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Picard (Foreign Representative Of Bernard L Madoff Investment Securities LLC) v Fim Advisers LLP: Disclosure of Documents and Whether the Court Should Make an Order under Article 21 of Schedule 1 to the Cross-Border Insolvency Regulations 2006

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1. Introduction

In the recent judgment of Kitchin J in *Picard Foreign Representative of Bernard L Madoff Investment Securities LLC (the ‘Trustee’) v FIM Advisers LLP*¹ (previously known as FIM Ltd) (‘FIM Advisers’)² the High Court considered an application made by the Trustee, in which the Trustee sought disclosure of documents and information under the Cross-Border Insolvency Regulations 2006 (SI 2006/1030) (‘CBIR’) against three English companies which were directly or indirectly involved with BLMIS as investors and investment managers.

2. The background

Bernard L Madoff Securities LLC (‘BLMIS’) was a New York limited liability company wholly owned by Mr Bernard Madoff who was its founder, chairman and chief executive officer. It operated an investment advisory business with approximately 8000 customers and appeared to be extraordinarily successful, generating returns of at least 12% regardless of the market conditions. In reality the business was being conducted fraudulently which became clear when BLMIS no longer was able to meet the redemption requests made by its investors.

On 15 December 2008, the Securities and Investor Protection Corporation (‘SIPC’) filed an application at the US District Court for the Southern District of New York seeking an order that the customers of BLMIS needed protection under the Securities Investor Protection Act 1070 (‘SIPA’). The Trustee was appointed with all the powers and duties of a trustee as set out in SIPA. At the same time the proceedings were moved to the United States Bankruptcy Court of the Southern

District of New York (the ‘Bankruptcy Court’) where they are now pending.

Kingate Global Fund Ltd (‘Kingate Global’) and Kingate Euro Ltd (‘Kingate Euro’) (together, the ‘Kingate Funds’), both incorporated under the laws of the British Virgin Islands, engaged in an investment strategy by which the shares in the Kingate Funds were sold to investors and the vast majority of monies were invested with BLMIS. The Kingate Funds paid 1.5% of the net value of their respective funds annually to Kingate Management Ltd (‘Kingate Management’) which was a company incorporated in Bermuda. The net value was calculated on the basis of the false statements of accounts prepared by BLMIS. Kingate Management received millions of US dollars in fees which they subsequently used to pay fees to FIM Advisers pursuant to several consulting services and distribution agreements. It was believed by the Trustee that the principals of FIM Advisers, Mr Grosso and Mr Ceretti, were the owners of and in control of Kingate Management and were responsible for setting up the investment strategy of the Kingate Funds.

3. The trustee’s duties and agreed issues

Under SIPA the Trustee has a statutory duty, among other things, to investigate the conduct, property, liabilities and financial condition of BLMIS, the operation of its business and any other matter to the extent relevant to a SIPA liquidation. In addition, the Trustee has a statutory duty to report to the Bankruptcy Court any facts ascertained by him with respect to fraud, misconduct, mismanagement and irregularities as well as any causes of action available to the estate.

Notes

1 [2010] EWHC 1299 (Ch).

2 Fim Advisers LLP Incorporated In UK on 8 October 2004. FIM Ltd was incorporated on 31 December 1980.

In order for the Trustee to be able to discharge his statutory duty under SIPA, he required more documents from FIM Advisers. The parties had agreed that, since the larger part of FIM Advisers' documents are held electronically, FIM Advisers should conduct searches of its electronic records by using key words and have agreed a list of key words for that purpose. The documents recovered would be reviewed by FIM Advisers to determine whether they fall within one of the categories of documents which it was required to disclose.

4. Issues remaining in dispute

However, whilst the parties agreed on some of the issues, the parties continued to disagree on a number of other issues. In particular, the date range of the search, the locations to be searched and the disclosure of specific categories of documents.

FIM Advisers considered that it was unlikely that there would be any material in its databases of electronic documents and emails which would assist the Trustee. As a consequence, the onerous nature of the order sought by the Trustee would not be proportionate to the benefits the Trustee would obtain from such an order being granted.

In response, the Trustee argued that the connection between FIM Advisers and the fraudulent activities of BLMIS was close enough to merit wide disclosure of the records of FIM Advisers.

4.1. Date range

FIM Advisers proposed that the search for hard copy documents as well as electronic documents be undertaken for the period 1 August 2005 until 11 December 2008. This was on the basis that on 1 August 2005 FIM Advisers took over the business of FIM Limited and on 11 December 2008 Mr Madoff was arrested and BLMIS ceased carrying on its business.

The Trustee, on the other hand, sought an order requiring FIM Advisers to search for and disclose documents generated at any time after the commencement of the fraud and prior to 31 January 2009.

4.2. Locations to be searched

FIM Advisers had electronically stored documents in three principal locations, which were live mailboxes, archived emails stored on local or network drives and FIM shared drives storing FIM's electronic documents. Additionally, FIM Advisers had documents stored on on-line backup system for emails and documents and on off-site backup tapes

4.3. Disclosure of specific categories of documents

FIM Advisers refused to disclose two specific categories of documents requested by the Trustee. These were:

Category 1:

- Complaints received by Kingate or FIM Advisers concerning any investments in BLMIS; and
- Inquiry or request for documents, subpoena, investigation or litigation by a US or a foreign authority or a law enforcement authority concerning BLMIS; and/or
- Litigation or arbitration concerning BLMIS.

Category 2:

- Documents concerning the organisation of FIM Advisers, the Kingate Funds and Kingate Management including constitutional documents of these entities and documents showing any ownership interest, direct or indirect, in FIM Advisers, Kingate Funds or Kingate Management of Mr Ceretti and Mr Grosso.

FIM Advisers resisted disclosure of both categories of documents on the basis that they did not concern the assets, affairs, rights, obligations or liabilities of BLMIS. Further, FIM Advisers submitted that reviewing any documents within these categories would be a disproportionate burden relative to the other documents of which disclosure is sought.

The Trustee argued that a disclosure of documents within these categories would, especially if they refer to events predating 11 December 2008, be highly relevant to the Trustee's investigations of the affairs of BLMIS.

The Trustee also argued that the ownership and organisation of Kingate Management and FIM Advisers were highly relevant to the Trustee's investigation into the affairs of BLMIS as was the role of Kingate Management and the extent of involvement of FIM Advisers, Mr Ceretti and Mr Grosso in the fraud. The Trustee believed that the Kingate Funds must have known or should have known that the business of BLMIS was fraudulent and that the payments made to Kingate Funds' investors and the fees paid to Kingate Management and FIM Advisers were likely to have been preferential payments or fraudulent transfers.

5. Relief under Article 21(1)(d)

Upon recognition of the proceedings, the High Court considered Article 21 of Schedule 1 to the CBIR (which outlines the relief that may be granted by the High Court), which states the following:

- '(1) Upon recognition of a foreign proceeding, whether main or non-main, where necessary to protect the

assets of the debtor or the interests of the creditors, the court may, at the request of the foreign representative, grant relief including...(d) providing for the examination of witnesses, the taking of evidence or the delivery of information concerning the debtor's assets, affairs, rights, obligations or liabilities.'

In addition, pursuant to Article 22 of Schedule 1 to the CBIR, in granting or denying relief, the court must be satisfied that the interests of the interested persons are adequately protected. The person against whom an order for delivery of information is sought is also an 'interested person'.

Article 21(1)(d) has both a jurisdictional and discretionary element. The court must be satisfied that the information sought concerns the debtor's assets, affairs, rights, obligations or liabilities. If this is satisfied, the court has a discretion to order delivery of that information. In exercising that discretion it must have regard to all relevant circumstances and ensure that the interests of the person against whom the order is sought are adequately protected.

6. Decision

In considering the application of Article 21(1)(d), the parties agreed that it was appropriate that the court had regard to the principles upon which the court exercises its powers under section 236³ and section 366⁴ of the Insolvency Act 1986 (as amended) (the 'Insolvency Act').

The court found the following five principles to be of importance in the present case, namely:

- (a) To establish the true facts that would enable him to discharge his duties quickly, effectively and at the lowest cost possible;
- (b) Even an honest person involved in a major fraud would be expected to co-operate with the office holder;
- (c) The court should not make an unreasonable or oppressive order on the respondent,
- (d) Consideration of the disruption, stress and expense likely to be caused to the respondent; and
- (e) In assessing what order to make, the court would attach considerable weight to the views of the Trustee.

6.1. The date range

When making a decision regarding the date range of documents to be searched, the High Court had in mind the scale of the fraud and the public interest in providing the Trustee with the necessary documents in order for the Trustee to properly investigate the affairs of BLMIS and discharge his duties in an effective manner.

The High Court also considered the facts presented with regard to the very substantial amount of funds invested by Kingate Funds in BLMIS dating back to as early as 1994.⁵ Further, Mr Grosso and Mr Ceretti were, from the outset, closely involved in the business of BLMIS and Mr Madoff. The unusual personal contact between Mr Grosso, Mr Ceretti and Mr Madoff together with the consultancy and distribution contracts suggest that Kingate Management, FIM Limited and FIM Advisers played an important role in the recruitment of new investors. The court concluded that it was no surprise that the Trustee believed that the Kingate Funds must have known that the business of BLMIS was fraudulent or that they should have known that the payments made to the Kingate Funds' investors as well as the management and consulting fees paid to Kingate Management and indirectly to FIM Limited and FIM Advisers were likely to come from preferential payments or fraudulent transfers received from BLMIS.

Based on the above, the court did not consider 1 August 2005 as a start date that was objectively justifiable, both in relation to electronic and hard copy documents. The court accepted the Trustee's submissions that FIM Advisers would search for documents generated at any time after the commencement of the fraud.

For the same reasons as described above, the court also rejected FIM Advisers end date, 11 December 2008, and accepted the Trustee's submissions that the way in which individuals responded to the discovery of the fraud in the period immediately after 11 December 2008 may be highly relevant to the Trustee's investigations. Documents reviewed from the period immediately following the discovery of the fraud may reveal the knowledge and states of the minds of individuals directly or indirectly involved. The court agreed with the Trustee that the end date for documents to be searched by FIM Advisers should be 31 January 2009.

6.2. The locations to be searched

FIM Advisers were, when the judgment was made, already undertaking searches of the live mailboxes, personal storage table archived emails and the FIM

Notes

³ Inquiry into company dealings.

⁴ Inquiry into bankrupt's dealings and property.

⁵ Kingate Global invested over USD 100 million to BLMIS between 1994 and 1996 and ultimately USD 1.7 billion in total.

shared drives. However, it only conducted searches for the period of 1 August 2005 to 11 December 2008. The court extended the disclosure exercise from 1 January 1993 to 31 January 2009 and ordered that disclosure of these documents should be on a rolling basis, following FIM Advisers' review.

However, the court was of a different view when considering the back-up systems and the offsite back-up tapes. The online back-up system had only been in operation since 2008 and contains a considerable amount of documents of which only the emails have been restored and there would therefore be a significant degree of overlap between those documents and the ones which would be disclosed pursuant to the order, as there would be in relation to the documents stored on the offsite back-up tapes. Consequently, the court did not order disclosure of the online back-up system. However, the court clarified that should the disclosure exercise result in the discovery of important documents, it would be sympathetic to a further application for the restoration of the application for an order for disclosure of such documents.

6.3. Disclosure of specific categories of documents

As regards the first category of documents, which included complaints received, inquiries for documents and any litigation or arbitration concerning BLMIS, the

court rejected FIM Advisers' submissions and agreed with the Trustee's approach that such documents were likely to be highly relevant to the Trustee's investigations as they may disclose or refer to aspects of the business of BLMIS, its assets, obligations and liabilities of which the Trustee was not yet aware.

The second category of documents concerned the organisation of FIM Advisers, the Kingate Funds and Kingate Management. The court did not consider FIM Advisers' objection to be well founded. The court agreed with the Trustee's submissions that the documents sought may clarify certain matters including the location of the assets of BLMIS and whether the Trustee has claims and, if so, against whom. The court ordered disclosure of these two specific categories of documentation.

7. Conclusion

When considering relief under Article 21(1)(d), the High Court would have regard to the principles applicable in relation to the court's exercise of its powers under section 236 and section 366 of the Insolvency Act. Given the background to this matter, the court found the need for the Trustee to discharge its duties, including investigating the conduct, property, liabilities and financial condition of BLMIS, outweighed the oppression on the respondent.

International Corporate Rescue

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