IN THE GRAND COURT OF THE CAYMAN ISLANDS
FINANCIAL SERVICES DIVISION

Cause No: FSD 0080/2015

IN THE MATTER OF THE COMPANIES LAW (2013 REVISION)

AND IN THE MATTER OF HARBINGER CLASS PE HOLDINGS (CAYMAN) LTD

Appearances:	**Mr. Tom Lowe Q.C. instructed by Ms. Laura Hatfield and Mr. Tom Wright of SOLOMON HARRIS for the Petitioner**
	Mr. Tom Smith Q.C. instructed by Mr. David Butler and Mr. James Elliott of HARNEYS for the Company
Before:	**The Hon. Justice Nigel Clifford Q.C.**
Heard:	**5th and 6th October 2015**

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JUDGMENT

INTRODUCTION

1. In this case there is a Petition dated 14 May 2015 (**"the Petition"**) for the winding up of Harbinger Class PE Holdings (Cayman) Limited ("**the Company**") and the appointment of official liquidators. The Petition has been presented by "NYROY/RBC Acct# 1583 pledged to Royal Bank of Canada" ("**the Petitioner**") which is recorded in the register of members as being a shareholder in the Company. The shares are said to be beneficially owned by Muirfield Capital LLC.

2. Accordingly it is a petition by a contributory of the Company. The shares registered to the Petitioner constitute a 0.20 per cent interest in the Company. Notices of Support have been filed by parties whose combined such interest is in the order of 6 per cent.

3. The Petitioner seeks the winding up of the Company pursuant to section 92(e) of the Companies Law (2013 Revision) ("**the Companies Law**") on the ground that it is "just and equitable" to do so. It is alleged in support of the Petition that there has been a failure of the substratum of the Company. This is denied by the Company which maintains that there has been no failure of the Company's substratum and that it has fulfilled, and continues to fulfil, the purpose for which it was established.

BACKGROUND AND CORPORATE STRUCTURE

4. The Company, a Cayman Islands exempted limited company, was incorporated on 16 December 2008 as a subsidiary of Harbinger Capital Partners Offshore Fund 1, Ltd ("**the Offshore Fund**").

5. The Company's Memorandum and Articles of Association are dated 30 December 2008. The Memorandum of Association gives the Company "all the functions of a natural person" and contains an unrestricted objects clause:

> *"The objects for which the Company is established are unrestricted and the Company shall have full power and authority to carry out any object not prohibited by any law as provided by Section 7(4) of the Companies Law (Revised)."*

6. The Articles of Association of the Company contain provisions as to share capital as follows:

i. The authorised share capital is US$50,000 divided into 100 Management Shares and 4,999,900 Participating Shares.[1]

ii. The directors may issue Participating Shares.[2]

iii. Participating Shares are not redeemable at the option of Members but may be compulsorily redeemed at the discretion of the Directors.[3]

7. The Management Shares are held by Harbinger Capital Partners L.P., and the Participating Shares are held by investors.

8. The investment manager of the Company is Harbinger Capital Partners LLC ("**Harbinger**") pursuant to the terms of an Investment Management Agreement dated 31 December 2008, whereby it provides fund management services to the Company. Harbinger is a Delaware limited liability company controlled by a Philip A. Falcone. Harbinger Holdings LLC, another Delaware limited liability company also controlled by Mr Falcone, serves as the manager of Harbinger. The Investment Advisor is Harbert Fund Advisors Inc., whose head office is in Birmingham, Alabama, USA. There is also a Company Administrator.

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[1] Article 6
[2] Articles 14-21
[3] Article 29(a)

9. The directors of the Company are Mark Cook and Ian Goodall, both resident in the Cayman Islands, who have sworn affidavits in opposition to the Petition.

10. The Company was formed as a subsidiary of the Offshore Fund at the height of the financial crisis in 2008 in order to restructure investments valued at some US$2.4 billion but which were at the time illiquid.

11. The Offshore Fund had previously been incorporated in the Cayman Islands on 5 December 2001 as an exempted limited company. It operated as a *"feeder fund"* to Harbinger Capital Partners Masters Fund 1 Limited (**"the Master Fund"**) or certain "affiliated" investment entities in a typical feeder fund – master fund structure. Various investors subscribed for shareholdings in the Offshore Fund and the sole asset of the Offshore Fund was in turn a shareholding in the Master Fund.

12. The objectives of the Offshore Fund and the Master Fund were explained to investors in a series of documents, including a Confidential Explanatory Memorandum ("**CEM**") of March 2007 and a Confidential Offering Memorandum ("**COM**") for the Offshore Fund dated September 2007, relating to the Offshore Fund and Master Fund combined, referred to as "the Fund". Under the heading "Investment Opportunity" in the COM (repeating a statement from the earlier CEM) there was included the following:

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"The Fund seeks to achieve superior absolute returns by participating primarily in investments involving distressed/high yield debt securities, special situation equities, and private loans and notes. The Fund focuses primarily on turnarounds, restructurings, liquidations, event driven situations and capital structure arbitrage, with characteristics that are consistent with the Fund's underlying investment strategy, building a portfolio including long and short positions of highly leveraged and financially distressed companies."[4]

13. The COM also contained a section headed "Limited Liquidity of Fund Assets" which stated:

"The Fund's investments will include securities and other financial instruments or obligations that are thinly-traded, for which no market exists and/or which are restricted as to their transferability. The sale of any such investments may be possible only at substantial discounts and it may be extremely difficult to accurately value any such investments. Further liquidity restrictions may arise from, among other things, access to non-public information, significant ownership of an issuer, or tax or other considerations."[5]

14. The Offshore Fund duly invested funds received from its own investors in the Master Fund. The Master Fund in turn made a number of investments of the type described in the COM, some inevitably very illiquid in nature.

[4] Exhibit GS-1 page207
[5] Exhibit GS-1 page 242

15. Following the start of the financial crisis which arose with the collapse of certain affiliates of Lehman Brothers Holdings Inc. in September 2008, the Master Fund found itself with significant assets that were caught up in the Lehman bankruptcy. The Offshore Fund was faced with substantial redemption requests from investors which it and, in turn, the Master Fund, lacked the liquidity to meet. This resulted in a restructuring.

16. The Master Fund issued a new class of shares, the "Class LU Shares". The position regarding these shares was set out in the Supplement to the COM of the Fund dated October 2008.[6] This included the statement as follows:

> *"Due to the bankruptcy of certain affiliates of [Lehman] on September 30, 2008, the directors of [the Master Fund] capitalised a new class of shares (the Class LU Shares) with all the assets, rights and liabilities believed to be associated with the Master Fund's relationships with Lehman, together with an amount sufficient to fund the liabilities believed to be owing to Lehman".*

17. The Master Fund issued the Class LU shares to the Offshore Fund. The Offshore Fund contributed those shares to a new company, Harbinger Class L Holdings (Cayman) Ltd, in return for shares in that company. Thereafter the Offshore Fund held shares (Class A) being an undivided interest in the assets of the Master Fund and shares in Harbinger Class L Holdings (Cayman) Ltd.

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[6] Exhibit GS-1 page 281

18. Following on from this the Master Fund capitalised another new class of shares, the Class PE Shares, to which it allocated certain private equity-type and other illiquid investments in what is called "**the Private Portfolio**". The shares designated as the Class PE Shares were expressed to represent an undivided interest in the Private Portfolio held by the Master Fund. The objective was to use these Class PE Shares to satisfy in part the redemption claims of investors in the Offshore Fund, with such investors also receiving a portion in cash.

19. This was achieved by the Class PE Shares being initially issued by the Master Fund to the Offshore Fund and certain of those shares then being contributed by the Offshore Fund to its newly created subsidiary, the Company. So the Company became the holder of these Class PE Shares. Participating Shares in the Company were then issued to investors who had lodged redemption requests in respect of their investments in the Offshore Fund prior to 31st December 2008, in part payment of those requests. In addition redeeming investors also received cash payments (as to 61% of their redemption requests) and shares in the company whose assets comprised the Class LU Shares.

20. The Company's sole asset is its holding of the Class PE Shares. It does not have any direct interest in the assets of the Master Fund comprised in the Private Portfolio. The Master Fund is governed by its own board of directors who are responsible for managing the Master Fund in the interests of all the shareholders of that fund.

21. As well as issuing the Class PE and Class LU Shares, the Master Fund has also issued Class A, A11, B, B11, LS1 and LS11 Shares. The assets of the Master Fund are owned by the Master Fund and are not legally segregated between the different share classes. However, the articles of association of the Master Fund, which allow the creation of different classes of shares, permit the holding of portfolios of investments on behalf of particular share classes. Accordingly, within the books of the Master Fund assets are allocated or "ear marked" to particular share classes so that those shares will receive the benefit of the allocated assets, after the discharge of all prior ranking liabilities of the Master Fund. The Class PE Shares are not redeemable at the option of the shareholders but may be compulsorily redeemed at the option of the Master Fund.

22. The restructuring steps taken were explained to investors in the Offshore Fund in a Supplement to the COM (**"the COM Supplement"**) issued in December 2008.[7] After setting out that redeeming shareholders in the Offshore Fund would receive shares in the Company as partial in-kind redemption proceeds, the COM Supplement stated:

[7] Exhibit GS-1 page 283

"Holders of [the Company's Participating Shares] may not voluntarily redeem [those shares] and such shares are transferable only in certain limited circumstances. [The Company], in the discretion of its board of directors, may cause a mandatory redemption of the [Participating Shares] of any shareholder and may also elect to distribute available net cash flow from realization proceeds or current income attributable to any of the assets of the Private Portfolio held indirectly by [the Company].

The Investment Manager will use commercially reasonable efforts to dispose of or otherwise realize the assets of the Private Portfolio by the end of 2010, subject to market conditions."

23. The reference to the Investment Manager, in this instance, must have been to Harbinger in its other role as investment manager of the Master Fund because it is the Master Fund which is responsible for realising the assets comprised in the Private Portfolio as the legal owner of those assets.

24. The Private Portfolio which was allocated to the Class PE Shares comprised various illiquid and less liquid assets of the Master Fund, as set out in Schedule A to the letter dated January 2, 2009 to investors in the Offshore Fund.[8] The letter contained the following statement:

"[the Company] holds the Fund's interest in the illiquid and less liquid assets of [the Master Fund] (the Private Portfolio). The assets comprising the Private Portfolio are listed on Schedule A attached hereto."

At that time the Private Portfolio comprised some 17 groups of assets. The position has since changed significantly.

[8] Exhibit KMH-2 page 846

SUBSEQUENT DEVELOPMENTS

25. Detailed evidence before the Court sets out the developments in relation to the Private Portfolio. There is no real dispute about what has actually happened in this regard. But it is what has resulted from these developments which is at the heart of the Petitioner's case on failure of substratum.

26. Since the establishment of the Company, significant steps have been taken by the Master Fund to realise the assets in the Private Portfolio. As a result of these steps, substantial sums representing what the Master Fund calculates as "net available cash flow" (and proceeds of realisations of other assets of the Master Fund) have been paid up to the Company by redemption of its shares in the Master Fund.

27. The Company has thereby been enabled to make distributions to its shareholders as follows:

i. As at 14th July 2015, total distributions of US$1,073,751,254 had been made to the holders of Class PE Shares in the Master Fund, including to the Company, with US$923,007,708 then distributed by the Company to its own shareholders.

ii. A further distribution of US$72 million was made by the Master Fund to the holders of Class PE Shares on 20 July 2015, with US$47 million distributed by the Company to its shareholders.

iii. A further additional distribution of around US$56 million has very recently been made, effective 30 September 2015, for payment in October 2015, with some US$36 million to be paid by the Company to its shareholders.

28. During this process of realisation, the 17 groups of assets originally in the Private Portfolio reduced to two, shares held in HRG Group, Inc. (**"HRG"**) and a minority shareholding in a company called Asian Coast Development (Canada) Limited (**"ACDL"**). But there was also the addition of a new asset, an "inter-class receivable" representing an adjustment made in the books of the Master Fund in favour of the Class PE Shares.

29. Since the start of these proceedings there has been a disposal of the HRG shares. There were restrictions on the ability to sell the shares due the status of the Master Fund as an "affiliate" of HRG. The shares have, however, now all been realised. It is said on behalf of the Company that the delay in selling the shares as a result of the restrictions on disposal has in fact been beneficial to Class PE Shareholders as the price of HRG's shares has risen significantly.

30. The position now, therefore, is that the investment in ACDL is all that remains of the assets which were originally in the Private Portfolio. ACDL is an international development company specialising in integrated resort destinations. In particular, ACDL, through its subsidiary, is the developer of an integrated resort and residential area at Ho Tram in Vietnam. Substantial efforts have been expended in seeking to preserve and enhance the value of the investment. This has included proceeding with the development. The first 541 room tower opened in July 2013 and the second 559 room tower is under construction. Funds have been reinvested by the Master Fund, where judged necessary, to support the development and protect the investment.

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31. The investment in ACDL is by its nature illiquid. The evidence suggests that at present it would be next to impossible for the Master Fund to sell its minority interest. However, it is hoped that the Vietnamese Government will within the next six to nine months approve a decree allowing Vietnamese nationals to gamble and will either initiate a pilot project involving the resort or will grant a licence to the resort. It is expected that these steps would materially improve the commercial prospects of the development and facilitate the introduction of third party capital or attract an acquirer.

32. Whatever concerns there may be on the part of the Petitioner about the reinvestment of funds in ACDL, the greater focus of its case has been on the creation of the inter-class receivable. How this came about is explained in the evidence of Harbinger's Mr Hladek[9]. What he says about it can be summarised as follows:

i. Although investments are allocated within the Master Fund to particular classes of shares, the liabilities of the Master Fund, such as bank indebtedness, are liabilities of the Fund as a whole and not limited to recourse to particular assets. Such liabilities rank ahead of any rights of shareholders.

ii. At the time that the Company was established and the Class PE Shares were issued to it, the Master Fund had existing third party and other senior liabilities of approximately US$2.7 billion. Subsequently, that indebtedness has been refinanced and paid down (using net cash flow of the Master Fund) to approximately US$135 million.

[9] 2nd affidavit, paragraphs 69-97; 3rd affidavit, paragraphs 36-57.

iii. In particular, in January 2012, the Master Fund refinanced its existing indebtedness through a loan with Jefferies High Yield Trading LLC. This loan was repaid with a combination of net cash flow of the Master Fund plus the proceeds of a new loan advanced by MSDC HMF Investments LLC. This loan was then in turn subsequently repaid in August 2014 by a combination of net cash flow plus the proceeds of a new loan advanced by Credit Suisse AG.

iv. These re-financings have successively reduced the amount of the third party debt of the Master Fund.

33. Cash derived from the realisation of assets within the Private Portfolio allocated to the Class PE Shares was put towards the funds needed for these re-financings. As it was considered that the Class PE Shares had contributed more than their fair share to such re-financings, as well as to the overall operating expenses and other cash requirements of the Master Fund for its investments, in circumstances where the Class LS Shares had not contributed any such cash, the inter-class receivable was created.

34. The inter-class receivable is said by Mr. Hladek to reflect commercial terms as to the use of money and presently bears an interest rate of 18 per cent per annum. As at 30 June 2015, the receivable amounted to US$198,329,506 comprising US$88,590,528 of principal and US$109,738,978 of interest.[10] The Master Fund has committed itself to settling the inter-class receivable before distributions are made to Class LS or Class A shareholders in the Master Fund.

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[10] 3rd Affidavit, paragraph 37

35. The receivable is backed by assets allocated to Class LS Shares which include investments in LightSquared, a company which is developing a wireless broadband service in the United States. LightSquared is presently the subject of bankruptcy proceedings in New York. The evidence is that on 27 March 2015 the Bankruptcy Court for the Southern District of New York approved a restructuring plan for LightSquared. The plan will become effective, and LightSquared will emerge from bankruptcy, when the relevant conditions are satisfied including the raising of exit financing and the obtaining of required change of control approval. Binding commitments for the exit financing have been received and it is expected that change of control approval will be forthcoming in the fourth quarter of 2015. Upon LightSquared's emergence from bankruptcy, the Master Fund will receive preferred and common equity stock in the new LightSquared company.

36. According to the evidence, the Master Fund is actively investigating the possibility of settling the inter-class receivable as a matter of priority. A restructuring of the Credit Suisse loan has been concluded for this purpose. In addition steps are being taken to investigate the possibility that when LightSquared emerges from bankruptcy finance can be raised by using the new preferred shares in LightSquared allocated to Class LS as collateral.

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37. These developments over time with the Private Portfolio are central to the Petitioner's case. It is contended that contrary to the objective set out in the COM Supplement of commercially reasonable efforts being made to dispose of or otherwise realise the assets of the Private Portfolio by the end of 2010, subject to market conditions, instead proceeds of realisation have been reinvested in largely illiquid assets rather than being distributed. Running through the Petitioner's case is a catalogue of complaints about what it contends has been misuse of the Private Portfolio. The result, it is contended, is that the Company is no longer doing what it was formed to do, but has embarked upon a wholly different venture.

38. The Company disputes this contention. It maintains that it was no part of the purpose of the Company (as distinct from the Master Fund) to manage and realise the underlying assets comprised in the Private Portfolio. The Company's own purpose, it is said, is limited to holding the relevant Class PE Shares issued by the Master Fund, receiving through the redemption of those shares from time to time the net cash flow from the realisation by the Master Fund of the assets in the Private Portfolio or income attributable to those assets and then distributing such monies in turn to the shareholders in the Company. The funds received by the Company for onward distribution to its shareholders represent, in accordance with the COM Supplement, *"available net cash flow from realization proceeds or current income attributable to any of the assets of the private Portfolio"*.

39. It is observed that there is no reference to "gross" proceeds of such asset realisations which, the Company contends, reflects the fact that cash generated from asset sales would first be required to satisfy and defray the due liabilities and expenses of the Master Fund as well as the cash needs of its investments. However, this managing and realising of the underlying assets comprised in the Private Portfolio is the business of the Master Fund which owns such assets. The Company's fundamental point is that it has fulfilled, and continues to fulfil, its own separate and distinct purpose.

40. There is a central issue therefore: Whether what has happened with the Private Portfolio is relevant to the case on failure of substratum. Although on the Company's case the management of the Private Portfolio is irrelevant, nevertheless it does not accept that in fact there has been any mismanagement by the Master Fund and it relies for support on evidence adduced of the independent monitoring of Harbinger in the United States. This involves the activities of Harbinger being subject to oversight and monitoring by an independent monitor, James D. Dunning Jr (**"the Independent Monitor"**).

THE INDEPENDENT MONITOR

41. The Independent Monitor was appointed on 5 February 2014 pursuant to a consent judgment of the US District Court for the Southern District of New York (**"the Consent Judgment"**) for a term of two years. The Consent Judgment compromised an action brought against Harbinger and other connected partier by the SEC concerning matters unrelated to the Company. Nevertheless the result is that the funds managed by Harbinger are in effect in wind-down having been closed to new investors with redemption requests being met from the net proceeds of the realisation of investments. The regime mandated for this wind-down was for Harbinger to remain in place as investment manager, but subject to monitoring from the Independent Monitor.

42. Mr. Dunning has sworn an affidavit in support of the Company's opposition to the Petition. It shows that his appointment as Independent Monitor includes monitoring and oversight of the Master Fund.[11] He has produced six quarterly reports to the US District Court reporting that Harbinger has been in compliance with its obligations under the Consent Judgment. Under the terms of the Consent Judgment, Harbinger is required to take all action reasonably necessary to expeditiously satisfy redemption requests which are received.

[11] Dunning affidavit, paragraph 4

43. The monitoring has included monitoring the efforts being made to liquidate assets of the Master Fund and the distribution of funds received.[12] Mr Dunning's express conclusion is that Harbinger is taking actions to satisfy all outstanding redemption requests of investors in relevant Harbinger Funds.[13]

44. The Independent Monitor's stated concern is that the relief sought by the Petitioner will disrupt the orderly disposition of assets by the Harbinger Funds.

THE LAW

45. The traditional starting place for the law on failure of substratum is ***In re Suburban Hotel***[14]. In that case the company had been incorporated for the purpose of carrying on an hotel business. This business was being carried on unprofitably and a petition was presented to wind up the company. A majority of shareholders opposed the petition. It was held that the fact that the business had been loss-making, and was likely to remain so, was not a ground for the making of a winding-up order. The oft-cited dictum of Lord Cairns is as follows:

> *"It is not necessary now to decide it; but if it were shown to the Court that the whole substratum of the partnership, the whole of the business which the company was incorporated to carry on, has become impossible, I apprehend that the Court might, either under the Act of Parliament, or on general principles, order the company to be wound up."*[15]

[12] Ibid, paragraph 10
[13] Ibid, paragraph 18
[14] (1867) LR 2 Ch App 737
[15] Page 750

46. Subsequent cases followed this approach. In ***In re Diamond Fuel Company***[16] the company had ceased to carry on business (which had previously been carried on at a loss), had expended its capital and disposed of the bulk of its assets (save for some worthless patents and a sum of cash insufficient to pay its debts). The Court of Appeal upheld the decision to make a winding up order. James LJ stated:

> *"The ground for the order seems to me to be this, that the company had, to all intents and purposes, come to an end without the slightest hope or prospect of ever being resuscitated."* [17]

47. In ***In re Haven Gold Mining Company*** [18] a company formed to work a mine in Australia discovered that it had no title to it. The great majority of shareholders voting at a meeting convened for the purpose resolved to send out an agent to attempt to salvage something from the situation and only a very small minority voted against and in favour of winding up. Lindley LJ said:

> *"It appears to me in substance to come to this, that it is proved by evidence upon which we must act, that the minority have established such a case as entitled them to say to the majority, "The undertaking in which we all embarked is proved to be impossible to carry out; we decline to enter into any further speculation, or to join you in trying to get this property from other people and upon other terms". Upon that strict ground I think that the minority are entitled to say we insist upon a winding-up."* [19]

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[16] (1879) 13 Ch D 400
[17] Page 407
[18] (1882) 20 Ch D 151
[19] Page 168

48. A further case about the same time was ***In re German Date Coffee Company***[20]. The Company had been formed for the purpose of exploiting a specific patent to manufacture a partial substitute for coffee made from dates. The specific patent was not granted and the company accordingly fell to be wound up since it could not carry on the business for which it had been formed. Baggallay LJ stated as follows:

> *"It appears to me that the principle involved in the decision of In re Suburban Hotel Company by Lord Cairns amounts to this, that if you have proof of the impossibility of carrying on the business contemplated by the company at the time of its formation, that is sufficient ground for winding up the company. Therefore the question arises in the present case, is there an impossibility of carrying out the objects of the company?"* [21]

49. In the same line of authority there are examples of other cases where a company was formed for a particular purpose or activity which was either abandoned, came to an end or was otherwise impossible to pursue. Mr Lowe, on behalf of the Petitioner, referred me in this context to ***Re Red Rock Gold Mining Company Limited***[22]; ***In re Crown Bank***[23]; and ***Re The Coolgardie Consolidated Gold Mines Limited***[24].

[20] (1882) 20 Ch D 169
[21] Page 187
[22] (1889) 61 LT 785
[23] (1890) 44 Ch D 634
[24] (1897) 76 LT 269

50. The same approach is evident from ***Re Kitson & Co Ltd***[25], where the Court of Appeal determined that there had been no failure of substratum where a company had sold its business, but at the same time was carrying on a similar type of business through a subsidiary. It was held that so long as the company could carry on that type of business, then prima facie at any rate it would be impossible to say that its substratum had gone.

51. The approach has also been followed in Scotland in ***Galbraith v The Merito Shipping Company Limited***[26]. Lord Moncrieff referred to the English authorities and concluded that:

> *" ... before the substratum should be found to have been withdrawn, business within the objects of incorporation should have become at least in a practical sense impossible."* [27]

52. In this jurisdiction the principle from this line of cases came to be considered in the context of an open-ended corporate mutual fund in the case of ***In the Matter of Belmont Asset Based Lending Limited***[28], and a somewhat different approach was taken. Having considered certain of the authorities, Jones J said:

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[25] [1946] 1 All ER 435
[26] (1947) SC 446
[27] Page 456
[28] [2010] 1 CILR 83

"To translate these statements into a modern context, it can be said that the 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. If such a company, organized as an open-ended mutual fund, has ceased to be viable for whatever reason, the court will draw the inference that it is just and equitable for a winding-up order to be made."[29]

53. It is clear that the analysis of Jones J related specifically to the position of an open-ended corporate mutual fund. He identified what he referred to as *"sound policy reasons for making a winding-up order in respect of non-viable mutual funds"*[30].

54. The test formulated by Jones J has found favour in other Cayman cases.[31] However, elsewhere there has been a different approach. In the British Virgin Islands, in ***Aris Multi-Strategy Lending Fund Ltd v Quantek Opportunity Fund Ltd***[32] an application by a shareholder for the winding up of an open-ended mutual fund on the ground of failure of substratum was rejected by Bannister J. He considered the English authorities and stated the principle underlying those decisions as follows:

[29] Page 89
[30] Page 90
[31] In the Matter of Freerider Limited [2010] CILR 486 (a decision of Foster J concerning breakdown of mutual trust and confidence in a quasi-partnership); In the Matter of Wyser-Pratte Eurovalue Fund Ltd [2010] 2 CILR 194 and In the Matter of Heriot African Trade Finance Fund Limited [2011] 1 CILR 1 (further decisions of Jones J in cases of open-ended mutual funds.)
[32] (Judgment 15 December 2010)

> *"It seems to me that the underlying principle to be extracted from these cases, with the exception of In re Bristol Joint Stock Bank [where Kekewich J referred to the impossibility of a business being carried on with any hope of success] is that a minority seeking a winding up on the grounds that the business life of a company has come to an end will only be permitted to overcome the will of the majority if they can show that further conduct of the company's business is impossible."* [33]

55. In this case Bannister J went on to consider the decisions of Jones J in ***Belmont* and *Wyser-Pratte***. He noted that the reasoning of Jones J was confined to open-ended investment funds, but in his view there could not be a separate principle applying to a particular type of business.[34] He also rejected the concept of "viability" as being too uncertain for determining loss of substratum.[35] He preferred to hold to the underlying principle derived from the English authorities to the effect that there will only be a failure of substratum if it is impossible for the business of the company to be carried on.

56. These different approaches to the test to be applied in determining failure of substratum of an open-ended investment fund were remarked upon by the Cayman Islands Court of Appeal in ***ABC Company (SPC) v J & Company Limited***[36]. In the event in that case it was not necessary for the Court of Appeal to make a determination as to the differences. However Chadwick P observed as follows:

[33] Paragraph 28
[34] Paragraph 34
[35] Paragraph 35
[36] [2012] 1 CILR 300

> *"It must be anticipated that an appeal will come before this court in which it will be necessary to choose between the approach of Jones J In Belmont and Heriot on the one hand, and that of Bannister J in Aris v Quantek on the other hand: or, perhaps, to decide that the true approach in this jurisdiction should lie somewhere between the approaches respectively adopted in those cases. But this is not that appeal."*[37]

57. Nor it is necessary to make any such choice in the present case. By common consent the Company here is not, and never has been, an open-ended corporate mutual fund, one that issues shares to, and redeems the shares of, investors at any time investing the net investment proceeds in investments for the benefit of shareholders.

58. In my judgment, therefore, the test to be applied in this case in determining whether there has been a failure of substratum is founded upon the established underlying principle of the line of authorities referred to which requires the Court to determine whether it has become impossible for the company to achieve the purpose for which it was formed. It is a question that must be determined by ascertaining the principal or main objects of the company and then deciding whether it has become impossible for the company to attain those objects.

59. To my mind, having considered the submissions of both counsel in the case, there is no real issue on this test. The real focus of the issue between them on the law relates to how the objects of a company should properly be ascertained.

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[37] Pages 333-334

60. Mr. Smith, for the Company, submits that it is a matter to be determined by reference to the objects as expressed in the memorandum and articles of association. As the Company has a modern form unrestricted objects clause this means, on his submission, that the Company is in effect able to carry out any object, so long only as not prohibited by any law. Reliance is placed on the analysis in ***McPherson's Law of Company Liquidation*** 3rd edition, to the effect that whether it has in fact become impossible for the company to achieve the purpose for which it was formed is a question that must be determined by first ascertaining the main objects of the company as expressed in the company's memorandum and articles.[38]

61. Mr. Lowe, for the Petitioner, contests this submission. He contends rather that a proper analysis of the authorities shows that the Court is required to look beyond a wholly general objects clause to ascertain the principal or main object for which the Company was formed. He places particular reliance on the Australian case of ***Re Tivoli Freeholds Ltd***[39]. In that case Menhennitt J referred to a test to be applied to ascertain the prime or main object or general intention and common understanding of the members when they became members and held there is authority that it is permissible to go beyond the company's memorandum for this purpose, for example to a prospectus. Thus he said:

[38] 4-031
[39] [1972] VR 445

"It has been recognised that it may be just and equitable to wind a company up if the company engages in acts which are entirely outside what can fairly be regarded as having been within the general intention and common understanding of the members when they became members."[40]

And he added:

"But where, even although a company could still pursue its original objects, whether they be main or paramount objects or not, if in fact the matter has gone beyond intention and the company has in fact embarked upon a different course which, even although it is within power, is quite outside and different from what was originally commonly intended and understood, then it appears to me that it may be just and equitable to wind up a company."[41]

62. On the question of whether it is permissible to go beyond the company's memorandum to ascertain the prime or main object, or the general intention and common understanding of members, he referred to cases where regard had been had to a prospectus or circular to shareholders for this purpose but said:

"However, a basic consideration is that the material being looked at must establish something general or common to all members"[42]

63. There are also other authorities on the point to which Mr Lowe referred. In ***Haven Gold Mining*** the Court looked at the prospectus, as it did also in ***Red Rock Gold Mining.*** In ***Crown Bank*** the Court looked at the prospectus and a circular. The judgment of Menhennitt J in ***Tivoli Freeholds*** was referred to with approval by Warner J in ***Re J E Cade & Son Ltd***[43].[44] In the ***Aris*** case Bannister J said as follows:

[40] Page 468
[41] Page 469
[42] Page 472
[43] [1991] BCC 360

"I have first to ask myself what is the business of the Fund. Mr Moverley Smith QC went as far as to submit that since the Fund has a 'modern' objects clause permitting it to do anything under the sun provided that it does not infringe the law it is not possible, as a matter of logic, to say that it has lost its substratum, because it does not have one and never has had one. I have no hesitation in rejecting this submission. Although, where a company has a defined set of objects set out in its memorandum, those objects must be the first port of call in deciding what is the business of the company, it has never been the law, as In re Haven Gold Mining Company Limited shows, that the Court is confined to the memorandum in ascertaining what is the business of the Company. Where a company has no objects clause, the nature of its proper business must be ascertained from other materials."[45]

64. And in this jurisdiction, the decision of Jones J in ***Belmont*** on this aspect shows that the investment business of the company was determined *"in accordance with the reasonable expectations of its participating shareholders, based upon representations contained in its offering document."*[46]

65. These authorities demonstrate, in my view, that the Court is required to look beyond a wholly general objects clause to ascertain on the particular evidence in a case the principal or main object of a company in line with the reasonable expectations of its participating shareholders.

[44] Westlaw transcript page 17
[45] Paragraph 37
[46] Paragraph 12, page 89

ANALYSIS AND FINDINGS

66. Having regard to the legal principles referred to, it is necessary to ascertain the principal or main object for which this Company was formed, in line with the reasonable expectations of its shareholders, and to determine whether the attainment of that object has been rendered impossible in some sense resulting in a failure of substratum.

67. The Petitioner's pleaded case is that *"the Company has no business other than holding shares in the Master Fund and compulsorily redeeming the shares of the Company."*[47] However, in advancing its case on failure of substratum, the principal or main object for which the Company was formed appears to be characterised as being for using *"commercially reasonable endeavours to complete redemption of the Class PE Shares by 2010"* which, it is alleged, it has failed to do.[48]

68. Reliance is placed on how the Company came to be set up and the statement referred to in the COM Supplement. Having regard to what subsequently happened with the Private Portfolio, the Petitioner's case is then put as follows:

> *"Accordingly, the Company has failed in achieving the stated objective of realising Class PE assets to pay sums due to shareholders who redeemed from the Offshore Fund prior to 31 December 2008, such as the Petitioner, which the Company said it would use commercially reasonable efforts to do by 2010. Instead much of the cash realised from sale of Class PE assets was converted into an even more illiquid asset in the form of a receivable from Class LS of the*

[47] Petition – paragraph 6
[48] Petition – paragraph 45

Master Fund whose asset are shares in a company that has been, and still is, in bankruptcy since 2012 and whose exit from bankruptcy is, amongst other things, contingent on further commitment of loan funds by Harbinger companies."[49]

69. It is on this footing it is pleaded that the substratum of the Company has failed and that it is just and equitable that it should be wound up.[50]

70. Mr Lowe, in his submissions on behalf of the Petitioner, has put the case on the basis that it is just and equitable to wind up the Company as it is no longer liquidating what constituted the Private Portfolio at the time it was established and as was promised but is engaging in an entirely new and different form of investment activity, namely the indirect investment in LightSquared, as well as impermissible inter-class lending.

71. For the purpose of making good this case, Mr. Lowe in his submissions has analysed in some detail what has happened with the assets in the Private Portfolio and what should or should not have been done with those assets by the Master Fund. There is no real issue about what has in fact happened with such assets. The issue rather is whether this has defeated the object for which the Company, as distinct from the Master Fund, was formed and resulted in a failure of substratum of the Company.

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[49] Petition – paragraph 49
[50] Petition – paragraph 50

72. As to the key issue of the principal or main object for which the Company was formed, Mr Lowe relies on what he contends is an admission in the Company's own evidence. In the Third Affidavit of Mr Hladek, of Harbinger, it is stated as follows:

> *"The Company was formed as a subsidiary of the Offshore Fund, for the purpose of holding the Offshore Fund's interest in the Class PE shares of the Master Fund, which in turn receives the economic benefits achieved by the Master Fund with respect to the Private Portfolio, comprised of illiquid assets. It is important to distinguish the Company's purpose from a typical Cayman Islands mutual fund, where the associated investment management agreement will not usually contemplate an investment manager performing a wind down or liquidation of the fund. That is not the case here. The investment management agreement dated 31 December 2008 (pages 16-32 of KMH-3) states that 'the Fund desires to liquidate its portfolio and distribute the proceeds thereof to its shareholders'. As such, the Company was set up with the liquidation and realisation of illiquid assets at its core, with the primary purpose of receiving and distributing proceeds received from the Company's investment in Class PE shares subject to the Master Fund complying with obligations and to creditors."*[51]

73. Mr Lowe points to this evidence as showing that the liquidation and realisation of the assets was at the core of the Company, being the source of the funds that were going to be received as a primary purpose and distributed .This, he submits, is consistent with the COM Supplement which set out that the Master Fund would consist of three different investments, one of which would be "*shares of Class PE*

[51] Hladek Third – paragraph 6

Holdings, the sole asset of which is Class PE Shares representing an undivided interest in the Private Portfolio held by the Master Fund".[52] The purpose of this, it is contended, was to create a system consistent with the division of the shares in the Master Fund into separate classes (as provided for in the Articles of Association of the Master Fund[53]) which segregated the Class PE shares from other classes of shares and gave investors the assurance of being paid out by reference to particular assets. Thus, it is submitted, that at its core this Company was about liquidating the Private Portfolio and returning the realisations to investors.

74. The case then made on behalf of the Petitioner is that what has happened with the Private Portfolio represents a fundamental departure from what is said to be the core business purpose of the Company. It is observed that although realisation of the assets in the Private Portfolio by the end of 2010 was expressed to be subject to market conditions, what has actually happened is that the Company, as Mr. Lowe puts it, has realised everything originally in the Private Portfolio apart from ACDL which more money has been put into as confirmed by Mr. Hladek in cross-examination. In addition there has been the creation of the inter-class receivable said to be contrary to the requirement of segregation between classes. The submission is that the assets in the Private Portfolio should not have been put in this position and it has resulted in a fundamental departure from the main object.

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[52] Exhibit GS-1 – page 284
[53] Exhibit MC-4 – page 17

75. For its part the Company characterises its principal or main object quite differently. Going beyond the memorandum of association, Mr Smith, on behalf of the Company, submits that the evidence is clear as to the purpose of the Company and it is not really in issue. The evidence, it is contended, clearly establishes that the Company's purpose has always been limited to holding the relevant Class PE Shares issued by the Master Fund, receiving through the redemption of those shares from time to time the net cash flow from the realisation by the Master Fund of the assets in the Private Portfolio or income attributable to those assets, and then distributing such monies in turn to the shareholders of the Company. Mr Smith observed that this in effect is what is pleaded in the petition itself. He also pointed to the specific evidence on the point.

76. Mr Cook, one of the directors of the Company, in his Third Affidavit at paragraph 10 said as follows:

> *"The Company was created as a special purpose vehicle for the purpose of holding the Offshore Fund's Class PE Shares in the Master Fund and issuing shares in partial satisfaction of redemption payments to the Offshore Fund's redeeming investors. It was intended that once the underlying investments in the Private Portfolio could be realised by the Master Fund and the Master Fund had made distributions to the Company, the Company would make distributions to its shareholders, and would generally handle the ordinary administration of the Company's accounts and investors. The Company does not itself own any interest in any assets held by the Master Fund."*

77. This evidence was not challenged and nor was the evidence to the same effect of the other director of the Company, Mr Goodall.

78. Reliance is also placed on the evidence of Mr. Hladek. His evidence went beyond what he said in paragraph 6 (referred to by Mr. Lowe) and added as follows:

> *"The Company's sole contemplated activities were holding shares in the Master Fund, distributing proceeds received from the Master Fund in respect of those shares upon the realisation of the Master Fund's underlying assets, and handling the normal administration of its accounts and investors."*[54]

79. Furthermore, it is observed, the Petitioner's own evidence is also to the same effect. In his Second Affidavit Mr Stern said as follows:

> *"Whilst it is true that the Company's stated Objects are unrestricted, it is a fact that all it actually does is (a) hold shares in the Master Fund which were allocable to the Private Portfolio assets and (b) compulsorily redeem the shares of the Company. That is all it was ever intended the Company actually would do, despite the broad nature of the Objects."*[55]

80. In cross-examination Mr Stern was asked to read this paragraph of his affidavit, which he did, and he agreed that it sets out the purpose of the Company.

81. Accordingly, it is submitted, that the evidence of this purpose for which the Company was formed is effectively common ground and uncontroverted.

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[54] Paragraph 10
[55] Paragraph 8

82. It is further submitted by Mr. Smith that the same goes for the question which follows, as to whether the Company is continuing to fulfil that purpose, which it plainly is according to the evidence. In his Third Affidavit Mr. Cook gives evidence that the Company continues to perform all of the functions for which it is intended.[56] The other director, Mr. Goodall, agrees with this. There was no challenge to this evidence. And in cross-examination Mr. Stern agreed that the Company is continuing to redeem its own shares using distributions from the Master Fund.

83. Having reviewed all this evidence it is clearly established, in my view, that the principal or main object for which this Company was formed was indeed limited to holding the relevant Class PE Shares issued by the Master Fund and receiving through the redemption of those shares the net cash flow from the realisation by the Master Fund of the assets in the Private Portfolio for onward payment to its own shareholders. There can be no reasonable expectation on the part of its shareholders for the Company to do anything else. Furthermore, the evidence demonstrates clearly that the Company has fulfilled this purpose and continues to do so.

84. That really is the end of the Petitioner's case. It cannot possibly be said that the attainment of the Company's principal or main object has been rendered impossible in some sense resulting in a failure of substratum. Accordingly there is no jurisdiction to make a winding up order.

[56] Paragraph 12

85. However, because so much time and attention has been given to examining what has transpired with the Master Fund's management of the Private Portfolio, and the reliance placed on this by Mr. Lowe on behalf of the Petitioner, I feel bound to say something about it. A number of detailed points and counter-points have been made about the management of the Private Portfolio and what has been termed by Mr Lowe in his submissions the misuse of the Private Portfolio. However, this is not a case against the Master Fund, no such case is pleaded and Mr Lowe confirmed during the hearing that he is not making a case of mismanagement. Nevertheless, running through the Petitioner's case is criticism of what has happened with the Private Portfolio.

This is because Mr Lowe has repeatedly put the Petitioner's case on failure of substratum on the basis of what the <u>Company</u> (emphasis added) has done in realising assets in the Private Portfolio and not liquidating what has remained of them. This, in my view, is based on a fundamental misconception that the purpose of the Company is to realise the Private Portfolio and return proceeds to investors, whereas its actual purpose is to receive proceeds from realisations of the Private Portfolio by the Master Fund. The misconception as to the real purpose of the Company, as distinct from that of the Master Fund, is the result of the conflation of the two entities in the case put forward on behalf of the Petitioner.

86. Accordingly, it is not necessary to make findings about the management of the Private Portfolio. Indeed it would not be appropriate to do so.

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87. Nor is it necessary to make a determination on various points raised going to discretion to make a winding up order. Having found that there is no jurisdiction to make a winding up order, it does not fall to me to consider whether to exercise such discretion.

88. Nevertheless, I can say that factors which might otherwise go to discretion are against there being a winding up.

89. As already observed, this petition has very little support from other contributories. Unlike the ***Tivoli*** case (where some 90 per cent of the minority investors wanted to withdraw their investments), here Notices of Support have been filed representing only about 6 per cent in value.

90. Furthermore, I do not see the need for the appointment of an independent liquidator, as contended for by Mr. Lowe. Indeed I find it difficult to see how the appointment of a liquidator could serve any useful purpose and it might even be counterproductive. It would introduce an additional layer of potentially significant costs for no obvious benefit. A liquidator could carry on receiving distributions from the Master Fund and paying them out to investors in the Company, but this is happening any way. The Company does not appear to have any grounds for applying to wind up the Master Fund. If there were to be a forced sale of the Class PE Shares, this is likely to be at a depressed value according to the evidence of Mr. Hladek which I accept.

91. There is also to be taken into account the evidence of the Independent Monitor, which is unchallenged. Mr Dunning states in his affidavit as follows:

> *"I write because of my concern that the relief sought by the Petitioner will disrupt the orderly disposition of assets by the Harbinger Funds ... the LightSquared Assets and ACDL, remain illiquid, I have observed that substantial steps have been taken to position these assets for a liquidity event, which are described below. I am concerned that the relief sought by the Petitioner will disrupt these efforts and potentially have collateral consequences that will negatively impact other investors in Class PE who are not participating in these proceedings as well as investors in other classes of the Master Fund and investors in Harbinger Funds that do not feed into the Master Fund but also hold these assets."*[57]

92. It appears, therefore, that the appointment of liquidators of the Company would likely serve no useful purpose and could even carry the risk of being detrimental to the interests of shareholders in the Company.

DECISION

93. For the reasons set out, this Petition is dismissed.

94. An order should be drawn up accordingly. If in default of agreement as to its terms there are matters to be resolved, application can be made limited to such purpose.

Dated this the 10th day of November 2015

The Honourable Justice Nigel Clifford Q.C.
Judge of the Grand Court

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[57] Paragraphs 4 and 12