IN THE GRAND COURT OF THE CAYMAN ISLANDS
HOLDEN AT GEORGE TOWN, GRAND CAYMAN

CAUSE NO. 430 OF 2008

BETWEEN:

RUSSELL ALTERNATIVE INVESTMENT FUNDS PLC

First Plaintiff

RUSSELL ALTERNATIVE STRATEGIES FUND II PLC

Second Plaintiff

RUSSELL DIVERSIFIED ALTERNATIVE FUND – U.S. BENEFIT PLAN LTD.

Third Plaintiff

AND:

LAURUS OFFSHORE FUND, LTD

First Defendant

LAURUS MASTER FUND, LTD

Second Defendant

DAVID GRIN

Third Defendant

EUGENE GRIN

Fourth Defendant

JOHN CLARKE

Fifth Defendant

DOV BABINOVITCH

Sixth Defendant

DAVID SHOHET

Seventh Defendant

Appearances: **Mr. D. Fraser Hughes of Conyers, Dill & Pearman for the Plaintiffs**
Mr. Colin McKie of Maples and Calder for the Defendants

Before: **Hon. Justice Henderson**

Heard: **September 18, 2008**

RULING

The summons before me seeks an *ex parte* injunction restraining the defendants from proceeding with a redemption offer to shareholders and from holding an extraordinary general meeting on September 19th 2008.

The applicants sent notice of the application to the respondents and then, by agreement of the parties, the application was made *inter partes*. It was however a hurried proceeding during which the parties did not necessarily have a full opportunity to develop all of their points.

The underlying action is evidenced only by a general endorsement on a writ of summons. There is as yet no statement of claim. That endorsement asks for a declaration that a redemption offer by the first defendant, Laurus Offshore Fund Ltd (to which I shall refer as the "Feeder Fund") made on the 5th of September 2008 (in what has been referred to as the "Dear investor letter") and any dispositions, redemptions, et cetera arising from that offer are invalid.

Item 5 in the endorsement asks for damages for breach. At that point the request stops. I have been told in argument by Mr. Hughes that should read "damages for breach of contract" and is meant to be a reference to the offering memorandum.

The background is well set out in the first affidavit of Mr. Hershel Victor Leverett. He says that the plaintiffs, the three Russell entities, are Irish and Cayman-based funds. The Russell entities are in the process of conducting an orderly liquidation of their assets, one of which is an investment in the Feeder Fund. The Feeder Fund is a Cayman Islands exempt company.

The second defendant, Laurus Master Fund Ltd., is the Master Fund in the structure and is also a Cayman Islands exempt company. The third and fourth defendants are the managing directors of the Laurus entities and also control the investment manager. The remaining defendants are the other directors.

Russell's current investment in Laurus is roughly US $300 million, which represents approximately 40 percent of the voting shares of the Feeder Fund.

On August 28th, 2008 Russell sent to Laurus a request to redeem all of its unredeemed shares, invoking its rights under the articles of association to do so. By virtue of the redemption provisions in the articles, that redemption day would be fixed at November 30th, 2008. The obligation of Laurus is to pay out within four months thereafter.

In response to this request by its largest shareholder for redemption, Laurus sent a letter to its investors on September 5th, 2008 offering to redeem the shares of any Laurus shareholder, provided only that the total shareholding of that entity, together with its affiliates, is less than $100 million and, secondly, provided that the

shareholder certify that it intends to remain in business for at least five years. I refer to that and the other terms of the "Dear investor letter" as the "redemption offer".

Russell says it is unable to meet either of those criteria and is unaware of any other shareholder in a similar position.

The other investors were urged in correspondence to submit their documents for what was referred to as a “transfer” to the new entity by September 15th, 2008 as part of the redemption plan. This new entity, referred to as the "Harvest Fund", is in the process of being set up by the principals of Laurus.

Mr. Eugene Grin explains in his affidavit the reasons necessitating the redemption plan. He says that the board of directors of the Feeder Fund believe that, without a restructuring of the sort proposed, that fund will not be in a position on 30th November to pay the Russell Fund's redemption in cash in full. He goes on to say in paragraph 9:

> "The offshore fund must before November 30th effect the restructuring or become insolvent".

Indeed, with the Russell Fund's redemption looming, the Feeder Fund is doubtful, in the absence of the implementation of the restructuring plan set out in the Dear Investor letter, that it will be in a position to pay redemptions otherwise due on 30th September 2008.

There is further explanation in the Dear Investor letter itself. The letter reads in part:

> "We understand that an unfortunate development involving the offshore fund's largest investor group has occurred. This investor group incurred substantial redemption requests from their own investors leading it to a wind down of its operations. Subsequently, the investor groups submitted redemption requests on August 28th 2008 to redeem, in full, their interests, which constitute approximately 45 percent of the assets under management of the offshore fund as of the date of this letter. This is, of course, entirely outside the control of Laurus."

Later, the letter asserts that the directors have concluded that the funds would be best served by placing the funds into voluntary liquidation in accordance with the relevant principles of Cayman Islands law which govern the fund. It is proposed that Messrs. David Grin and Eugene Grin, the third and fourth defendants, be appointed as joint voluntary liquidators. Later still, the letter says the fund assets will be liquidated with the intention of making cash distributions to investors on a pro rata basis as assets are realised. Mr. Eugene Grin's affidavit also asserts unequivocally that the distribution is to be a cash distribution.

The proposal itself is addressed in these terms in the letter:

> As an additional measure to create investment options for our investors which preserve and maintain the integrity and the potential to continue an uninterrupted harvesting of the equity upside of their current fund investment, the LV Portfolio Harvest Funds have been established for the purposes of receiving transfers by offshore fund investors and will, prior to the approval of the liquidation process, accept subscriptions from current fund investors

> in accordance with the terms and conditions of the applicable offering documentation including those terms and conditions set forth on Exhibit 2.
>
> The Portfolio Harvest Fund will allow investors to participate in the pro rata distributions of the fund's equity harvest while enjoying reduced fees and receiving a monthly NAV. It is intended that the Portfolio Harvest Fund's assets will be distributed to investors on a pro rata basis as such cash becomes available. Dates for the distribution of available capital have not been determined and disbursements of the available capital will be made at the discretion of the investment manager of the Portfolio Harvest Fund."

Appended to that as Exhibit 2 was a document entitled "Additional Portfolio Harvest Fund Investor Qualification Criteria" which set out the two limiting factors to which I have referred earlier.

Mr. Grin observes in paragraph 10 of his affidavit that all of the Feeder Fund's assets are comprised of its shareholding in the Master Fund. The Master Fund's assets are made up of highly illiquid interests in small micro-cap and/or private companies in the manner of private equity investments.

He explains at paragraph 16 and following that the Feeder Fund proposes to transfer to the Harvest Fund the pro rata part of its assets and liabilities in such a way as to make no difference to the value of the assets transferred or remaining in the Master Fund. He says each and every security, investment balance and liability in the Master Fund, regardless of its size, is capable of being divided and transferred in the same

proportion as, and corresponding to, each shareholder of the Feeder Fund's proportionate share of the offshore fund's investment in the Master Fund.

> "Contrary to what Mr. Leverett states in his first affidavit at paragraph 15B, the offer made to shareholders in the investor letter and transfers of assets pursuant to the form of MSNA – [a reference to a netting agreement] -- will in no way result in the assets remaining in the Master Fund being less liquid or different in nature to those that exist in the Master Fund at the present time, nor will those assets remaining in the Master Fund have an intrinsically lower value than those corresponding assets that have been transferred if such assets remain under management by Laurus."

In paragraph 23 he asserts that:

> "No cash is being paid away by the offshore fund to the Harvest Fund or any other fund. All cash currently available to the offshore fund is to be applied to pay the outstanding redemption requests outlined above".

In the early part of his affidavit he referred to several now outstanding redemption requests.

The articles of association of the Feeder Fund at article 28 and following deal with the redemption of common shares by investors. Article 28(b) provides that a redemption request must be referable to a redemption day which is at least 90 days after the request is received by the company. Article 29 contains in sub items (a) and (b) a power in the directors to abridge the 90 day period. Article 29(a) permits the directors

"in their sole discretion" to compulsorily redeem all or any part of a member's holding of common shares on not less than 20 days' notice.

Pursuant to article 30(b), a redemption price will generally be paid in dollars by cheque or by telegraphic transfer over a period not to exceed four months from the redemption date.

Article 29(b) permits the directors in their sole discretion to redeem an investor's shares on not less than five days' notice "because the continued participation of the member in the company might cause the company to violate any law".

Finally, there is a power in article 28(a) granted to the directors to waive any redemption condition "either generally or in any particular case."

The first question I must ask is whether there is a serious question to be tried. The endorsement on the writ is sufficiently terse that this is not a particularly easy question. I start by referring to some basic principles of company law.

First, the articles of association constitute a contract to which all of the members of the company and the company itself must adhere. Second, the Court may restrain a company and its directors from acting in a way which violates the articles. Third, shareholders of the same class are entitled to equal treatment.

These articles contemplate that most redemptions must be initiated by a redemption request at least 90 days prior to the redemption day. Article 28(a), however, does

permit the directors to waive that condition generally. They appear to have done so. However, the effect of the waiver has much different consequences for the Russell plaintiffs than for the other investors. Unlike all other investors, these plaintiffs are prohibited from transferring their investment to the Harvest Fund. Eugene Grin says the Russell Group is "just too big".

That prohibition on investing in the Harvest Fund has not come about by accident. Those who control the investment manager, the Feeder Fund and the Master Fund have set up the Harvest Fund and created the limitations in question. The general waiver of the redemption rules is part of a restructuring scheme which, because of the limitations imposed upon Harvest Fund investments, results in unequal treatment of the investor shareholders. They are members of the same class but (at least arguably) are being treated unequally. Ultimately, the explanation given by Mr. Grin in his affidavit that the degree of liquidity of the investments will in effect be apportioned pro rata between the Harvest Fund and the Feeder Fund may prevail, but an assessment of that defence must await a trial. I am satisfied on the balance of probabilities that the apparent inequality does raise a serious question to be tried.

I also consider there to be a serious question to be tried in relation to the requirement in the articles that redemptions be in cash. At least arguably, in effect and in substance, these proposed redemptions are in specie.

I turn to the balance of convenience.

Neither counsel really addressed this issue in any but the most cursory of terms due to the limited time available. If damages would be an adequate remedy, and if the respondents would be in a position to pay them, the injunction must be refused.

The intention of the respondents is to transfer as much of the assets as possible over to the Harvest Fund and then liquidate the company. That intention is enough to demonstrate a reasonable prospect that damages would not be an adequate remedy, which in turn tips the balance of convenience in favour of these plaintiffs. I also note that granting the injunction would serve to maintain the status quo, which is an element favouring these plaintiffs.

For these reasons, I will grant an injunction restraining the defendants from proceeding with the redemption plan described in the letter of September 5th, 2008.

The second affidavit of Mr. Leverett contains an adequate undertaking as to damages. However, and notwithstanding their $300 million investment in the Feeder Fund, there is doubt about the continuing ability of the plaintiffs to satisfy that undertaking. I order the plaintiffs to file their most recent audited financial statements within seven days and I grant to each respondent liberty to apply for a review of this order at that time. In addition, the plaintiffs are to file a statement of claim within 12 days.

I have not overlooked the argument that the redemption plan is really an unauthorised merger or consolidation, but I find no merit in that proposition.

I will not restrain the company from holding an EGM on September 19th, as the

respondents say that the plaintiffs can exercise their voting rights in such a way as to control the outcome. The request for that injunction is therefore entirely unnecessary.

Dated this 18th day of September, 2008

Henderson, J.
Judge of the Grand Court