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Madoff fraud

In the context of the Madoff fraud, an important judgment was handed down by the Luxembourg Court of Appeal on 15 July 2014 in relation to the Sicav LUXALPHA. The appeal judgment largely confirms the legal developments of the first instance judgment of the District Court dated 4 March 2010.

It is *i.a.* confirmed that **shareholders of a Luxembourg UCITS have no direct claim against the depositary bank on the basis of Article 36 of the Law of 20 December 2002 on undertakings for collective investment.**

In fact:

A French *société anonyme* acting in its capacity as management company of a fund had subscribed on 15 December 2006 for shares of the Sicav LUXALPHA and had notified on 12 December 2008 a redemption request to the depositary of the funds of the Sicav LUXALPHA. The redemption was not executed and LUXALPHA was put into liquidation pursuant to a decision of the Luxembourg District Court dated 2 April 2009.

The plaintiff (and also appealing party) sued a number of parties (including companies acting as management companies of the Sicav, the auditor of the Sicav and former directors) for damages in compensation for the prejudice suffered as a result of wrongful acts allegedly committed by these parties.

In particular, the plaintiff sought to hold the depositary of the funds liable on the basis of Article 36 of the Law of 20 December 2002 on undertakings for collective investment and, in the alternative, in tort.

Moreover, the plaintiff sought to hold the management companies and the auditor liable in tort and took action against the former directors of the Sicav LUXALPHA, mainly on the basis of Article 59, 2nd indent, of the Act of 10 August 1915 on commercial companies and, in the alternative, on the basis of Articles 1382 and 1383 of the Luxembourg Civil Code.

The claimant company claimed on behalf of an investment fund for which it acts as management company. In that capacity it sought compensation for a loss suffered as a result of the LUXALPHA shares becoming worthless. It also claimed compensation for custody fees for the LUXALPHA shares, and additional fees and a loss of profits. The claimant company claimed to have furthermore personally suffered a loss with respect to the non-payment of management fees, as well as a moral damage.

In law:

The plaintiff alleged on appeal (as in the first instance) that it had a direct claim against the depositary of the Sicav LUXALPHA, on the basis of Article 36 of the Law of 20 December 2002. The plaintiff alleged that Article 36 would constitute, by its very existence, an exception to the liability principles with respect to public limited companies (*sociétés anonymes*), since it would not have any equivalence in the Law of 10 August 1915 on commercial companies, and such Article 36 would add an additional feature to company law, *i.e.* a link of direct liability between the shareholder-investor and the depositary bank which would be found guilty of mismanagement or improper performance.

The plaintiff asserted that Council Directive 85/611/EEC of 20 December 1985 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) provides for the depositary's liability both towards the investment company and the shareholder-investor, so that the investment company and the shareholder would have a competing action towards the depositary.

On the basis of the parliamentary work prior to the adoption of the law of 30 March 1988 (Article 35 of the law of 1988 was identical to Article 36 of the Law of 20 December 2002), which refers to the principles of the law on commercial companies, the Court of Appeal dismissed the plaintiff's arguments in this respect and confirmed the judgment of first instance to the extent that the claim made by the plaintiff against the depositary of the Sicav on the basis of Article 36 of the Law of 20 December 2002, on a contractual or tort basis, was declared inadmissible by the District Court.

The Court of Appeal further declared inadmissible the main claim of the plaintiff, acting in its capacity as management company, seeking compensation for the damage suffered as a result of the loss in value of the shares held in LUXALPHA, given that such damage does not constitute a damage which is specific to each shareholder but a damage suffered by the Sicav itself. The damage caused to the shareholders is only the corollary of the damage suffered by the Sicav.

The Court of Appeal also reaffirmed the judgment of first instance and declared inadmissible the claim of the plaintiff acting in its capacity as management company for loss of profit following the redemption request, i.e. compensation for the loss of interests over a period of five years as from 1 January 2009 to 31 December 2013 on the net asset value of its shares, given that such damage resulting from the blocking of its debt in the collective proceedings of its debtor does not constitute damage which is distinct from that of the other creditors.

However, as for the material damage for lost management fees claimed on a personal basis by the plaintiff-appealing party, this part of the claim was declared admissible (*recevable*) by the Court of Appeal: the damage which was claimed consisted in the non-payment of the management fees and the non-payment of the commitment fees for the years 2009 to 2013.

As for the part relating to the moral damage personally claimed by the plaintiff, the Court of Appeal held that the question as to whether a legal entity may suffer a moral damage and claim compensation for such damage is debated in legal theory. However, case law provides that a legal entity has the right to claim compensation for the moral damage caused to it as a result of actions of third parties, notably to impugn its honour and reputation.

The Court of Appeal held that the plaintiff-appealing party has not provided any element which would be useful to characterise the moral damage which it claims to have suffered. Therefore, since the moral damage was not characterised, it was not consistent enough for it to be the subject of a legal action for compensation and the Court of Appeal confirmed that the claim pertaining to this part was rightfully declared inadmissible (however for another reason than in first instance, where the District Court held that the moral damage invoked by the plaintiff was only a reflection of a material damage and was as such inadmissible).

This judgment of the Court of Appeal can be appealed in the Cour de Cassation, but only on purely legal, as opposed to factual, grounds.

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