4-01-11

IN THE GRAND COURT OF THE CAYMAN ISLANDS

FINANCIAL SERVICES DIVISION

The Hon. Mr Justice Andrew J. Jones QC
17th and 20th December 2010 and 4th January 2011

FSD 87 of 2010

IN THE MATTER OF THE COMPANIES LAW

AND IN THE MATTER OF HERIOT AFRICAN TRADE FINANCE FUND LIMITED

FSD 219 of 2010

IN THE MATTER OF SECTION 64(b) OF THE COMPANIES LAW

AND IN THE MATTER OF HERIOT AFRICAN TRADE FINANCE FUND LIMITED

Appearances : Mr Ross McDonough Mr Guy Manning of Campbells for the Petitioner/ Applicant
Mr Kenneth Farrow QC and Mr Tim Richards of Mourant Ozannes for the Fund

GRAND COURT CAYMAN ISLANDS

JUDGMENT

Introduction

1. Heriot African Trade Finance Fund Limited ("the Fund") was incorporated and registered as an exempted company under the Companies Law on 17th April 2007. The Fund was established as an open ended mutual fund and was duly registered under section 4(3) of the Mutual Funds Law, thereby imposing important statutory duties upon its directors. The person principally responsible for promoting the Fund was Mr Gianfranco Cicogna, acting in his capacity as chief executive officer of Heriot Commodity and Trade Finance (Pty) Ltd, a South African company which is part of the Heriot Group of Companies, of which Mr Cicogna has been chairman since 1996.

2. The Fund's investment manager is Heriot Investment Management (Cayman) Ltd ("the Investment Manager"), a special purpose company incorporated under the Companies Law on 23rd May 2007, which delegated most of its functions to Heriot Commodity and

Trade Finance (Pty) Ltd ("the Investment Adviser") pursuant to an investment advisory agreement, a copy of which has not been put in evidence. The Investment Manager does not appear to have played any role in the events giving rise to these proceedings but it is relevant to bear in mind that it owns 100% of the Fund's voting shares for which it subscribed a nominal $10. The redeemable participating shares issued to the Fund's investors do not carry the right to vote.

3. The Fund's investment objective is described in its Private Placement Memorandum dated June 2007 ("the PPM") which constitutes the Fund's offering document for the purposes of section 4(6) of the Mutual Funds Law. It follows that the PPM must be filed with CIMA; it must describe the equity interests, in this case the rights attaching to the Fund's participating shares, in all material respects; and it must contain such other information as is necessary to enable a prospective investor in the Fund to make an informed decision as to whether or not to subscribe for shares. This statutory duty is a continuing one, at least so long as the Fund is open to new subscriptions. If the Fund's promoter (which in this case includes the Investment Adviser and Mr Cicogna) or its operator (which means the directors) become aware of any change that materially affects the accuracy of any information contained in the PPM, section 4(8) imposes an obligation to file an amended offering document with CIMA within 21 days.

4. Section 3 of the PPM describes the Fund's *Investment Objective* in these terms. "The primary object of the Fund is to invest in commodities and act as a provider of trade finance through its trading company named Heriot Trading Limited (the "Trading Company')", which is a wholly owned subsidiary. In the event, it appears from the Fund's audited financial statements for the year ended 30th June 2008 that all the business was actually conducted by the Fund itself and not through its wholly owned subsidiary, but nothing turns on this point. Section 3 of the PPM goes on to describe the *Investment Strategy and Process* in the following terms. "The Fund [acting through the Trading Company] will act as a principal trader in commodities and a provider of trade finance." It described the Investment Adviser's experience in African trade finance and banking and went on to state that "The subscription proceeds will be utilized as collateral security to secure banking facilities in the form of Documentary Credits and short term collateralized loans and other financial instruments related to securing and execution of trade related transactions. These facilities will be used to purchase commodities against orders from qualifying African commodities traders and to assist in the provision of trade finance for import and export related transactions". This is the Fund's business and investment objective as described in its offering document. The final part of Section 3 of the PPM sets out a series of investment restrictions under the heading *Prudential Risk Management,* the meaning and effect of which is directly relevant to one of the issues raised in these proceedings. Its full terms are recited in paragraph 16 below.

5. The Fund's register of members has not been put in evidence and the Court has not been provided with any comprehensive statement about the shareholder profile. However, it is agreed that the Petitioner/Applicant holds a total of 23.47% of the issued participating shares in its capacity as custodian for Aris Multi-Strategy Lending Fund Limited and Aris Africa Fund Limited, both of which are themselves carrying on business as collective investment funds. For simplicity's sake, I shall refer to the Petitioner/Applicant as "Aris". The evidence is that Aris is one of the five largest participating shareholders who, collectively, hold about 80% of the equity. These five shareholders constitute an Investor Committee which was established in June 2009 as a channel of communication between the Fund's management and its principal investors. This Investor Committee has performed an important role and affidavits have been sworn on behalf of its four other members for the purposes of these proceedings, in which they oppose the positions adopted by Aris

Procedural History

6. Aris presented a winding up petition on the just and equitable ground on 5th June 2009. As originally pleaded, it was said to be just and equitable to make a winding up order because the Fund's directors and Investment Adviser have breached their duties in such a way that Aris has justifiably lost confidence in their management of the Fund. The breaches of duty relied upon were (i) the failure to file audited financial statements with CIMA in compliance with section 8(2) of the Mutual Funds Law and (ii) the failure to comply with the investment restrictions contained in the PPM under the heading *Prudential Risk Management.* Aris did not pursue its winding up petition in a diligent way. Three hearings were adjourned on 21st August 2009, 30th October 2009 and 29th January 2010.

7. Directions for trial were given on 14th April 2010 and the winding up petition eventually came on for trial before Henderson J. on 16th June 2010. What happened at that hearing has been related to me by Mr Farrow who appeared for the Fund. Aris was then represented by a different firm of attorneys. I am told that Henderson J. expressed misgivings about the merits of the winding up petition (as then pleaded) and that he refused to allow Aris to rely upon un-pleaded allegations of breach of fiduciary duty on the part of the Fund's management. He apparently gave Aris a choice. It could either proceed on the basis of the petition without any allegations of breach of fiduciary duty or, alternatively, he would adjourn the hearing and give Aris leave to amend its petition. Aris chose to have an adjournment, but did not file its amended pleading until 26th November 2010 (although a draft had been served earlier). By this time Aris had changed its attorneys.

8. The appointment of new attorneys led to a different approach on the part of Aris. On 4th October 2010 Aris issued an originating notice of motion by which it sought an order for the appointment of inspectors pursuant to section 64(b) of the Companies Law. The grounds and evidence relied upon in support of the notice of motion are the same as those now relied upon in support of the winding up petition, including the allegations of breach of fiduciary duty.

9. In the meantime Henderson J. decided that it was no longer appropriate for him to deal with the matter and an order was made by the Registrar that both proceedings be re-assigned to me. I convened a Case Management Conference, which took place on 10th November 2010, for the purpose of informing myself about the issues and giving appropriate directions for trial. I made orders for directions, including an order that the winding up petition and the notice of motion be tried together on 17th December 2010. I also gave Aris leave to make a significant amendment to its petition so as to seek a winding up order on the additional ground that the Fund has lost its substratum, in that it is now impractical or impossible to carry on its investment objectives as described in its PPM and that its management are engaged in an ad hoc liquidation which ought to be brought under the control of official liquidators. The re-re-amended petition filed on 26th November 2010 includes both the allegation of breach of fiduciary duty (for which Henderson J. gave leave on 16th June) and the loss of substratum allegation (for which I gave leave on 10th November 2010).

10. The winding up petition and notice of motion, in their final amended form, give rise to the following issues. The first issue concerns the reasons why the Fund's management have (i) failed to produce any financial statements and/or disclose them to its shareholders for any period after 30th June 2008 and (ii) failed to have those financial statements audited in a timely manner. The second issue is whether or not the Fund's management have acted in breach of the investment restrictions contained in Section 3 the PPM under the heading *Prudential Risk Management.* The third issue is whether or not the affidavit evidence relating to the alleged breach of fiduciary duty discloses a real issue to be tried which is sufficient to justify, or at least support, an order for the appointment of inspectors or a winding up order. These three issues arise in connection with both the winding up petition and the notice of motion for the appointment of inspectors. The fourth issue is whether or not it is just and equitable for a winding up order to be made on the basis that the Fund has lost it substratum, in that it is now impractical or impossible to carry on its investment objectives as described in its PPM and that its management are engaged in an ad hoc liquidation which ought to be brought under the control of official liquidators. This issue is relevant only to the winding up petition. Indeed, the resolution of this issue is capable of being determinative of the winding up petition. A fifth and subsidiary issue is whether or not KPMG meet the

independence requirement (contained in the Insolvency Practitioners' Regulations, regulation 6) as regards the Fund. I now turn to consider each of these issues. Counsel for Aris put its case on the basis that I should make a winding up order. Alternatively, in the event that I am not persuaded to make a winding up order, Counsel seeks an order for the appointment of inspectors.

The Accounting Issue

11. The Fund has a statutory obligation, pursuant to section 8(2) of the Mutual Funds Law, to file audited financial statements with CIMA annually and to do so within six months of each financial year end. The audit must be conducted by a firm of professional accountants approved by CIMA. Under the terms of the PPM, the Fund and its directors represented to the shareholders that they would be provided with copies of audited financial statements within six months of the financial year end and also provided with copies of the unaudited half yearly financial statements and reports. This representation is repeated in Sections 1 and 4 of the PPM. The representation was also repeated by the Investment Adviser's chief operating officer in his answers to Aris' Questionaire (in one of the Alternative Investment Association's standard forms) dated 25th May 2007. The PPM also represents that the financial statements will be prepared and presented in accordance with US GAAP.

12. The significance of the unaudited half yearly financial statements, and the reason why these financial statements are required to be published to shareholders, is that they are necessary for the purposes of calculating the Investment Manager's performance fee, as described in Section 7 of the PPM. In particular, the NAV reflected in the unaudited half yearly financial statements for the six months ended 31st December 2007 was critical to the calculation of the total performance fee of $3,342,367 said to be payable for the year ended 30th June 2008. In this context it is also relevant to note that redemptions and subscriptions were to take place quarterly at the NAV ruling on the relevant quarter day, which necessarily means that the Fund's administrator must prepare quarterly financial statements as 31st March, 30th June, 30th September and 31st December. During the course of his submissions, counsel for the Fund made the surprising admission that no quarterly or half yearly management accounts had ever been prepared.

13. It is not in dispute that the only financial statements ever published by the Fund to its shareholders are those for the year ended 30th June 2008, which were not delivered until May 2010. In my judgment a continuing failure to file audited financial statements after the statutory deadline, or after the expiry of any extension of time allowed by CIMA, is a serious matter. It constitutes a criminal offence under section 8(3) of the Mutual Funds Law. A failure to produce financial statements and/or secure an audit opinion in a timely manner 'raises a red flag'. It is usually indicative of financial difficulties and failings on

the part of management. Nor can such a breach of duty be regarded as a purely technical matter because CIMA can, and frequently does, grant extensions of time for good cause. Given that CIMA is willing to grant extensions under section 8(2) retrospectively, a breach of statutory duty will normally only arise after CIMA has considered and rejected a fund's explanation for needing more time in which to complete an audit.

14. The Fund's explanation for failing to file and distribute audited financial statements is given by Mr Stuart McArthur who was the chief operating officer of the Investment Adviser and Ms Sharon Lamb who is one of the Fund's directors. They have both sworn a number of affidavits. The most recent and most comprehensive explanation for the failure to produce the 2008 audited financial statements on time is contained in Ms Lamb's second affidavit sworn on 5th May 2010 and filed in the winding up proceeding and Mr McArthur's first affidavit sworn on 26th November 2010 and filed in the notice of motion proceeding. In my judgment their explanations are superficial. Mr McArthur says that it was difficult to value the assets in the volatile market conditions prevailing in the aftermath of the demise of Lehman Brothers in September 2008, which I do not doubt for a moment. He blames Deloitte's "dismal record" for the delay in issuing an opinion. Ms Lamb describes having obtained two extensions of time, which CIMA granted as a matter of course, but she does not appear to have engaged in any discussion with Deloitte about the actual audit issues. Neither of them offers any explanation for failing to prepare or publish any unaudited financial statements for the six months ended 31st December 2007 or any half year thereafter.

15. The assets in respect of which Deloitte ultimately qualified their opinion were *Loan receivables - $26,554,191* and *Trade receivables - $22,507,523,* as more particularly described in Notes 4 and 5 respectively. Although not expressed in these terms, the audit issue must have been what, if any, loan loss provisions should be made and whether the provision actually made in respect of the trade receivables was sufficient. The issued audited financial statements reflect that management made a provision of $3,350,515 in respect of the trade receivables but no provision at all in respect of the loan receivables. However, Mr McArthur's affidavits do not reveal how the Investment Adviser justified this position; why Deloitte disagreed; what audit evidence was available; or how they evaluated that evidence. Deloitte's requests for information and their analysis of the information supplied must be recorded in memoranda or correspondence, but none of this material has been put in evidence. There is no evidence which reflects the audit engagement partner's approach to this issue and how his approach differed from that of the Investment Adviser. Mr McArthur's affidavit tends to portray himself as a frustrated bystander trying to persuade Deloitte to get on with the job, whereas in fact the unusual fee arrangement gave the Investment Manager/Investment Adviser a powerful financial interest in the outcome of the difficult audit issue faced by the Fund. The Investment

Adviser is dependent upon the Investment Manager for its fee. The Investment Manager is not entitled to any management fee at all. Instead, it is entitled to a performance fee, calculated semi-annually, equal to 40% of the appreciation in the NAV per share during the calculation period above the NAV per share at the time of issue, subject to an 8% hurdle per annum. The financial statements reflect a provision of approximately 15% in respect of trade receivables. If a similar provision were to be made in respect of the loan receivables, the Investment Manager's performance fee would be reduced to nil. Counsel for the Fund urged me not to draw an adverse inference from his client's failure to make and full and frank disclosure of the reasons surrounding the issue of a qualified audit opinion almost two years after the balance sheet date. Even though I accede to this submission, I am still unable to conclude on the basis of the evidence put before the Court that there is a compelling reason to excuse the admitted breach of statutory duty. The difficulty surrounding the valuation of the assets and/or loan loss provisions is understandable. This difficulty explains why the audit opinion was qualified. It does not explain why a qualified opinion was not issued until May 2010, almost two years after the balance sheet date.

The Investment Restrictions issue

16. Section 3 of the PPM contains the following statement.

Prudential Risk Management
Once all Capital Commitments have been drawn down and invested by the Fund, the Fund will adhere to traditional risk management principles, both in the management of the Income Statement and Balance Sheet. The following are a list of the prudential covenants which will be applicable, as currently determined by the Investment Manager :-

Single Client Exposure
The Investment Manager shall insure that no single client exposure, secured or unsecured, shall exceed more than 25% of the total asset base of the Fund.

Commodity Exposure
The Investment Manager shall ensure financial exposure to any one commodity shall not exceed 30% of the total asset base of the Fund.

Country Exposure
The Investment Manager shall ensure that the aggregate exposure to any one country shall not exceed 25% of the total asset base of the Fund.

17. The effect of this provision is in issue. Counsel for Aris focuses on the word "covenant" and urges me to treat this provision as an obligation with which there must be strict compliance at all times. Counsel for the Fund submits that on a proper construction of the PPM as a whole one should treat this provision as a guideline rather than rigid restriction

to be applied for the life of the Fund. I agree with the latter approach. I view it as a representation that the Fund's management will adopt this risk management policy and make a good faith effort to comply with it, so long as it appears to be in the commercial interests of investors to do so. Clearly, relative exposures can change quite suddenly as a result of circumstances outside the control of the Fund's management and they must be allowed to exercise judgment about the manner in which the portfolio is adjusted if and when the exposures get out of line with the restrictions.

18. The 2008 audited financial statements reflect that the Fund had ceased to be in full compliance with these restrictions by the financial year end. Thereafter, it is admitted that there was a decision on the part of the Investment Adviser to depart from the restrictions. Whether or not there was a good commercial reason for this decision is not the issue. Aris is not entitled to ask the Court to second guess the Investment Adviser's judgment. However, if the Fund's management decide to make a material change in the prudential risk management policies as set out in the PPM, the effect of section 8(4) of the Mutual Funds Law is that they must inform the investors and file an amended offering document with CIMA, at least so long as the Fund is still open to new subscriptions, which it was in June 2008.

19. The Fund failed to comply with this obligation. It got itself into a position in which the exposures to Chambua Minerals (Proprietary) Limited and Black Rock MaCarthy Mining (Proprietary) Limited, which were under common ownership, represented a huge proportion of its asset base, way in excess of the restrictions. The criticism which can be leveled at the Fund's management is not that they made a wrong judgment call. The justifiable criticism is that they failed to inform the investors (and potential new investors) that they had decided to change the Fund's risk profile in a material way. They failed to file and circulate an amended offering document; they failed to produce and circulate unaudited half-yearly financial statements, from which the change in policy should have been immediately apparent; and they failed to disclose the change in policy in any of the Monthly Updates circulated to investors during the period up to May 2009.

The Related Party Issue

20. Aris asserts that there is evidence that the Fund's management have acted in breach of their fiduciary duties in its dealings with Liberation Holdings Limited ("Liberation") and Webster Minerals Limited ("Webster"). For present purposes the question is whether the affidavit evidence discloses a real issue to be tried which is sufficient to justify, or at least support, the making of a winding up order or the appointment of inspectors. The series of transactions about which Aris complains are described in Mr Cicogna's first affidavit (filed in the notice of motion proceeding) commencing at paragraph 17. He says that the Fund began to finance manganese shipments from November 2007 onwards following

an approach from a group of individuals who owned Liberation. Mr Cicogna says that he allowed the Fund's counterparties to put the transactions through a dormant shell company called Chambua Minerals (Pty) Limited ("Chambua") which he had incorporated, but never actually used. This was done to save time. In early 2008 he says that the counterparties incorporated their own company, namely Webster, to own the shares in Chambua. Again, in order to save time, they were allowed to incorporate Webster on the basis that the shares would be temporarily held by the trustees of Messrs' Cicogna and McArthur's family trusts. Declarations of trust were executed to the effect the shares of Webster are held upon trust for the benefit of Liberation. Mr McArthur swore an affidavit confirming the truth of what Mr Cicogna said about the matter. Whilst it may not have been a very sensible arrangement, in my judgment the evidence does not caste any real doubt upon Mr Cicogna's story.

21. A second financing transaction (or series of transactions) was done with another manganese mining company called Black Rock Macarthy (Pty) Limited. Mr Cicogna says that this company was also owned by the same group of individuals who owned Liberation. It too became a subsidiary of Webster. Ultimately the Fund's exposure to Webster and its two subsidiaries reached a sum in excess of $83 million including interest. Webster defaulted and the Fund secured its position by negotiating a debt for equity swop, the result of which was that Webster became a wholly owned subsidiary of the Fund. I describe it as a "wholly owned subsidiary" but in fact the original owners retained 1,000 shares which represented 0.000012% of the equity. Under the terms of the agreement dated 7th August 2009, by which the Fund exchanged its debt for the equity in Webster, the original owners of Webster were allowed to retain part of any upside benefit. In the event that the Fund ultimately makes a profit by selling its shares in Webster (or its assets) for a sum in excess of the amount which was owed (which is about $83 million), the original owners will be entitled to receive 15% of the excess.

22. Aris accuses Messrs Cicogna and McArthur of acting in breach of their fiduciary duty by retaining a beneficial interest in Webster and then gratuitously giving themselves 15% of any surplus after repayment of the $83 million to the Fund. Messrs Cicogna and McArthur have sworn affidavits in which they deny having any beneficial interest in Webster and assert that the debt/equity swap was an arm's length transaction. In my judgment there is no evidence which leads me to doubt the truth of what Messrs Cicogna and McArthur have said in their affidavits. In my judgment the affidavit evidence, taken as a whole, does not give rise to a real issue to be tried which is sufficient to support Aris' case for a winding up order or the appointment of inspectors.

The Loss of Substratum Issue

23. The primary facts relating to the loss of substratum issue are not in dispute. By July 2008 a very high proportion of the Fund's capital was exposed to financing Webster's manganese shipments. By this time the Fund's only other trade finance business was being done with a small cocoa producer in the Ivory Coast called SIDCAO. The credit crunch of September 2008 led to a temporary collapse of the commodities markets. Both Webster and SIDCAO defaulted. Redemption requests were received from investors representing at least 60% of the equity. Mr Cicogna summed up the Fund's situation in the following way. *"....it became clear that the Fund had no alternative other than to suspend redemptions. The Fund had very little liquidity and could not meet the redemption requests it had received. Further, had that liquidity been paid away to redeeming investors, the interests of the other investors would have been prejudiced."* (First affidavit filed in the notice of motion proceeding, paragraph 35). The decision to suspend redemptions was communicated to investors by a letter dated 20th March 2009.

24. It is accepted that it is impossible for the Fund to carry on its original business in the sense that it will not make any new investments or enter into any new trade finance transactions. As the counsel for the Fund stated in his written submission (paragraph 92), "It is agreed by the Fund, Investment Adviser and the investors (including Aris) that the assets of the Fund must be liquidated and moneys returned to investors". There is no suggestion that it should seek to raise new capital for any purpose whatsoever. The suspension of subscriptions is permanent. The individual shareholder's right to redeem on 120 days' notice is said to have been suspended, but in reality it has been permanently terminated. His shares will only be redeemed compulsorily as part of an informal liquidation process. The Fund's management have in fact been engaged in an ad hoc liquidation process at least since March 2009. Counsel for Aris argues that these undisputed facts lead to the conclusion that it is just and equitable to make a winding up order. Counsel for the Fund argues that the substratum has not gone or, even if it has, a winding up order should not be made because the majority oppose it; there are alternative remedies available; and Aris is guilty of unconscionable behavior. At the end of the day, I think the real issue is whether the Fund should be liquidated by its management in whatever manner they consider to be appropriate or by official liquidators acting in accordance with the provisions of the Companies Law and the Companies (Winding Up) Rules. .

Loss of Substratum - The Applicable Law

25. Counsel have referred me to a number of familiar cases in which the English courts have held that a winding up order will be made on the just and equitable ground, upon the petition of a minority of shareholders, where it is shown that it has become practically impossible for a company to carry on the business for which it was established. I explained the way in which this principle will be applied to open ended corporate mutual

funds in *Re Belmont Asset Based Lending Ltd* (unreported, 21st January 2010) but, in deference to counsel, I will deal briefly with these English authorities.

26. In *Re Diamond Fuel Co* (1879) 13 Ch. D. 400 the English Court of Appeal unanimously upheld a decision of the Vice-Chancellor to make a winding up order in respect of a company which had ceased to carry on its business. James L.J. said (at page 480) – *The Vice-Chancellor, in my opinion, was quite right in taking the view that the company practically had ceased to carry on its business, and the carrying on of the business had become, in a practical sense, impossible. Under those circumstance it was the right of the shareholders to have the concern wound up...".* In this case the petition was supported by a large body of shareholders, but the earlier case of *In Re Suburban Hotel Company Ltd* (1867) L.R. 2 Ch. App. 737 shows that the "right" referred to is that of an individual shareholder. In this case a winding up order had been made on this basis notwithstanding the opposition of a large body of shareholders.

27. In *Re Haven Gold Mining Company* (1882) 20 Ch.D.151 the English Court of Appeal reversed a decision of the Vice-Chancellor and made a winding up order in respect of a solvent company which had been formed for the purpose of exploiting gold mining rights in the Thames goldfield in New Zealand. It turned out that the company had no title to the land or mining rights. It was held that "*Where the Court is satisfied that the subject-matter of the business for which a company was formed has substantially ceased to exist, it will make an order for winding up the company, although a large majority of the shareholders desire to continue to carry on the company".*

28. *Re Blériot Manufacturing Aircraft Company Limited* (1916) 32 TLR 253 concerned a company which was established and promoted on the basis that it would acquire the business of Monsieur Blériot who was described as a "an inventor of aircraft of world-wide repute". Although the company's memorandum stated its objects in wider terms, Neville J. held that it was, in fact, formed to carry out the Blériot contract and that, once one came to the conclusion that there was no reasonable prospect of carrying out the contract, it led to the conclusion that the substratum had gone and the company should be wound up.

29. *Re Baku Consolidated Oilfields Ltd* [1944] 1 All E.R.24 concerned a company formed for the purpose of acquiring and consolidating the undertakings and assets of four other companies which carried on oil drilling and production businesses in the Baku oilfields in Russia. After having paid the purchase price, the oilfield assets were confiscated by the new Soviet government in 1920 and the company had since then ceased to carry on any business except for its attempt to obtain compensation from the government of the USSR. However, the company was solvent because it also had substantial assets outside of

Russia and in 1943 two shareholders presented a winding up petition on the just and equitable ground. Bennet J. found that the substratum of the company had gone because it was no longer able to carry on the oil production business for which it was formed and he made a winding up order. The fact that a majority of the shareholders opposed the petition on the basis that the directors were best placed to pursue the compensation claim was held not to be a sufficient ground for refusing an order.

30. These cases establish the principle, for the purposes of English law, that where it has become impossible, in a practical sense, to carry on the business for which a company was established, it will be would up on the just and equitable ground even though the petition is opposed by a substantial majority of shareholders. The only reason that the English case law has any relevance at all is that Part V of the Companies Law (2010 Revision) was, and to some extent still is, derived from the provisions of the English Companies Act 1862. Nevertheless, it is incumbent upon this Court to apply the Cayman Islands law in the context of this country's economy. The Fund is one of about 9,000 mutual funds currently registered with CIMA and it is not surprising that a very high proportion of the winding up petitions presented to this Court concern mutual funds . Assuming that the general principle derived from the English case is followed, the real issue about which there has been debate in this case is in what circumstances can it be said that it has become practically impossible for an open ended corporate mutual fund to carry on the business for which it was promoted. In *Re Belmont Asset Based Lending Ltd* (21st January 2010, unreported) I answered this question in the following way -

"...it can be said that it is just and equitable to make a winding up order in respect of an open ended corporate mutual fund if the circumstances are such that it has become impractical, if not actually impossible, to carry on its investment business in accordance with the reasonable expectations of its participating shareholders, based upon representations contained in its offering document."

The application of this formulation involves identifying the nature and scope of a mutual fund's investment business by reference to its offering document.

31. The key characteristics of the Fund, as set out in its PPM are as follows. First, it is a regulated mutual fund which has been registered with CIMA under section 4(3). Second, subscriptions and redemptions will be accepted quarterly at the NAV ruling on the applicable quarter day which is 31st March, 30th June, 30th September and 31st December. The right to redeem on 120 day's notice (subject to a typical suspension provision) is one of the Fund's key characteristic. Third, the PPM contemplates that the Fund will continue in business indefinitely. It was not established as a limited duration company. Fourth, the Fund's investment objective and strategy is described as acting as a principal trader in commodities and provider of trade finance for African commodity producers. Having thus described the Fund's business, it is relevant to note what is *not* said in the PPM. The

Fund was not set up as a "liquidation fund". The PPM is wholly silent about the circumstances in which it might be put into liquidation and the only reasonable inference to draw is that it will be liquidated in accordance with the provisions of Part V of the Companies Law and the applicable rules. The PPM does not describe any "soft wind down" procedure. Nor does it say that the Investment Adviser may assume the role of liquidators. The PPM describes circumstances in which the participating shareholders' right to redeem may be suspended, but it does not state that the right to redeem at the option of the shareholder may be suspended permanently, that it to say terminated, as part of a soft wind down or ad hoc liquidation procedure.

32. Counsel for the Fund has argued that an ad hoc liquidation conducted by the investment manager is an inherent aspect of *every* mutual fund's business and is therefore something which should be within the reasonable expectations of this Fund's shareholders, in spite of the fact that its PPM is wholly silent on the subject. I reject this argument, as I did in *Re Wyser-Pratte Eurovalue Fund Ltd* (26th October 2010, unreported). In that case counsel for the company sought to argue that an ad hoc liquidation conducted by the investment manager (which was described as a "wind down plan" and/or "compulsory redemption plan") was "at the heart of what each shareholder signed up to when it made its investment". In rejecting this argument, I said –

"In my judgment Counsel's submission is highly artificial and ignores the commercial realities. There is nothing in the Company's offering document which would lead its shareholders to anticipate that the suspension of redemptions and the imposition of a wind down plan is something which may happen 'in the ordinary course of business'."

This observation applies with equal force in the present case.

33. The undisputed evidence is that the Fund suspended subscriptions and redemptions in March 2009. It is not in dispute that the "suspension" is permanent, in that the directors have determined that capital will only be returned to shareholders as part of an ad hoc liquidation process. Precisely how this outcome is intended to be achieved is yet to be determined but it was suggested that it would be done by means of compulsory redemptions for which purpose the Investment Manager (which holds 100% of the voting shares) might need to amend articles 52-56 of the Fund's articles of association. The fact that there is no directly applicable liquidation/redemption procedure set out in the Fund's articles tends to confirm the conclusion that it cannot be something which the participating shareholders should have anticipated in the ordinary course of business. It is not in dispute that by March 2009 redemption notices had been received in respect of about 60% of the participating shares. I have been told that all the shareholders are now agreed that the Fund should be liquidated. The Investment Adviser is now engaged only

in realizing the assets. The Fund will not make any new investments. The Fund is no longer a going concern. In these circumstances, it cannot sensibly be said that the Fund is carrying on the business described in its PPM for which it was established and promoted.

34. It was drawn to my attention that the Eastern Caribbean Supreme Court has approached this issue in a different way. Counsel for the Fund relied upon the most recent decision of Bannister J. in *Aris Multi-Strategy Lendings Fund Ltd –v- Quantek Opportunity Fund, Ltd* (15th December 20910, unreported) in which the learned judge reviewed the English authorities and my own recent decisions at length. *Quantek* had suspended redemptions in October 2008 in response to the prevailing market conditions and unusually high number of redemption requests resulting from the general credit crunch. Its investment manager put forward a plan, set out in a revised offering document, to the effect that the existing assets (referred to as the "legacy investments") would be split between those wishing to remain invested and those wishing to redeem. Those wishing to redeem would be transferred to a new company, together with an appropriate proportion of the legacy investments. The new company would be set up as a liquidation fund which would not invest in any new assets. Its investment managers would simply manage its apportioned share of the existing assets with a view to realizing them and distributing the "liquidation proceeds" over the following three years. A majority of *Quantek's* shareholders accepted this proposal, but Aris Multi-Strategy Lending Fund Ltd did not and it applied for the appointment of liquidators (which is the same thing as petitioning for a winding up order) on the ground, inter alia, that *Quantek* had lost its substratum.

35. Having reviewed what I said in *Re Belmont Asset Based Lending Ltd*, the learned judge concluded as follows -

If Jones J. was deciding (as I think he was) that it is just and equitable to wind up an open ended investment fund on substratum grounds in circumstances where the company has yet to reach the limit of its possible existence, then unfortunately I have to disagree with him. In my judgment the only purpose for which liquidators are appoint by the Court is in order to manage the final moments of companies which the Court has decided, according to established principles, ought to be put out of existence...."

He went on to describe *Quantek* as being "in run off". As I understand it, Bannister J. would say that it will not be just and equitable to appoint liquidators (the equivalent of making a winding up order) on loss of substratum grounds in respect of an investment fund under the law of the British Virgin Islands unless and until its management have realized all the assets and distributed all the proceeds to its shareholders. If I have understood his judgment correctly, the law of the British Virgin Islands is not the same as that of the Cayman Islands.

36. Counsel referred me to *Re Perfectair Holdings Ltd* [1990] BCLC 423 in which Scott J. (as he then was) said (at page 437) "*The directors were not put into office and cannot claim to be maintained in office for the purpose of liquidating the company. That is not the function of managers. That is the function of a liquidator*". This must be right as a general statement of principle. However, I do recognize that there may be circumstances in which it can be said that a liquidation is being carried out in the ordinary course of a company's business, as contemplated by its articles of association and offering documents. A fund may be set up for the very purpose of liquidating distressed assets. A fund may be set up as a limited duration company, in which case its articles of association will set out when, how and by whom the company is to be liquidated at the end of its pre-determined life. In these circumstances, it may be said that the liquidation is itself part of the company's business, in which case it would not be appropriate for the Court to interfere in the process by making a compulsory winding up order, at least in the absence of serious breach of duty or serious mismanagement on the part of those responsible for the company's liquidation. The present case is wholly different. The Fund's ad hoc liquidation has been forced upon its management by a combination of extraordinary events outside their control. It is said that the credit crunch of September 2008 caused a complete collapse in the commodity markets which, in turn, led to defaults on the part of all the Fund's counterparties and a sudden influx of redemption requests. Whether or not managements' decision to concentrate the Fund's counterparty risk in breach of the investment restrictions contributed to its failure is an open question. In my judgment is cannot be said that an hoc liquidation of the Fund, conducted informally by management, is something which, in these circumstances, the participating shareholders should have anticipated would happen in the ordinary course of business.

The Fund's Case

37. I now turn to the various other reasons relied upon by counsel for the Fund in support of his argument that I should exercise the Court's discretion under section 92 by not making a winding up order. Counsel places great emphasis upon the fact that the management's ad hoc liquidation has substantial shareholder support. In June 2009 the Fund's five largest institutional shareholders formed themselves into an investor committee for the purposes of improving access to information about the Fund's investments, monitoring its performance and offering counsel to its Investment Adviser. The five committee members, including Aris, collectively own around 80% of the Fund's participating shares and the individual representatives are themselves professional investment managers. The Investment Adviser agreed to work with the Investor Committee. Four of the committee members have sworn affidavits in which they have expressed support for the Investment Adviser and opposition to the positions taken by Aris, as a result of which I think that there has been a natural tendency to exclude Aris from the committee's deliberations. In

summary, they say that the appointment of official liquidators at the present time is unnecessary, would not add value and is likely to be counter-productive. In two earlier affidavits they expressed concern that the appointment of official liquidators might impede the negotiations for the sale of Webster which were then on-going. This point has been overtaken by events because a contract has now been executed. I think that the underlying concern, expressed in their most recent affidavits, is that the committee members do not want official liquidators or inspectors to engage in the investigation of what they consider to be unmeritorious complaints made by Aris. I think that they are concerned that any such investigation would be a waste of money and tend to distract the Investment Adviser from the important job in hand, which is the realization of the assets. I sympathise with this view, but it is not a reason for refusing to allow the Fund to be wound up in accordance with the provisions of the Companies (Winding Up) Rules. In the event that a winding up order is made, the members of the Investor Committee can anticipate being reconstituted as a liquidation committee, which will have a formal role in the liquidation. If Aris succeeds in persuading an official liquidator to embark upon an investigation of its allegations of breach of fiduciary duty, which is inherently unlikely having regard to my view of the evidence expressed in paragraph 22 above, they would be entitled in their capacity as the liquidation committee to make an application to the Court for a direction that the liquidator should not conduct any such investigation. Furthermore, making a winding order would prevent Aris from commencing a derivative action against the Investment Adviser in the name of the Fund. Far from being counter-productive, it seems to me that a winding up order will have the effect of empowering the committee and enhancing its role which is currently dependent upon the goodwill of the Investment Adviser which could decide to ignore their input.

38. In his written submission Counsel for the Fund also argued that the Court should not exercise its discretion to make a winding up order or appoint inspectors on the application of Aris because it has allegedly behaved unconscionably in the matter on two occasions. First, for reasons explained in an affidavit sworn by Mr Philip Chapman who is one of the Investor Committee representatives, Aris is alleged to have disclosed confidential information to a third party engaged in litigation against the Fund. Aris denies this allegation. Second, on 11th June 2010 Mr Jason Papastravrou, who is a director of both the Aris companies, circulated an e-mail to a large number of people, including all the Fund's shareholders, claiming to have "irrefutable evidence that Gianfranco Cicogna and Stuart McArthur attempted to enrich their family trusts at the expense of Heriot investors". This relates to the breach of fiduciary duty allegation asserted in Aris' amended pleadings. In my view, it was unwise of Mr Papastravrou to have sent this e-mail, especially as he had not sought any explanation from Messrs Gigocna and McArthur. Having read their affidavits, I concluded that the evidence before the Court did not disclose a real issue to be tried. In other words, I think that the allegation

contained in the e-mail is unsupported by the evidence which would have been available to Mr Papastravrou if he had asked.

39. However, the fact that Mr Papastravrou has behaved unwisely does not led to the conclusion that I should refuse to grant a winding up order, even if I do impute his poor behaviour to Aris. Counsel originally relied upon the dictum of Lord Cross in *Ebrahami –v- Westbourne Galleries Ltd* [1973] AC 360, at 387 in which he said *"A petitioner who relies upon the 'just and equitable' clause must come to court with clean hands, and if the breakdown between him and the other parties to the dispute appears to have been due to his misconduct he cannot insist on the company being would up if they wish it to continue."* This was a quasi partnership case in which the petitioner complained of being wrongly excluded from management. As the Privy Council subsequently explained in *Vujnovich –v- Vujnovich* (1989) 5 B.C.C. 740, Lord Cross was saying that if the matters complained of were brought about by the petitioner's own conduct, he could not expect the court to make a winding up order. In this case Mr Papastravrou's poor behavior has no bearing upon the reasons why I consider that it is just and equitable to make a winding up order and Counsel rightly abandoned his argument.

Conclusions

40. I am satisfied that it is just and equitable to make a winding up order on the basis that the Fund is no longer viable, in the sense that it is practically impossible to carry on its business in accordance with the reasonable expectations of its participating shareholders, based upon the representation contained in the PPM. The evidence is that all the participating shareholders agree that the Fund should be liquidated and its management have in fact been engaged in an ad hoc liquidation at least since March 2009 when they suspended redemptions. There is no basis upon which it can be said that an ad hoc liquidation conducted by management is itself part of the Fund's business, such that the participating shareholders should not have any reasonable expectation that the Fund would be liquidated in accordance with the Companies Law and the Companies (Winding Up) Rules. To the contrary, investors who put their money into mutual funds incorporated in the Cayman Islands have every reason to expect that the companies' affairs will be conducted in accordance with Cayman Islands law including the Companies (Winding Up) Rules.

41. The Fund is being liquidated because it failed commercially and because it is now practically impossible to carry on the business for which it was established, with the result that the investors want to withdraw what is left of their capital and deploy it elsewhere. The investors agree that the Fund should be liquidated. In these circumstances there are strong policy reasons for saying that the liquidation should be conducted by qualified insolvency practitioners in accordance with the provisions of the Companies

(Winding Up) Rules. This would be so even if there is no breach of duty on the part of a company's management. In this case I have concluded that the evidence relied upon in support of the alleged breaches of fiduciary duty does not disclose a triable issue. The Investment Adviser did act in breach of duty in connection with the investment restrictions. Whether that breach materially contributed to the Fund's failure remains an open question. The Fund's directors are in breach of the statutory duty to file audited financial statements. The 2009 accounts should have been filed a year ago and the 2010 accounts should have been filed today. The failure to produce quarterly management accounts and the Fund's inability to obtain an unqualified audit report in respect of its financial statements for the year ended 30th June 2008 give rise to two issues which must be resolved for the purposes of liquidating the Fund. Having regard to the terms of Deloitte's qualification, there is necessarily an issue about the Investment Manager's entitlement to a performance fee of $3,342,367 and an issue about the validity of the NAV at which the subscriptions of $22,870,000 received in advance of the balance sheet date were actually processed. Clearly, the mere fact that these issues have arisen could not, by itself, justify the appointment of inspectors pursuant to section 64. However, the fact that these issues have to be resolved for the purposes of liquidating the Fund, is a reason for appointing as liquidator a qualified insolvency practitioner who is independent, rather than members of management who have a strong financial interest in the outcome.

42. The nominated liquidators are Messrs Simon Whicker and Kris Beighton of the Cayman Islands firm of KPMG. Only Mr Beighton swore an affidavit attesting to his qualifications, but I am satisfied that Mr Whicker is also a qualified insolvency practitioner. Mr Farrow questions whether they meet the independence requirement of Regulation 6 as regards the Fund, although no alternative candidates are put forward. The objection is based upon the fact that the South African firm of KPMG was engaged in 2008 to perform audits of the financial statements of Chambua and Black Rock, which subsequently became wholly owned indirect subsidiaries of the Fund in circumstances which are summarized in paragraphs 20-22 above. The nature and scope of the work done is described in a letter dated 31st December 2010 and written by Mr Beighton, presumably on instructions from the South African firm. The audits were never completed and no audit opinions were ever issued. The Cayman Islands firm was not involved in this work at all but, if appointed as joint official liquidators, Messrs Whicker and Beighton do intend to engage the services of the South African firm on a consultancy basis. Chambua and Black Rock were recently sold to a Chinese state owned purchaser, although various conditions precedent and subsequent may not yet have been satisfied.

43. The audit field work done in respect of Chambua and Black Rock will be relevant to the resolution of the valuation issues referred to in paragraph 41 above. In my judgment, the mere fact that this field work was performed by a KPMG firm does not impair the ability

of Messrs Whicker and Beighton to complete the work and bring the valuation issue to a conclusion for the purposes of the liquidation. It seems to me that by appointing Messrs Whicker and Beighton as official liquidators, I am not putting them in a position in which they have to review or challenge an opinion expressed by a related firm. My conclusion would have been different if the South African firm had issued an opinion. However, the fact that Messrs Whicker and Beighton may well make use of field work done by the South African firm in 2008 does not give rise to any actual or potential professional embarrassment. For these reasons, I do not think that there are good grounds for rejecting the conclusion reached by the KPMG firms that Messrs Whicker and Beighton meet the independence requirements imposed by both the Regulations and their own professional standards. I therefore accept that Messrs Whicker and Beighton can properly accept appointment as joint official liquidators of the Fund and I so order.

44. Finally, I turn to the question of costs. Having ultimately succeeded on its winding up petition, albeit only as a result of amending it to include the claim based upon the fact that the Fund is no longer viable because it is practically impossible to carry on its business, I think that Aris is entitled to an order for costs on the indemnity basis pursuant to CWR Order 24, rule 8(2)(a). Aris can be criticised for amending its petition more than once and failing to pursue it diligently, but I am not satisfied that these criticisms amount to exceptional and special circumstances which would justify making some other order or no order for costs on the petition.

45. Having made a winding up order, it follows that the notice of motion pursuant to section 64 of the Companies Law for the appointment of inspectors will be dismissed. I have made some findings in favour of Aris in connection with the accounting and investment restrictions issues, but I determined the related party issue in favour of the Fund and its management. The related party issue was the most relevant to the notice of motion. In all the circumstances, I conclude that it would be appropriate to make no order for costs on the notice of motion. I also conclude that the Fund's costs of both the petition and the notice of motion should be paid out of the assets on the indemnity basis.

DATED this 4th day of January 2011

The Hon Mr Justice Andrew J. Jones, QC

GRAND COURT CAYMAN ISLS