

1 **IN THE GRAND COURT OF THE CAYMAN ISLANDS**
2 **FINANCIAL SERVICES DIVISION**

3
4 **Cause No: FSD 0080/2015**

5
6 **IN THE MATTER OF THE COMPANIES LAW (2013 REVISION)**

7
8 **AND IN THE MATTER OF HARBINGER CLASS PE HOLDINGS (CAYMAN) LTD**

9
10
11 **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**

12
13
14
15
16
17
18 **Before:**

The Hon. Justice Nigel Clifford Q.C.

19 **Heard:**

5th and 6th October 2015

20 **JUDGMENT**
21



22 ***INTRODUCTION***

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

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

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

5 ii. The directors may issue Participating Shares.²

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

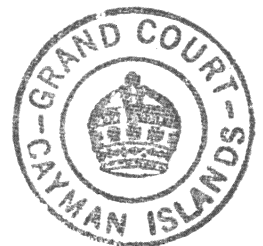
8 7. The Management Shares are held by Harbinger Capital Partners L.P., and the
9 Participating Shares are held by investors.

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

¹ Article 6

² Articles 14-21

³ Article 29(a)



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

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

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

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



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

8
9 13. The COM also contained a section headed “Limited Liquidity of Fund Assets”
10 which stated:

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

18
19 14. The Offshore Fund duly invested funds received from its own investors in the
20 Master Fund. The Master Fund in turn made a number of investments of the type
21 described in the COM, some inevitably very illiquid in nature.



⁴ Exhibit GS-1 page 207

⁵ Exhibit GS-1 page 242

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

7 16. The Master Fund issued a new class of shares, the "Class LU Shares". The position
8 regarding these shares was set out in the Supplement to the COM of the Fund dated
9 October 2008.⁶ This included the statement as follows:

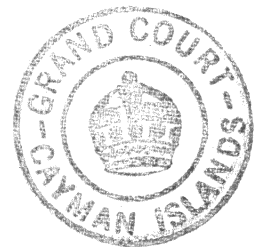
10 *"Due to the bankruptcy of certain affiliates of [Lehman] on September 30,*
11 *2008, the directors of [the Master Fund] capitalised a new class of shares (the*
12 *Class LU Shares) with all the assets, rights and liabilities believed to be*
13 *associated with the Master Fund's relationships with Lehman, together with an*
14 *amount sufficient to fund the liabilities believed to be owing to Lehman"*

15

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

21

⁶ Exhibit GS-1 page 281



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

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

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



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

12 22. The restructuring steps taken were explained to investors in the Offshore Fund in a
13 Supplement to the COM (“**the COM Supplement**”) issued in December 2008.⁷
14 After setting out that redeeming shareholders in the Offshore Fund would receive
15 shares in the Company as partial in-kind redemption proceeds, the COM
16 Supplement stated:

17

18

19



⁷ Exhibit GS-1 page 283

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

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

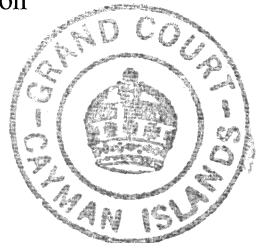
11
12 23. The reference to the Investment Manager, in this instance, must have been to
13 Harbinger in its other role as investment manager of the Master Fund because it is
14 the Master Fund which is responsible for realising the assets comprised in the
15 Private Portfolio as the legal owner of those assets.

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

20 *“[the Company] holds the Fund’s interest in the illiquid and less liquid assets*
21 *of [the Master Fund] (the Private Portfolio). The assets comprising the Private*
22 *Portfolio are listed on Schedule A attached hereto.”*

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

⁸ Exhibit KMH-2 page 846



SUBSEQUENT DEVELOPMENTS

1

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

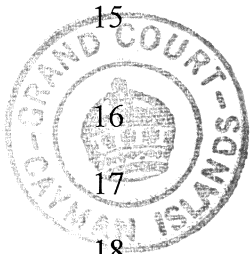
6 26. Since the establishment of the Company, significant steps have been taken by the
7 Master Fund to realise the assets in the Private Portfolio. As a result of these steps,
8 substantial sums representing what the Master Fund calculates as "net available
9 cash flow" (and proceeds of realisations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

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

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

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

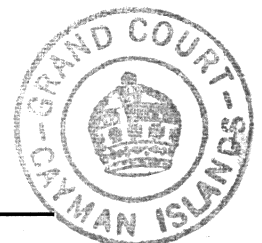
19 iii. A further additional distribution of around US\$56 million has very recently
20 been made, effective 30 September 2015, for payment in October 2015, with
21 some US\$36 million to be paid by the Company to its shareholders.



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

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

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



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

9 32. Whatever concerns there may be on the part of the Petitioner about the reinvestment
10 of funds in ACDL, the greater focus of its case has been on the creation of the inter-
11 class receivable. How this came about is explained in the evidence of Harbinger's
12 Mr Hladek⁹. What he says about it can be summarised as follows:

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

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

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



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

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

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

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

¹⁰ 3rd Affidavit, paragraph 37



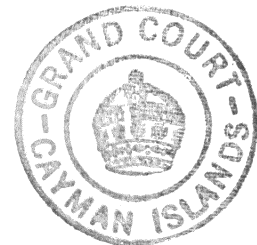
1 35. The receivable is backed by assets allocated to Class LS Shares which include
2 investments in LightSquared, a company which is developing a wireless broadband
3 service in the United States. LightSquared is presently the subject of bankruptcy
4 proceedings in New York. The evidence is that on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

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



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

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



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

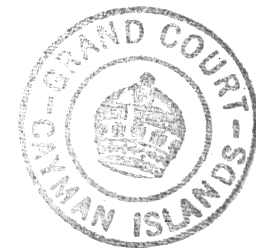
9 40. There is a central issue therefore: Whether what has happened with the Private
10 Portfolio is relevant to the case on failure of substratum. Although on the
11 Company’s case the management of the Private Portfolio is irrelevant, nevertheless
12 it does not accept that in fact there has been any mismanagement by the Master
13 Fund and it relies for support on evidence adduced of the independent monitoring
14 of Harbinger in the United States. This involves the activities of Harbinger being
15 subject to oversight and monitoring by an independent monitor, James D. Dunning
16 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 parties 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

Page 750



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

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

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

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



¹⁶ (1879) 13 Ch D 400

¹⁷ Page 407

¹⁸ (1882) 20 Ch D 151

¹⁹ Page 168

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

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

12

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

19



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

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

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

10 “ ... before the substratum should be found to have been withdrawn, business
11 within the objects of incorporation should have become at least in a practical
12 sense impossible.”²⁷

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



²⁵ [1946] 1 All ER 435

²⁶ (1947) SC 446

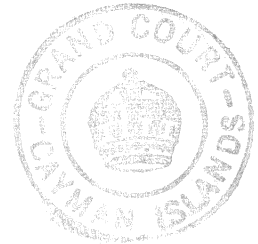
²⁷ Page 456

²⁸ [2010] 1 CILR 83

1 “To translate these statements into a modern context, it can be said that the it is
2 just and equitable to make a winding-up order in respect of an open-ended
3 corporate mutual fund if the circumstances are such that it has become
4 impractical, if not actually impossible, to carry on its investment business in
5 accordance with the reasonable expectations of its participating shareholders,
6 based upon representations contained in its offering document. If such a
7 company, organized as an open-ended mutual fund, has ceased to be viable for
8 whatever reason, the court will draw the inference that it is just and equitable
9 for a winding-up order to be made.”²⁹

10
11 53. It is clear that the analysis of Jones J related specifically to the position of an open-
12 ended corporate mutual fund. He identified what he referred to as “*sound policy*
13 *reasons for making a winding-up order in respect of non-viable mutual funds*”³⁰.

14 54. The test formulated by Jones J has found favour in other Cayman cases.³¹
15 However, elsewhere there has been a different approach. In the British Virgin
16 Islands, in *Aris Multi-Strategy Lending Fund Ltd v Quantek Opportunity Fund*
17 *Ltd*³² an application by a shareholder for the winding up of an open-ended mutual
18 fund on the ground of failure of substratum was rejected by Bannister J. He
19 considered the English authorities and stated the principle underlying those
20 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)

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

8
9 55. In this case Bannister J went on to consider the decisions of Jones J in ***Belmont and***
10 ***Wyser-Pratte***. He noted that the reasoning of Jones J was confined to open-ended
11 investment funds, but in his view there could not be a separate principle applying to
12 a particular type of business.³⁴ He also rejected the concept of "viability" as being
13 too uncertain for determining loss of substratum.³⁵ He preferred to hold to the
14 underlying principle derived from the English authorities to the effect that there will
15 only be a failure of substratum if it is impossible for the business of the company to
16 be carried on.

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

22

³³ Paragraph 28

³⁴ Paragraph 34

³⁵ Paragraph 35

³⁶ [2012] 1 CILR 300



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

7
8 57. Nor it is necessary to make any such choice in the present case. By common
9 consent the Company here is not, and never has been, an open-ended corporate
10 mutual fund, one that issues shares to, and redeems the shares of, investors at any
11 time investing the net investment proceeds in investments for the benefit of
12 shareholders.

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

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

³⁷ Pages 333-334



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

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

³⁸ 4-031

³⁹ [1972] VR 445



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

5 And he added:

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

12
13 62. On the question of whether it is permissible to go beyond the company's
14 memorandum to ascertain the prime or main object, or the general intention and
15 common understanding of members, he referred to cases where regard had been had
16 to a prospectus or circular to shareholders for this purpose but said:

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

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

⁴⁰ Page 468

⁴¹ Page 469

⁴² Page 472

⁴³ [1991] BCC 360



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

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

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



⁴⁴ Westlaw transcript page 17

⁴⁵ Paragraph 37

⁴⁶ Paragraph 12, page 89

1 *ANALYSIS AND FINDINGS*

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

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

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

16 *"Accordingly, the Company has failed in achieving the stated objective of*
17 *realising Class PE assets to pay sums due to shareholders who redeemed from*
18 *the Offshore Fund prior to 31 December 2008, such as the Petitioner, which*
19 *the Company said it would use commercially reasonable efforts to do by 2010.*
20 *Instead much of the cash realised from sale of Class PE assets was converted*
21 *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



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

5
6 69. It is on this footing it is pleaded that the substratum of the Company has failed and
7 that it is just and equitable that it should be wound up.⁵⁰

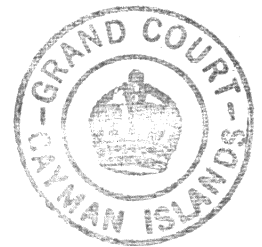
8 70. Mr Lowe, in his submissions on behalf of the Petitioner, has put the case on the
9 basis that it is just and equitable to wind up the Company as it is no longer
10 liquidating what constituted the Private Portfolio at the time it was established and
11 as was promised but is engaging in an entirely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

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

21

⁴⁹ Petition – paragraph 49

⁵⁰ Petition – paragraph 50



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

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

20

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

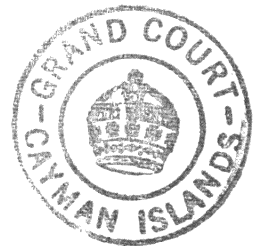
⁵¹ Hladek Third – paragraph 6

1 *Holdings, the sole asset of which is Class PE Shares representing an undivided*
2 *interest in the Private Portfolio held by the Master Fund*".⁵² The purpose of this, it
3 is contended, was to create a system consistent with the division of the shares in the
4 Master Fund into separate classes (as provided for in the Articles of Association of
5 the Master Fund⁵³) which segregated the Class PE shares from other classes of
6 shares and gave investors the assurance of being paid out by reference to particular
7 assets. Thus, it is submitted, that at its core this Company was about liquidating the
8 Private Portfolio and returning the realisations to investors.

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

⁵² Exhibit GS-1 – page 284

⁵³ Exhibit MC-4 – page 17



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

12 76. Mr Cook, one of the directors of the Company, in his Third Affidavit at paragraph
13 10 said as follows:

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

23

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

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

3 *“The Company’s sole contemplated activities were holding shares in the*
4 *Master Fund, distributing proceeds received from the Master Fund in respect*
5 *of those shares upon the realisation of the Master Fund’s underlying assets,*
6 *and handling the normal administration of its accounts and investors.”*⁵⁴

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

9 *“Whilst it is true that the Company’s stated Objects are unrestricted, it is a fact*
10 *that all it actually does is (a) hold shares in the Master Fund which were*
11 *allocable to the Private Portfolio assets and (b) compulsorily redeem the*
12 *shares of the Company. That is all it was ever intended the Company actually*
13 *would do, despite the broad nature of the Objects.”*⁵⁵

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

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

18

19

⁵⁴ Paragraph 10

⁵⁵ Paragraph 8



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

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

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

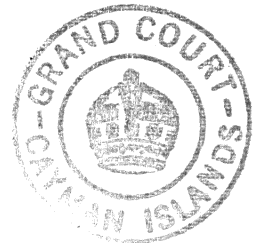
⁵⁶ Paragraph 12



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

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

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



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

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

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

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

21 91. There is also to be taken into account the evidence of the Independent Monitor,
22 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.

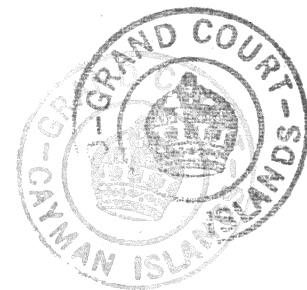
DECISION

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



⁵⁷ Paragraphs 4 and 12