excluding negligence of every kind, it seems to me that it must mean the doing of something, or the omitting to do something, which it is wrong to do or to omit, where the person who is guilty of the act or the omission knows that the act which he is doing, or that which he is omitting to do, is a wrong thing to do or to omit; and it involves the knowledge of the person that the thing which he is doing is wrong; I think that if he knows that what he is doing will seriously damage the goods of a consignor, then he knows that what he is doing is a wrong thing to do; and also, as my Lord has put it, if it is brought to his notice that what he is doing, or omitting to do, may seriously endanger the things which are to be sent, and he wilfully persists in doing that against which he is warned, careless whether he may be doing damage or not, then I think he is doing a wrong thing, and that that is misconduct, and that, as he does it intentionally, he is guilty of wilful misconduct; or if he does, or omits to do something which everybody must know is likely to endanger or damage the goods, then it follows that he is doing that which he knows to be a wrong thing to do. Care must be taken to ascertain that it is not only misconduct but wilful misconduct, and I think that those two terms together import a knowledge of wrong on the part of the person who is supposed to be guilty of the act or omission."

And, in the judgment of Lord Justice Cotton (*ibid*, 213):

"Now, I do not think there can be any doubt at all that wilful misconduct is something entirely different from negligence, and far beyond it, whether the negligence be culpable, or gross, or howsoever denominated. There must be the doing of something which the person doing it knows will cause risk or injury, or the doing of an unusual thing with reference to the matter in hand, either in spite of warning or without care, regardless of whether it will or will not cause injury to the goods carried or other subject-matter of the transaction."

91 At page 436 of his judgment in the *City Equitable* case Mr Justice Romer J referred to *Forder v Great Western Railway Company* [1905] 2 KB 532. As its title suggests, *Forder* was another railway case: the facts were similar to those in the *Lewis* case

(save that the consigned goods were not cheeses, but sheepskins). The Divisional Court held that there was no evidence of wilful misconduct. Lord Alverstone, Chief Justice, (with whose judgment Mr Justice Kennedy and Mr Justice Ridley concurred) said this:

> "I am quite prepared to adopt, with one slight addition, the definition of wilful misconduct given by Johnson J in *Graham v Belfast and Northern Counties Rly Co.* [[1901] 2 I.R. 13], where he says: 'Wilful misconduct in such a special condition means misconduct to which the will is party as contradistinguished from accident, and is far beyond any negligence, even gross or culpable negligence, and involves that a person wilfully misconducts himself who knows and appreciates that it is wrong conduct on his part in the existing circumstances to do, or to fail or omit to do (as the case may be), a particular thing, and yet intentionally does, or fails or omits to do it, or persists in the act, failure or omission regardless of consequences.' The addition which I would suggest is, 'or acts with reckless carelessness, not caring what the results of his carelessness may be.' In *Lewis v Great Western Ry Co* . . . Brett LJ states the law in much the same language: 'If it is brought to his notice that what he is doing or omitting to do may seriously endanger the things which are to be sent, and he wilfully persists in doing that against which he is warned, careless whether he may be doing damage or not, then I think he is doing a wrong thing, and that that is misconduct, and that, as he does it intentionally, he is guilty of wilful misconduct.'"

92 The third case on which Mr Justice Romer relied in formulating his test in the *City Equitable* case was *Leeds City Brewery Limited v Platts* [1925] Ch 532 (Note). The issue in that case was whether the trustee of a debenture trust deed was liable for loss occasioned by an unauthorised investment. The trust deed indemnified trustees against claims arising from losses incurred "without their. . . wilful default". The judgments in the Court of Appeal contain the following observations. Lord Sterndale, Master of the Rolls, said this: ([1935] Ch 532,538):

> "... the question to my mind which has to be decided to settle this appeal is whether Mr. Beevers was to be held to have done this wilfully and intentionally knowing that what he was doing was wrong. The learned judge has found that he did. It was wilful neglect, as he calls it, which I take to mean wilfully doing what was wrong, and wilfully doing what he knew it was his duty not to do, or not doing what he knew it was his duty to do."

And Lord Justice Warrington observed (*ibid,* 544 to 545):

> "The learned judge, and here I agree with his view, has held that assuming that the trustee was guilty of wilful breach of trust, he would not be protected by that clause. I am inclined to agree with him there. But then it becomes important to consider what is meant be a wilful breach of trust or wilful negligence or wilful failure to perform his duty. I think it means this. I think it means deliberately and purposely doing something which he knows, when

> he does it, is a breach of trust, consisting in a failure to perform his duty as trustee.
>
> What he did was, I think, unquestionably imprudent, and imprudent to an extent which I am surprised to find displayed by a gentleman in Mr. Beavers' position and of his experience, but I think we cannot go further than saying that it was imprudent and imprudent to a high degree, but if it was merely imprudent, and not such as could properly be described as a wilful breach of trust, it could be covered by the clause in the trust deed . . ."

93 Mr Justice Romer's formulation of the test was approved by the Court of Appeal in the *City Equitable* case. At [1925] Ch 407, 517, 518, Sir Ernest Pollock. Master of the Rolls, after referring to the passages from the judgments of Lord Justice Bramwell in *Lewis* and Lord Alverstone, Chief Justice, in *Forder* which have been set out in the preceding paragraphs, said this:

> "For my own part, I agree with that definition quoted by Lord Alverstone, with the addition he proposes to make to it. It seems to me in close accord with the previous decisions to which I have already referred, and to give a proper meaning to the words which are before us."
>
> "In those circumstances, when you find a default which has been made, and an error of judgment in accepting as trustworthy what is now proved to be untrustworthy, can you say, within the definition, that he has been guilty of wilful neglect or default? For my part, for the reasons I have indicated, and upon the evidence to which I have called attention, it seems to me impossible to so characterise Mr. Lupine's conduct. He did not, to my mind, shut his eyes to conduct which he thought needed criticism; what he did was that, in common with a great number of other persons, he thought that the persons with whom he was dealing were trustworthy, and, as pointed out again and again in the cases cited to us, in such circumstances he was entitled to accept the statements which were made to him by those whom he was entitled to trust when he had no reason or call for suspicion."

Lord Justice Warrington, in agreeing with Mr Justice Romer's formulation of the test, began his own review of the authorities with the following observation (*ibid*, 521):

> "What then is the meaning of a loss which happens by or through their own wilful neglect or default? Bear in mind that the words are not "by or through their own wilful act or omission." We have, therefore, not merely to look at the act or omission in itself and see whether there was a conscious will impelling the person in question to commit that act or to omit to do the thing which is suggested to be wrongly omitted, but we have to consider whether the neglect or default was or was not wilful. In saying that, I am only really repeating what was said in much better language than I can find to use by Bramwell LJ in *Lewis* . . ."

and concluded (*ibid*, 524 to 525):

> "I think, therefore, that Romer J was quite right in arriving at the conclusion that a person is not guilty of "wilful neglect or default" unless he is conscious

that in doing the act which is complained of, or in omitting to do the act which it is said he ought to have done, he is committing a breach of his duty, and also, as he said, recklessly careless whether it is a breach of duty of not."

Lord Justice Sargant said this (*ibid*, 528 to 529):

> "What is the meaning of the exception "wilful neglect or default" in that article? Romer J has analysed with great care the cases on the subject, and in my opinion he has, as a result of that analysis, come to a correct conclusion. I think that the word "wilful" in this phrase is of importance, and means that the officer in question is consciously acting, or failing to act, in a reprehensible manner. It may no doubt be for him to show that this is not so, and I do not think he would be protected if he simply failed to give any consideration at all to the question of his duties, if he acted recklessly and without caring whether he was fulfilling them or not. But in my judgment, these words excuse an officer if through mere inadvertence or error of judgment, and while endeavouring honestly to carry out his duty he does or omits to do something which apart from these words might have rendered him liable. I need not carry the definition further, for as will be seen this is enough, having regard to the view I take of the facts."

94 In the light of the observations as to the meaning to be given to "wilful misconduct", "wilful default" and "wilful neglect" in the passages to which we were referred by counsel for the Directors (set out in the preceding paragraphs) it was submitted that, in considering how Mr Justice Romer's test should be applied to the evidence in this case, the judge should have given weight to the principle that conduct which is capable of being characterised as negligent, grossly negligent or even reckless cannot, without more, amount to wilful neglect or default. It is said that the law in this area reflects the fundamental common law distinction between negligent conduct on the one hand and deliberate misconduct on the other. Our attention was drawn to the observation of Lord Justice Millett in *Armitage v Nurse* [1998] Ch 241, 254B-C:

> "... English law differs from civil law systems, for it has always drawn a sharp distinction between negligence, however gross, on the one hand, and fraud, bad faith and wilful misconduct on the other."

And we were reminded that the Judicial Committee of the Privy Council has recently approved the judgments in *Armitage v Nurse* as a correct statement of English law. In *Spread Trustee Company Limited v Hutcheson* [2011] UKPC 13, it was held, by a majority, that the expression "fraud or wilful misconduct", in the context of a trustee liability exclusion clause, is not wide enough to include gross negligence. As Lord Clarke of Stone-cum-Ebony put it (*ibid*, [51]):

> "[The English cases] show that English law recognises the difference in legal principle between negligence and gross negligence and between those types of

> negligence and fraud. To describe negligence as gross does not change its nature so as to make it fraudulent or wilful misconduct."

Sir Robin Auld explained the distinction between negligent and wilful conduct in these words (*ibid* [117]):

> "On the plain meaning of the words, and as a matter of logic, and common sense, the terms "negligence" and "gross negligence" differ only in the degree or seriousness of the want of due care they describe. It is a difference of degree, not of kind, as stated by Millett LJ in *Armitage v Nurse* [1998] Ch 241. Gross negligence, like negligence not so qualified, may be committed in good faith and, therefore, without dishonesty or wilfulness. Indeed, dishonesty – an inherent ingredient of fraudulent or wilful misconduct – is the antithesis of negligence, an inadvertent falling short of a duty to take reasonable care in all the circumstances. To describe such inadvertence as "gross" does not turn it into fraudulent or wilful misconduct."

95 In my view it is clear, on the authorities to which we were taken, that in order to establish "wilful neglect or default" for the purposes of defeating the protection given to directors under an article in the terms of Article 182 of the Company's Articles of Association, it is necessary (at least under the first limb of Mr Justice Romer's test in the *City Equitable* case) for the Company to prove to the satisfaction of the court that the director made a deliberate and conscious decision to act or to fail to act in knowing breach of his duty: negligence, however gross, is not enough. As Sir Robin Auld put it in *Spread Trustee Company Limited v Hutcheson* [2011] UKPC 13, wilful neglect and default is "the antithesis of negligence or an inadvertent falling short of a duty to take reasonable care".

96 It seems to me, however, that the judge did appreciate that Mr Justice Romer's test did require that, before holding either of the Directors liable under the first limb, he must be satisfied that, in failing to read the Q3 2008 Quarterly Report with sufficient care to satisfy himself that there had been no breach of the investment restrictions, the director did make a deliberate and conscious decision to act or to fail to act in knowing breach of his duty. As I have said, the judge had directed himself, at paragraph 13 of his judgment, that the purpose and intended effect of Article 182 is to protect directors who do their incompetent best. As he put it (*ibid*): "Those who *attempt* to perform their duty, but fail as a result of their carelessness, no matter how gross, are relieved from liability. Those who have an appreciation of their duty, but make no attempt, or at least no serious attempt, to perform the duty are not relieved from liability." Subsequent passages in the judgment – at paragraph 51 (that the Directors

"consciously chose not to perform their duties to the Macro Fund, or at least not in any meaningful way") and at paragraph 52 (that the Directors' behavior, in December 2008 "leads unequivocally to the conclusion that they knew perfectly well that their behaviour was wrong") – are consistent with the view that the judge was aware of the need (under the first limb of the *City Equitable* test) to satisfy himself that each of the Directors had made a deliberate and conscious decision not to read the Q3 2008 Quarterly Report with sufficient care to satisfy himself that there had been no breach of the investment restrictions, knowing that failure to do so was in breach of his duty. It was on that basis, that the judge concluded that the Company had established a case under the first limb of Mr Justice Romer's test: it had proved on a balance of probabilities that each of Mr Ekstrom and Mr Stefan Peterson had knowingly and intentionally acted in breach of duty.

97 It is said on behalf of the Directors, correctly in my view, that there was no specific evidence that either of them made a deliberate and conscious decision not to read the Q3 2008 Quarterly Report with sufficient care to satisfy himself that there had been no breach of the investment restrictions, knowing that failure to do so was in breach of his duty. Given the terms in which the Company's case (under the first limb of *the City Equitable* test) was pleaded against them, that was unsurprising. As I have explained the pleaded case against each of the Directors– so far as relevant to the causative breach of duty in respect which he was held to have committed – was that his failure to read the Q3 2008 Quarterly Report with sufficient care to satisfy himself that the counter-party to the IRS contracts was WCF was the result of wilful neglect or default in that (i) the breach of duty was, of itself, so serious that it can only have been as a result of a conscious decision not to question WCUK and Mr Magnus Peterson's conduct or (ii) no director acting in the way the Directors acted could have thought that he was complying with his duty to obtain the information necessary to enable him to confirm whether or not the Company had complied with the investment restrictions.

98 The evidence, to which I have referred in the previous section of this judgment, was that each of the Directors had read the Q3 2008 Quarterly Report (at least in part); but had missed the sentence "The Interest Rate Swap positions are priced from the counterparty which is Weavering Capital Fund Limited" which appeared in the section headed "Prices". As I have said, that evidence was not challenged in cross-

examination. It was not, in my view, inherently incredible; and the judge gave no reason why it should be disbelieved, other than his conclusion (expressed at paragraph 51 of his judgment) that "the evidence in this case leads, unequivocally, to the conclusion that both of these Directors are guilty of wilful neglect or default because they consciously chose not to perform their duties to the Macro Fund, or at least not in any meaningful way." But, in referring there to "the evidence in this case", the judge could not have had in mind the evidence specific to the Directors' failure to pick up the relevant sentence in the Q3 2008 Report. He must be taken to have inferred that each of the Directors consciously chose not to read the Q3 2008 Quarterly Report with sufficient care to satisfy himself that there had been no breach of the investment restrictions, knowing that failure to do so was in breach of his duty, from his view, based on evidence of other matters, that they had consciously chosen, generally, not to perform their duties to the Company. The judge's approach raises the question whether it was open to him to draw that inference on the basis of the evidence of the other matters on which he had made findings of fact.

99 The basis upon which the judge reached the conclusion that the evidence led, "unequivocally, to the conclusion that both Directors were guilty of wilful neglect or default because they consciously chose not to perform their duties to the Macro Fund, or at least not in any meaningful way" is found in paragraph 51 of his judgment (which I have already set out). The judge relied upon the following matters:

(1) That, given their business backgrounds and experience, they must have known that the directors of an investment fund whose shares were listed on the Irish Stock Exchange, would be expected to act in a businesslike manner and that they could not discharge their duty by signing whatever documents were put in front of them (including standard form minutes of meetings) without reading them, or if they did read them, without applying their minds to their content.

(2) That, although the Directors each claimed to have appreciated that he had a high level supervisory duty, they never asked any of those whom they were supposedly supervising to give them a written report or attend a board meeting to provide them with an oral report.

(3) That every board meeting took the form of a discussion with Mr. Magnus Peterson and no one else. There were no agendas and there is no record of the discussion. The board minutes were created by Mr. Magnus Peterson, but they are standard

form documents intended to constitute a 'note' for the file and create the impression that the Directors were reviewing the affairs of the Company on a regular quarterly basis, whereas there is no evidence that any real business was ever in fact conducted at these meetings.

(4) That the Directors consistently signed financial statements, management representation letters, side letters and other documents without making any enquiry whatsoever. In 2007 they signed sham investment management and advisory agreements either without reading them or, if they did, knowing that the agreements would never be acted upon.

(5) That not even the bankruptcy of Lehman Brothers and the ensuing financial crisis was sufficient to prompt them into convening a board meeting or reading the Q3 2008 Quarterly Report.

(6) That the failure to read the Q3 2008 Quarterly Report cannot be treated as an error of judgment or negligence, because Mr Ekstrom subsequently signed minutes which falsely asserted that a board meeting did take place and that they did review the administrator's report.

The judge placed particular reliance on the sixth of those matters. He said, at paragraph 52 of his judgment, that the behavior of the Directors in December 2008 "when Mr Ekstrom signed fictitious minutes of two meetings which never took place" led unequivocally to the conclusion that they knew perfectly well that their behavior was wrong".

100 In my view the judge's finding that Mr Ekstrom's signature of board minutes on 23 December 2008 which appeared to record proceedings at meetings of the directors on 29 July 2008 and 28 October 2008 which had not taken place led "unequivocally to the conclusion that they both knew perfectly well that their behavior was wrong" cannot be supported. It is important to keep in mind that, on each of the minutes which Mr Ekstrom had signed on 23 December 2008, he noted, in manuscript "23/12" against the date which appeared in typescript (29 July 2008 or 28 October 2008, as the case may be). There was no reason, in my view, for the judge to reject Mr Ekstrom's evidence that he did so to record the fact that those were minutes of a meeting, or meetings, which had taken place on 23 December 2008; rather than on the date which appeared in typescript. That may have been a thoroughly inept way of dealing with the position that had arisen; but it cannot properly be regarded as a manifestation of an attempt,

dishonestly, to pretend that the meetings had taken place on 29 July 2008 or 28 October 2008 (as the case may be). And, given that the Q3 2008 Quarterly Report was received by the Directors after 28 October 2008, there would be no sensible purpose in seeking to pretend that it had been considered by the Directors at a board meeting held on 28 October 2008. The judge gave no reason (and there was no reason) for treating the signature of the minutes on 23 December 2008 as evidence of a dishonest attempt to cover up the true position; rather than as evidence of the Directors' general incompetence in relation to board minutes.

101 The judge was right to criticize the Directors for the inadequacy of the minutes of the meetings of the board. But he was wrong, as it seems to me, to draw the conclusion that their failure to keep adequate minutes was evidence of a conscious decision that they would not, generally, perform their high-level duty of supervision. The inadequacy of the board minutes was evidence of the Director's general incompetence in relation to board minutes; but it could not properly be treated as evidence of a decision by the Directors that, generally, they would not perform their duties as directors of the Company.

102 The judge was wrong, as it seems to me, to treat the Directors' failure to require anyone from PCN, WCUK or EY to attend board meetings or to give a written or oral report as to the position of the Macro Fund as evidence of a decision, generally, not to perform their duties as directors of the Company. The Directors took the view that they could rely on the Quarterly Reports from PCN to alert them as to breaches of the investment restrictions: that information could be expected to be contained within the section of the Quarterly Reports headed "Errors and Breaches". It is unnecessary to decide whether or not it was the duty of PCN under the Administration Agreement to provide that information: the relevant question is whether the Directors could reasonably take the view – given the section in the Quarterly Reports headed "Errors and Breaches" - that PCN would, in fact (whether or not it was obliged to do so under the Administration Agreement) alert them to any breaches of the investment restrictions. In my judgment they could reasonably take that view.

103 The judge was right to criticize the Directors for signing documents without reading them. But, as it seems to me, directors who sign documents which they have read, which appear on their face to be documents which they could properly be advised to

sign, and which they are advised by those who may be taken to have considered whether or not it is in the interests of the company it is appropriate for them to sign, are not to be held in breach of a high-level supervisory duty. *A fortiori*, a director's decision to sign such documents is not to be taken as a decision, generally, not to perform the duties which the director owes to the company.

104 It is said on behalf of the Company that it was open to the judge to draw the inference that he did. Reliance is placed on the judge's observations at paragraphs 13, 26, 43, 44, 51 and 52 of his judgment. I have already referred to those passages earlier in this judgment; but, for convenience, I will set out the particular observations in paragraphs 26, 43 and 44 on which the Company relies:

(1) At paragraph 26, in the context of his criticism of Mr Stefan Peterson's approach to the Quarterly Reports, the judge said this:

> "26 . . . Having listened to him give evidence, it was plainly obvious that he knew how to perform the directors' supervisory role in an effective way, but the evidence leads to the conclusion that he never attempted to do so. Whilst he repeatedly said in evidence that he understood that he had a supervisory responsibility in his capacity as a director, he never in fact behaved as if he had any intention of performing this duty".

(2) At paragraph 43, in the context of his criticism of Mr Ekstrom's failure to read the Q3 2008 Quarterly Report with sufficient care, the judge said this:

> "43 . . . His failure to read the key part of the Q3 2008 Report or do any of the things which one might expect a director to do in these circumstances, is evidence pointing to the conclusion that he never intended to perform his duties as a director."

(3) At paragraph 44, in the context of his criticism of Mr Stefan Peterson's failure to read the Q3 2008 Quarterly Report with sufficient care, the judge said this:

> "44 . . . There is no evidence that Mr Stefan Peterson took any steps at all, even after the bankruptcy of Lehman Brothers, to assure himself that the Macro Fund would be able to meet its obligations. He repeatedly said in evidence that he understood that, as a director, he had a supervisory role, but the evidence is that he never made any attempt to perform this role, which leads me to the conclusion that he never intended to perform his duties. He behaved as if he was doing a favour for his brother by acting as a director of the Macro Fund in name only."

105 In my view, none of those passages – in the context of the criticism in relation to which they were made - provides support for the conclusion that the Directors, or either of them, never intended to perform his duties as a director of the Company. As I have explained, in the previous section of this judgment, the Directors advance reasoned

submissions in support of their contention that the judge identified the scope of the high-level supervisory duty by reference to his own expectations of what they should have done, without reference to authority and on a "rigid and overly prescriptive basis". Those submissions cannot be dismissed as fanciful. It may be said that the conduct of the Directors which the judge criticized in the passages to which I have just referred is consistent with the judge's conclusion that neither of the Directors ever intended to perform his duties; but it is equally consistent with an understanding on the part of the director concerned as to what the high-level supervisory duty required which differed from that of the judge; and, as it seems to me, it is equally consistent with negligence or gross negligence in the performance of whatever the Directors believed the high-level supervisory duty required of them.

106 It is said on behalf of the Directors that it was not open to the judge to draw the inference which he did. It is accepted on their behalf that the judge held, correctly, that the Company's investment management, administration and accounting functions were all properly delegated to professional service providers; and that the Directors, as independent non-executive directors, retained a high-level supervisory role. Indeed, that was not in issue at the trial. But, as I have explained in the previous section of this judgment, it is submitted that the judge defined the content and scope of that high-level duty in a rigid and prescriptive way; by setting out the specific steps which he, himself, would have expected them to take as directors in order to discharge their duty. His fundamental error, it is submitted, was in holding that, in failing to take the specific steps which he, himself, would have expected them to take as directors in order to discharge their duty, the Directors had consciously chosen, generally, not to perform their duties to the Company; without having made findings (i) that the Directors were aware that their high-level duty to supervise required them to take the various steps identified by the judge; and (ii) that they made conscious decisions not to take those steps, knowing that they would be in breach of duty if they did not do so.

107 It is said that those findings were essential if the judge were properly to reach the conclusion that he did; that he did not make those essential findings; and, further, that it would not have been open to him to do so on the evidence.

108 The evidence as to the Directors' state of mind – and, in particular, their evidence as to their genuine understanding of the limited scope of their high-level duty to supervise -

was, it is said, clear and unchallenged. In particular, it is said that their evidence that each of the Directors genuinely believed that he was complying with his high-level duty to supervise and never thought that the matters in relation to which his conduct was criticized by the judge were matters in which his conduct fell short of what that duty required was clear and unchallenged. The Directors rely on the following matters. It is said:

(1) That they each gave clear evidence that they believed that they were complying with their duties. No witnesses were called to contradict the Directors' evidence as to their honestly held view that they were acting in compliance with their duty; and there was no documentary material to contradict that evidence. In relation to Mr. Stefan Peterson, to the very limited extent that it was suggested to him that he should have taken some of the specific steps identified by the judge, his clear evidence, which was unchallenged, was that he did not believe that it was necessary to take those steps; let alone that he would have been in breach of his duty if he had not taken them. In relation to Mr. Ekstrom, it was never suggested to him in cross-examination that he should have taken any of the specific steps identified by the judge; or that he knew that he was breaching his high-level supervisory duty by not doing so.

(2) The judge gave no reasons for disbelieving the Director's evidence that they believed that they were complying with their duties. In the circumstances that the veracity of their evidence was never challenged by the Company at trial, there was no proper basis for the judge to disbelieve it; and, given that it was never put to either of the Directors in cross-examination that they knowingly and intentionally breached either their high-level duty to supervise or any of the various specific duties which the judge has held to be comprised in that high-level duty, it was wrong in principle, and fundamentally unfair to the Directors (both as witnesses and as defendants), for the judge to make a finding that any neglect or default on their part was "wilful".

(3) That, even if the judge's summary in paragraph 51 of his judgment had been an accurate or fair reflection of the evidence, the conduct which was the subject of the criticisms which he made is capable of being seen as the result of errors of judgment or oversight on the part of one or both of the Directors. The judge fell into error in attributing conduct consistent with (at worst) gross negligence to a

conscious choice by the Directors to act in an "intentional", "knowingly wrongful", "consciously reprehensible" or "wilful" way.

(4) That the overall impression from the judgment is that the judge dealt with the critically important issue of "wilful neglect or default" in a superficial way, unfitting to the seriousness of the allegation. That approach, it is said, reflected "the casual way in which the allegation was advanced by the Liquidators throughout the litigation: from the threadbare way in which the allegation was pleaded to the Liquidators' attempts, in opening and closing submissions at trial, to marginalise or significantly water down the requirement to prove knowing and intentional breach of duty".

109 In my judgment the Directors are right to contend that it was not open to the judge to draw the inference that they had each consciously chosen, generally, not to perform their duties to the Company. More particularly, as it seems to me, the judge was wrong to hold (if and in so far as he did) that either of them had made a deliberate and conscious decision not to read to read the Q3 2008 Quarterly Report with sufficient care to satisfy himself that there had been no breach of the investment restrictions, knowing that failure to do so was in breach of his duty. The judge should have rejected the case pleaded against each of the Directors – so far as relevant to the causative breach of duty which he was held to have committed – that his failure to read the Q3 2008 Quarterly Report with sufficient care to satisfy himself that the counter-party to the IRS contracts was WCF was the result of wilful neglect or default (within the first limb of *the City Equitable* test) in that (i) the breach of duty was, of itself, so serious that it can only have been as a result of a conscious decision not to question WCUK and Mr Magnus Peterson's conduct or (ii) no director acting in the way the Directors acted could have thought that he was complying with his duty to obtain the information necessary to enable him to confirm whether or not the Company had complied with the investment restrictions. That case was not established on the findings of fact which the judge made.

The third issue: whether the judge ought to have held that the failure of each of the Directors to discover (as and when they should have done) that the counter-party to the IRS contracts was WCF arose as a result of his own wilful neglect or default within that second limb of Mr Justice Romer's test in the City Equitable case?

110 As I have said, the judge did not find it necessary to resolve the issue whether a company which sought to establish the liability of a director under the second limb of the *City Equitable* test – "recklessly careless in the sense of not caring whether his act or omission is or is not a breach of duty" – needed to satisfy the court that the director appreciated that his or her conduct might be a breach of duty and made a conscious decision that, nevertheless, he or she would do (or omit to do) the act complained of without regard to the consequences; or whether – as the Company contends by its respondent's notice – there was no such requirement.

111 In support of the submission that there is no such requirement, the following submissions are made on behalf of the Company:

(1) It is pointed out that the second limb of the test, as formulated by Mr Justice Romer in the *City Equitable* case, is whether the director "is recklessly careless in the sense of not caring whether his act or omission is or is not a breach of duty".

(2) Reliance is placed on the observation of Lord Justice Warrington, in his judgment in the appeal in the *City Equitable* case ([1925] Ch 407, 523), that:

> ". . . a person wilfully misconducts himself who knows and appreciates that it is wrong conduct on his part in the existing circumstances to do, or to fail or omit to do (as the case may be), a particular thing, and yet intentionally does, or fails or omits to do it, or persists in the act, failure or commission, regardless of the consequences . . . or acts with reckless carelessness, not caring what the results of his carelessness may be."

and on the observation of Lord Justice Sargant, in the same case (*ibid*, 528), that:

> "I think the word wilful in this phrase is of importance, and means that the officer in question is consciously acting, or failing to act, in a reprehensible manner. It may no doubt be for him to show that this is not so, and I do not think he would be protected if he simply failed to give any consideration at all to the question of his duties, if he acted recklessly and without caring whether he was fulfilling them or not."

(3) It is not surprising that a director should be liable on the basis of wilful neglect or default "if he simply failed to give any consideration at all to the question of his duties" because one of the duties of a director is to ensure that he knows what his duties are. Reliance is placed on observations of Mr Justice Jonathan Parker in *Barings (No 5)* ([1999]1BCLC 433, 488):

> "Directors' duties of skill, care and diligence have been exhaustively analysed by the Supreme Court of New South Wales in *Daniels v Alexander* (1995) 16 ACSR 607. Of particular materiality in the present case is the following passage in the judgment (at 668):

'A person who accepts the office of director of a particular company undertakes the responsibility of ensuring that he or she understands the nature of the duty a director is called upon to perform . . ."

It is said that it would be odd if a director who stopped to consider whether or not his actions might be a breach of duty and considered they might be but on the other hand might not be could be guilty of wilful neglect or default (as the Directors accept) but a director who did not even bother to consider what his duties were could not be. "Surely of the two . . ." it is submitted ". . . the latter was the more reckless and was not someone who could be described as doing his 'incompetent best'".

(4) In the context of determining whether a trustee should be ordered to account "on the basis of wilful default" it is not necessary to find wilful default "in the sense of conscious wrongdoing".

(5) "Wilful neglect and default" falls short of dishonesty; but even dishonesty does not require a subjective or conscious belief that the actions may be dishonest: all that is required, it is said, is knowledge that the facts would lead an ordinary person to that conclusion. Reliance is placed on observations in *Barlow Clowes International (in liquidation) v Eurotrust Ltd [*2006] 1WLR 1476, [15]-[16].

112 It is accepted on behalf of the Directors that, in the company law context, a director might be guilty of "wilful neglect or default" if the evidence established that the director had suspected that his conduct might be wrongful, but had deliberately decided to turn a blind eye to that possibility and to carry on regardless of the consequences. Such conduct might accurately be characterised as knowingly wrongful, or even dishonest. But, it is said that, if the evidence does not establish that the defendant at least suspected that his conduct might constitute a breach of duty, it is not accurate to characterise his breach of duty as "wilful neglect or default" whether under the first or the second limb of the *City Equitable* test.

113 It is, I think, important to keep in mind that, in referring to reckless carelessness "in the sense of not caring whether his act or omission is or is not a breach of duty" Mr Justice Romer was seeking to distill the observations as to what constituted wilful neglect or default contained in the earlier judgments – in *Lewis v The Great Western Railway Company* [1877] 3 QBD 195; *Forder v Great Western Railway Company* [1905] 2 KB 532; and *Leeds City Brewery Limited v Platts* [1925] Ch 532 (Note) –

from which he derived his formulation of the test. In particular, the terms in which Mr Justice Romer formulated the second limb of his test – "is recklessly careless in the sense of not caring whether his act or omission is or is not a breach of duty" have their origin, I think, in the "addition" suggested by Lord Alverstone, Chief Justice, in *Forder*.

114 The suggestion that wilful neglect or default might be found in conduct other that deliberate and conscious wrongdoing (that is to say, in conduct which falls within the second, rather than the first, limb of the *City Equitable* test) was raised in *Lewis v The Great Western Railway Company* (*supra*). In passages of their judgments which I have already cited Lord Justice Bramwell observed that he was "much inclined to think" that there would be "wilful misconduct" where a man acted under the supposition that it might be mischievous, and with an indifference to his duty to ascertain whether it was mischievous or not; and Lord Justice Brett said that ". . . if it is brought to his notice that what he is doing, or omitting to do, may seriously endanger the things which are to be sent, and he wilfully persists in doing that against which he is warned, careless whether he may be doing damage or not, then I think he is doing a wrong thing, and that that is misconduct, and that, as he does it intentionally, he is guilty of wilful misconduct; or if he does, or omits to do something which everybody must know is likely to endanger or damage the goods, then it follows that he is doing that which he knows to be a wrong thing to do." In my view those passages provide support for the proposition that, if the evidence does not establish that the defendant at least suspected that his conduct might constitute a breach of duty, it is not appropriate to characterise his breach of duty as "wilful neglect or default" under the second limb of the *City Equitable* test. I do not think that the reference in the observations of Lord Justice Brett to "something which everybody must know is likely to endanger or damage the goods" is to be understood in a sense which is inconsistent with that proposition: in other words "everybody must know" is not to be understood to mean "everybody but the defendant must know". That view, I think, is reflected in the terms in which Lord Alverstone, Chief Justice, in the passage of his judgment in *Forder* which I have set out, approved the observations of Lord Justice Brett in *Lewis*.

115 Given that, in the *City Equitable* case, Mr Justice Romer was seeking to distill the observations as to what constituted wilful neglect or default which were contained in

the earlier judgments to which he had referred, it is, I think, clear that, when he referred in his formulation of the test to a director who "is recklessly careless in the sense of not caring whether his act or omission is or is not a breach of duty", he did not intend to suggest that, if a director who did not (at the least) suspect that his conduct might constitute a breach of duty would be in "wilful neglect or default".

116 Nor am I persuaded that, on the appeal in the *City Equitable* case, the Court of Appeal, in approving Mr Justice Romer's formulation, intended to extend the second limb to a case where a director who did not (at the least) suspect that his conduct might constitute a breach of duty. The observations of Lord Justice Warrington ([1925] Ch 407, 523) on which the Company places reliance must be read in conjunction with his earlier observations (*ibid*, 521) which I have already set out – and, in particular, with his endorsement of the observations of Lord Justice Bramwell in *Lewis* – and his subsequent observations (*ibid*, 524-525) to which, also, I have already referred. And the observations of Lord Justice Sargant (*ibid*, 528) must be read in context: in that, in the sentence which immediately precedes the citation on which the Company relies, the Lord Justice had expressed the view that Mr Justice Romer "has analysed with great care the cases on the subject, and in my opinion he has, as a result of that analysis, come to a correct conclusion".

117 It follows that, in my judgment, the Directors are correct to contend that, in order to establish the liability of a director under the second limb of the *City Equitable* test – "recklessly careless in the sense of not caring whether his act or omission is or is not a breach of duty" – it is necessary to satisfy the court that the director appreciated (at the least) that his or her conduct might be a breach of duty and made a conscious decision that, nevertheless, he or she would do (or omit to do) the act complained of without regard to the consequences; and that if the evidence does not establish that the defendant at least suspected that his conduct might constitute a breach of duty, it is not appropriate to characterise his breach of duty as "wilful neglect or default" whether under the first or the second limb of the *City Equitable* test. To hold otherwise would, in my view, be to fail to give full meaning to the requirement that the "neglect or default" relied upon must be "wilful".

118 That conclusion is consistent, as it seems to me, with observations in two more recent cases to which we were referred:

(1) In *Kenyon, Son & Craven Ltd v Baxter Hoare & Co Ltd* [1971] 1 WLR 519 Mr Justice Romer's test was applied by Mr Justice Donaldson in the context of a clause in a warehousing contract which excluded liability "unless such loss or damage is due to the wilful neglect or default of the company or its own servants". In that case, a consignment of bagged groundnuts stored by the plaintiff in the defendant's warehouse was damaged by rats. The evidence established that the defendant was aware of the presence of rats in the warehouse; but had made only ineffectual efforts to control them. After referring (*ibid*, 523D-524A) to Mr Justice Romer's formulation of the test in the *City Equitable* case – and to the fact that it had been approved by the Court of Appeal in that case - Mr Justice Donaldson held (*ibid*, 529E-G):

> "If this was not deliberate and conscious neglect or default, and, as I have said, having seen and heard the witnesses, I think that it was not, was it reckless? Was it a matter of indifference to the defendants and their servants whether their conduct did or did not constitute a breach of their duty to the plaintiffs, to apply Romer J's test, or what might be the results of their lack of care, to apply Sir Ernest Pollock MR's test. Such a conclusion is also attractive, but again would, I think, be unjust. They thought at the time that they were doing their best and if it had been brought home to them that they were not, would I am sure have done more. Their carelessness was the carelessness of the fatalist and the defeatist. It was the carelessness of the incompetent, but it was not a reckless carelessness."

(2) In *Morley v United Friendly Insurance* [1993] 1 WLR 996, the Court of Appeal of England and Wales, after referring to *Lewis* and *Forder*, gave the following guidance on the meaning of the word "wilful"; in the context of a clause in an insurance policy which excluded liability for death resulting from "wilful exposure to needless peril". Lord Justice Beldam, having set out passages from the judgments in *Lewis* and *Forder*), observed (*ibid,* 1004C-D):

> ". . . the meaning to be given to "wilful exposure to needless peril" in the clause excluding liability under the policy requires that the conduct relied on must go beyond negligent exposure to needless peril. It must be shown that at the time of his actions the insured was mindful of a real risk of the kind of injury for which benefit was provided by the policy and that he either intended to run that risk or exposed himself to it not caring whether he sustained such injury or not."

119 In so far as reliance on the second limb of the *City Equitable* test is founded on the contention that liability for loss caused by "wilful neglect or default" of duty under that limb requires no conscious appreciation on the part of the Directors that their conduct

might be in breach of duty, it must be rejected. To the extent that such reliance is based on the contention that the Directors had the requisite conscious appreciation that they might be breaching their duty to read the Q3 2008 Quarterly Report with sufficient care to discover that the counter-party to the IRS contracts was WCF, the case against the Directors finds no support in the evidence.

Conclusion

120 For the reasons which I have set out in this judgment, I would allow this appeal and set aside the order made on 26 August 2011. My provisional view is that there is no reason why costs in this Court and below should not follow the event; but either party may (if so advised) seek a different order as to costs by lodging representations in writing within twenty one days of the date of this judgment.

Abdulai Conteh, Justice of Appeal

121 I have had the benefit of reading in draft the judgment of the President. In his careful and fulsome analysis of the evidence in the case as reproduced in the learned trial judge's judgment, I agree with the President that it was not open to the judge to draw the inference that the Directors (the appellants) were, in the circumstances of the case, "willfully negligent" within the meaning of that term, as the authorities establish, in their treatment of the Q3 2008 Quarterly Report, such as to deny them the protection of Article 182 of the Company's Articles of Association. Also the slap-dash manner of noting the minutes of the Board in the handwriting of the second appellant -- 23/12 - cannot be regarded as conclusive evidence of any conscious decision that they would not perform their supervisory duties as directors of the Company.

122 For the reasons more fully set out in the judgment of the President, I agree that the appeal should be allowed and the order dated 26 August 2011, pursuant to the judge's judgment be set aside. Subject to any further representations that may be made, I would also award the appellants the costs of this appeal and in the proceedings below.

Sir Anthony Campbell, Justice of Appeal:

123 I agree that, for the reasons which the President has set out in his judgment, this appeal should be allowed.