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Weaving a rude awakening for investors

By Sam Jones and Caroline Binham in London

Spring Awakening is a sexually explicit, violent and critically acclaimed rock musical, adapted from a German play of the same name.

But it is not just critics who are interested in its success. A clutch of sophisticated investors discovered they owned the rights to a legacy investment in it thanks to the UK's biggest hedge fund fraud case, [that of the collapse of Weaving Capital](#).



Yesterday, Mrs Justice Proudman of the UK's High Court found Magnus Peterson, Weaving's founder; his wife Amanda; and two colleagues, Chas Dabha and Edward Platt, jointly and severally liable for breach of fiduciary duties – awarding \$450m in damages against them in what the hedge fund sector sees as a landmark case.

While it is certainly a victory for those who invested with Weaving, which at its height in 2009 purported to run more than \$600m in assets, it has been a long and difficult process.

The same investors were dealt a blow in September when the UK's Serious Fraud Office decided to drop its criminal probe into Mr Peterson. The move was met with indignation from the hedge fund industry.

"This is the first major fraud in the UK of a management company that was regulated by the FSA," says Jeff Holland, managing director of London-based fund of hedge funds Liongate Capital, which did not invest in Weaving.

"If you look at the hedge fund community in London and fund managers based here, there has been a much lower rate of fraud than in the US, so it's a shame that one bad apple risks spoiling the bunch. It does a discredit to the industry."

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While the damages awarded against Mr Peterson and his colleagues are substantial, they are unlikely to be paid in full.

"There will be a lot of happy people today pleased that some justice has been done, but there are also still going to be a lot of people unhappy that most of their money is never going to come back," says Christopher Miller, founder of the due diligence specialist Investment Quotient.

That leaves Weaving's investors – who include Jersey-based fund of funds Ermitage and London-based Signet – with something of a hollow victory.

Mr Peterson maintains he is innocent. "The judgment is simply wrong," he said in a statement on Wednesday. "Even if this is just a civil case, the judgment shows a very limited understanding of the financial and trading aspects of the management of the fund. This, which is the central part of the case, has just been glossed over."

At its core, the Weaving fraud hinged on a series of huge "swap" transactions that the main Weaving fund, Weaving Macro, entered into with a related counterparty – an entity named WCF, which was also controlled by Mr Peterson, the High Court found.

As Mr Dabha later said to a compliance consultant, according to court documents: "It's just one big f*****g swap. Not only that, it is with a related party."

WCF, Mrs Justice Proudman concluded yesterday, had no possibility of meeting its liabilities.

Apart from an angel investment in *Spring Awakening*, WCF's "grossly overinflated" investments, as the judgment found, also included an interest in the documentary *Lobos Gris*, about Hitler escaping Germany in a U-boat.

The swaps with WCF enabled Mr Peterson to present steady, consistent and ultimately bogus returns to investors – and, perhaps more controversially, to Weaving's third-party auditors, administrators and brokers.

Indeed, one outstanding question is whether legal action will now be sought against Ernst & Young, Weaving's auditor. PNC, Weaving's administrator, is already the target of legal action in Ireland.

Another is whether the SFO will reopen its criminal probe.

Weaving's investors are adamant that it should – or else face calls for judicial review. The mere threat of that could not come at a worse time for the agency, which is still reeling from a three-day court case last week in a separate legal challenge brought by the Tchenguiz brothers.

The mistakes that the SFO conceded then crystallised wider concerns over its ability to prosecute complex economic crime. Even without such challenges, the SFO is suffering from low morale and budgetary cuts.

Its new director, David Green, has been in the job a month. Its operating budget is £32m, compared with £52m in 2008 when the financial crisis began.

"Whatever its decision, technically the SFO could be challenged," said Robert Wardle, a former SFO director.

Additional reporting by Jane Croft and Max Bromwich in London

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