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IN THE GRAND COURT OF THE CAYMAN ISLANDS

IN THE MATTER OF THE COMPANIES LAW (REVISED)

AND

IN THE MATTER OF THE GLOBAL OPPORTUNITY FUND LIMITED

C 564 of 1996

For the Petitioner - Mr. Guy Locke
For the Respondents - Mr. Roger Kaye, QC , Mr. Ross McDonough
For Morgan Stanley (Finance) Jersey Ltd. & Morgan Stanley (Structured Products) Jersey Ltd. - Mr. Neil Timms

REASONS FOR ORDER

This was an amended winding up petition by the Company pursuant to Section 93 (d) of the Companies Law (1995 Revision).

The company was incorporated as a Cayman Islands exempt company on the 18th February 1992 with authorized and issued share capital denominated in several currencies. Each class of participating shares had a priority claim over a specific portfolio of assets, known as a sub-fund.

The assets in each fund were acquired with the proceeds of the subscriptions to the class of shares applicable to the sub-fund concerned. By far the largest of these sub-funds was known as the Hedge Fund.

The company's assets were managed by Inter Capital Asset Management Limited ("ICAM") a company registered in England and Wales pursuant to an investment advisory agreement dated 4th March 1992. ICAM has been placed into compulsory

liquidation and is the subject of investigation by the Investment Management Regulatory Organization ("IMRO").

The custodian and administrative agent (registrar and transfer agent) of the company is Morgan Stanley Bank Luxembourg SA (MSBL). Its auditors are Coopers and Lybrand (Cayman). That is germane to the question of choice of liquidators which is a central issue in this case.

There was an arrangement to allow certain investors ("the Investor Borrowers") to leverage their acquisition of shares in the company. Morgan Stanley International ("MSI") advanced loans for this purpose which were secured by mortgages of the shares acquired and their associated rights and property. In 1994 , another fund, known as the Growth Fund, was established (also as an open ended investment vehicle) governed by Cayman Islands Law to allow investors to leverage their investment into the Hedge Sub-fund. This was achieved by MSI providing loans to the Growth Fund for the purchase of shares by that fund in the Hedge Sub-fund. As security for the loans the Growth Fund pledged its shares to MSI. With effect from 1st February 1994 MSI novated its loan agreements to Morgan Stanley International Limited (MSIL).

In March 1995 the net asset value of the Company was discovered to be substantially less than had been previously believed. MSIL demanded repayment of all loans made to the investor borrowers and the Growth Fund. Following the failure of the investor

borrowers and the Growth Fund to repay the loans MSIL enforced its security over the pledged shares. This resulted in MSIL holding at that time approximately 93% of the issued share capital of the company. The shares were subsequently transferred to nominee companies ("the Jersey Companies"). After the lifting of the suspension of the redemption of the company's shares on 26th May 1995 the company made a pro-rata redemption of shares from the Hedge sub-fund. As a result the Morgan Stanley shareholders' holding in the issued share capital of the company.was reduced

All parties before me agree that the sub-stratum of the Company has gone and that there are matters to be investigated. There is however disagreement as to whether or not the company is or appears to be insolvent and on the choice of liquidators. The question of the company's solvency has bearing in relation to the weight which I should attach to the views of creditors and contributories respectively under Section 104 of the Companies Law. The question of who are creditors entitled to be heard on the hearing of the winding up petition was argued at considerable length before me.

The investors in the various sub-funds, notably the Hedge Fund into which the preponderance of the subscriptions went, have lost a great deal of money. There are grievances set out in an affidavit dated 23rd December 1996 and sworn by Mr. John M. Bates on his own behalf and on behalf of others. These include a number of other members and former members of the Company who claim to be its creditors and, it is to be noted,. a former director and her husband and certain partnerships connected to another former director. These claims are based on an alleged history of incorrect

certification of net asset values, negligence, misrepresentation, breaches of the articles and of contract by the Company. On the 7th March 1995 the Company's then directors resolved to suspend all redemptions from and subscriptions into the company indefinitely, following a significant decline in the valuation of its net asset value. This was caused in part by foreign exchange transactions, and certain warrants held by the company were also found to be over-valued . Following the suspensions, the majority of the company's assets were liquidated and converted into cash and the company has not conducted any business since March 1995.

The IMRO investigation to which I have referred found that a Mr. DeSibert a former director of the company misrepresented the position to the investors, who, it is alleged, purchased shares direct in the company or indirectly through shares in the Growth Fund as a result. The Growth Fund shareholders have purported to rescind their shareholdings and claim proprietary interests in assets in the sub-funds. Those who invested directly into the company have intimated claims against it for breach of contractual duty and misrepresentation.

Proceedings have also been issued against MSBL in the Luxembourg court where a number of investors allege negligence in relation to the company's net asset value.

These matters and others are dealt with in great detail in the affidavits.

The affidavit in support of the winding up petition was sworn by Mr. Stuart Hendel who was appointed as a director of the company on the 11th April 1995. He was one of three new directors appointed on that date following a decision by MSIL to appoint its own directors.

The first of three extraordinary general meetings of the company was held on the 26th February 1996. A special resolution was proposed that the company should be wound up subject to the supervision of the Grand Court and that Ian Wight and Christopher Morris of Deloitte & Touche be appointed liquidators. The minority shareholders who represented slightly more than one-third of those present and voting at the meeting voted against the resolutions which were in consequence rejected. The minority shareholders present were mostly those investor borrowers who continued to hold shares in the company. Those who voted against the resolutions at this first EGM indicated that they did so because they believed that any investigation of the company's affairs would be better carried out by an independent board appointed by the minority who would consult with all the shareholders. The Morgan Stanley shareholders did not support this on the basis that they saw it as a means whereby the minority shareholders and investors could conduct an investigation serving only their own interests. Their view was that a liquidator was in the best position to conduct an objective review.

A further EGM proposed for the 9th July 1996 had to be cancelled for technical and other reasons but in subsequent correspondence it was agreed between the parties that a liquidator should be appointed although the minority shareholders wanted their own

choice of liquidators and confirmation that the company be wound up as insolvent. At a further EGM on the 13th August 1996 a motion proposed by the minority shareholders that the company be wound up as insolvent and that their choice of liquidators be accepted was rejected and ordinary resolutions sanctioning the directors presenting a petition on behalf of the company on the just and equitable ground and for the liquidators favoured by the majority to be appointed was passed. It was on the basis of this authority and under the following principle enunciated by Mr. Justice Brightman in Re Emmadart Limited (1979 1 ALL ER at p. 604) that the winding up petition has been presented -

> "Clearly, the board can cause a peition to be presented in the name of the company if a special resolution has already been passed resolving that the company be wound up by the court, because that is expressly covered by Section 222(a) of the 1948 Act [the equivalent of Section 93(a) of the Law]. The board can also properly act on ordinary resolutions of the shareholders conferring the requisite authority on the board provided that this does not contravene any provision in the articles."

That brief history indicates the remaining issues. All shareholders present and voting at the EGM on 13th August 1996 were in favour of the compulsory winding-up of the company although the two blocks of shareholders disagreed over the company's solvency and the choice of liquidators.

I had no difficulty in the exercise of my discretion in favour of the winding-up of the company on the grounds that it was just and equitable to do so. The company was formed to pursue a business objective which cannot be pursued without further capital which the members will not contribute and at the date of presentation of the winding-up petition there was no reasonable hope that the object of trading at a profit, with a view to which the company was formed, would be attained. Moreover, all parties are

agreed that the substratum of the company is gone and that a full investigation of the company is in the circumstances required. There is not "deadlock" as usually understood in terms of the impossibility of achieving any management decisions or management progress due to an equality of opposing factions but that is neither here nor there. The grounds on which there is consensus are ample to justify a winding-up order on the just and equitable ground. That leaves me with issue of the choice of liquidators. The arguments about that rested heavily on the opposing views as to the solvency or otherwise of the company. The respondents claim to be creditors and say that they can at the very least be regarded as contingent creditors. They also say that their status as members is of relevance. On the basis of their claimed status as creditors they strongly dispute that there is or will be a surplus available for distribution having regard to the creditors' claims. They say that there is no evidence to support the existence of a financial surplus, other than as to the existence of cash balances. They complain that bare denial of their claims is put forward by the petitioners; no accounts, no statement of affairs, nothing beyond a bare assertion of unfounded belief by the Morgan Stanley directors. On the other hand they say that the affidavit sworn by Mr. John Montague Bates on his own behalf and on behalf of a number of other members and former members of the company who also claim to be its creditors sets out in detail why there are claims against the company based on the history of incorrect certification of net asset values, negligence, misrepresentation, breaches of the articles and of contract by the company. I will seek, as briefly as I can, to set out the salient aspects of these claims.

First there is concern over the manner in which the company has been administered both before the events of 1995, (when the Morgan Stanley directors assumed office) as well as after. This includes a particular concern that a schedule claimed by the directors of the company to be an accurate schedule of the Register of Members was inaccurate and unreliable. This matter was gone into at some length in relation to certain amendments to the petition which were not formally opposed by the respondents. I am going to pass over that quite briefly because it bears upon the real issue only to the extent which was expressed on behalf of the respondents in a brief passage in their skeleton argument which read as follows-

> "Whatever, it does not reflect any credit on the Morgan Stanley directors, given the company was aware, as long ago as 10th December 1992 of potential defects in the Register of Members."

I am compelled to agree with that assessment. It is accepted by the majority shareholders of the company, the Jersey companies, that a proper matter for investigation by the liquidators will be the conduct of former directors of the company.

The next matter deponed to by Mr. Bates was the manner in which the respondent investors claimed to be creditors of the company. He refers to the roles of various associated entities of the company and in particular that of ICAM, Morgan Stanley Bank Luxembourg SA, Morgan Stanley International and Morgan Stanley and Co International Ltd. It is entirely believable that the involvement of the Morgan Stanley companies and their supposed standing and reputation was a major factor in

influencing and inducing Mr. Bates and other respondent investors and others to invest in the company.

Moreover, it is common ground that the net asset values of the Hedge Fund were substantially overstated and incorrectly certified. Mr. Bates asserts that this could only have been successfully accomplished by the failure of MSBL as administrative agents and as the entity responsible for the certifying of the net asset values either to identify or correct the inaccuracies and that although MSBL and the directors of the company were responsible for the net asset values from the outset this task was left to ICAM with neither MSBL nor the directors taking any independent steps to verify the figures provided for the benefit of investors. The false statement of the net asset values had a crucial and lasting impact on the investors and led directly to their substantial losses. A very serious allegation made by Mr. Bates is that MSI and MSIL having access to their own more accurate data and information, nevertheless then made margin calls on investors under their loan documentation as well as on the Growth Fund to provide further security. This, he says, resulted in MSIL seizing by way of enforcement of its security the secured shares when the margin calls were not met and using them to appoint its own directors of the company.

These matters and others are hotly disputed. On the basis of their view of them the respondent investors claim to be substantial creditors of the company, in aggregate to the tune of a sum in excess of thirty five million dollars on present estimates. They remain concerned at the attitude of the Morgan Stanley directors to the management of the company and the winding-up petition in particular and point out that they

represent a diverse group of a large number of different investors with divergent claims (as opposed to the single Morgan Stanley block) and contend that it is inappropriate for the Morgan Stanley nominees to be appointed liquidators although they have no reason to doubt their integrity or professional experience.

Re Palmer Marine Surveys Ltd (1986) 1 WLR 573 was a case where shortly after the petitioning creditor had obtained a money judgment against the company the company went into voluntary liquidation and the liquidator was in effect appointed by the sole director of the company and its controlling shareholder. The court was exercising its power to wind up a company which could not pay its debts and under circumstances which were very different from the present case. The case however is of some relevance in the light of the observations of Hoffman J that the court was entitled to have regard to the general principles of fairness and commercial morality underlying insolvency law as applied to companies. In spite of those different circumstances of the case I believe that the following extract from the judgment of Hoffman J, even though it applies specifically to creditors, expresses an important and wider principle. It is this -

> "Disappointed creditors are bound to view with cynicism any investigation undertaken by a liquidator chosen by the very persons whose conduct is under suspicion. There is no criticism in this case of the integrity or competence of Mr. Smith. But the fact that he was chosen by Mr. Davies and that Mr. Davies has gone to great length to maintain him in office is itself enough to

> disqualify him in the eyes of the petitioning and supporting creditors. Although this involves no reflection on Mr. Smith I do not think that the creditors' attitude can be simply rejected as irrational. It is something which the court can take into account."

Earlier in his judgment Hoffman J had said this-

> "Besides counting debts, I think I am also entitled to have regard to the general principles of fairness and commercial reality which underlie the details of the insolvency law as applied to companies."

It seems to me that what I am being asked to do is to extend that principle to a case where the petition for winding-up is being brought by the company itself and the question of whether the company is insolvent at all is a matter for dispute. However, the respondents have more than that to say. They say that an important consideration is the potential claims by the company itself against its former directors and directors of MSBL as well as those against it by former members. Justice, they say, is not seen to be done by the appointment of liquidators at the behest of the major shareholders who (or who are beneficially owned by or associated with companies who) are also intimately concerned in the establishment, administration and collapse of the company. They also complain that the same shareholding companies acquired their majority shareholding simply by exercising the power in their security which they are using not to enforce or realize that security but to attempt to block the creditors' nominees for liquidators being selected. They say that while the petitioners' choice of liquidators may be independent, they should be seen to be independent too. These

are arguments of weight in the light of the principles of fairness enunciated by Hoffman J in Re Palmer Marine Surveys to which I have referred.

As I have said, there are two sets of claims against the company. The first is from shareholders who claim breach of a contractual duty or misrepresentations. The second is from investors in the Growth Fund who allege that the contracts for the purchase of shares in that fund were voidable and that the shareholders can make proprietary tracing claims into the company in relation to sums that represent their investments into the Growth Fund. Section 94 of the Companies Law (1995 Revision) sets out the circumstances in which a company shall be deemed to be unable to pay its debts. One of these is set out in Section 94 (c). It is that it is proved to the satisfaction of the court that the company is unable to pay its debts. That is a residual general category not limited by the special provisions of Section 94 which precede it. Nevertheless, it needs to be interpreted in accordance with precedent and principle. The Companies Law (1995 Revision) reflects the position which obtained in England before the 1907 Companies Act by which it was first provided that in determining whether a company is unable to pay its debts the court shall take into account the contingent and prospective liabilities of the company.

Whatever the merits of the claims, I share the view of the petitioner that these are matters to be dealt with by the liquidators. Only the petitioner and the company are entitled to be heard as of right on the hearing of the petition but in practice the court allows others to address it. I allowed counsel for the investor borrowers to do so. The question of whether they would have had locus standi to present a petition themselves is a different one. All that I need say about that is that they have not done

so. Having heard the respondents, I do not share their views that justice will not be seen to be done by reason of the liquidators, in the circumstances of this case, being those proposed by the petitioners. This liquidation will not be a hole-and-corner affair. The eyes of the international financial community will be upon it. The good name of Morgan Stanley is involved. The petitioners have proposed liquidators of known probity and expertise. Had it been the duty of the court to choose liquidators the result might well have been the same. They will be under a duty to seek the directions of the court from time to time and they have particular experience in liquidation in England,. Luxembourg and the Cayman Islands. This is not a creditors' petition. It will be for the liquidators to decide whether claims admitted in due course make the company insolvent. That is not for me now.

It is for these reasons that I approved the petitioners' choices of liquidators in making the winding up order.

G.E. Harre
Chief Justice

1st August 1997