UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

ANWAR, et al.,
Plaintiffs,
v.
FAIRFIELD GREENWICH LIMITED, et al.,
Defendants.
This Document Relates to : All Actions

Master File No. 09-cv-118(VM)

SUPPLEMENTAL AFFIDAVIT OF GERARD ST.C. FARARA, Q.C.

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SUPPLEMENTAL AFFIDAVIT OF GERARD ST.C. FARARA, Q.C.

I, **GERARD ST.C. FARARA** of Road Town, Tortola, British Virgin Islands, MAKE OATH and SAY as follows:

1. I am the same Gerard St.C. Farara Q.C. who swore an affidavit in this matter on December 22, 2009 ("first affidavit"). I use the same abbreviations here as in my first affidavit.
2. I make this affidavit in reply to the affidavits of Lewis Hunte, Q.C. ("Hunte Aff.") and Robert Miles, Q.C. ("Miles Aff.").
3. In paragraph 2 of his Affidavit, Mr. Miles states that he is "able to provide expert evidence about the law of the British Virgin Islands". However, Mr. Miles does not claim to be admitted as a member of the BVI bar nor does he claim to have appeared in any case before the BVI courts. In my opinion, it would be incorrect to express an opinion relating to BVI law based purely on an assumption that U.K. and BVI law are identical.

The Rule In *Foss v Harbottle*

4. As Mr. Hunte states in paragraph 12 of his affidavit, *Foss v Harbottle* is authority for the principle that "where a company suffers a wrong, the company alone has the right to bring an action for relief in respect of that wrong." Hunte Aff. ¶ 12.

5. Thus, as discussed in my first affidavit, Plaintiffs' claims are barred under the rule in *Foss v Harbottle* to the extent that those claims belong to or are based on the same losses as those suffered by the Funds. Indeed, Mr. Miles agrees that breach of fiduciary duty claims and other claims of mismanagement belong to the corporation "in so far as the claim is for breach of a duty owed exclusively to the corporation." Miles Aff. ¶ 24.

6. Mr. Miles and Mr. Hunte appear to take issue only with those of Plaintiffs' claims involving alleged "misrepresentations made by the defendants that were relied upon by Plaintiffs in purchasing shares in the Funds and remaining invested in the Funds." Hunte Aff. ¶ 20; Miles Aff. ¶ 24-25.

Shareholders' Claims Are Barred By The Rule Of Reflective Loss

7. As Mr. Miles correctly states, the rule of reflective loss, which bars a shareholder's claim where the shareholder's loss is reflective of the company's loss "represents one strand of a series of decisions going back to *Foss v Harbottle*." Miles Aff. ¶ 5.

8. The applicable principles regarding the rule of reflective loss are set out by Lord Bingham in *Johnson v Gore Wood and Co*:[1] (1) if a shareholder suffers a loss as a result of a breach of duty owed to the company alone, then only the company has the right to sue to recover the loss; (2) if the company suffers a loss but has no cause of action, a shareholder who has an independent cause of action may sue to recover the loss, and (3) if the company and the

[1] [2002] 2 AC 1, 35-36.

shareholder both suffer a loss as a result of a breach of duty, the shareholder may recover only the loss which is separate and distinct from the company's loss.[2]

9. In my opinion, the first scenario applies here because, as I explain below, the Complaint does not establish that the Fairfield Greenwich Defendants owed a duty of care to the Plaintiffs.

10. The second scenario would not apply here. This scenario may apply if, for example, the company suffers a loss but has no cause of action (*e.g.*, where its cause of action is statute barred), and a shareholder has a cause of action independent of that of the company. That is clearly not the case.

11. With respect to the third scenario, Mr. Miles opines that it applies only where the shareholder's losses are not "the same as, and for the same amount as" those of the company. Miles Aff. ¶ 15. However, neither Mr. Miles nor Mr. Hunte asserts that the Funds' losses are in fact less than those of the Plaintiffs. Instead they suggest that the Plaintiffs losses may be distinct solely on the basis that Plaintiffs may have a direct claim arising from alleged misrepresentations to shareholders, while the Funds do not have that claim. Miles Aff. ¶¶ 25, 29; Hunte Aff. ¶ 20.

12. However, it is irrelevant that a claim based on misrepresentation or inducement is a claim personal to the individual plaintiff and that such a claim is unavailable to the company. The relevant question for the purpose of determining reflective loss is whether a shareholder's *loss* is distinct from the company's loss, not whether the *claims* themselves are different.

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[2] *Id* at 36. Mr. Miles appears to state these principles at paragraph 8 of his affidavit, and Mr. Hunte appears to do the same at paragraphs 14 and 15 of his affidavit.

13. As illustrated in *Prudential v Newman* [3] and quoted by Lord Millett in *Johnson v Gore Wood and Co*:

> "Suppose that the sole asset of a company is a cash box containing £100,000. The company has an issued share capital of 100 shares, 99 of which are held by the plaintiff. The plaintiff holds the key of the cash box. The defendant by a fraudulent misrepresentation persuades the plaintiff to part with the key. The defendant then robs the company of all its money. The effect of the fraud and the subsequent robbery, assuming that the defendant successfully flees with the money, is (i) to denude the company of all its assets; and (ii) to reduce the sale value of the plaintiff's shares from a figure approaching £100,000 to nil. *There are two wrongs, the deceit practised on the plaintiff and the robbery of the company. But the deceit on the plaintiff causes the plaintiff no loss which is separate and distinct from the loss to the company. The deceit was merely a step in the robbery. The plaintiff obviously cannot recover personally some £100,000 damages in addition to the £100,000 damages recoverable by the company.*"[4]

14. A BVI court would not consider the Plaintiffs' alleged loss to be separate or distinct from any loss allegedly incurred by the Funds. The Complaint unambiguously alleges that the Plaintiffs' loss consists of the loss of the value of their investment in the Funds as a result of alleged mismanagement and failure to conduct diligence.[5] Indeed, the Complaint identifies the Plaintiffs as "shareholders and/or equity holders of the four Madoff feeder funds . . . who suffered a net loss of principal invested in the Funds."[6]

15. Therefore the losses alleged by Plaintiffs here would be, by definition, reflective of the losses suffered by the Funds themselves. In my opinion, the Plaintiffs claims would be stricken out under the rule of reflective loss.

16. This accords with Mr. Miles' interpretation of the rule: "where a company, C, has suffered a loss at the hands of a wrongdoer, D, and as a result the value of the shares in C have fallen, if the loss in value of the shares merely reflects losses recoverable by the company,

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[3] *Prudential Assurance Co. Ltd v Newman* (No 2) [1982] 1 All ER 354 at 366-67.
[4] [2002] 2 AC 1, 63 (emphasis added).
[5] Compl. ¶¶ 359, 365, 394, 399.
[6] Compl. ¶ 2.

a shareholder, S, is prevented from claiming, even though he has his own cause of action against D." Miles Aff. ¶ 7.

17. As Lord Bingham stated in *Johnson v Gore Wood and Co.*, in determining whether a claimed loss is reflective of a company's loss: "In some cases the answer will be clear, as where the shareholder claims the loss of dividend or a diminution in the value of a shareholding attributable solely to depletion of the company's assets, or a loss unrelated to the business of the company."[7] And as Lord Millet observed in *Johnson v Gore Wood and Co*, where a "shareholder's loss . . . is measured by the diminution in the value of the shareholding or the loss of dividends," that loss "merely reflects the loss suffered by the company in respect of which the company has a cause of action . . . If the shareholder is allowed to recover in the respect of such loss, then either there will be double recovery at the expense of the defendant or the shareholder will recover at the expense of the company and its creditors and shareholders. Neither course can be permitted. This is a matter of principle; there is no discretion involved."[8]

18. The loss claimed by the Plaintiffs, that is, the loss of their investment in the Funds, is the same as the loss suffered by the Funds themselves for the alleged breach of duties, as it is a loss directly as a result of the depletion of the company's assets. Regardless of whether the company and shareholders each have or claim to have separate causes of action against the defendants, the rule of reflective loss bars claims based on alleged loss stemming from the depletion of the company's assets.

19. As I stated in paragraph 56 of my first affidavit, I understand that the Funds are already in the process of seeking to recover the very losses claimed by Plaintiffs. On March 4, 2009,

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[7] [2002] 2 AC 1, 36.
[8] [2002] 2 AC 1, 62.

Sentry filed a customer claim in the Securities Investor Protection Act liquidation proceeding of BLMIS, and on May 29, 2009, Sentry, through its Liquidators, filed a lawsuit in New York state court seeking, *inter alia*, compensatory damages for the loss of its investment with BLMIS.

No Independent Duty

20. As discussed above, if the company suffers a loss as a result of a breach of duty owed to the company only, then only the company has the right to sue to recover that loss, irrespective of the fact that the shareholders have suffered a diminution in the value of their shareholding. In other words, if the defendants owed a duty only to the Funds, then Plaintiffs' claims cannot be maintained. And absent an independent duty, Plaintiffs cannot sue to recover any loss in the value of their shares/investment in the Funds.[9]

21. In my opinion, the Complaint contains no allegations establishing that any Fairfield Greenwich Defendant provided any specific undertaking to act as a fiduciary to any individual shareholder under BVI law.

22. As I discussed in paragraph 60 of my first affidavit, directors and/or officers of an entity acting as an investment manager do not owe fiduciary duties to the shareholders of the funds the investment manager serves.

23. Pursuant to the ruling in *Arklow Investments Ltd v Maclean*, for a fiduciary duty to arise, an individual must *voluntarily undertake* a role involving trust and confidence.[10] Here, the Complaint does not allege any facts indicating that any of the Fairfield Greenwich Defendants undertook a role giving rise to an independent fiduciary duty. The Complaint, in fact, contains no allegation that any Fairfield Greenwich Defendant had any direct

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[9] *Johnson v Gore Wood and Co.*, [2002] 2 AC 1, 35-36.
[10] [2000] 1 W.L.R. 594, 599.

interactions with any plaintiff through which a Fairfield Greenwich Defendant could have intentionally undertaken a role as an independent fiduciary.

24. Mr. Hunte disagrees that *Arklow Investments Ltd v Maclean* stands for the proposition that one does not become a fiduciary under BVI law merely because one is trusted by the other party to a business transaction, or by superior knowledge, or by having the right or ability to control some action or asset. Hunte Aff. ¶ 25. Not only does Mr. Hunte fail to provide authority that holds to the contrary, he misstates the holding in *Arklow*. The plaintiff in *Arklow*, a potential buyer of land, was in negotiations with a merchant bank for financing. The plaintiff sought financing elsewhere, and a company associated with the bank bought the land using the plaintiffs' confidential information. The Privy Council held that there was no duty of loyalty in these circumstances because such a duty only arises where there is an evidential basis for finding that a relationship of trust and confidence, that is, the undertaking of an obligation of loyalty.[11]

25. Both Mr. Miles and Mr. Hunte acknowledge that in order to pursue individual claims, Plaintiffs must establish that the Fairfield Greenwich Defendants owed them a duty that was independent from the duty that Fairfield Greenwich Defendants owed the Funds. Miles Aff. ¶ 24; Hunte Aff. ¶ 21. However, neither Mr. Miles nor Mr. Hunte provides any basis for concluding that such a duty existed.

26. Mr. Miles suggests that the Complaint establishes such a duty, but does not provide any analysis of how the facts of this case support its existence. Miles Aff. ¶ 24.

27. At paragraphs 36 and 37 of his Affidavit, Mr. Miles states that under certain "special circumstances," directors may owe duties to shareholders under U.K. law. Mr. Miles offers

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[11] *Id.*

two cases to support his argument, but both cases arise in the corporate takeover context and neither case is applicable here.

28. The first case is *Dawson International Plc v Coats Paton* (1988) 4 BCC 305. In *Dawson*, Lord Cullen considered whether, *in a takeover situation*, directors were under a fiduciary duty to the shareholders to act in their best interests. The holding in *Dawson* is entirely irrelevant here because Lord Cullen specifically limited it to takeover situations:

> "I think it is important to emphasise that what I am being asked to consider is the alleged fiduciary duty of directors to current shareholders as sellers of their shares. This must not be confused with their duty to consider the interests of shareholders in the discharge of their duty to the company."

29. In any event, the holding in *Dawson* would actually support the Fairfield Greenwich Defendants' position:

> "It is well recognized that directors owe fiduciary duties to the company…In contrast I see no good reason why it should be supposed that directors are, in general, under a fiduciary duty to shareholders, and in particular current shareholders with respect to the disposal of their shares in the most advantageous way. The directors are not normally the agents of the current shareholders."[12]

30. The second case Mr. Miles uses to illustrate a "special circumstance" in which directors can owe duties to shareholders is *Coleman v Myers* [1977] 2 NZLR 297, a New Zealand case that is not binding or highly persuasive authority in the courts of the BVI. In *Coleman v Myers*, a fiduciary relationship between directors and shareholders arose where, in a private company with the shareholding spread over a few associated family groups, the directors had a high degree of inside knowledge that they failed to disclose to the other shareholders when the shares in the company were the subject of a takeover offer from a

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[12] Lord Cullen stated in dicta that if "directors take it upon themselves to give advice to current shareholders…they have a duty to advise in good faith and not fraudulently…" There are no allegations here that any Fairfield Defendant specifically gave any advice to any plaintiff or any "current shareholder," much less in the context of a takeover situation. *Id* at 314.

company owned by one of the directors. The court stressed that the existence of such a relationship depended entirely on the facts of that particular case. The circumstances here are entirely different, thus the holding of *Coleman v Myers* is inapplicable.

31. Mr. Hunte also suggests that directors can owe duties to shareholders and cites two U.K. cases in support: *Hedley Byrne & Co Ltd v Heller & Partners Ltd.* and *Henderson v Merrett Syndicates*. Hunte Aff. ¶ 21. Neither case supports the finding of a fiduciary duty in the circumstances here.

32. Lord Morris stated the general principle concerning directors' duties of care in *Hedley Byrne & Co. Ltd v Heller & Partners Ltd* [1964] A.C. 465, and this principle was applied in *Henderson v Merrett Syndicates Ltd* [1995] 2 A.C. 145. Under *Hedley Byrne*, a duty of care arises where someone possessing "*a special skill undertakes, quite irrespective of contract, to apply that skill for the assistance of another person who relies upon such skill...*"[13].

33. In my opinion, no allegation in the Complaint suggests that any Fairfield Greenwich Defendant "undertook" a duty of care to any Plaintiff, and certainly not outside the scope of the operative Investment Management Agreements.

34. In *Henderson v Merrett*, the court further held that in order for a duty of care to exist, the shareholder must have reasonably relied on the director's express assumption of responsibility.[14] The House of Lords clarified this requirement in *Williams v Natural Life Health Foods Ltd* [1998] 1 W.L.R. 830, explaining that directors owe duties to shareholders only in the most extraordinary circumstances. In order for a director or employee of a limited company to be personally liable for a negligent misstatement made

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[13] *Id* at 502

[14] [1995] 2 A.C. 145, 180.

on behalf of the company, under the *Hedley Byrne* principle, there would have to be (1) an assumption of personal liability by the director to the plaintiff and (2) reasonable reliance by the plaintiff on an assumption of personal responsibility so as to create (3) a special relationship between plaintiff and defendant.[15]

35. The test for "*assumption of responsibility*" is an objective one:

> "[t]he touchstone of liability is not the state of mind of the defendant. An objective test means that the primary focus must be on things said or done by the defendant or on his behalf in dealings with the plaintiff and whether it was conveyed, whether directly or indirectly, that the director assumed personal responsibility for the risk involved."[16]

36. The test for "reliance" requires more than reliance in fact. Rather, the "test is whether the plaintiff could reasonably rely on an assumption of personal responsibility by the individual who performed the services on behalf of the company."[17]

37. Thus, in order to establish a duty of care, Plaintiffs must establish that each individual Fairfield Greenwich Defendant *assumed a personal responsibility* to each individual plaintiff regarding each alleged misstatement or omission made by each Fairfield Greenwich Defendant.

38. The Complaint here contains no allegation that each Fairfield Greenwich Defendant expressly assumed a personal responsibility to each Plaintiff. Indeed, it is unclear in the Complaint which statements were made by which Fairfield Greenwich Defendant or to whom these statements were made.

39. There is likewise no sufficiently pleaded allegation of actual reliance by each Plaintiff. A bare allegation that the Fairfield Greenwich Defendants knew, or ought to have known, that

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[15] [1998] 1 W.L.R. 830, 835.
[16] *Id* at 836.
[17] *Id* at 837.

their alleged representations or omissions would be relied upon by Plaintiffs is not sufficient to establish a duty of care.

40. Indeed, the recent House of Lords majority decision in *Stone & Rolls Ltd v Moore Stephens Ltd* [2009] 1 AC 1391 clarifies that where a service provider (such as an accountant, or equally in my view, a management company or a director) provides services to a company pursuant to a contract, as a general rule that person will owe a duty of care to the company alone – not to any individual shareholder of the company.

41. It therefore continues to be my opinion that the Complaint contains no allegations establishing that any Fairfield Greenwich Defendant provided any specific undertaking to act as a fiduciary to any Plaintiff under BVI law.

In Pari Delicto

42. Mr. Miles and Mr. Hunte suggest that the defense of *in pari delicto* could bar the Funds from pursuing their own causes of action, and on that basis, Plaintiffs would be permitted to pursue their claims notwithstanding the reflective loss principle. Miles Aff. ¶ 20, Hunte Aff. ¶ 23. Neither Mr. Miles nor Mr. Hunte provides any legal authority to support this conclusion.

43. The two cases cited by Mr. Hunte, *Parkinson v College of Ambulance Ltd* [1925] 2 KB 1 and *Lemenda Trading Co. v. African Middle East Petroleum Co.* [1988] 2 W.L.R. 735 simply stand for the proposition that a plaintiff cannot recover from another party with whom it entered into an illegal contract.[18]

44. *Parkinson* involved a colonel who entered into an agreement with a charity whereby the charity would grant knighthood in exchange for a contribution to the charity by the colonel.

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[18] Mr. Hunte has failed to attach these two cases as exhibits to his affidavit. They are included herein as exhibits to this affidavit.

The colonel sued because the charity did not perform its obligation under the contract. The court held that the colonel could not recover against the charity because the contract itself was illegal.[19]

45. In *Lemenda*, an oil company entered into a contract to pay the plaintiff a commission in exchange for the plaintiff using his position to influence the Qatari government for the procurement of oil contracts. The court held that the contract was unenforceable in the U.K. because it was unenforceable in the place of performance (Qatar) and was against Qatari public policy.[20]

46. The doctrine of *in pari delicto* does not arise here because the Plaintiffs make no allegation that the underlying agreements under which the Funds and the Fairfield Greenwich Defendants operated – the Investment Management Agreements – are in any way illegal, unenforceable or against public policy.

47. Mr. Miles erroneously suggests that the case of *Giles v. Rhind*, while not directly addressing *in pari delicto*, may be persuasive on this issue. Miles Aff. ¶ 20. In *Giles*, the company was unable to pursue any claims against the defendant because the defendant's wrongdoing had destroyed the company, and the company could thus not maintain an action against the defendant to recover its losses stemming from the wrongdoing. In contrast, here the Funds, through their Liquidators, have already begun pursuing an action against the Fairfield Greenwich Defendants.

48. With respect, it is my view that Mr. Miles' and Mr. Hunte's theory or arguments based on *in pari delicto* would be given no such weight by a BVI court and would not prevent the court from striking Plaintiffs' state law claims under BVI law.

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[19] [1925] 2 KB 1.
[20] [1988] 2 W.L.R. 735.

The Applicability Of The Rule Of Reflective Loss Can Be Determined At This Stage In The Proceedings

49. I respectfully disagree with Mr. Miles and Mr. Hunte that the applicability of the rule of reflective loss cannot be determined that this stage in the proceedings but would require an excursion by the court into the evidence and facts in this matter. Miles Aff. ¶¶ 16-17, Hunte Aff. ¶ 22.

50. As Lord Bingham noted in *Johnson v Gore Wood and Co.*, the question of whether the rule of reflective loss bars a shareholder's claims may be "*resolved by close scrutiny of the pleadings at the strike-out stage...*" [2002] 2 AC 1, 35.

51. As discussed above, it is clear from the face of the pleadings both that Plaintiffs have failed to allege an independent duty owed to them and that the loss they claim is the same as the loss suffered by the company for the alleged breach of duty owed to the company.

52. I conclude, as I did in my first affidavit, that all of Plaintiffs' state law claims against the Fairfield Defendants would be stricken out by a BVI court as a matter of BVI law.

SWORN TO by the said)
GERARD ST.C. FARARA, Q.C.)
at Road Town, Tortola)
British Virgin Islands)
on the 10 day of May, 2010)
Before me:)
.....)
A COMMISSIONER TO ADMINISTER OATHS IN THE BRITISH VIRGIN ISLANDS

GERARD ST.C. FARARA

ANNETTE C. WILLIAMS-SWEENEY A COMMISSIONER FOR OATHS BRITISH VIRGIN ISLANDS