

IN THE GRAND COURT OF THE CAYMAN ISLANDS
(FINANCIAL SERVICES DIVISION)

IN THE MATTER OF THE COMPANIES LAW (2009 REVISION)

AND IN THE MATTER OF THE EXEMPTED LIMITED PARTNERSHIP LAW (2007
REVISION) AS AMENDED BY THE EXEMPTED LIMITED PARTNERSHIP (AMENDMENT)
LAW 2009

AND IN THE MATTER OF CAPSTONE CAYMAN SPECIAL PURPOSE FUND LP

PETITION

TO: The Grand Court of the Cayman Islands

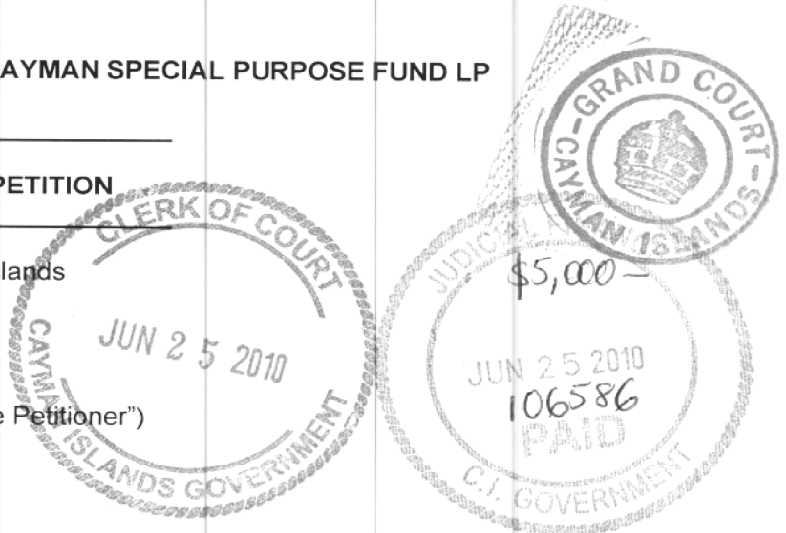
THE HUMBLE PETITION of:

Fortis (Isle of Man) Nominees Limited ("the Petitioner")

shows that:

A Summary

- 1 The Petitioner seeks, in its capacity as both a limited partner and a creditor, an order under s. 92(c), (d) and (e) of the Companies Law that Capstone Cayman Special Purpose Fund LP ("the Partnership") be wound up.
- 2 The grounds for this Petition, which are set out in detail in this Petition, can be summarised briefly as follows:
 - (a) The Partnership is Unable to Pay Its Debts
 - (i) The Petitioner has submitted a valid request for withdrawal and the Permitted Withdrawal Date (as defined in the Partnership's Limited Partnership Agreement) has passed and the Petitioner remains unpaid.
 - (ii) The general partner of the Partnership has confirmed that the amount due to creditors exceeds the value of the assets of the Partnership.



- (iii) The general partner of the Partnership has admitted the Petitioner is a creditor whose payment is due, but has invalidly suspended payment of withdrawals.
 - (iv) Whilst payment of withdrawals are purportedly suspended, the Partnership has attempted to make payments in specie to both creditors and unredeemed limited partners comprising of shares which are illiquid with unascertained value.
 - (v) The general partner of the Partnership has stated that the Partnership has divested itself of its assets to a third party and therefore may currently have no assets.
- (b) The substratum of the Partnership has been lost
- (i) In contravention of the purpose and investment strategy of the Partnership, and contrary to specific and express representations made by the general partner of the Partnership, and without disclosing the change in strategy, or seeking the consent of limited partners, the Partnership has invested approximately 40% of its assets in second tier loans to real estate developments.
 - (ii) The Partnership has announced an intention to restructure and wind down over a 2-3 year period.
- (c) There is a justifiable loss of confidence in the management of the Partnership
- (i) The general partner of the Partnership used the Partnership's assets to invest in real estate (and at the peak of the real estate market) despite the fact that the Partnership Agreement and offering documentation for the Partnership contained no mention of investment in real estate.
 - (ii) The investment in real estate was made despite express representations made by the general partner of the Partnership that the Partnership's assets would not be used for real estate investment.
 - (iii) Once it was disclosed that the Partnership's assets were being used to invest in real estate, the general partner of the Partnership

misrepresented to limited partners the proportion of assets under management being invested in real estate.

- (iv) Many of the real estate investments, which were undisclosed to investors, have now been written off.
- (v) The individuals who manage the affairs of the Partnership have direct or indirect conflicts of interest arising out of personal interests in, or liability in respect of, the real estate transactions.

(d) There is a need for an investigation into the restructuring transactions and the affairs of the Partnership

- (i) The restructuring is potentially ultra vires and ought to be investigated by an independent liquidator. It involves the cancellation of the secured creditor position held by the Partnership, and the conversion of limited partners and creditors of the Partnership into unsecured members of a US public holding company. The restructuring appears to be costly, yet affords no apparent benefit to the limited partners of the Partnership, and is detrimental to the interests of creditors, whilst providing the general partner of the Partnership with significant management fees.
- (ii) Insufficient information has been provided to creditors, and accordingly the Petitioner is unable to know whether the purported payment in kind of shares in the US holding company constitutes a valid discharge of its debt.
- (iii) In the event that the Partnership is insolvent and has divested itself of its assets, an investigation is required into the circumstances surrounding the Partnership's divestment of assets and insolvency.

(e) The general partner of the Partnership has stated that all the assets of the Partnership have been disposed of to a third party. In accordance with Section 13.01(d) of the Limited Partnership Agreement, upon the occurrence of such an event the Partnership shall be dissolved.

B The Partnership

- 3 The Partnership was formed on 10 June 2004, and registered on 17 June 2004, as a limited partnership pursuant to the Exempted Limited Partnership Law (2003 Revision).
- 4 The Partnership was registered under section 4(3) of the Mutual Funds Law (as Revised) in September 2006.
- 5 The Registered Office of the Partnership is at Caledonian Fund Services Limited PO Box 1043 GT, George Town, Grand Cayman.
- 6 The general partner of the Partnership is Capstone Capital Management Inc (“the GP”), a Delaware corporation registered as a foreign company in the Cayman Islands.
- 7 The Partnership was marketed as employing an asset based lending (“ABL”) and trade finance strategy. Consistent with this, the stated principal purpose of the Partnership is to make senior subordinated loans on a fully collateralised basis to Capstone Capital Group I LLC (“Capstone Capital”), Capstone Business Credit LLC (“Capstone Credit”) and Capstone Trade Partners Ltd (“Capstone Trade”) (together “the Capstone Operating Entities”). The Partnership invests in promissory notes issued by the Capstone Operating Entities. The Capstone Operating Entities pay a fixed annual return of 12% to the Partnership. The proceeds of the promissory notes are used by the Capstone Operating Entities to execute the strategy of making collateralised loans to small to medium sized businesses.
- 8 The Partnership shares in its participation in lending to the Capstone Operating Entities with an affiliate onshore partnership, Capstone Special Purpose Fund LP, a Delaware limited partnership (the “Onshore Partnership”). From the 2008 financial statements provided in respect of both the Partnership and Onshore Partnership, it appears that the lending to the Capstone Operating Entities is divided in the following proportions: 75% provided by the limited partners in the Partnership and 25% provided by the limited partners in the Onshore Partnership. The Petitioner understands that the portfolio of the Partnership and the Onshore Partnership is identical and that the capital contributed by limited partners of both partnerships was consolidated by the GP in terms of managing the assets and lending to the Capstone Operating Entities. Therefore, references in this Petition to the assets under

management ("AUM") are references to the total assets of both partnerships, and any valuations are subject to apportionment in accordance with the respective proportion of the partnerships' lending to the Capstone Operating Entities.

9 According to the latest Financial Statements for the Partnership for the year ended 31 December 2008, the total amount of the capital accounts of the limited partners of the Partnership as at 31 December 2008 was \$262,304,322.

10 The Management Committee of the Capstone Operating Entities was at all material times made up of the directors and owners of the GP, namely Mr Joseph Ingrassia ("Mr. Ingrassia"), Mr John Rice ("Mr. Rice") and Mr John Beasty ("Mr. Beasty"). These individuals were also the owners of the Capstone Operating Entities. The GP is also General Partner of the Onshore Partnership.

C The Petitioner

11 Fortis Custodial Services (IOM) Limited ("FCS") acts as custodian on behalf of Eden Rock Finance Fund LP ("ERFF"), Eden Rock Asset Based Lending Master Ltd ("ERABL") and Eden Rock Unleveraged Finance Master Ltd ("ERUM"). The Petitioner is nominee for FCS, and as such is the registered limited partner in the Partnership, on behalf of ERABL and ERUM, and is the registered limited partner in the Onshore Partnership, on behalf of ERFF.

12 Eden Rock Capital Management LLP ("ERCM") acts as investment adviser to a number of funds, including ERABL, ERUM and ERFF (collectively "the Eden Rock Funds") all of which invested in the Partnership or the Onshore Partnership, and ERCM acted as agent for the Eden Rock Funds in respect of their investments through FCS and the Petitioner in the Partnership and in the Onshore Partnership.

13 This Petition is presented by the Petitioner in respect of ERUM's investment in the Partnership, but the Petitioner understands that each of the Eden Rock Funds and their respective nominees support this Petition.

14 The Petitioner first invested in the Onshore Partnership on behalf of ERFF in July 2004. On 1 March 2007 the Petitioner, on behalf of ERUM, subscribed for a \$3,000,000 interest in the Partnership. Two further subscriptions of \$1,000,000 each were made by the Petitioner on behalf of ERUM on 1 April 2007 and 1 July 2007 respectively.

15 ERUM relied upon the contents of the confidential private placement memorandum dated 19 September 2006 for the sale of limited partnership interests in the Partnership (“the CPPM”) and ERCM’s due diligence enquiries in making its investment, through the Petitioner, in the Partnership.

D The Offering

16 Pursuant to the CPPM, and consistent with the marketing associated with the sale of limited partnership interests, the Partnership was to specialise in secured short-term investments, through the Capstone Operating Companies, in pre-sold finished goods and products of small to medium sized companies. The ABL and trade finance investment strategy described in the CPPM to potential investors was that the Partnership would provide factoring and inventory finance to middle market businesses.

17 A marketing presentation dated 20 January 2004 stated that the criteria to be employed for the Partnership’s investment were as follows: all transactions would be “*secured, profitable and payable in 90 to 120 days*” and would be in relation to “*pre-sold finished commercial or consumer goods*”, lending to entities which have “*experienced management*”, “*sound inventory control procedures*”, “*strong sales potential*” and “*excellent growth prospects*”.

18 Pursuant to the CPPM, the Capstone Operating Entities were to use a comprehensive due diligence process to ascertain the client’s suitability for funding, and the Capstone Operating Entities would only undertake investments that met full collateral requirements. The CPPM further provided that when using debt instruments, the Capstone Operating Entities would secure themselves against the assets of the borrowing company, and take personal guarantees and third party collateral.

19 The CPPM stated:

- (a) The Partnership was formed, inter alia to “*provide a reasonably protective environment for the Limited Partnership to make loans to the Capstone Entities who will invest in transactions provided the investment can meet the criteria of capital preservation and steady annual base rate of return.*” (page i of the CPPM)

- (b) *“Each Limited Partner will receive: (i) annual audited financial statements of the Partnership (ii) a monthly portfolio report from the General Partner indicating the value of the loans outstanding by portfolio company and its concentration to the portfolio.”* (page 5 of the CPPM)
- (c) *“The Partnership’s principal purpose will be to make capital disbursements yielding interest return of 12% per annum, payable monthly in arrears, to the Partnership. The loans will be senior secured subordinated debt loans to one or more of the Capstone Entities....”* (page 1 of the CPPM)
- (d) *“The program is based on a Capstone Entity making cash advances, loans, trade financing arrangements, equity participation bridge loans, and asset backed bridge investments to emerging or growth companies, partnerships or ventures that meet the underwriting guidelines of the particular Capstone Entity managing a given transaction”* (page 12 of the CPPM).
- 20 The Capstone Operating Entities were described as affiliates of Capstone & Company LLC, a Delaware company established as a merchant banking financing and international trading company engaged in cash advances, factoring, inventory finance and trade financing.
- 21 Capstone Capital was said to be an *“investment vehicle funding trading activities”* (page 14 of the CPPM) which *“issues payment instruments to various manufacturers on a global basis in exchange for the promise of the delivery of pre-sold merchandise.”*
- 22 Capstone Credit’s purpose was said to be *“to purchase accounts receivable from Capstone Capital thus creating liquidity for Capstone Capital.”* (page 14 of the CPPM)
- 23 Capstone Trade was said to be *“engaged in international merchandise trading through the direct purchase and re-sale of products from various foreign suppliers.”* (page 15 of the CPPM).
- 24 The CPPM further stated (page 24 of the CPPM): *“The General Partner is accountable to the Limited Partners as a fiduciary, and consequently must exercise the utmost good faith and integrity in handling Partnership affairs.”*

E The Petitioner's investment

25 The Petitioner subscribed on the basis and understanding that the Partnership would adhere to the investment strategy set out in the offering documentation, and the Petitioner did not at any time consent to any divergence from such strategy.

26 On 27 July 2006, prior to the Petitioner's subscription on behalf of ERUM, a meeting was held between ERCM and the GP to discuss the Partnership and its structure and in order for ERCM to get an update on the GP's business. In a note of that meeting prepared by Michael Staveley of ERCM, it is noted that "*the manager seems very experienced in this business*" which, consistent with the CPPM, is described as the provision of "*working capital to small businesses secured on trade merchandise or receivables.*" The note also records "[the GP] *appear[s] to be very hard on clients who step out of line and [has] the resources and contacts necessary to foreclose and liquidate collateral effectively.*" As evidenced by this note ERCM was attracted to the Partnership due to the GP's experience in the type of lending set out in the CPPM – ie lending working capital to small businesses secured on trade merchandise, and because the GP had the ability and means to enforce security when necessary.

27 At that meeting the launch by the GP of a proposed separate commercial real estate fund as a joint venture with certain individuals was mentioned.

28 The Eden Rock Funds had no interest in investing in the separate real estate fund that the GP was establishing, and the note prepared by Mr Staveley records "*The new property business may be a concern as [the GP] may become distracted. The existing business draws heavily on the managers time and requires a lot of hand holding to ensure everything runs smoothly.*" During that meeting Mr Staveley sought the GP's assurance that the Partnership's assets would not be used to seed the real estate fund, and that real estate positions would not be acquired by the Partnership. The GP provided an express assurance that the Partnership's assets would be kept wholly separate to the real estate fund, and that the Partnership's funds would not be used to invest in real estate.

29 As stated above, at paragraph 14, between March and July 2007 the Petitioner on behalf of ERUM subscribed for a total of \$5,000,000 interest in the Partnership and also entered into a Limited Partnership Agreement with the GP.

F The Limited Partnership Agreement

30 The Limited Partnership Agreement of the Partnership dated 28 February 2007 (“the LPA”) inter alia, provides as follows:

(a) *“The principal purpose of the Partnership is to make senior subordinated loans on a fully collateralized basis to [the Capstone Operating Entities] and to provide the Limited Partners with a return. The Partnership may also trade with and invest in businesses and securities of all kinds and descriptions, including, but not limited to, equity, debt, convertible securities, preferred stock options, warrants and monetary instruments, all as determined by the General Partner provided the investments meet the criteria of collateralization and rate of return target.”* (section 1.03)

(b) *“The General Partner shall not authorize the transfer of any Limited Partner’s interest in the Partnership ... if the result of the said transfer will be a sale or exchange of more than .. 50% .. of the Partnership Interests within a .. 12 .. month period or if it would otherwise materially affect the income benefits anticipated by the Limited Partners.*

The General Partner shall not do any act, whether of omission or commission, that would make it impossible to carry on the normal business of the Partnership (other than a sale at arm’s length of all or any portion of the Partnership’s assets to which the Limited Partners hereby consent).” (section 3.05)

(c) *“At all times during the existence of the Partnership, the General Partner shall keep full and true books of account on the accrual basis, in which shall be entered fully and accurately each transaction of the Partnership.”* (section 3.07)

(d) *“Each Limited Partner shall have the... right to receive on demand true and full information regarding all transactions and circumstances affecting the Partnership, and a formal account of the Partnership’s affairs whenever circumstances render it just and reasonable.”* (section 5.04)

(e) *“Distributions of cash or property to the Limited Partners are to be made at times and in amounts determined by the General Partner. The General*

Partner will distribute to the Limited Partners a base return of 1/12 of the annual base return (12%) on the last day of every month starting one month after the Limited Partner had made his investment into the Partnership. To the extent the General Partner makes distributions, such distributions shall be made in proportion to the Limited Partners Percentage Interests.” (Section 7.01)

(f) *“A Limited Partner may withdraw all or any part of such Limited Partner’s Capital Account (as defined below) in the manner and to the extent provided in Section 7.03” (Section 7.02).*

(g) *“Withdrawal Procedure Except with the consent of the General Partner, which may be withheld in its sole discretion, Limited Partners may be permitted to withdraw from the Partnership at any time with one hundred and twenty days prior written notice to the Partnership (the “Permitted Withdrawal Date”). ...*

...After the Permitted Withdrawal Date, subject to certain restrictions, Limited Partners may withdraw all or part of their Interests as of the end of any fiscal quarter... The Partnership will, as soon as possible, pay the value of any Partnership Interest¹ withdrawn (determined as of the fiscal quarter end). If practicable, in cases where liquidation of a Partnership position (or a portion thereof) cannot be timely made or would, in the opinion of the General Partner, result in a disadvantageous return or an excessive discount, the Partnership may distribute securities or other property to the withdrawing Limited Partner in lieu of cash for all or a portion of the Interest to be withdrawn. In view of the anticipated non-liquidity of certain of the Partnership’s investments, the right of withdrawal may be suspended by the General Partner as to all or any portion of the Interest to be withdrawn, to the extent and for so long as is deemed necessary by the General Partner to safeguard the best interests of the non-withdrawing Limited Partners...

The Partnership has the right to pay cash or securities, or both, to a Limited Partner that makes a withdrawal from such Limited Partner’s capital account” (Section 7.03)

¹ Partnership Interest is defined as a “Limited Partner’s interest in the Partnership” (section 3.05)

- (h) *“A Limited Partner who is withdrawing capital from the Partnership shall, as soon as possible, be paid the value of any Partnership Interest withdrawn (determined as of the fiscal quarter end)....” (Section 7.03(a))*
- (i) *“Payment of Withdrawals The Partnership may extend the payment of any withdrawals from Capital Accounts (a) when circumstances exist as a result of which in the opinion of the General Partner it is not reasonably practicable for the Partnership to dispose of investments or as a result of which any such disposal would be materially prejudicial to Partners; (b) when a breakdown occurs in any of the means normally employed in ascertaining the value of investments or when for any other reason the value of any of the investments or other assets cannot reasonably or fairly be ascertained; or (c) during which the Partnership is unable to repatriate funds required for the purpose of making payments due on withdrawals or during which any transfer of funds involved in the realisation or acquisition of investments or payments due on withdrawals cannot in the opinion of the General Partner be effected at normal rates of exchange. The General Partner has the right to determine on any Withdrawal Date that the Partnership shall not permit withdrawals of more than twenty-five percent (25%) of the Partnership’s Net Worth as of such Withdrawal Date. Withdrawals may be accordingly reduced or deferred.” (section 7.04)*
- (j) *“The General Partner may admit, as of the first day of any Fiscal Period, or at any other time that the General Partner determines, as additional Limited Partners...persons who contribute cash and / or securities...for Partnership Interests (“Capital Contributions”)...” (Section 8.01)*
- (k) *“A Limited Partner’s Capital Account as of a particular date shall consist of the following:*
- An amount equal to the Limited Partner’s Original Capital Contribution²;*
- The increase if any, to such account by reason of Additional Capital Contributions;*

² Defined as the amount of the Capital Contribution contributed by the Limited Partner upon such limited Partner’s admission as a Limited Partner (section 9.02)

The decrease, if any, to such account by reason of withdrawals or distributions from such Capital Account; and

The increase or decrease, if any, to such account in accordance with the provisions of section 9.06 below” (Section 9.01)

- (l) *“The net worth of the Partnership (“Net Worth”) shall be determined on the accrual basis of accounting in accordance with generally accepted accounting principles consistently applied....securities and instruments...shall be valued at their last sales prices...all other assets of the Partnership shall be valued in the manner determined by the General Partner to reflect their market value...there shall be deducted the Management Fee, estimated expenses for accounting, legal, administrative, custodial and other operating expenses and such reserves for contingent liabilities...” (Section 9.05)*
- (m) *“Taxable income, losses and deductions of the Partnership for each year shall accrue to, and be borne by, the parties in proportion to their Capital Accounts, the allocations of various types of taxable income and losses likewise being as nearly as possible proportionate. The accountants will review for the Limited Partnership the allocations and apportionments as may be appropriate with respect to Partners who are admitted to, or who withdraw from the Partnership...All matters concerning the allocation of profits, gains and losses among the parties (including the taxes thereon) and accounting procedures not expressly provided for by the terms of this Agreement shall be determined by the General Partner in consultation with the accountants for the Partnership, and the General Partner’s determination shall be final and conclusive as to all of the parties.” (Section 9.06)*
- (n) *“The Partnership shall be dissolved upon the earliest to occur of: .. (d) The distribution, pursuant to this Agreement, of the proceeds of the sale, exchange or other distribution of all or substantially all of the assets of the Partnership”. (section 13.01)*

31 Accordingly, the Petitioner was entitled to a base return of 1% per month on its original capital contribution, and to a proportionate share in the gains and losses of the Partnership. The Petitioner was entitled to withdraw the value of its

partnership share on 120 days notice and be paid that value as soon as possible, either in cash or the equivalent.

G The Fiduciary and other Duties of the GP

32 The GP owed the following duties (“the GP duties”) in its direction and control of the affairs of the Partnership and in its management of its underlying investments:

- (a) to act with the utmost good faith and integrity;
- (b) to act in the best interests of the Partnership;
- (c) to exercise reasonable care;
- (d) to exercise its powers for proper purposes;
- (e) not to put itself and those connected with it, in particular its principals, namely Mr. Rice and Mr. Ingrassia, in a position of conflict between their personal interests and their duties with regard to the Partnership without the approval of the Limited Partners upon prompt full and frank disclosure to them;
- (f) to ensure that the terms of the LPA were observed in full, including, in particular, the keeping of proper and accurate records of transactions affecting the Partnership’s underlying investments and the prompt provision to limited partners on demand of a full, accurate and up-to-date account of the status and value of those investments.

H Wrongful, unauthorised and undisclosed investments in real estate and non-disclosure

33 Contrary to the above-mentioned representations and promises made to the Petitioner, to the effect that the Partnership funds would be invested in accordance with the factoring and inventory ABL / trade finance strategy (“the Strategy”) and not in real estate, and/or in breach of the GP Duties, the GP wrongfully and without authority procured and permitted Partnership funds to be invested in and committed to real estate and failed to disclose the said real estate investments to the Petitioner, and it is to be inferred to the other limited partners, promptly and fully. Particulars are given as follows.

- 34 On a date prior to December 2007, Mr Rice and Mr Ingrassia incorporated an entity called Capstone Realty Investment Partner Limited Partnership ("RIP") (which is described in the 2008 Accounts for Capstone Capital and Capstone Credit as having common ownership with Capstone Capital and Capstone Credit) for the purpose of financing commercial real estate bridge loans. Without consultation with the Petitioner and, it is to be inferred, the other limited partners, and without the consent of the Petitioner and the limited partners of the Partnership, RIP was funded by loans from Capstone Credit and therefore with the assets of the Partnership (and the Onshore Partnership).
- 35 The lending to RIP involved Mr Rice and Mr Ingrassia procuring the lending of assets from an entity controlled by them (the Partnership) to an entity controlled and owned by them (Capstone Credit) which in turn lent to another entity controlled and owned by them (RIP), in order to fund real estate projects which were outside the investment strategy and objectives of the Partnership.
- 36 Unbeknownst to the Petitioner, and therefore, it is to be inferred, to other investors, in April to June 2007 RIP and Capstone Credit made use of the Partnership's funds to finance, inter alia, two large real estate projects:
- (a) 158 Madison Avenue - a loan of \$39.3m (which alone comprised 14.85% of the combined assets of the partnerships) made in April 2007. An email from Mr Rice dated 11 June 2008 ("the 11 June 2008 Email") revealed that the exposure on this loan as at 30 April 2008 was \$38,000,000 and that it was subordinate to a senior loan of \$34m. It appears from the documents publicly available that this property is owned by an entity controlled by the GP, 158 Madison Ave Associates LLC ("158 Madison LLC"), of which Mr Rice of the GP is described as the Managing Member. Mr Rice is signatory to the mortgage documentation, between 158 Madison LLC and Capstone Credit, on behalf of both parties. The senior lender on the property is North Hill Funding of New York LLC ("North Hill"). Capstone Credit entered into an agreement on 30 April 2009 ("the 30 April 2009 Agreement") to secure the lending by North Hill by the provision of personal and corporate guarantees to North Hill, and, according to press reports, North Hill has now issued proceedings in New York against the guarantors, Capstone Credit, Capstone Capital, Mr Rice, Mr Ingrassia and two others, in respect to the default on the loan of 34m.

(b) 18 East 68th Street - a loan of \$19.5m (which alone comprised 6.6% of the combined assets of the partnerships) made in May 2007. Following a refinancing in October 2007, the Partnership's lending was subordinated to a senior loan of \$25m from a third party and according to the 11 June 2008 Email the total exposure as of 30 April 2008 was \$12,213,269. This property is owned by an entity controlled by the GP, 18 E68 Owner LLC. It appears from press reports that pre-foreclosure proceedings have been commenced against the holding entity. It is also apparent from the 30 April 2009 Agreement entered into between North Hill and Capstone Credit, that the latter has now assigned its interest in this property to North Hill in order to secure the \$34m loan from North Hill to Capstone Credit in respect of 158 Madison Avenue.

37 Therefore, by June 2007, over 20% of the Partnerships' funds were invested in commercial real estate developments which are now both in default and the subject of proceedings. According to the portfolio summary reports produced by the Partnership ("PSRs"), by January 2009 over \$137m was invested in real estate developments (31% of the AUM). By September 2009 the proportion of the AUM invested in real estate transactions had increased to 37%.

38 The real estate transactions entered into by the Capstone Operating Entities related to bridge loans to finance developments such as the acquisition of land for construction or existing buildings for conversion. These projects required expertise and skills quite different from those required for the Strategy and involved risks which are wholly different from those present in the Strategy:

(a) Security - the investments in the real estate projects are secured by illiquid and 'in-progress' assets, the value of which are potentially volatile and dependent on the progress of the project and market conditions, as well as being contingent upon the actions of the senior lenders. It is possible that the senior lender may choose to enforce their interests by effecting a quick sale for a lower price, which would have the effect of impairing any second lender's security. In contrast, the security for the factoring and trade finance consists of receivables and inventory, assets which have a readily ascertainable value based on invoices and purchase orders, and which are easily enforced against, of which the Petitioner understood the security protecting its investment would consist.

- (b) Rate of Return - the LPA provides for a monthly fixed return of 1%. Based on the Partnership's stated investment parameters (in senior secured loans collateralised by receivables and inventory), this rate of return is proportionate to the risks involved. However, for investment in commercial real estate, where the risks to which investors are exposed are considerably greater, a 1% rate of return would be considered disproportionately low, as it fails to compensate for the exposure to subordinated debt, illiquidity, high loan to value ratios and relatively high execution risk.
- (c) Seniority - A number of the investments have been written off due to foreclosure by the first lien lender.
- (d) Expertise - Mr Ingrassia and Mr Rice's field of expertise, as represented to the Petitioner and other investors, lay in trade finance / asset based finance, not real estate. It now appears that the Partnership made significant investments at the peak of performance of the commercial real estate development market, in early to mid 2007, and this in itself highlights the lack of experience and knowledge of the market on the part of the GP.

39 The Petitioner and, it is to be inferred, other limited partners in the Partnership, were not made aware of the risks associated with the types of investments entered into and did not consent to exposure to such a significant portion of real estate positions.

40 The GP undertook to provide current monthly portfolio information for the Partnership to the Petitioner from the books and records of the Partnership. In fact, the PSRs were not produced monthly, and for those months for which a PSR was prepared, the PSRs were disclosed several months after the time period covered by the reports. Therefore investors were not given an accurate and timely report of the portfolio:

- (a) The March 2007 PSR was provided on 21 August 2007
- (b) The June 2007 PSR was provided on 9 November 2007 (notwithstanding that the "report date" was 15 July 2007, suggesting that it had been prepared well before it was finally produced). This omitted several loans which had been made in respect of real estate developments (see further below).
- (c) The September 2007 PSR (dated 15 October 2007) was provided on 6 February 2008. Without explanation this report and all subsequent reports,

until 2009, removed all the names of the underlying assets / investments making it impossible to identify the individual interests.

- (d) The subsequent PSRs were delayed by several months:
- (i) The PSR for January 2008 was not provided until 9 May 2008, and did not contain all the real estate investments that had been entered into as at December 2007.
 - (ii) The November 2008 PSR was not provided until April 2009.
 - (iii) The January to June 2009 PSRs were not provided until July 2009.
 - (iv) The October, November and December 2009 PSRs were not provided until the end of March 2010.

41 It has subsequently become apparent that substantial investments in real estate were made using the Partnership's funds between January and May 2007 that were not disclosed in the relevant PSRs. Despite ERCM's repeated enquiries concerning the proposed real estate fund (which, as the GP was aware, ERCM was keen to ensure was not funded with Partnership assets) and requests for information concerning the largest investments in the Partnership, the GP failed to disclose the extent of the real estate exposure until many months after the investments had been made.

42 At a meeting between Mr Ingrassia and representatives of ERCM on 13 June 2007, at the offices of the GP, it was announced that the launch of the real estate fund was postponed until 1 October 2007. ERCM raised concerns about the poor reporting by the Partnership to investors as it was felt that insufficient information was available concerning the investments. At that meeting the largest exposures of the Partnership were reviewed and yet no mention was made of the investment in the 158 Madison Avenue or 18 East 68th Street projects. Given the size and nature of these transactions, and the concerns raised by ERCM, the GP had a duty to disclose the fact of these investments to the Petitioner and all other investors who had subscribed on the basis of the CPPM. It is clear from Mr Rice's email dated 30 January 2008 ("the 30 January 2008 Email") to James Beaumont (Head of Asset Based Lending Research for ERCM) that the 18 East 68th Street investment had been made in May 2007, before this June meeting took place. The 30 January 2008 Email states that the 158 Madison Avenue bridge loan originated in June of 2007, but the June 2007

PSR states that the date of this loan was 29 April 2007, well before this meeting on 13 June 2007.

43 By letter dated 21 August 2007 the Partnership circulated a PSR for March 2007 which stated that the AUM were \$223,549,748. The PSR set out the names of the underlying investments, the loan amount, the loan value, and the percentage of AUM that the loan represented. No mention was made in the March PSR or the covering letter of the real estate investments which had already been made by the date this PSR was circulated. Moreover, the March 2007 PSR itself failed to include loans which according to later PSRs had been made in and before March 2007. According to the January 2008 PSR the following real estate loans had been made in or before March 2007:

- 29.3.07 - \$3,706,737 loan - \$4,349,947 outstanding as at January 2008
- 9.1.07 - \$1,000,000 loan - \$895,587 outstanding as at January 2008
- 1.2.07 - \$343,256 loan - \$466,044 outstanding as at January 2008
- 1.2.07 - \$3,275,757 loan - \$2,938,304 outstanding as at January 2008

44 On 1 October 2007 there was a meeting between ERCM and the GP at the GP's offices. Notwithstanding ERCM making it clear that it was concerned to ensure that the Partnership's funds not be used to fund the new real estate fund, the GP failed to disclose to ERCM or the Petitioner that a substantial portion of the Partnership's assets had already been invested in a number of real estate positions. The GP misrepresented that only \$5m of bridge loans had been financed by existing funds, and failed to disclose that by this time \$61,685,943 (21% of AUM) was outstanding on 10 loans made in respect of real estate projects. It is clear from the PSR for January 2008 finally disclosed in May 2008 that, contrary to the representations made by the GP at the meeting on 1 October, that as of October 2007 the following real estate loans had been made:

- 29.3.07 - \$3,706,737 loan - \$4,349,947 outstanding
- 7.5.07 - \$19,500,000 loan - \$12,179,436 outstanding
- 29.4.07 - \$45,629,936 loan - \$34,322,575 outstanding

•	9.8.07 -	\$1,750,000 loan -	\$43,562 outstanding
•	18.4.07 -	\$749,000 loan -	\$978,683 outstanding
•	24.4.07 -	\$372,250 loan -	\$483,644 outstanding
•	9.1.07 -	\$1,000,000 loan -	\$895,587 outstanding
•	1.2.07 -	\$343,256 loan -	\$466,044 outstanding
•	30.8.07 -	\$3,988,978 loan -	\$5,028,161 outstanding
•	1.2.07 -	\$3,275,757 loan-	\$2,938,304 outstanding
	Total -	\$80,315,914 loan -	\$61,685,943 outstanding

45 The ERCM note of the meeting on 1 October 2007 records that the funding of the new real estate fund with US\$5m of the GP's existing fund's assets *"is obviously a concern for us as our money is being used to get this fund up and running."* The note also states that the ERCM representative will *"confirm with Capstone how much capital [of] the existing funds have been used so far and whether it is their intention to continue to financing [sic] bridge loans using this money."* The note concludes *"A concern for us is [the GP's] real estate lending fund because the managers do not have a background in real estate lending and their attentions get diverted away from their usual business and towards getting their new fund up and running. In addition, Capstone have raised capital to finance the bridge loans using money from the existing funds of which we are investors. VS [Vanessa Shia, the ERCM representative in attendance at the meeting] to monitor and to make sure this does not happen going forward and decide if we are comfortable with Capstone's future plans on all fronts."*

46 In November 2007, the June 2007 PSR was provided to ERCM, and this disclosed for the first time that a substantial portion of the Partnership's funds had been used to finance several real estate projects. The cover letter stated *"we are adjusting our ABL activities to include real estate bridge lending, primarily in the New York city area, as this has proven to be a very stable business with attractive returns and solid underlying asset values. We expect financing volume in this asset class to increase this year."*

- 47 According to the June 2007 PSR, by the end of June 2007, the Partnership had invested in 7 real estate transactions totalling \$58m, approximately 20% of the Partnership's total investments. This was a significant departure from the original investment strategy.
- 48 None of the real estate investments which had been entered into between January and May 2007 had been previously disclosed to the Petitioner despite express requests for information concerning the portfolio and concerning real estate investments.
- 49 Due to the concerns of ERCM as to the level of real estate investment disclosed in the PSRs, ERCM requested a meeting with the GP and on 26 November 2007 a meeting was held at the offices of the GP. At that meeting in response to the concerns voiced by ERCM that the Partnership funds should not be used to fund the real estate investments, the GP confirmed that the Partnership's assets had been invested in 7 real estate deals totalling \$62.5m (22% of the total portfolio) including the sole financing of a low income housing development in the Bronx borough of New York. The GP assured ERCM that 90% of these investments would be transferred to the new real estate fund which was expected to be launched in December 2007. The GP also stated that the profit from the real estate deals was being used to build a 10% capital loss reserve in the fund to ensure the Capstone Operating Entities remain profitable.
- 50 There was a further meeting at the GP's offices with the GP on 24 January 2008 between ERCM and Mr Rice, at which ERCM expressed its concerns regarding the lack of reporting by the Partnership, specifically: "*Capstone has not been very transparent in disclosing the level of real estate in the fund. It is clear style drift from their factoring and purchase order finance business.*" Again assurances were given by the GP that the all the existing real estate deals would be transferred to the new fund as soon as it was up and running, and that the new fund would be launched in the first quarter of 2008. The GP represented that the new fund had \$50m in seed capital.
- 51 In the 30 January 2008 Email Mr Rice confirmed that all real estate orientated transactions of the Partnership were being transferred to the new fund "this quarter" and stated that he would provide an update "*as soon as this transfer is completed*

within the next week". It has since become apparent that this statement was false and that the transfer never in fact occurred.

- 52 On 17 April 2008 ERCM had a conference call with Mr Rice and Mr Ingrassia in which the Petitioner again raised its concerns as to the lack of reporting and transparency. During that call the GP provided an update on some of the real estate investments and it became apparent that the transfer of real estate investments to the new fund had not yet transpired despite previous assurances, and that \$55m (15% of the portfolio) remained invested in real estate but that it was expected the percentage of the AUM invested in real estate would grow even higher as redemptions rose. ERCM's note of that meeting records: *"As discussed in previous meeting notes, we are not comfortable with the real estate exposure in the portfolio (as these guys are trade finance specialists)... as we have had very little transparency on the structure of these deals and have been shown limited dd documentation. Despite our continuous requests for further information, we have been largely "ignored"...[Vanessa Shia] has sent Capstone a follow up email to the conference call requesting the following for each real estate deal on a monthly basis: (1) A breakdown of the remaining loan amount outstanding (2) Notification of any changes to the capital structure including ownership of the various tranches (3) Notification where there has been a change in the valuation of the properties (4) Notification if there was a change in the exit strategy timescales or any developments that would delay Capstone being paid back on their loan."*
- 53 By email dated 10 June 2008 ERCM requested that the GP disclose all real estate exposures over \$1m. Mr Rice, on behalf of the Partnership provided an update by the 11 June 2008 Email, but failed, in that email, to disclose a subordinate \$35m loan made in respect of a property development at 151-161 Maiden Lane, New York ("the Maiden Lane Investment"). ERCM and the Petitioner first learned of this investment in July 2009 when the January 2009 PSR was provided by the GP, notwithstanding that the investment had been entered into at the end of 2007.
- 54 The Maiden Lane Investment concerns an exposure of \$35m (including interest) subordinated to a senior loan of \$40m from US Bank (now \$43m due to accruing interest). The first lien loan has been in default since April 2009. Detail of this development has not been provided to the Petitioner but public documents show that RIP Holdings VIII LLC acquired the Maiden Lane property from LH Realty LLC for \$20.1m in December 2007. During a call between Mr Rice and representatives of

ownership interest in the Capstone Operating Entities and also in RIP. Therefore any profits received after the Partnership's loans are repaid will indirectly benefit Mr Rice and Mr Ingrassia and any profit will impact on the management fees payable to the GP. In light of their own interests Mr Rice and Mr Ingrassia have an incentive to protect these investments and maximise the returns rather than taking action to enforce the Partnership's interests and paying off the Partnership's creditors in priority. A full independent investigation is required into the conflict of interest in this regard.

- 61 For example, the 18 East 68th street development was initially financed by the Capstone Operating Entities in May 2007. Capstone advanced \$19,500,000. Subsequently the project was refinanced and Capstone became a second lien lender of \$12m behind a senior loan of \$25m by a separate hedge fund entity. According to the 11 June 2008 Email the property was valued at \$57m but put on the market at a price of \$64m. It appears that in order to pay off both senior and subordinated loans only \$37m was needed. In June 2008 an offer was made of \$54m which would have been more than sufficient to discharge the Partnership's interest in the property, but this offer was declined. The property did not sell and at the end of January 2009 the price was lowered to \$54m, which according to press reports, is still higher than any Manhattan mansion has ever sold for. In July 2009 the property was removed from the market and then, in November 2009 it was re-listed with an asking price of \$39m. The senior lender has now initiated the foreclosure process. Once the foreclosure process is complete the Partnership's interest will be written off and Mr Ingrassia and Mr Rice's exposure under the personal guarantees will be eradicated. The senior lender is entitled to interest of \$500,000 a month. Given that the senior lender may only be able to sell at a price which will only discharge its own debt it is possible the Partnership will recover nothing from the sale. The GP's priority should have been to realise the value of the Partnership's loan in order to settle creditors' claims, which could have been achieved by selling the property for \$37m. As a result of the property being marketed for more than the valuation, and well over the price they were advised it would sell for, they have prejudiced the Partnership's creditors, and now that nothing is likely to be realised for the Partnership the decision has prejudiced the Partnership as a whole. The December 2009 PSR records a \$16,685,098 figure in relation to this investment (principal plus interest accrued), and therefore makes no adjustment to take account of the realistic likely recovery on this loan. No other valuation has been produced to indicate the proper value of this and

other real estate loans. By email dated 28 January 2008 to Mr Rice, James Beaumont, of ERCM, requested details of the three main real estate loans - specifically asking whether the lending was "1st, mezz or equity". In reply Mr Rice, in the 30 January 2008 Email, stated that the 18 East 68th street investment originated in May 2007, but did not disclose the status of the loan in relation to other lenders.

62 During the call on 3 August 2009 Mr Ingrassia confirmed to ERCM that he and Mr Rice had provided personal guarantees to support the real estate transactions. This has enabled the GP to increase borrowing on certain poorly performing assets to the detriment of the remainder of the portfolio at a time when they should have been reducing exposure. By a Collateral Assignment of Mortgage and Pledged Note Agreement dated 30 April 2009 Mr Rice and Mr Ingrassia provided personal guarantees to North Hill to support the senior loan on 158 Madison Avenue. It appears from that agreement that, contrary to Mr Ingrassia's statement that to his knowledge the Capstone entities have not provided any corporate guarantees, Mr Ingrassia and Mr Rice have also procured Capstone Capital and Capstone Credit to provide guarantees, to North Hill. The provision of corporate guarantees provides the senior lender with recourse against the Capstone Operating Entities. According to press reports, North Hill is now seeking a \$32m payment from the guarantors. Therefore, in addition to writing-off part of the investment, the Capstone Operating Entities may have to pay \$32M to North Hill. Although the Capstone Operating Entities would be left with the property (should they manage to pay \$32M from other sources), it is believed that the value of the project has significantly decreased.

63 A further conflict of interest exists regarding another fund launched by the GP. The GP entered into a joint venture with Akin Bay, an investment banking firm to launch a private equity fund, Capstone Positive Value Equity Fund ("CPVEF"). CPVEF owned the shares of Tyree and Monarchia, two businesses which were financed by the Capstone Operating Entities and which appear in the list of investments of the Partnership. Tyree and Monarchia defaulted on a combined total of \$73.1m of loans advanced by the Capstone Operating Entities. The Capstone Operating Entities had security over the shares of Tyree and Monarchia, but notwithstanding the default it appears that the Capstone Operating Entities did not enforce their security. The GP has stated in a question and answer document circulated to investors on 23 November 2009 (the "Q&A Document") that the transactions were "reversed" and

“unwound”. It is not known what was the nature of this reversal and an investigation is required as to whether the security was enforced, and if not, why not.

J The Withdrawal

64 By written notice dated 29 February 2008 the Petitioner requested a withdrawal of \$2,000,000 of its partnership interest held on behalf of ERUM from its capital account.

65 By written notice dated 29 May 2008 the Petitioner requested a withdrawal of the balance of the value of its partnership interest held on behalf of ERUM from its capital account.

66 In accordance with the LPA, the relevant Withdrawal Dates were 1 July 2008, and 1 October 2008 respectively.

67 In accordance with Section 7.03(a) of the LPA, the Partnership was required to pay the Petitioner the value of its interest being withdrawn from the Partnership “*as soon as possible*”.

68 As at the date of this Petition the Fund has failed to make any payment in respect of the Petitioner’s withdrawal. An attempt has been made to induce the Petitioner to accept a payment in kind of preference shares in a new US based entity, Amincor Inc (“Amincor”), but for the reasons set out below the Petitioner has refused to accept such shares as a valid discharge of the debt owed to the Petitioner.

69 By letter dated 8 March 2010 and by the statements produced in respect of the Petitioner’s capital account, the GP has confirmed that the Petitioner on behalf of ERUM is a creditor of the Partnership in the amount of \$6,162,687 (which amount has remained fixed since December 2008). The GP has also confirmed that the Petitioner is a creditor of the Partnership on behalf of ERABL in the amount of \$2,276,637.30, and of the Onshore Partnership, on behalf of ERFF, in the amount of \$9,087,145.27.

70 The letter to ERCM of 8 March 2010 in respect of ERUM stated that the Partnership was making payment in kind of 61,627 Class A preferred shares in exchange for the Petitioner’s limited partnership interest, on behalf of ERUM, valued at \$6,162,687.

71 At a meeting held on 8 April 2010 at the GP's offices, which was attended by, amongst others, a representative of ERCM, the GP was asked what valuation had been ascribed to the Amincor shares with which the GP was purporting to make payment in kind to the limited partners. The GP stated that it was not clear what the value of the Amincor shares were at this time, and that the value would be established at a later date.

72 In June 2010 the Petitioner was provided with a copy of the consolidated balance sheet for Amincor for the months of January, February and March 2010. These accounts show that as at March 2010, the net assets of Amincor are valued at \$40,924,000.

73 By email dated 27 January 2009, Mr Beasty of the GP provided ERCM with a schedule of redemptions for the Partnership and the Onshore Partnership. This shows that as at 31 December 2008 (after the date withdrawals and payment of withdrawals had been suspended) the total redemptions were \$163,772,591.52, which, it is to be inferred from the suspension of payment of withdrawals, remain unpaid. During a meeting on 14 January 2010 at the GP's offices to discuss the Restructuring, which a representative of ERCM attended, the GP stated that the creditors were owed \$172m, and that they would be paid in kind with \$100 preference shares in Amincor, and that non redeemed limited partners would be issued common shares to a par value of \$202m.

74 It is understood from information provided by the GP that all creditors were to receive preference shares and that 1,720,000 Amincor preference shares were created at a purported par value of \$100. Given that the total amount owed to creditors was \$172m, and that the net worth of the assets held by Amincor as at March 2010 was only \$41m, it is clear that the preference shares were not worth \$100 in March 2010 and that the attempted payment in kind to the Petitioner with respect to ERUM's investment in March 2010 of 61,627 Amincor preference shares was not a valid discharge of the debt owed to the Petitioner.

K Suspension of withdrawals

75 The inability to meet redemptions is clearly largely due to a significant portion of the Partnership's assets being tied up in illiquid real estate transactions which have performed poorly and which are outside the Strategy.

76 By email dated 21 October 2008, the GP notified ERCM that, pursuant to Section 7.04(a) of the LPA, it was extending the payment of withdrawals for all present and future withdrawal requests.

77 The above-mentioned purported extension of payment of withdrawals constituted a breach of the GP duties and/or was ineffective under the LPA, in that:

(a) The inability to meet redemptions was due in whole or in part to a significant portion of the Partnership's assets being tied up in illiquid real estate transactions which have performed poorly and which are outside the Strategy

(b) The investments of the Partnership in accordance with the Strategy were readily disposable for the benefit of the Partnership's creditors. The Partnership owned security which could have been enforced to settle withdrawal requests. The fact that the value of the assets (including those which have been acquired by the wrongful divergence from the Strategy) had decreased and may have been insufficient to recoup the entire investment could not justify delaying payment to creditors.

(c) The value of the investments was readily ascertainable, and in fact values have been ascertained by an independent third party as to a portion of the assets (see paragraphs 83 to 86 below).

(d) The reason subsequently given by the GP as to why valuations had not been sought in respect of the real estate transactions was "*the real estate valuations are underwater and there is no point in spending \$25,000 per appraisal to verify that values are less than what was loaned against them. When the market turns a bit it may make sense to have appraisals conducted*". This cannot justify the Partnership suspending payment to creditors.

L Valuation of Assets

78 In breach of the GP Duties, PSRs have been presented which do not reflect the value of the portfolio.

79 For example, it was disclosed during a meeting between representatives of ERCM and Mr Ingrassia on 20 July 2009, that the partnerships' assets were used to invest

\$27m in a construction development on 10th Avenue New York. The GP stated that the intention was to build a pre-fabricated hotel with low cost rooms, but that there was no capital available to develop the project. The original investment was a bridge loan of \$27m in 2007 (at a high loan to value ratio) but by July 2009 the exposure was \$34m, subordinated behind both a first lien \$24m loan and a second lien \$10m lien lender. The GP reported that in light of the fact that New York property values had dropped by 25%, the value of the property would be worth only \$51m, leaving the Partnership's position worth only \$15m, and that this position might be marked down in June. Notwithstanding this, the December 2009 PSR still records the value of the partnerships' interest in 10th Avenue as \$27.7m.

- 80 The Petitioner is not in a position to know what the true value is, if any, of the New York real estate positions, but it is clearly ascertainable by obtaining an independent valuation, and in light of the fall in values in real estate since 2007 and the subordination of the debt behind \$34m of senior loans, it is unrealistic and misleading to maintain the value on the Partnership's records as the full amount of the original loan. An independent liquidator ought to be appointed to ensure that a true and fair valuation is obtained.
- 81 In relation to the non-real estate positions of the Partnership, the valuations applied by the Partnership are inexplicably and substantially higher than those assessed by an independent valuation expert.
- 82 On 20 August 2009 a group of investors (including the Petitioner) wrote to the GP asking that an independent agent be appointed to assist in the process of returning capital to all creditors as swiftly as possible and, in particular to assist (i) with the valuation of assets, (ii) with the realisation of assets, and (iii) with the reporting to creditors as to the liquidation strategy and the cash movements and distributions to creditors and investors.
- 83 The GP agreed to engage an independent valuation expert (the "Valuation Expert") to carry out a valuation of the investments of the Partnership. The GP also purported to consult with the Valuation Expert concerning a restructuring of the assets of the Partnership.
- 84 The Valuation Expert prepared a valuation report in respect of a portion of the assets of the Partnership for the period ending 30 September 2009 ("the Valuation Report"),

a copy of which was provided to ERCM upon it entering into a confidentiality agreement with the Valuation Expert.

85 Inexplicably, the Valuation Report excluded the real estate positions in which the Capstone Operating Entities had invested, which by September 2009, according to the September 2009 PSR, constituted 37% of the Partnerships' AUM. The scope of the Valuation Report was limited to 10 portfolio companies which represented only 53% of the assets (based on the September 2009 PSR). Real estate investments and certain corporate lending investments ("the Other Assets") were not valued and were merely listed in a separate report. The Other Assets constitute 33% of the Partnership's AUM. Two of the largest investments which represented 14% of the assets as at end of September 2009 were omitted from Valuation Report and the list of Other Assets, namely the Maiden Lane Investment (\$35M) and D'Annunzio Distribution (\$26M). ERCM queried the exclusion of the Maiden Lane Investment from the Valuation Report and the report on Other Assets, and in a Question & Answer document circulated to all investors on 25 November 2009 ("the Q&A Document") the GP responded by stating "*John Rice has reviewed this with you*". John Rice mentioned during a call with ERCM on 23 November 2009 that the Maiden Lane Investment was to be fully written-off due to foreclosure by the senior lender, but no further detail has been provided by the GP. Notwithstanding what ERCM was told by Mr Rice that this position was to be written off, and notwithstanding that the PSR reports show that several other real estate investments have been written-off, the Maiden Lane Investment is still reported as having an outstanding balance of \$35M in the November and December 2009 PSRs.

86 Notwithstanding the Valuation Report, the Partnership has produced a number of PSRs subsequent to the Valuation Report which do not take into account the valuations provided by the Valuation Report. Each of the subsequent PSRs report a significantly higher value for the assets than the figures contained in the Valuation Report.

M The Restructuring

87 The covering letter from the GP dated 10 November 2009 ("the 10 November Letter"), which enclosed the Valuation Report, sets out the restructuring and liquidation strategy the GP proposed with respect to the Partnership's assets ("the Restructuring").

- 88 From the 10 November Letter and other communications with the GP it appears that the Restructuring concerns the group of businesses which have fallen under the ownership of the Capstone Operating Entities following default and foreclosure under the loan agreements. The Restructuring involves bringing the equity of these businesses together within a single listed company called Amincor. The GP has stated that the intention is to run these businesses together in terms of administration and finance, in order to increase cost efficiency by combining working capital and cashflow, while creating more flexible financing options. The GP has apparently unilaterally determined that investors and creditors of the Partnership will receive shares and preference shares in the new entity.
- 89 The Partnership has attempted to satisfy creditors with an in specie delivery of preference shares in Amincor notwithstanding that such preference shares were of an indeterminate value at the date the payment in kind was attempted.
- 90 The preference shares in Amincor constitute only partial ownership in the Amincor entity. Shares in Amincor have also been allocated to the GP, which has entered into a lucrative management contract with Amincor of \$15.6m over 3 years. The GP has stated that there is no plan to sell or liquidate any of the Amincor assets and the majority of available cash is to be retained to fund a growth strategy.
- 91 The Restructuring compromises the position of creditors in the Capstone Funds. Based on the Valuation Report and the Amincor balance sheet circulated in June 2010 the value of all the assets within Amincor is less than the Partnership's creditor obligations. Consequently, the value of the preference shares are by definition lower than the value of the creditor positions. Therefore, the attempt to make payment in specie does not satisfy the debt owed to creditors.
- 92 In addition, the unilateral debt for equity swap in Amincor results in creditors' priority over the assets / cashflows being lost. In the Restructuring, whilst preferred shareholders (i.e. creditors) will retain priority over the net cash flows generated from the Other Assets (which were not included in the Valuation Report, and which are held in a subsidiary of Amincor), most of these Other Assets consist of the real estate investments which are worthless (the majority of the real estate projects having been the subject of foreclosure proceedings by the senior lenders). Net recoveries from Other Assets, if any, are now likely to be negligible. Therefore, the only valuable

assets are the 10 portfolio companies over which creditors will no longer have any priority (except in liquidation).

93 It appears that the Restructuring is an attempt to divert available cash generated by performing businesses away from creditors for the benefit of the GP and the non redeemed limited partners, who are the ordinary shareholders of Amincor. Assets which could and should be liquidated to satisfy creditor claims are being withheld and used to finance the growth of a new business while enriching the GPs. Furthermore, the GP has stated that the business plan of the restructured entity will involve securing banking facilities, which, it is to be assumed, will further subordinate the rights of creditors.

94 The Petitioner is particularly concerned that whilst there is no evident benefit to limited partners the following disadvantages to the Restructuring are evident:

- (a) The promissory notes issued by the Capstone Operating Entities which were in default have been cancelled;
- (b) Costs have inevitably been incurred in establishing Amincor and transferring the Capstone Operating Entities' assets to Amincor;
- (c) The GP will receive higher management fees;
- (d) There has been an unjustified in specie payment of Amincor shares to non-redeemed limited partners thereby reducing assets available to creditors;
- (e) There has been a diversion of cashflow from performing businesses to support non-viable entities;
- (f) The liquidation of the assets held by Amincor is indefinitely delayed;

95 The 10 November Letter stated as follows:

- (a) The equity of the Capstone Operating Entities would be "*reverse merged into a trading public shell*".
- (b) Two classes of shares in the public shell would be issued - convertible preferred shares ("the Preferred Shares") which would be passed to the creditors of the Partnership with "*a priority right of redemption from proceeds*

of the monetized Other Assets", and common shares which would be held by the limited partners and the GP.

- (c) The real estate loans and Other Assets excluded from the Valuation Report would be "*monetized*" as soon as reasonably possible and "*tendered on a pro rata whole share basis to all the Preferred shareholders*" after expenses were paid, including the payment of management fees and expenses, financial advisor fees and establishment of a cash reserve for "future needs".
- (d) The 10 companies valued would be "*merged into the [trading public] shell as expeditiously as possible.*" It was stated that it was anticipated that the time frame for completion of the merger would take between several weeks and several months.
- (e) Contracts for the mergers were to be executed prior to the issuance of the preferred and common shares.
- (f) A new asset based line of credit would be arranged using the current short term assets of the portfolio companies as collateral, and this liquidity was to be funded through a Capstone lending entity by a third party lender with the accounts receivable to be credit insured by AIG.
- (g) There would be arranged "*a special situation fund to purchase preferred shares from the creditor class of shareholders for those who need immediate cash and are interested in exiting immediately.*"
- (h) Approximately six months after the public shares are trading arrangements would be made for the leveraging of the core real estate and equipment assets of the light manufacturing companies which are currently unencumbered by Capstone.
- (i) The intention was that the "initial steps" to implement the strategy would be completed by 31 December 2009. What those "initial steps" were was not explained.

96 Subsequent to this letter, questions and concerns were put to the GP, and in response the GP prepared the Q&A Document. The Q&A Document states, inter alia:

- (a) The liquidation strategy could take 36 months to complete.
- (b) On the one hand it was the GP's intention to use the Valuation Expert's valuations for the merger, but on the other it was the GP's intention to issue shares to creditors and shareholders based on a 30 November 2009 valuation to be produced. It is unclear how the Valuation Expert's valuation, which only purports to be a valuation as of September 2009, could be considered a reasonable basis for the merger of the companies into the holding company many months later. No 30 November 2009 valuation was ever produced. The Partnership has instead produced PSRs for November and December 2009, which as explained above, do not reflect true or accurate values.
- (c) The creditor claims are larger than the current value of the portfolio.
- (d) The reason given as to why all the positions were not valued by the Valuation Expert was "the real estate values are underwater and there is no point spending \$25,000 per appraisal to verify that the values are less than what was loaned against them."
- (e) The Strategy would be implemented without the vote of any shareholders or creditors, and the GP considered that their consent was not necessary.

97 Accordingly, it has been conceded by the GP that the Partnership is unable to satisfy its debts and unlikely to be in a position to do so in the near future.

98 By letter dated 4 March 2010 from the Partnership's attorneys, Stuarts Walker Hersant, and by letter dated 7 April 2010 from the GP, the GP set out the steps it had taken to implement the Restructuring. The 4 March letter states "*all promissory notes have been exchanged for shares in Amincor Inc (formerly Joning Corp)*" and "*the debt from the [Capstone Operating Entities] was assigned in its entirety to Amincor*". It is understood from the GP that Amincor was originally wholly owned by the GP or by Mr Rice and / or Mr Ingrassia.

99 The letter of April 7 makes it clear that the GP's intention was to make a payment in kind of the Amincor shares to all limited partners.

100 By letter dated 8 March 2010 to ERCM with respect to the Petitioner's interest in the Partnership, the GP stated:

"In our previous communications we advised that you would be receiving payment in kind of your interest in the above referenced fund through the issuance of shares of Amincor Inc, in exchange for your limited partnership interest.

As a creditor of the fund on December 31 2009, your account was valued at \$6,162,687.00. Accordingly, attached is Stock Certificate... for 61,627 shares of Class A Preferred Shares in Amincor Inc."

101 It seems the Fund has simply attributed \$100 value per share, but has not provided any detail as to what valuation it has used to justify the claim that the Amincor shares are valuable consideration for the Petitioner's partnership interest. The purported extinguishment of its rights as creditor is invalid.

102 Therefore it is to be inferred from the correspondence from the GP that the following steps have already taken place:

- (a) The Partnership has taken on equity interests in a number of the underlying investments, a substantial portion of which consists of real estate.
- (b) Those investments have been transferred and are now owned by Amincor.
- (c) The security that was held by the Partnership in respect of the lending has been extinguished and exchanged for unsecured positions and shares in Amincor.
- (d) The shares in Amincor are to be or have been divested to the limited partners.

103 On the above basis, it appears that the event specified in section 13.10(d) of the LPA has occurred, as a result of which the Partnership shall be dissolved.

104 The Restructuring is clearly adverse to the interests of those limited partners including the Petitioner whose rights to withdrawal payments had crystallised prior to the purported suspension of payments on 1 October 2008. From being creditors of a Cayman partnership with security over tangible assets, they would become mere

shareholders in a US company which holds assets of a value far below the amount owed to creditors of the Partnership. Any third party lenders and leverage providers will now have priority.

105 The GP's equity position in the Capstone Operating Entities was valueless due to the fact that the amount due to the Partnership's creditors exceeded the value of the assets of the Capstone Operating Entities. However, the GP appears to have taken shares in Amincor through the Restructuring. Moreover the GP will receive \$5.2m per annum by way of management fees from Amincor in priority to all the unsecured creditors. Therefore whilst it is apparent that the Restructuring if implemented would prejudice the limited partners, it is clear that it will benefit the GP.

106 The GP adopted and implemented the Restructuring without prior consultation with and the approval of all interested parties, including those limited partners including the Petitioner whose rights to withdrawal payments had crystallised prior to the purported suspension of payments on 1 October 2008, and any attempt to implement the same, constitutes a flagrant and fundamental breach and repudiation of the GP Duties, including its obligations under the LPA, and a flagrant disregard of the interests of the limited partners whose rights to withdrawal payments have crystallised.

107 Further, the GP had no power under the LPA to adopt and implement the Restructuring without the approval of all interested parties, including the Petitioner.

108 For the avoidance of doubt, the Petitioner is under no obligation to accept shares in Amincor in discharge of the withdrawal payments to which it is entitled, and, given the Restructuring, there could no longer be any justification for any further extension of payment under section 7.04 of the LPA, even if (which is denied) time for payment had been validly and lawfully extended until then.

N Correspondence

109 By letter dated 4 December 2009 ("the 4 December Letter") ERCM and a number of other representatives of investors with beneficial interests in the Partnership ("the Investor Group") wrote to the GP to express their objections to the proposed liquidation strategy.

110 The 4 December Letter stated:

- (a) That the proposed restructuring / liquidation plan poses no tangible benefit to investors and is detrimental to creditors, and will incur cost.
- (b) The Investor Group was only prepared to support a liquidation plan which provides for a monetisation strategy for each individual asset and which is fully under the control of an independent party.
- (c) That the real estate investments, which by the end of 2008 comprised 41% of the Capstone Operating Entities' assets, are a significant deviation from the stated investment strategy of the Partnership.
- (d) That it has become apparent that the GP had consistently misrepresented the amount and nature of the real estate investments to investors, both verbally and in written portfolio reports over the previous two year period. Examples given are that between March and October 2007 \$60m of real estate investments were concealed from investors, and that the largest real estate exposure, Maiden Lane (in which \$35m of Partnership assets were invested) which is now worthless, was concealed until July 2009.
- (e) That it appeared that the investment decisions by the GP were tainted by conflicts of interest on the part of the GP, and it is believed the GP had ownership stakes in many of the operating companies and projects to which the Partnership had invested. The investment in East 68th Street is given as an example.
- (f) That the borrowers to which the Capstone Operating Entities made loans include vehicles under the GP's control (eg. RIP), and the letter pointed out that a foreclosure against these assets and pursuit of the borrowers on the Partnership's behalf would be against the GP's interests.
- (g) That the individual principals of the GP have provided personal guarantees to some of the real estate investments which are collateral to loans made by the operating companies.
- (h) That the GP is involved in Capstone Positive Value Equity Fund which was invested in businesses financed by the Capstone Operating Entities.

- (i) That the GP procured the provision of corporate guarantees from the Capstone Operating Entities in favour of North Hill Funding which is the senior lender of the 158 Madison Avenue project. Legal action has now been commenced against the guarantors. It now appears the GP has pledged the majority of the remaining value in East 68th Street to the 158 Madison project thereby impairing further recoveries.
- (j) That the Partnership has been mismanaged for the GP's own benefit, and / or negligently.
- (k) That the Investor Group requested the GP resign with immediate effect so that independent work-out specialists could be appointed to monetise the investments free from conflicts of interest, and that following the GP's resignation the Investor Group would be prepared to discuss the GP's future role in assisting with the monetisation process.
- (l) That if satisfactory responses were not received that the Investor Group would take measures available to protect their investment and prevent the proposed Restructuring.

111 No satisfactory response to the matters raised in the 4 December Letter has been received. No explanation of the conflicts alleged to exist has been provided. Further questions have been raised in correspondence but unsatisfactory and incomplete answers have been received.

O Summary

112 The Petitioner is entitled to a winding up order on the following bases and each of them:

- (a) The event specified in section 13.01(d) of the LPA has occurred.
- (b) The Partnership is unable to pay its debts.
- (c) The Petitioner has justifiably lost confidence in the proper management of the affairs of the Partnership by the GP; and/or there are matters requiring investigation in relation to that management by an independent liquidator.
- (d) The substratum of the Partnership has been lost.

- (e) The Restructuring is unauthorised under the LPA and has been adopted and implemented by the GP in breach of the GP Duties.
- (f) It is in all the circumstances referred to above just and equitable that the Partnership be wound up.

P Conclusion

113 For the reasons set out above, the Partnership should be wound up on the basis that (a) for the purposes of section 92(c) of the Company Law, an event has occurred, namely that specified in section 13.01(d) of the LPA, upon the occurrence of which it is provided by the LPA that the Partnership be dissolved, (b) for the purposes of section 92(d), it is unable to pay its debts, and / or (c) for the purposes of section 92(e), it is just and equitable that the Partnership be wound up.

YOUR PETITIONER THEREFORE HUMBL Y PRAYS THAT:

- (1) The Partnership be wound up under the provisions of the Companies Law (2009 Revision).
- (2) Geoff Varga and Steven Staatz of Kinetic Partners (Cayman) Limited be appointed as joint official liquidators of the Partnership ("the Liquidators").
- (3) The Liquidators be authorised to exercise any of the powers listed in the Third Schedule to the Companies Law (2009 Revision) without the further sanction or intervention of the Court.
- (4) The Liquidators be authorised to do any act or things considered by them to be necessary or desirable in connection with the liquidation of the Partnership and the winding up of its affairs.
- (5) The Liquidators do file with the Clerk of the Court a report in writing of the position of the Partnership and the progress which the Liquidators have made with the winding up of the Partnership, with the realisation of its assets and in relation to any other matters connected to the winding up of the Partnership, at such time and in such manner as the Court may direct.

- (6) The Liquidators be at liberty to appoint such counsel, attorneys, professional advisors, whether in the Cayman Islands or elsewhere, as they may consider necessary to advise and assist them in the performance of their duties and on such terms as they may think fit and to remunerate them out of the assets of the Partnership.
- (8) The Liquidators and their staff be remunerated out of the assets of the Partnership at the usual customary rate.
- (9) The Liquidators be at liberty to apply generally.
- (10) The costs of the Petition and the Petitioner be paid out of the assets of the Partnership.
- (11) Such further or other relief be granted as the Court deems appropriate.

AND your Petitioner will ever pray, etc.

Dated the 25ⁿ day of June 2010

Ogier
Ogier

Attorneys-at-Law for the Petitioner, whose address for service is 89 Nexus Way, Camana Bay, Grand Cayman, Cayman Islands KY1-9007. Tel: +1 345 949 9876. Fax: +1 345 949 9877. Ref: 420650.00004/CRU/RAR.

NOTICE OF HEARING

TAKE NOTICE THAT the hearing of this Petition will take place at the Law Courts, George Town, Grand Cayman, on [] 2010 at [].

Any correspondence or communication with the Court relating to the hearing of this Petition should be addressed to the Registrar of the Financial Services Division of the Grand Court at P.O. Box 495, Grand Cayman, KY1-1106, telephone 345 949 4296.